# EMERGING MARKETS FOR THE HOSPITALITY INDUSTRY: UKRAINE

Ilona Doerfler ■ Johns Hopkins University ■ April 2006

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## INTRODUCTION

So far, the 21st century has been good to the real estate industry, both domestically and abroad. Every sector of the industry is celebrating the new millennium with increased development and marketing activities. The US hospitality sector, in particular, has remained interestingly competitive as a result of its domestic and global expansions.

Internationally, post WWII Europe had been an emerging market domain for the US and UK hospitality brands, and acknowledged leaders among international hotel chains. Every capital of the leading European countries features Ritzs, Marriotts, Four Seasons, Hiltons and Sheratons. The presence of the posh hotels not only defines the perceptions of a country's affluence but also its influence in the international arena. In the recent decade; however, the increasingly global economy began opening doors to emerging markets as well. Since the fall of the communist bloc, the Eastern European countries and former Soviet republics have been gradually accepting participation of the western hotel chains within domestic markets. However, the global expansion of the leading international hotel brands has not touched Ukraine, the second largest country in Europe.

The purpose of this paper is to introduce Ukraine as an emerging market for the western hotel chains. This paper begins with a brief discussion of the global expansion of international chains into Eastern European emerging markets. The discussion highlights the existing hotel inventory in the country's capital – Kyiv. Kyiv is a major business center and the primary point of wealth concentration and international tourism in Ukraine. The initial entries onto the Ukrainian market by the international hotel chains will be facilitated through this city. This paper also outlines modes of entry available to foreign hotel companies and existing popular ownership structures employed in the Ukrainian market.

Further, the research concentrates on current demand of Ukraine as a travel destination by looking at the country's geographic location, tourism infrastructure, travel patterns, human resources, and economy in general. Additionally, this paper provides an overview of the Ukrainian government's attitude and policies toward foreign participants in the domestic markets and present political events.

The research material was obtained primarily through secondary sources. Statistical data, highlights, and facts introduced in the paper, are not all-inclusive but rather are intended as a starting point for further research.

## OVERVIEW

American and Western hotel companies are expanding rapidly in the emerging markets of Eastern Europe and former Soviet regions. According to Anikeeff (2005), the common strategy of the major hotel chains is to establish an upscale presence in the capital cities of the targeted countries[1]. While brands are providing top quality accommodations at demanding prices, the cost of labor remains low by the western standards. The combination of the two promises high profit margins and presents Eastern Europe as a lucrative market for the international hotel chains. The table below gives some examples of the presence of the top international US and UK hotel chains in the capital cities of the Eastern European countries as of August 24, 2005.

| ..JTEL CHAIN (NATIONALITY) # OF HOTELS WORLWIDE*** COUNTRY | CAPITAL | INTERCONTINENTAL (UK) 100 | HILTON INTERN'L (UK) 78 | STARWOOD (US) 82 | MARRIOTT INT'L (US) 66 | BEST WESTERN (US) 80 |
|---|---|---|---|---|---|---|
| BULGARIA | SOPHIA | | HILTON | SHERATON | | BEST WESTERN CITY<br>BEST WESTERN EUROPE<br>BEST WESTERN EXPO<br>BEST WESTERN ROYAL |
| CZECH REPUBLIC | PRAGUE | INTERCONTINENTAL<br>CROWNE PLAZA<br>HOLIDAY INN<br>EXPRESS BY HOLIDAY | HILTON | | EXECUTIVE LONGIN<br>MARRIOTT<br>RENAISSANCE | BEST WESTERN KAMPA<br>BEST WESTERN PREMIER<br>BEST WESTERN ALTA<br>BEST WESTERN CITY<br>BEST WESTERN SMARAGD<br>BEST WESTERN SELSKY<br>BEST WESTERN BILA LABUT<br>BEST WESTERN METEOR |
| GEORGIA | TBILISI | | | SHERATON | COURTYARD<br>MARRIOTT | |
| HUNGARY | BUDAPEST | INTERCONTINENTAL<br>HOLIDAY INN | HILTON<br>HILTON WEST END | | MILLENIUM COURT<br>MARRIOTT | BEST WESTERN ART<br>BEST WESTERN LIDO<br>BEST WESTERN GRAND<br>BEST WESTERN ORION |
| LATVIA | RIGA | | | | | BEST WESTERN MARA |
| LITHUANIA | VILNIUS | | | | | BEST WESTERN |
| ..LAND | WARSAW | INTERCONTINENTAL<br>HOLIDAY INN | ATHENEE HILTON | SHERATON<br>THE WESTIN | COURTYARD<br>MARRIOTT | |
| ROMANIA | BUCHARET | INTERCONTINENTAL<br>CROWNE PLAZA | | | JW MARRIOTT GRAND | BEST WESTERN |
| RUSSIA | MOSCOW | | | SHERATON PALACE | MARRIOTT GRAND<br>MARRIOTT ROYAL<br>MARRIOTT TVERSKAYA<br>RENAISSANCE<br>COURTYARD | |
| SLOVAKIA | BRATISLVA | | | | | BEST WESTERN |

Source: Reservation Websites of
*** Source: *Hotels* July, 2005 Special Report

In October 2005, Hilton International announced that it plans to double its presence in Central and Eastern Europe in the next three years[2]. Currently, Hilton operates six Hiltons in Central and Eastern Europe and the Balkans. The group is close to securing five contracts for the Hilton brand in Central and Eastern Europe. Among the selected locations are Moscow (Russia), Warsaw (Poland), Bratislava (Slovakia), Kyiv

(Ukraine), and Split (Croatia). Also, a contract for Conrad, a new exclusive luxury brand, is being negotiated in Moscow.

The Eastern European market attracts not only high-end brands but also economy lodgings. Hilton International plans to expand its three star Scandic brand, operating only in the Scandinavia and Baltic states, through franchise agreements. Days Inn, the world's largest lodging franchise, opened the doors of its first hotel in Europe in August 1999[3]. Days Hotel Lednice is located in the Czech Republic 42 miles from Vienna. Introduction of this 44-room hotel offers visitors western style quality lodging at affordable prices. On November 24, 2004, Cendant Hotel Group announced the signing of a deal with Hermitage Hospitality Ltd[4]. In order to facilitate the franchise of the Days Inn hotels in Russia, and in fourteen CIS countries including Ukraine, forty-five hotels will be developed in the countries of the former Soviet Union where quality economy and mid-scale lodging is in dire need.

The explosion of hotel development and branding in Eastern Europe did not have a significant effect on the Ukrainian hospitality market until 2005. The Orange Revolution evoked interest in Ukraine around the world resulting in the number of tourists visiting Kyiv, the country's capital, to gradually increase. In May 2005, the lack of quality lodging became obvious when thousands of foreign tourists flocked to the city for the Eurovision Song Contests[5]. The event represented a unique opportunity to introduce the home of the Orange Revolution in a positive light to thousands of people. However, many visitors left Ukraine disappointed. The main complaint was a lack of hotel space and the inadequacy of the provided accommodations. The existing rooms in aging Soviet style hotels had been booked for months. Low service standards were apparent as well - many reservations were canceled by hotels without notifying guests and re-booked at much higher prices.

The Ukrainian government strongly supports and often initiates the organization of various events as part of a promotion campaign to increase the inflow of tourists. For example, Ukraine and Poland submitted an application to co-host the Euro 2012 football tournament. On November 8, 2005, UEFA announced that Poland/Ukraine bid is among three bids to be short-listed to host the 2012 European football championships. However, the Union of European Football Association stipulates that a hosting country must possess, as a minimum, 10 to 15 hotels that meet European standards, among other things[6]. In light of the increasing demand, new projects have been announced in the Ukrainian hotel sector. Particularly, the movement towards quality lodging is currently taking place in the Ukrainian capital – Kyiv.

For example, the Radisson SAS Kyiv, located in the center of Kyiv, is the first fully privately financed, newly built international-standard hotel in Ukraine[7]. This four star hotel features 255 rooms, including 150 standard rooms, 83 business class and 22 suites. The rooms are designed in Maritime, Italian and Scandinavian styles and are capable of accommodating over 82 thousand travelers annually. Such features are French and Italian restaurants, a cigar bar, and over 303 square meters of meeting space capable to accommodate up to 205 people. Prices per night range from $265 for the standard guest room to $815 for the presidential suite. The hotel opened its doors on September 1, 2005. The hotel is owned by Doriscus Enterprises Ltd, a Cypriot limited liability company organized by Rainffeisen Property Investment (60% of ownership), the European Bank for Construction and Development (30%), and Rezidor SAS Hospitality

(10%). The opening of the hotel created 180 new jobs. "Yes I can" personnel training philosophy provides a refreshing alternative to stale unfriendly service standards inherited from Soviet times. This new hotel puts price and quality pressure on local hospitality providers ultimately benefiting a large group of travelers visiting Kyiv.

St. Sofia Hyatt Regency Kyiv is currently in the pipeline. This four star hotel is located in the center of the city on the picturesque Sofievska Square. It will count 235 rooms that comply with the standards of Hyatt[8]. The hotel will feature two restaurants with Oriental and Mediterranean cuisine, a lobby bar, conference and negotiation halls, and an exercise center with a 500 square meter swimming pool. The hotel was scheduled to open in May 2005; however, financing hurdles delayed its completion. In August 2005, The International Finance Corporation signed an agreement to provide a senior loan of up to $29 million to the project. This financing arrangement includes an A loan of up to $14.5 million and a syndicated B loan of up to 13 million. The total cost of the project is estimated to amount to $50 million. The project's sponsor and major shareholder is The Industrial Union of Donbass, a privately owned Ukrainian diversified group involved in production and trade of metal. Once operating, the project is expected to create 500 direct jobs and additional indirect jobs through vendor contracts.

Currently, the only domestically managed hotel in Kyiv operating up to European Standards is the Premier Palace. It was built in the beginning of the 20$^{th}$ century before the Great October revolution. However, in 2004, the hotel went through extensive renovations to satisfy the requirements of modern comfort and quality standards.

Located only a few steps away from the main street Khreschatyk, Premier Palace offers a panoramic view of the city's central streets. The prices per night range from

$291 for the economy room to $1,443 for the deluxe suite; prices include breakfast and all taxes.

The presence of the international up-scale brands is expected to have a positive effect on the development of the Ukrainian tourism industry due to increasing demand for business class hotels in Kyiv. It is expected that in the course of time, consumers will have a chance to satisfy the need for high quality hotel services.

Contiguous with increased tourism, the Ukrainian hotel companies have also increased their activities in the domestic market as well. For example, a domestic company created in 1997, HCM Property Management, has undertaken the construction of hotel Opera. The site is situated near the National Opera, one the city's prime locations[9]. The design of the 149-rooms is inspired by motifs of classical operas. This hotel is scheduled for delivery in early 2006. The project's budget is $14 million.

***National Opera of Ukraine, Kyiv***

In November 2004, the domestic entrepreneurial group Myrova Karta (The World Map) purchased municipally owned Hotel Khreschatyk for 6.5 million EURO. The hotel is located in the center of Kyiv and is expected to meet the four-star rating standards, once renovations are completed. In the beginning of operations, Khreschatyk will be managed by the domestic company XXI Century. However, delegation of management to the one of the international operators is being considered.

XXI Century is planning to create a chain of three star hotels, most of which will be located in and around Kyiv. Currently, the entity owns several sites and projects to invest 30 to 50 million EUROS into construction of similarly designed hotels. The company is also preparing for the development of four-star hotels that should be operated by an international management companiy.

Overall, Kyiv offers forty-five hotels and motels, three of which – the centrally located Dnipro, Ukraine and President - are still state run. It is interesting to note that the disaggregation of the hotel market sector not only reveals the legitimate hotel entities, but also an alternative lodging option referred to in Ukraine as the "shadowy" market[10]. This very active market highlights many tourists' preference to stay at private apartments rather than at a hotel. The shadowy market may result from a low supply of affordable accommodations in the areas of high demand such as the Crimean seacoast. There are an estimated fifty thousand such apartments in Kyiv alone.

The lack of the brand name hotels in the Ukrainian market provides a unique investment opportunity for leading American hotel chains. Much needed upscale western hospitality centers will fill an existing domestic demand for luxury and high quality service and increase the flow of tourists from Western countries. Presence of reputable hospitality brands will reduce the uncertainty factor and provide assurance of quality accommodations and services. Cautious Western tourists will feel more comfortable spending hard earned vacation time and money if they know what to expect from lodgings. Visiting a new country does not seem as risky and uncertain when the customer interacts with a familiar hospitality organization with a recognized brand.

## OWNERSHIP STRUCTURE

The major advantage of the leading chains is an established worldwide reputation. However, even though the international players have the advantage of knowing how to do business in a diverse environment, an entry into a new market is a complicated process. Anikeeff (2005) outlines six ownership structures that provide modes of entry into international markets: sole ownership, joint ventures, franchising, management contract, strategic alliances, and consortia[11]. These structures offer different degrees of cost of entry and control over operations.

Sole ownership provides the highest level of control and it's the most expensive mode of entry. It also results in the highest exposure to external risks. Joint venture requires moderate equity investment and reduces exposure to risk factors; however it also reduces the degree of control. Ukrainian Law provides for three forms of ownership: private, collective and state[12]. The legal presence in Ukraine can be established in form of company such as general partnership, limited partnership, limited liability company (LLC) and joint shock companies (JSC)[13]. LLCs and JCSs are the popular vehicles for conducting business in Ukraine due to embodied concept of limited liability to investors. Similar to U.S. corporations, joint stock companies are divided into two categories: open and closed. An open JSC is established through public offering and subscription of shares. In contrast shares of closed JCS are distributed privately among founding shareholders. If foreign investments comprise at least 10% of the contributed equity a company will qualify as "enterprise with foreign investment." Such companies are governed by Commercial Code of Ukraine and Foreign Investment Law. Under this law foreign investment companies are entitled to certain privileges and guarantees such as: protection against changes in legislation; protection against nationalization; guarantee for compensation and reimbursement of losses resulted from improper actions by state bodies of Ukraine; guarantee to withdraw investment from Ukraine duty free in the event of the termination of investment activity; and guarantee of reparations of profits.

Foreign legal entities and contractual vehicles, such as joint ventures and joint cooperation, are entitled to own residential and commercial real estate as well as other property of social, cultural and industrial character. There is no legal requirement for a foreign entity to establish any form of residency or presence, such as a representative office or a branch, for the purpose of real estate property acquisition. The same rules apply to individual investors. Foreign citizens and persons without Ukrainian citizenship are explicitly allowed to own residential buildings, apartments, vacation homes and other types of real estate property. However, land ownership is limited. Foreign individuals and legal entities allowed to own, use and dispose of certain non-agricultural land if there is an existing building or structure on the purchased lot, or undeveloped lot may be owned with in the city limit if used for construction purposes. Foreign legal entities are explicitly prohibited from agricultural land ownership, and companies with 100% foreign investment do not have any right to land ownership. Ukrainian and foreign legal entities and individuals may use land for other purposes through lease or by obtaining the "right of use." Currently, hotel projects with 100% foreign ownership can be developed on the basis of a land lease with a term up to 50 years.

According to the "Ukraine Country Commercial Guide 2004," published by the US Department of State, Joint Ventures between Ukrainians and Western partners gained popularity at the beginning of the current economic transformation process[14]. Joint Venture is the middle point between common "national ownership and the necessity to attract foreign investors and learn foreign business practices." There are two purposes of Joint Venture ownership under the Ukrainian law: 1) pooling assets from different owners and mixed type ownership; 2) combining the capital of Ukrainian and foreign founders and sharing in management, distribution of results, and risks associated with investment. In practice the availability of foreign investors is a condition of setting up and launching a Joint Venture. Ukrainian law provides that agencies participating in managing the State Property Fund of Ukraine have authority to establish Joint Ventures on behalf of state owned enterprises. There is wide opportunity in setting entities under this form of ownership that can be "established as limited corporations, stock companies, or other associations." Registering in the State Register of Enterprises of Ukraine is mandatory.

On the other hand, alliance and consortia minimize the cost of entry and related risks; however the level of control is also minimal.

Franchising is at the emerging stage in Ukraine. This form of ownership is gaining popularity primarily in the fast food sector where McDonalds is one of the first and most prominent players. Other major participants in the fast food market are Dunkin

Donuts and Baskin Robbins. Currently, franchising is taking root in other service industry sectors as well. CarRent Ukraine and First Lease acquired their franchising licenses from Hertz for car rental and for leasing, respectively. Express Personnel Services and Xerox copy centers also established their presence in Ukraine. Even though franchising has a promising start in Ukraine, development of legitimate franchising instruments is necessary for encouraging this mode of entry by foreign investors. Franchising is a low cost and low risk mode of entry in the new market; however it does not guarantee a sufficient level of control over operations. Possibility of compromised quality of service and the lack of a clear legal framework for franchising hinders the Ukrainian market entry enthusiasm of other US chains.

Paivi Karhunen examines the entry mode by the international chains into transition economies[15]. He builds his case on entry into the Russian market. Karhunen stresses the importance of "non-equity models of involvement" such as franchising agreements and management contracts. The trend of the chain management contracts emerged in the United States during the 1980s[16]. Under this arrangement a hotel company is paid for running a hotel's day-to-day operations and the right to use the chain's trade name. The significance of the management contracts is that it reduces the relationship between ownership and control, and allows the operator to retain a high level of control without significant equity investment and without any obligation to fund operating losses. For example, Hilton Group prefers an "asset-light" manner of entry and expands into Central and Eastern Europe through management agreements rather than through hotel ownership[17].

## LOCATION SELECTION CRITERIA

Besides global exposure, host countries are looking for equity investment from international players entering their markets. Karhunen outlines five location factors that would influence an international hotel chain's decision as to whether invest in the targeted market[18]:

1. factors determining the size and growth of tourism demand to particular place;
2. the general infrastructure of tourism;
3. the policy of the host country;
4. the availability and quality of inputs, including personnel; and
5. the general political, social and economic stability of the host country.

The following sections concentrate on discussion of these factors in relation to Ukraine. The first set of factors will be described in terms of location advantages, proximity to other tourist destinations, and accessibility. An overview of general infrastructure of tourism includes outline of cultural, historical, and natural resources in the four Ukrainian regions most frequented by foreign tourists: Kyiv, Crimea, Odessa and Lviv. The policies of the host country are described in terms of government involvement in development of the tourism industry and general investment environment. Availability and quality of input are discussed in terms of workforce and building resources. Finally, the paper outlines major economic indicators and trends and provides an outlook on political and social stability within the country.

## A. FACTORS DETERMINING SIZE AND GROWTH OF TOURISM DEMAND IN UKRAINE

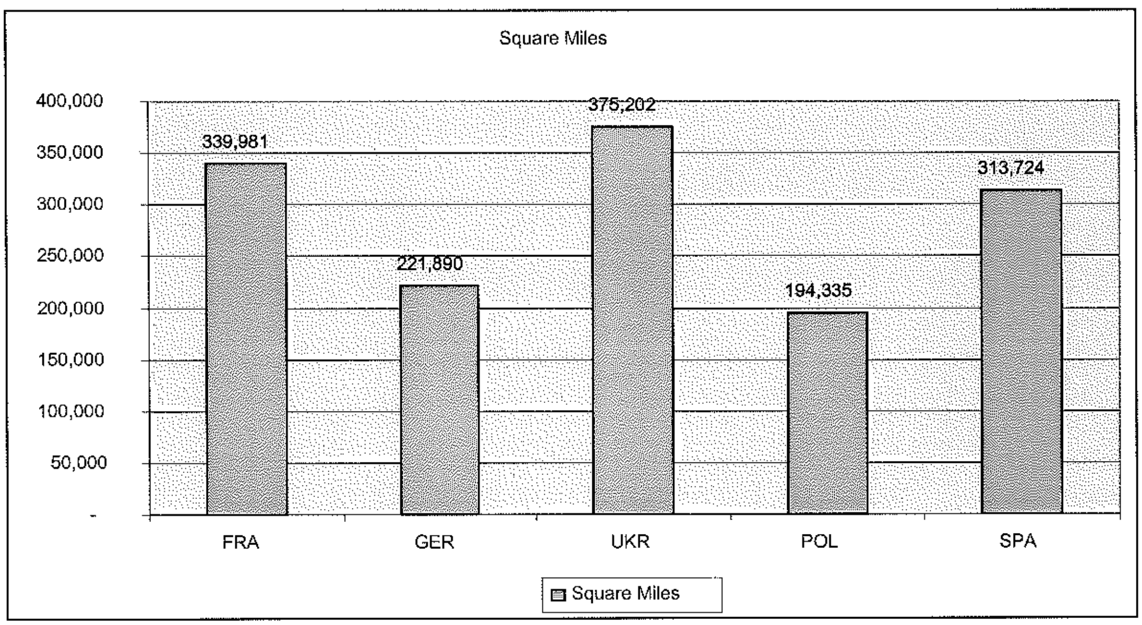
There are three significant factors that quantify and stimulate growth within Ukraine tourism industry, and they are as follows:

### 1. Geographical Location

At 375,202 square miles (603,700 square kilometers), Ukraine is the largest country in Europe, excluding Russia, as set forth in the Area Chart – Table 1-A as follows:

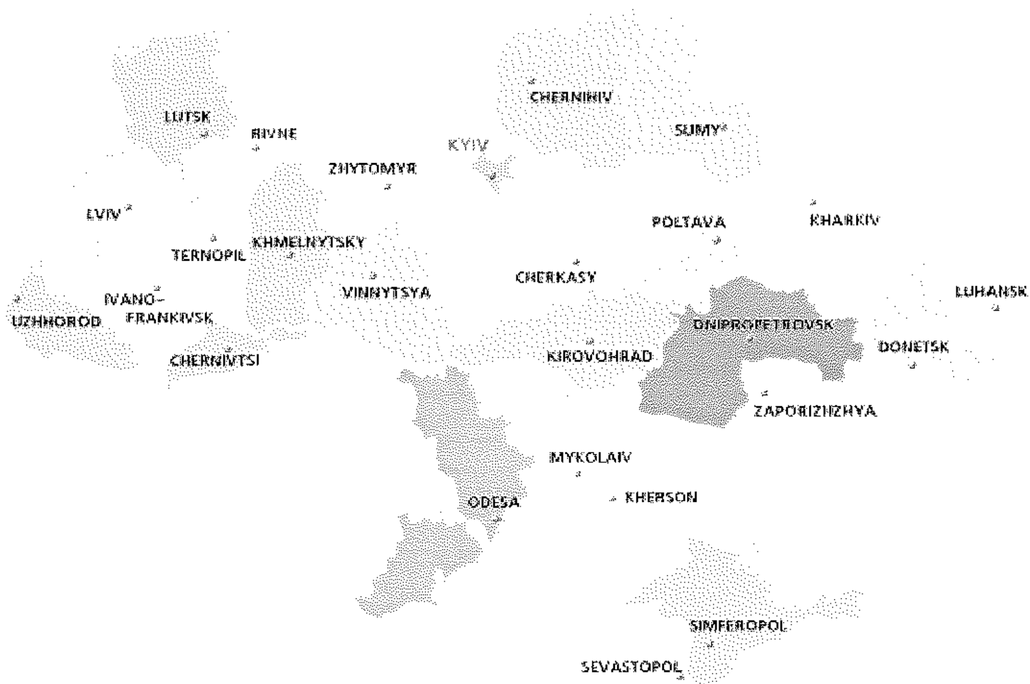
TABLE 1-A

Area of the Largest European Counties (excluding Russia)




Source: *CIA – The World Factbook*

Ukraine has a very advantageous geographic location – a strategic position at the crossroads between Europe and Asia. The country occupies the South-Western part of the Eastern-European Plains and a part of the Carpathian and Crimean mountain ranges. It stretches for 555 miles (893 km) from North to the South and for 818 miles (1316 km) from West to East. Ukraine is located in moderate latitudes and has outlets to the Black and Azov Seas. It features a diversity of beautiful landscapes, cultures, and historical attractions. The country is comprised of the following 24 provinces (oblasts), Crimean autonomous republic, and two cities with special status--Kyiv and Sevastopol.




Additionally, Ukraine benefits by being located between two spectacular mountain ranges and having access to the Black sea. Sheer geographic size and diversity of the landscapes offer an opportunity for development of a variety of recreational tourist attractions. The scenic countryside invites rural and ecological explorations, fishing, hunting and golf activities. Spectacular mountain regions have provided excellent potential for the development of up-scale ski and health improvement resorts. The breathtaking beauty of the South Crimean sea cost, if properly developed, can compete with prime European beaches. According to Prof. Hennady Naumenko, Vice president of the Institute of Tourism, Ukraine has great potential for year round tourism[19]. There are "excellent conditions for winter tourism in the mountains, and for summer tourism at the seacoasts." In between seasons, there are many places where "people can go and combine holidays with medical treatment and general health improvement."

### 2. Proximity and Accessibility

Ukraine has the advantage of geographic proximity to numerous European countries. It has extensive land and maritime borders. Their total length is 4717miles (7590 km)[20]. Land borders are 3500 miles (5631 km) long and include three parts: western, northern and eastern. Sea borders are 1218 miles (1959 km) long. Ukraine has land borders with the Russian Federation 1,282 miles (2063 km), the Republic of Byelorussia 606 miles (975 km), the Republic of Poland 337 miles (542.5 km), Slovak Republic 61 miles (98 km), Hungary 84 miles (135 km), Romania 378 miles (608 km) and the Republic of Moldova 742 miles (1194 km). Ukraine's geographical situation at the intersection of key transportation and tourist routes provides easy access from Europe and Asia.

One of the measurements of the emerging markets in Europe is presence of infrastructure such as roads, airports, waterways, and so on. Ukraine's extensive transportation network includes 14 thousand miles of railways, 101,863 miles of paved highways and 3,476 miles of unpaved roads[21]. Three out of nine international transport corridors authorized at the second Pan-European conference pass through Kyiv : "Berlin – Vrotslav – Lviv – Kyiv", "Helsinki – St.Petersburg – Moscow – Kyiv – Chishenau – Bucharest – Alexandropolis", "Trieste – Lublana – Budapest – Kyiv". One of the main transeuropean highways "Milan – Budapest – Lviv – Kyiv" passes through Ukraine as well. The railways connect the capital of Ukraine practically to all capitals of the countries of Western and Central Europe, the Baltic States, and the large cities of Russia, as well as Byelorussia and to other locations in Ukraine.

Source: Ukrainian Embassy Website (http://www.ukremb.com/about/map.html)

There are 174 airports with paved runways and fifteen major ports and harbors. The nation's major airport, "Boryspil", located 19 miles from Kyiv, serves mainly international airlines and connects the capital with more than 40 capitals of the countries of the world. The river Dnipro connects Kyiv to the following: northern and southern regions of Ukraine, and ports of the Black and Azov seas, and 15 European countries of Danube and Main, and also Russia, Poland and Byelorussia.

### 3. Existing Tourism Demand

Tourism is one of the fastest growing industries in Ukraine. It has become one of the key factors driving the Ukrainian economy. According to State Tourism Administration of Ukraine, twelve and a half million foreign tourists visited Ukraine in 2003; the number represents a 19 percent increase from 2002[22]. Over fifteen and a half million foreigners crossed Ukrainian borders in 2004, 24.9 % increase from 2003. Overall volume of the tourist services consumption increased from 3.2 billion USD in 2000 to 6.6 billion USD in 2004. Almost eighteen million of foreign tourist visited Ukraine in 2005 and nineteen and a half million were expected in 2006[23]. According to the 2002 statistics, the most popular destinations are Kyiv (approximately 35% of all visitors), Crimea (30%) and the Carpathian region including Lviv (15%)[24]. The Ukrainian tourist market attracts visitors primarily from the countries of the former Communist Bloc, such as Russia, Poland and Hungary. One of the STAU's (State Tourism Administration of Ukraine) priorities is a development of the tourist products that will attract visitors from the USA, Canada, Germany and Japan. These countries lead the world as to the number of their tourists. In order to attract western travelers, the Ukrainian tourist industry needs to upgrade its existing facilities and services to the globally accepted standards.

## B. INFRASTRUCTURE OF TOURISM

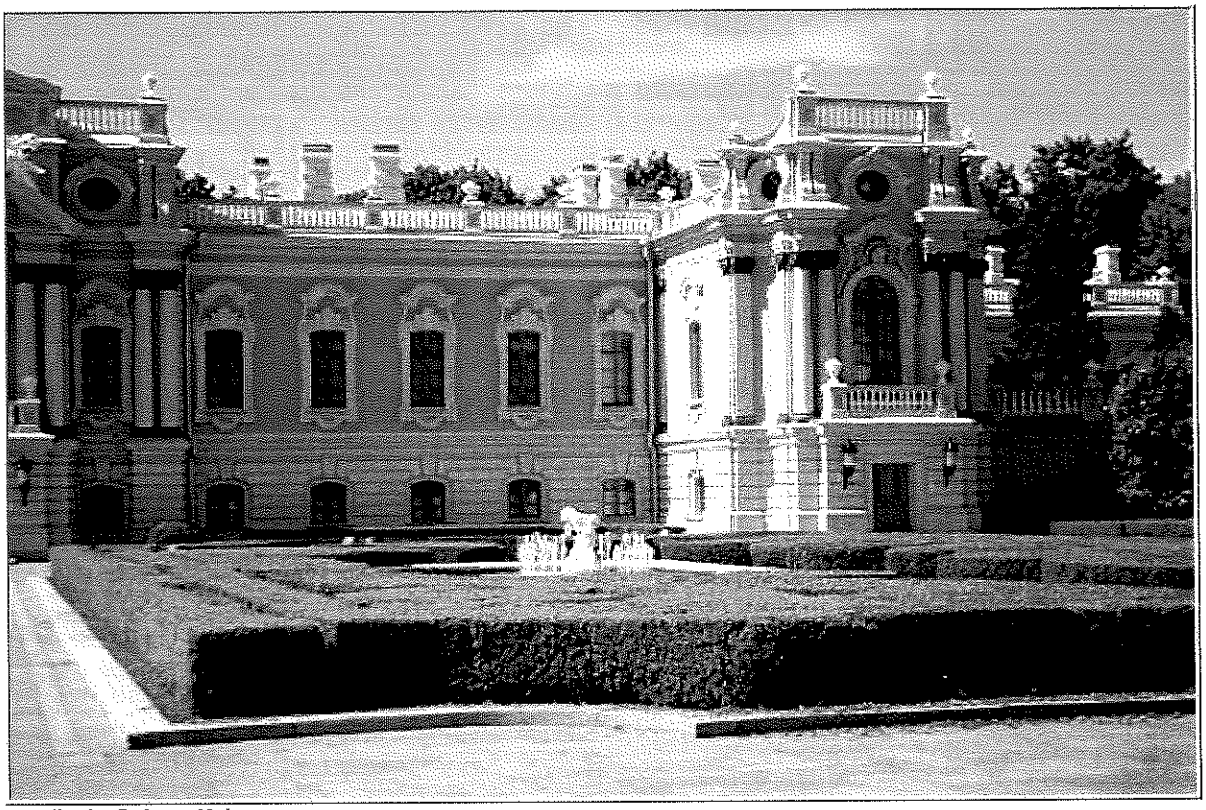
Ukraine inherited an extensive tourism infrastructure from the Soviet Era: more than four and a half thousand hotels, and tourist complexes, and health resorts, with the total potential of accommodating roughly sixty million people a year[25]. During Soviet times, the Republic of Ukraine was a major center for recreational tourism, prophylactic and therapeutic treatment, and children's recreation.

Health improvement centers are very common in Eastern Europe. Such centers are normally located in the coastal and mountain regions. Each resort offers natural treatments for a specific type of health problem. The first attribute of the centers is their location in the appropriate climate zones. For example, the fresh air of the Black sea coast is recommended for people suffering from such illnesses as lung decease and asthma. The second attribute is the scope of voluntary treatments made available, which normally include such therapies as mineral water and vitamin intakes, massages, prescribed diets, physical activities, mud baths, and much more. Though prevalent in Eastern Europe, such health enhancement centers within the American marketplace are almost non-existent. The development of up-scale resorts in Ukraine that offer natural health enhancement treatments will create a new product to sell to the western tourist market. Currently, hundreds of such facilities exist in Ukraine; however, due to a decade of economic decline, ninety percent of the existing facilities are in need of considerable investment for reconstruction and overhaul.

Within Ukraine, the most popular tourist destinations are the urban centers, particularly the ancient city of Kyiv and the elegant baroque city of Odessa, Autonomous Republic of Crimea, and the Lviv region, including the city of Lviv. Kyiv is the most popular tourist destination in Ukraine, as it accounts for over a third of all visitors. Kyiv was founded in the 500's AD. The city is rich in history, art and culture. Kyiv is home to the oldest orthodox monastery complex in the Slavic part of the Eastern Europe. Pecherska Lavra, founded in the late 900's AD, is still active and open to tourists.

Another 1000 year-old cathedral complex, the graceful Sophia, dates back to the times of legendary Kyivska Russ. The antique fresco of the cathedral tells the story about the might of the largest kingdom in the $12^{th}$ century Christendom. Ancient dignity of religious landmarks is contrasted by charming playfulness of architectural monuments from the Baroque period. Opulence of chestnut trees transforms the city into an inviting garden during late spring and summer seasons.

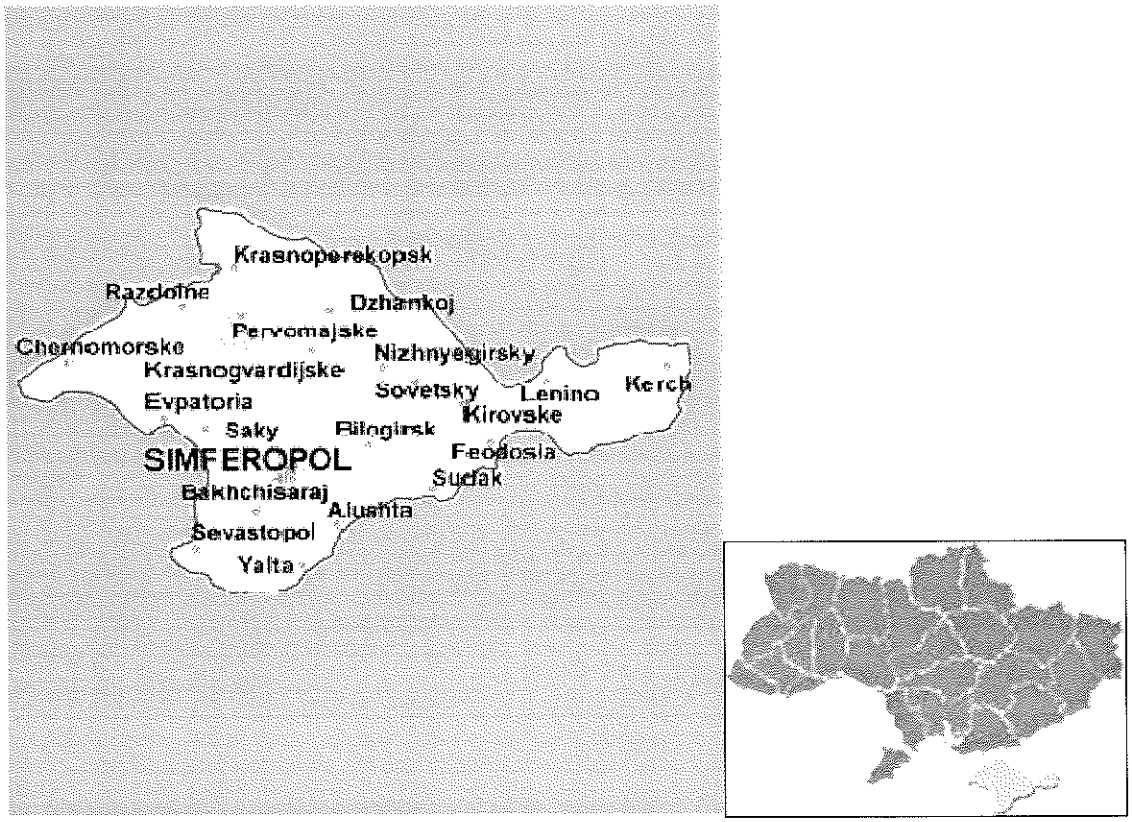
***Bell Tower of St. Sofia Cathedral, Kyiv***



*Mariinsky Palace, Kyiv*

Even though Kyiv lacks architectural sumptuousness of other European capitals, due to 800 years of foreign occupation, constant warfare and deliberate destruction by invaders, the city's charm is undeniable. There is an opportunity to enhance the soft tranquil beauty of the Ukrainian capital with the grandeur of modern architecture, following examples of the major American and Canadian cities such as New York, Toronto and Montreal.

Crimea shares in approximately a third of tourist services in Ukraine thereby catering to foreign tourists who arrive for rest[26]. The region accounts for half of the excursion services provided in the country as well. The majority of tourists come from Russia, Ukraine and other CIS countries. The main non-CIS tourist suppliers are Germany and Turkey.

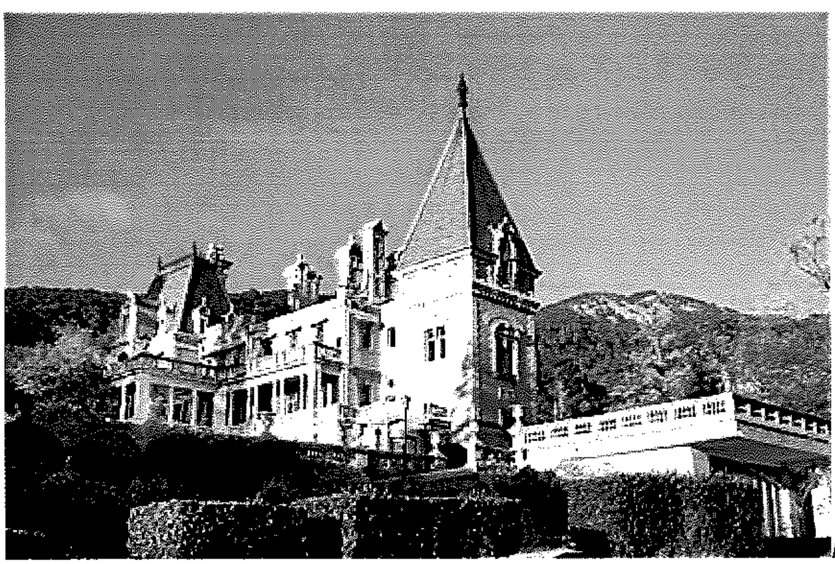



Existing tourist attractions include over 11,500 historical, cultural, and architectural monuments in the Crimea, related to various historical epochs, civilizations, peoples, and religions. The most unique of them are the complex of cave towns and monasteries, Genoa fortresses, and sacred places of various denominations. The pilgrim tourism is an emerging trend in the Crimean region. To accommodate the rising interest in the Crimea's holy shrines, one-day tours to renewed monasteries and temples of Simferopol, Sevastopol, and Greater Yalta have been developed and offered.

Cultural resources of Crimea are comprised of ancient and modern architectural and historical monuments. The ancient towns of Yevpatoriya, Feodocia and Kerch display artifacts of over 2,500 years of history. The Crimean peninsula is a historical motherland to ancestors of modern German, Bulgarian, Greek, Crimean Tatar, and Czech citizens.

Significant historical sights include, but are not limited to the following: remains of a fortress wall of the ancient Greek town of Kerkinitida, Greek and Scythian settlement sites, the medieval Dzhuma-Dzhami mosque, Turkish baths of XVI century, dervish takiye of VI-XV centuries, Karaim Kenassa of XVIII century, Armenian Church of St. Serge (Sury-Sarkiz) XIV century, Mufta-Dzhami mosque of XV century, St. Constantine's Tower, Greek Church of Introduction, Church of John the Baptist, Royal Burial Mound of IV century BC, Melek-Chesmen Burial Mound of III century BC, Scythian Burial Mound Kul-Oba, remains of the ancient town Panticapei, and Turkish fortress Eni-Kale.

There is an abundance of museums and art galleries such as The I.K. Aivazovsky Feodosiya Picture Gallery, The Kerch History and Archeological Museum, Museum of the Black Sea Fleet in Sevastopol, Bakhchisarai Historical and Architectural Reserve, and residences of the Russian emperors Massandra and Livadia.



*Massandra. Palace of Alexander III*

Crimea is home to Yalta – an internationally popular resort and tourist center at the South coast of the Crimea. Yalta is permanent residence to 81,000 people out of the Crimea's total population of 2,018,400 of people.

Yalta

Landscape resources of Crimea comprise of five state reserves, 33 game reserves, including 16 national ones, 87 natural monuments, including 13 national ones and 10 reserved tracts. A combination of picturesque mountains and wide plains, forests, steppes, seas, lakes, unique flora and fauna, a wide-ranging network of natural, historical, and ethnographic monuments provide great potential in the development of green (rural) tourism.

The Crimean peninsula is famous for its curative and mineral resources. The Crimean mineral (mud-bath) resources, its beaches, and coastal plots of land offer high potential for development of resorts in accordance with top world standards. The peninsula has 26 deposits of curative mud and brine, as well as over 100 mineral water springs of various chemical compositions. 15 mud deposits and 13 major mineral springs have been recognized as curative by a special decree of the Ukrainian Cabinet of Ministers.

Available territorial resources consist of 632 sanative and preventive healthcare facilities. Over 90% of the facilities are concentrated mainly at the Crimea's South coast surrounding the city of Yalta and the Yevpatoriya resort. The sanative and preventive healthcare sector is based on using mineral waters (with a potential capacity of 14,000 m3 per day), curative mud (with reserves of 22.4 mn m3), beaches (517 km long), and climatic and landscape resources, such as sea and mountain air. According to their specialization, the sanatoria are divided into tuberculosis, respiratory, locomotoric, neurological, ophtalmological, cardiovascular, general therapeutic, and multipurpose sanatoria.

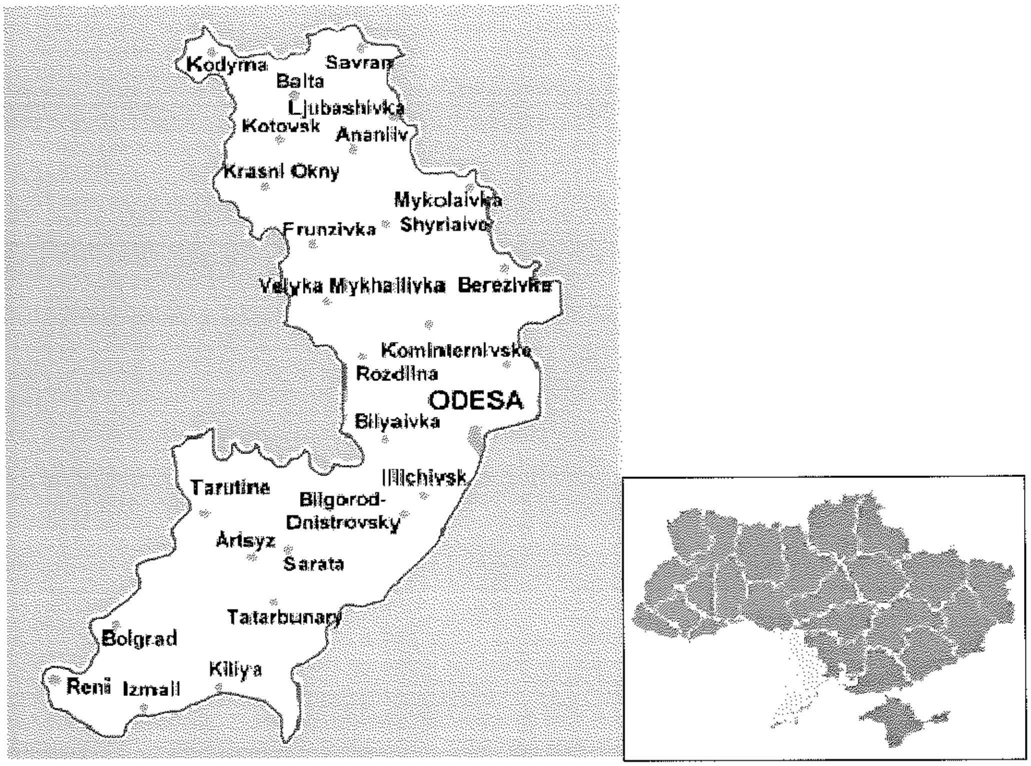
Inland territories, mountains and foothills, have a network of tourist bases and camps and a small number of hospitality facilities (less than 100 beds) with only basic amenities, even though the mountain region of Crimea has all the necessary conditions and resources for a high-level recreational development.

The availability of tourist resources and existing infrastructure in the Crimea provide a solid foundation for further development of various forms of tourist attractions, such as rock-climbing, horse-riding, hang-gliding, mountain hiking, wine tasting and hunting tours, helicopter rides, yachting trips, scuba-diving, scientific and motor tourism. There is a great potential to advance show business and entertainment industry and develop new infrastructure for elite kind of sports such as golf.

The Crimean tourist industry is supported by other sectors of the economy. Beneficial geographic location of the peninsula and riches of its natural resources offer advantageous natural conditions for development of not only recreational industry, but also agriculture and certain extractive industries, such as fluxing, limestone mining and construction materials production. Historically, agriculture in the Crimea has focused on plant farming. It specializes in viticulture, horticulture, growing of tobacco, essential oil crops, and grain. The region's animal husbandry includes dairy and meat cattle breeding with well-developed livestock breeding. There is also participation in the special market sector of the poultry industry.

The Odessa region is the largest in Ukraine and it represents approximately 5.5% of the country's territory[27]. Its total area is 20,969 square miles, an approximate size of Belgium or the Netherlands. This region is located in the far Southwest of Ukraine and borders Moldova and Romania. It stretches over the territory on the Northwest Black Sea coast, from the river Danube delta to the Tiligoulskiy estuary, and occupies 186 miles of coastline.

Odessa's mild climate, natural and cultural resources, wide transportation network and existing infrastructure make it the third leading region of Ukraine in terms of its tourism-recreation potential. Approximately 174,000 foreigners visited the region. The majority of the foreign tourists came from Russia, Germany, Italy, Moldova, Belarus, Poland and Turkey. Some 15-20 % of the foreign visitors came to Odessa Region for business and others visited the region for pleasure. The region is famous for its warm sea with many sand beaches, numerous cultural, historical, architectural, wild life sites, and curative mud and mineral water resources.




The region's multinational historical, architectural and cultural sites include the following: the world renown Odessa State Theater of Opera and Ballet, the Potyomkinskaya stairs, the Ukrainian Venice – Vilkovo town, the fortress in 2500 year old Belgorod-Dnistrovsk town, the ruins of the antic cities of Tira and Nikoniya, the architectural monuments in Odesa, Izmail, Reni, Kiliya and many other places of interest.

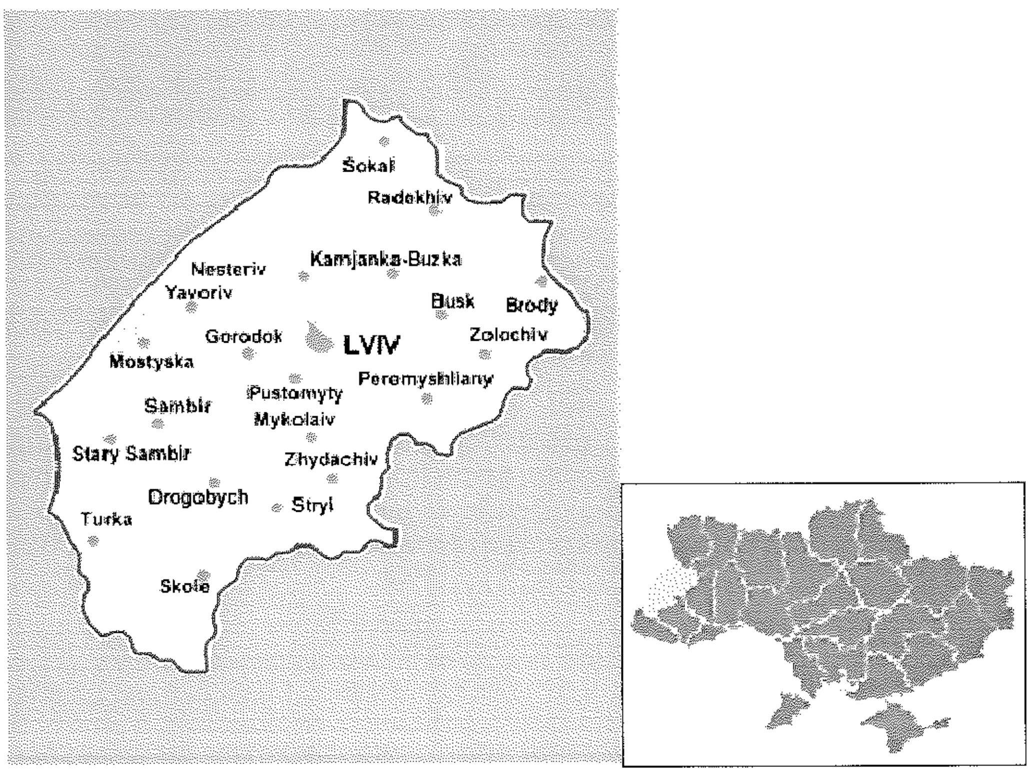

Odessa State Theatre of Opera and Ballet

The Danube biosphere preserve, the Danube and Dniestr wetlands, the landscape park "Tiligulskiy", the Botanic Garden of Odessa National University and 19 national parks are among Odessa region's 92 wild life reserve zones.

The Black Sea and Danube cruises provide a popular mode of entry into the region. International cruise passenger liners enter the region by the Black sea and by two major rivers, Dnipro and Danube. During the cruising season, from May till October, an average of 70-80,000 tourists per year visit Odessa. The passengers come mainly from Germany, Italy, France, Holland, Switzerland, Poland, and Hungary.

Odessa, the capital of the region, occupies terraced hills overlooking Odessa Bay, an inlet of the Black Sea that forms a natural harbour. The city is among the largest ones in Ukraine; it serves as the southern gateway of the state. It is an important resort, cultural, transportation, scientific, and industrial centre, with a population of 1,022,000.

The Lviv Region takes the 4th place in Ukraine according to the number of foreign tourists. The region is located in the Western part of Ukraine along the border with Poland, and is sometimes referred to by its ancient name Galychyna. The region is home to more than 4,000 monuments of Ukraine's cultural inheritance[28]. Some of the most popular historical sites among tourists are united in a popular tourist route referred to as the "Gold Horseshoe of Lviv Region" which includes the castles Oleskyi, Zolochivskyi, Pidgoretskyi, and Svirzkyi.




The Lviv Region has a distinctive climate, and natural resources, and attracts different kinds of tourists. The major part of the region is occupied by the Carpathian Mountains. The mountainous area is considered a unique nature complex and one of the cleanest locations in Europe. Numerous natural parks include "Skolivski Beskydy" and

"Yavorivskyi", natural reserve "Rostochchya", state historical and architectural reserves "Knyazhyi Bells", "Zhovkivskyi", and "Tustan'". Green rural tourism is developing in the Carpathian mountain areas. There are four mountain ski resorts situated on the Region's territory: Slavsk, Tysovyts, Rosluch, and Turka.

There are over 200 unique reserves of mineral waters and medical mud, of which the fundamental tourist attraction is sustained by the vibrant and nationally renown health resorts. There are 127 health centers and other healthcare institutions in this region, such as Truskavets, Morshyn, Shklo, Nemyriv, Lubin', Velykyi, and Skhidnicya.

The capital of the region Lviv is known as "The Pearl of Europe" and is designated as an open-air museum. The central part of the city is declared the historical and architectural reserve and is included in the "The List of World Cultural Inheritance of UNESCO".

*Lviv*

## C. THE POLICY OF THE HOST COUNTRY

With respect to overall support of the tourism industry at-large, the policy of the Ukrainian government has been improving during the last decade:

### 1. Support of Tourism Industry

During the Soviet era, the country's tourist industry was viewed as a branch of the neglected sphere of services. Inflow and outflow of tourists were restricted. During the decade, that followed the collapse of the Soviet Union in 1991, more Ukrainians began to travel abroad. Observed western lifestyle ideas found a fertile ground in the Ukrainian society. Still unattainable by the majority of Ukrainians, the western standards of living became a benchmark for achievement, and a guideline for the present and future of the country's development. With changed attitudes came the realization of the importance and potential of the tourist industry. The current tourism industry is becoming a prominent driver of the Ukrainian economy. In 1998, Ukraine joined the World Tourism Organization. The head of the State Tourism Committee of Ukraine was elected a member of the World Tourism Organization Executive Council in 1999.

The Ukrainian government has been taking steps to advance the development of the industry. The State Tourism Administration of Ukraine (STAU), a state body of the executive power, was created in December 2001 to promote and realize state policies in the sphere of tourism. One of the main tasks of STAU is the development of an advanced marketing strategy of Ukrainian tourism with the creation of a new global and local image of the country's attractions and related goods and services. The agency aims to introduce global practices and standards into the organization of the Ukrainian market. For example, in 2002, the Ukrainian legislative body of government outlawed the hotels' common practice of charging higher rates to foreign visitors as the result of pressure applied by STAU.

Currently, nearly two and a half thousand tourist agencies operate in Ukraine. Most of the employees working in the tourist industry receive specialized education. In contrast to the Soviet system, today's hotel and tourist agency managers receive industry training and even degrees from the higher learning educational establishments, such as the Institute of Tourism in Kyiv. There are approximately seventy schools and departments that educate students in tourism-related majors (Naumenko).

In 2002, the Ukrainian government took its first steps to simplify the entrance formalities for foreign visitors. Foreign citizens were able to obtain visas for up to eight days stay at the Ukrainian airports and seaports. In 2005, the administration displayed good will towards the West by lifting visa requirements for citizens of the EU counties, Switzerland, Liechtenstein, the United States, Canada and Japan. The new rule came into effect on September 1, 2005. The hope is that this gesture will be reciprocated.

Inadequate accommodations and services of the majority of Ukrainian hotels drive away even domestic vacationers. Those who can afford it prefer to spent their precious funds and vacation time overseas. Ukrainian tourists feel that they are getting better hotel accommodations and services for the same cost abroad. Major state-competitors include Turkey, Egypt, Spain, Croatia and Bulgaria. Introduction of the world-class hotels and resorts will boost the global image of Ukraine as a tourist destination and retain domestic vacationers.

### 2. Investment Environment

Among 117 countries investing in Ukraine are the following major participants: Cyprus accounts for 14.1% of the foreign direct investment (FDI), the United States (13.6%), the United Kingdom (10.4%), Germany (7.1%), the Netherlands (6.8%), the Virgin Islands (6.1%), Russia (5.5%), Switzerland (4.9%), and Austria (4%)[29]. According to the state statistical committee, foreign investment in Ukraine increased by 24% in 2004. 1.32 billion USD entered Ukraine in 2004 while $277 million were withdrawn. Total foreign cumulative investment in Ukraine since independence amounted to $7.6 billion as of December 2004. The major destinations of FDI are the domestic trade industry (16%), food processing (14.6%), machine building and finance (8.4%), and transportation and communication (7.3%).

Even though the increase is significant, the total figure is modest in comparison to other Eastern European countries. For example, an average annual FDI in Poland for 2000-2004 fluctuates between 7-8 billion USD. The Ukrainian investment climate improved dramatically over the past years; however, much remains to be done. The primary complaints of the investment community include lack of predictability and transparency in the Ukrainian regulatory system. Selective enforcement of the tax laws, backlogging refunds by tax administration, discrimination against foreign companies by the court system, and individual corruption in the various spheres of government hinder investment activities in Ukraine. However, slow but positive changes are taking place.

An official position of the Ukrainian government is to create a positive investment climate within the country. According to the U.S. Department of State, Ukraine has significantly improved its market conditions over the past few years. The "Ukraine has liberalized its markets, reduced regulation, eliminated most licensing requirements, eliminated most restrictions on foreign exchange and begun the transformation of the agricultural sector from state-run farms to private agriculture." Ukraine 1996 law "On Foreign Investment Regime" guarantees equal treatment of Ukrainian and foreign-owner businesses with some exceptions in publishing and broadcasting.

In May 2001, the Cabinet of Ministers approved a resolution to exempt from taxation profits of non-Ukrainians who pay taxes on repatriated profits to home nations that signed bilateral agreement with Ukraine against double taxation. On December 24, 2002, Verhovna Rada (Ukrainian equivalent of Parliament) voted to cut the corporate tax rate from 30% to 25% and to liberalize provisions for loss carryovers.

In October, 2004 Verhovna Rada supported a draft law "On State Support and Stimulation of Investment". The purpose of this law is to create favorable conditions for increasing the amounts of foreign investments in the economy of Ukraine, particularly the activity of foreign investors as it relates to the acceleration of social and economic development of the regions and priority branches of production. Some of the main objectives of this law include: simplification of procedures of registration by investors, and establishing the administrative responsibility by officials for the actions that have adverse impact on investment climate in the branches of economics and regions promoted by government. The draft is to be voted on by the end of 2005.

Currently, foreign investment activities in Ukraine are proceeding at a cautious but stable pace. On September 23, 2005, Kharkiv region deputy governor Yaroslav Yuschenko announced that German company Natursafte will build a new juice production plan in the region. The company plans to invest 25 million EURO in the new plant. On September 28, 2005 Hewlett-Packard announced a decision to become the first international IT brand to manufacture desktops in Ukraine. This step is expected to prove HP's leadership in the Ukrainian IT market. The first HP desktops manufactured in Ukraine are estimated to become available in October 2005. On October 20, 2005 the Vienna-based Raiffesen International Bank-Holding AG finalized the acquisition of a majority stake of 93.5 % of the Ukrainian leading bank Aval. Founded in the 1992, Bank Aval operates a country-wide network of 1,400 business outlets and serves more than 3 million customers. This transaction gives a positive signal to international investors considering venture into the Ukrainian market. On October 24, 2005, the boost in the foreign investors' confidence was ultimately demonstrated when the Netherlands subsidiary of the British-based Mittal Steel Co paid a premium price of 4.8 billion USD for a 93.02% stake of the government-owned Ukrainian major steelmaking complex Kryvorizhstal. The televised auction represents the country's largest ever privatization sale and symbolizes current government's move towards transparency and fair treatment of the foreign investors. Other bidders included the Luxemburg-based Arcelor SA and Ukrainian conglomerate, the Industrial Union of Donbass. The final bid exceeded by far the most optimistic expectations of 3 billion USD.

## D. THE AVAILIBILITY AND QUALITY OF INPUTS

### 1. Workforce

Having a population of 47.5 million (July 2005 est.), Ukraine is the third most populous country in Europe, excluding Russia. According to the world fact book, published by CIA, the Ukrainian labor force consists of over 21.1 million people, 44% of which are employed in service industry. About 70% of adult Ukrainians have a secondary or higher education. Approximately one third of the high school graduates advance to universities and other higher education institutions. Ukraine has about 150 higher education colleges and universities, of which the most important are located at Kiev, Lviv, and Kharkiv. There are about 70,000 scholars in 80 research institutes (http://www.state.gov/r/pa/ei/bgn/3211.htm).

The official unemployment rate in Ukraine is 3.5%, however there is a large number of unregistered or underemployed workers. The International Labor Organization estimates that the actual unemployment rate reaches 10%. Even though the population of Ukraine is well educated, possess a 99.7% literacy rate, hard working and eager to explore new employment opportunities, wages in Ukraine are very low by Western standards. In 2004, the nominal average monthly wage in Ukraine reached approximately $120. In February 2005, the average salary rate in Kyiv made up UAH 1099.85 or approximately $200. Kyiv's salary rate is 1.6 times higher than the national average. The highest wages are in the financial and credit sectors, while the lowest wages are paid to agricultural workers.

In 2004, the minimum monthly wage was increased to UAH 237, approximately $45 in the US currency. As of January 2005, the subsistence level was UAH 423 ($77). According to Ukrainian legislation, the minimum wage is due for adjustment whenever CPI reaches a 5% increase, and in 2004 the government of Ukraine announced that the minimum wage would reach the subsistence level by 2007.

Even though the average per capita monthly wage fluctuates between $100 and $150, the Ukrainian shadow economy, of "in kind" revenue received by private farmers and land owners, and increases in unaccounted entrepreneurial and commercial activities raise the average disposable income per capita above official rates.

Overall, the presence of very affordable and highly skilled workforce represents a great savings opportunity for foreign businesses, and partially compensates for other present risk factors.

### 2. Construction and building resources

In 2003-2004, 23.8% of the economic growth in Ukraine was driven by the construction industry[30]. The industry is supplied by the domestic and foreign building material manufacturers. Materials such as cement, baked and lime-sand bricks, clay roofing shingles, asphalt shingles, metal roofing components and bituminous sparking and tar paper are produced domestically in abundance. The domestic production also includes steel components, building and masonry lime, finishing lime, gypsum rock and plasterboard, alkyd penta- phthalic paints, ceramic wall tiles, exterior and façade tiles, linoleum and vinyl floor tiles, and various porous insulations.

The following imported materials are available and preferred in the Ukrainian construction market: linoleum, carpet and tufted floor covering, interior ceramic tiles, mineral wool insulation, and acrylic paints. The Ukrainian market for building materials is highly competitive, and major foreign suppliers are from Germany, Italy, the Scandinavian countries, as well as France and Spain. Several European companies established joint ventures to manufacture building materials in Ukraine in order to reduce prices and to gain a competitive advantage in the Ukrainian market. Kyiv, in particular, is well supplied with domestic and imported building materials.

## C. ECONOMIC, POLITICAL AND SOCIAL STABILITY

### 1. Economic Overview

According to the opening remarks of the World Bank's report No. 30928-UA "Ukraine. Building Foundations for Sustainable Growth" issued on December 27, 2004,

> *"Conditions in Ukraine have never been so favorable for the realization of policies and reforms that are crucial to the country's future development. Most economic trends and short-term prospects in Ukraine remain highly positive. After a decade of economic decline and crisis, the Ukrainian economy has exhibited strong growth and unprecedented macroeconomic stability since 2000. By the end of 2003, official GDP stood 30 percent higher than in 1997. During the same period, industrial output grew by an estimated 56 percent and fixed capital investment doubled. Unemployment has fallen, household incomes increased significantly, and progress in poverty reduction is visible. Inflation has been under control since mid-2000, while credit markets have expanded at a remarkable pace. Competition and restructuring have increased, and institutions of outside corporate governance have emerged. These conditions provide the government with an important window of opportunity to pursue policies and reforms that can ensure the continuation of strong growth and poverty reduction over the medium and longer term."*

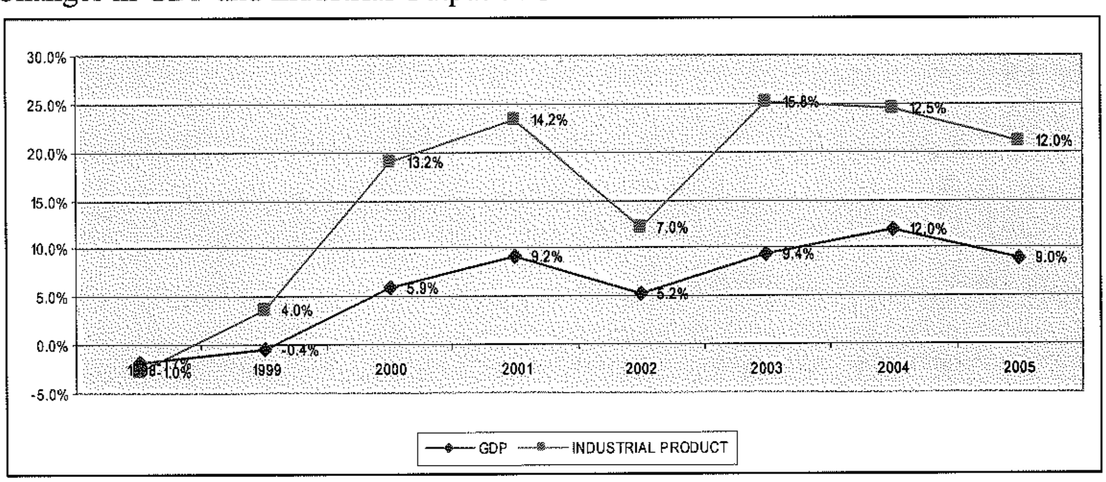
Today, Ukraine is a $60 billion economy consisting mainly of heavy and light industry, oil and gas transit, coal and mineral extraction, oil refining, and chemicals. Ukraine has vast agricultural and food processing industries that supply 97% of the domestically consumed food products such as fresh and canned meat, poultry, dairy, fresh and canned fruit and vegetables, grain products, alcohol and non-alcoholic drinks, and so on. The retail industry is one of the most productive sectors of the Ukrainian economy. Between 2000 and 2004, retail turnover experienced 20.8% growth nationwide and 27.8% growth within Kyiv.

Following the rapid decline of the early 1990s, the Ukrainian economy has been showing optimistic signs of improvement starting in 2000. According to the

PriceWaterhouseCoopers LLP Economic Overview, a strong export-based growth of the gross domestic product (GDP) over the past five years indicates a positive trend of Ukraine's economic recovery. Table 5-C shows GDP and Industrial Production over the past seven years. The Ukrainian currency, introduced in 1998 Hryvnia (UAH), has been stable against the dollar over the past five years but declined against the EURO (Table 5-B). The strong currency policy combined with successful management of the external debt-service obligations implemented by the Cabinet of Ministers lead to an openly floating exchange rate. The 2004 consumer price index (CPI) reached 9% on average and 12.3% on the year-end basis (Table 5-C).

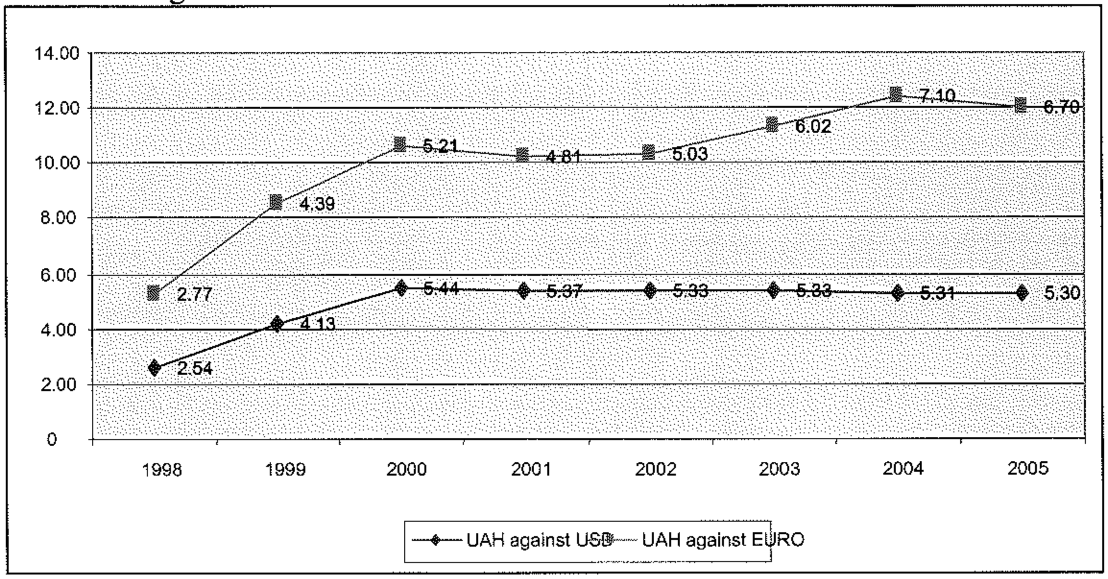
However, 2005 was a disappointing year for the Ukrainian economy. According to the state statistics, committee Ukraine's GDP rose only by 2.4 pct in 2005 from the year before, a sharp slowdown from the record 12.1 pct growth seen in 2004 and well below earlier estimated 12%. GDP shrank by 2.7 pct in November and by 1.6 pct in August year-on-year for the first time since 1999[31].

TABLE 5-A
Changes in GDP and Industrial Output of Ukraine



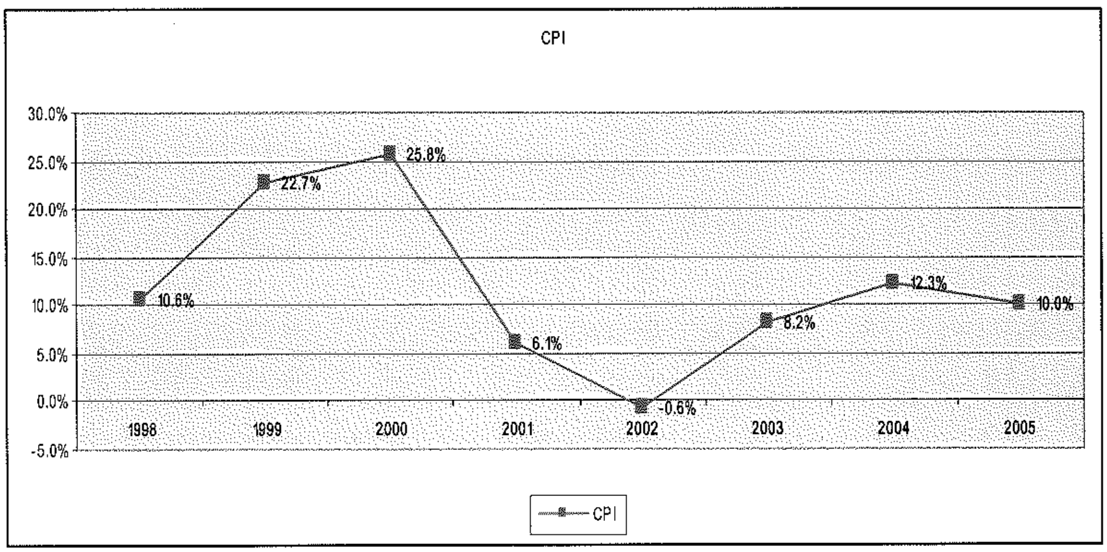

Source: *ICPS,* March 2005 and wiiw forecasts
2005 is an estimate

TABLE 5-B
UAH Exchange Rate




Source: *ICPS,* March 2005 and wiiw forecasts
2005 is an estimate

TABLE 5-C
Consumer Price Index of Ukraine




Source: *ICPS,* March 2005 and wiiw forecasts
2005 is an estimate

## 2. <u>Political and Social Stability</u>

Despite the government's increasing support of tourism industry development, Naumenko, vice president of the Kiyv Institute of Tourism, points out that "One of the most disruptive things is the constant change in all echelons of power, from top to bottom." Frequent power shifts within the government create a notion of political instability. There have been significant shifts in power starting in December 2004. The current president of Ukraine, Victor Yushchenko, emerged as the leading opposition candidate in the 2004 presidential race. Running against Prime Minister Victor Yanukovych, Yushchenko advocated stronger ties with the West and radical market reforms. Alternatively, however, pro-Russian Yanukovych had close ties to corrupt ex-President Leonid Kuchma, and was endorsed by Russian president Vladimir Putin. As a result of the massive poorly concealed election fraud in the November 2004, Yanukovych was proclaimed a winner of the presidential election's second round that pushed hundreds of thousand of outraged Ukrainians into the streets. In early December the Supreme Court ruled that the November election had been fraudulent and annulled the results. A non-violent protest that became known as the "Orange Revolution" lasted for 21 weeks. As a result, Yushchenko was victorious in the repeat second round of elections that took place on December 26, 2005. Yushchenko won the election with 52 percent of the vote whereas Yanukovych, popular in the eastern and southern regions of Ukraine, took 44 percent of the vote. The Supreme Court of Ukraine upheld Yushchenko's election victory in January 2005. Yushenko's victory is partially due in part to the support of a charismatic political leader Yulia Tymoshenko who was appointed a prime minister of Ukraine.

However, Tymoshenko's populist agenda that included increases in pro-social spending and a hard line on re-privatization allegedly led to confusion in the investment community and rapid economic decline. In the months following the Orange Revolution, foreign investment in Ukraine dropped 14% during the first half of 2005. On September 8th, President Viktor Yushchenko dismissed his former political ally, Prime Minister Yulia Tymoshenko and her cabinet.

A pragmatic pro-business Yuri Yekhanurov was appointed and confirmed as a new acting Prime Minister in the same month. His appointment will last until march 2006 when a newly elected parliament will appoint new cabinet. An alert business community welcomed this appointment. Yekhanurov has solid managerial experience and he is well versed in economic matters. In his interview with One Plus One TV Station, Kyiv on October 2, 2005, the new Prime Minister confirmed that "the main priority of his cabinet is to revive economic growth in the country." He promised to ensure a safe business environment for companies of all sizes and to promote transparency by publishing documents regarding government activities on the treasury's web site. In February, 2005, Yekhanurov had spoken against major re-privatizations in Ukraine. In dealing with past corrupt re-privatizations, Yekhanurov has chosen to reduce a number of re-privatization cases to a handful of the most obvious examples of cronyism and outright corruption.

Another major political even in Ukraine took place on March 206, 2006: the first free and fair Parliamentary Election in the Ukrainian history. Over forty political parties contended for 450 parliamentary seats. Only five parties passed the 3% vote threshold. According to the Ukraine's Central Election Commission's announcement made on April 11, 2006, "Party of Regions, led by former presidential candidate Viktor Yanukovych, won 32.14% of the vote and would take 186 seats in Ukraine's 450-seat parliament, the Supreme Rada. Yanukovych's party is followed by former Prime Minister Yulia

Tymoshenko's bloc with 22.29% of the vote (129 seats), the pro-presidential Our Ukraine bloc with 13.95% (81 seats), the Socialist Party with 5.69% (33 seats) and the Communist Party with 3.66% (21 seats).[32]" None of the parties gained the majority number of seats; therefore the formation of ruling coalition is inevitable. In popular opinion, the parties that supported Orange Revolution, Our Ukraine, Yulia Tymoshenko's block and Socialist party, are expected to reunite and to form the parliamentary majority. The significance of the March 2006 Parliamentary elections is a result of the constitutional reforms that transfer some of the executive powers, including appointment of the Prime Minister, to parliament.

There is a hope that the outcome of current turmoil will include a solid legislative framework for protection of private property rights and decisive steps towards a free market economy. According to Taras Kusio, PhD in Eurasian Studies, everyone is interested in it[33]. In particular, old and new oligarchs who strive to gain respectability and to protect their rights to former state property privatized under questionable circumstances. Due to the perception of political instability, the attitude of the foreign business community is expected to remain cautions. Investment activities are expected to increase once the ruling coalition in the post March 2006 Supreme Rada is established.

Overall, the Orange Revolution attracted global attention to Ukraine and put the country on the political map of the world. For the most part, it generated a positive impression of Ukraine being on the right path to democratic and open society. Yushchenko kept true on at least one of his campaign promises – media freedom. The most noticeable positive effect of the Orange Revolution is a new atmosphere of openness and accessibility. It embodies the ideal of nonviolent civic struggle and demonstrates the peacefulness and civility of Ukrainian society. The revolution signals the Ukrainian peoples' desire to move towards democracy, transparency and a competitive market economy. According to the "2005 Investment Climate Statement – Ukraine," published by the U.S. Department of State, massive peaceful demonstrations during the Orange Revolution resulted in minimal disruption in normal business activities. "The likelihood of future widespread politically inspired violence that would affect foreign property interests remains relatively low."

## SUMMARY AND CONCLUSION

The paper began with the brief overview of the expansion of the major international hotel chains into Eastern Europe, and current inventory of the Ukrainian hotel market. The overview demonstrated that Ukraine remains a virgin territory to be explored by the western hospitality players. The listed six modes of entry into a new market are ownership, joint venture, alliance, consortia, franchising, and management contract. The entry via management agreement appears to provide the best balance between low cost and high control; however, the host countries are seeking not only the foreign presence in their market but also for the inflow of capital from abroad.

The research concentrated on five factors influencing investors' decision to venture into the new market: factors influencing tourist demand; existing tourism infrastructure; the policy of the host country; the availability and quality of inputs; and the general political, social and economic stability of the host country. These factors were discussed in relation to Ukraine. The discussion demonstrated that Ukraine has a favorable geographical location and sufficient existing infrastructure for further development of the tourism industry. Abundance and diversity of historic, cultural and natural resources provide Ukraine with the potential of becoming one of the world's prime tourist destinations. However, a considerable capital investment is needed to upgrade the existing hospitality complexes to the world standards.

Overall, the outwardly Ukrainian government's attitude towards development of the tourism industry and towards foreign investors is positive. However, the insider economy, favoritism, and corruption in the governmental circles, hinder the foreign investors' confidence. The investors' hopes are concentrated on the new government's promise to work towards predictability, transparency, and fair and equal enforceability of the Ukrainian laws. The new administration's pledge to lead the country to market economy status and to restore the investors' confidence helped to facilitate a number of high profile investments from abroad that took place in the end of the third quarter and the beginning of the fourth quarter of 2005. Those projects play an important part in encouraging other companies to pursue investment opportunities in Ukraine as the country's perceived risk begins to diminish.

Currently, Ukraine is experiencing "growing pains" of the young democracy; however this emerging market has large potential and should be included on the expansion radar of the major hospitality brands.

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