

# From teething troubles to optimised performance

BY MAJA NYBO  
MAFCON

## The story of V. Guldmann A/S

In 2004, the Danish manufacturer of technical aids and tools for the disabled, V. Guldmann A/S, completed its first study on possible establishment in Ukraine. Today, Ukraine has become a strategic production platform for the company and the initial expectations have been met long ago. But the establishment in Ukraine was not without teething troubles, and for a short time, the company was unsure as to whether Ukraine was in fact the right choice.

### Why Ukraine?

An educated workforce and low wages were the central elements that let to closing down V. Guldmann A/S' production facilities in Herning, Denmark, and

moving machinery and production to Ukraine.

The general market situation for the family-owned business was characterised by low profit margins and intensified competition. Both vertical and horizontal integration increased the market concentration and segmentation. The development in the industry forced V. Guldmann A/S to take action and search for low-cost production facilities outside the domestic arena. With an establishment of production close to the EU, V. Guldmann A/S would be able to maintain its position as a competitive international player in the industry.

The aim for the Ukrainian production site was to fabricate parts for later assembly which meant no differentiation on products but instead high volume production. Some specialised machines used in Denmark could not be easily serviced and repaired and spare parts would be impossible to find in Ukraine; moreover, specific

materials were too expensive to transport to the Ukrainian production facilities. Therefore, production would be limited to standardised products.

Several East European countries were considered as possible production platforms before Ukraine was eventually chosen. Prior to start-up, it was extremely important for V. Guldmann to conduct a thorough investigation of the possibilities in Ukraine to avoid future difficulties. A feasibility study was conducted in co-operation with Munk, Andersen & Feilberg (MAFCON). Logistical aspects were covered, resources for establishment assessed, and a transfer plan was made.

For V. Guldmann A/S, a key element in the preparations was to find qualified personnel. In general, it was not a problem to find skilled labour with the right attitude. The Ukrainian workers proved to be both flexible and effective.

From management down to production level the organisation consisted mainly of Ukrainian personnel, making preparatory training in specific production and management procedures a necessity. Danish managers traveled to Ukraine to educate Ukrainian employees and almost the entire Ukrainian organisation visited Denmark and was introduced face-to-face with their mother company. These initiatives embedded the Ukrainian factory within Guldmann A/S, thus inspiring a general understanding of corporate values and identity.

### The right choice, eventually

The start-up in Ukraine was not trouble-free, and transfer efforts were much higher than expected due to changing laws and high documentation standards.

Preparations are essential when starting a business abroad, as many problems can be avoided by means of a thorough analysis. "We

didn't experience surprising or sudden problems. Ukraine is influenced by a heavy bureaucracy, but we knew what was in store for us and were well prepared" says Carsten Guldmann, managing director.

As V. Guldmann A/S continues to grow, the Ukrainian production facility steadily gains importance as a strategic business platform, with additional production hours being assigned to the Ukrainian production site in the future. The outcome of the relocation is a decrease in the company's production costs. Commitment in

Ukraine is strengthened and local suppliers are sought within steel production and tool manufacturing.

The establishment of production in Ukraine has been a success. Carsten Guldmann explains that the factors that contributed to the success were finding the right team of people, creating the right organisation and conducting a detailed feasibility study. A central point was also the integration of the entire Danish organisation in the establishment and emphasising that this project was and still is an essential strategic decision to increase V. Guldmann A/S' competitiveness.



## How to get established in Ukraine

BY YURI ARABSKIY  
MAFCON

Even though the main principles of establishment remain the same, i.e. management, legal entity, premises, permits, approvals, and licences, there are significant differences between establishment of production and sales companies. This article describes only the establishment of production companies, not sales divisions.

### Two approaches to cost efficiency

Many EU-production companies strive to take advantage of the possibilities for cost-efficient production in Ukraine, which enables them to meet the steeply increasing competition on costs in Western Europe while still enjoying proximity to their main markets.

Basically, there are two approaches to cost-efficient production: one is to outsource processing activities to local companies in Ukraine; another is to establish own production in the country.

Whichever approach is chosen often relates to individual corporate strategy, production volume, market estimates, financial abilities, and management skills. From a risk point of view the first option puts the business idea at stake, whereas the second option is mainly a financial risk.

### Outsourcing

Outsourcing in EU-countries is usually associated with a package of economical, technical, organisational, and administrative advantages. However, in a Ukrainian context, outsourcing to local companies is only associated with low cost structures, whereas the business conditions are completely different from what is known in Western Europe. Outsourcing to Ukrainian companies might be cheaper in monetary terms, but not necessarily easier or faster. Presently, Ukrainian companies can 'only' contribute with a well-qualified and well-educated workforce, and basic production conditions. Consequently, the outsourcing company should – as a minimum – expect to contribute with project management, technology,

and know-how.

Another outsourcing option is to place an order at a foreign company already established in Ukraine. By doing so, the company will be able to by-pass the complex local business environment; however, it still faces reduced prices.

Furthermore, the concept of joint venture as such refers only to a special form of ownership structure and not, in any way, to notions such

### "The foreign company must carefully consider its own capabilities"

as efficiency, profitability, etc. Joint ventures can grow to become successful companies, but in Ukraine they usually do not.

One of the main reasons for the failure of joint ventures is the difficulty of making a correct evaluation of the assets in the local company – and to get this assessment accepted. In addition, Ukrainian partners in general only possess basic technologies and skills, so all contributions have to come from the Western partner. Therefore, differences in expectations towards performance as well as the division of roles

and responsibilities often transform into lasting internal struggles for control of management, operations, and major assets.

In most industry sectors, a foreign production company can easily get access to specific local resources, competencies, production facilities, markets and distribution channels without forming a joint venture with a Ukrainian company.

Consequently, forming a joint venture with Ukrainian partners with such a purpose in mind would be both

unwise and unnecessary. So, Ukrainian partners should to a larger extent be judged on their internal competencies, rather than their ability to act as intermediaries or 'access-keys' to the local business environment.

### Establishing own production facility

Because of the problems that still exist with outsourcing, and due to strategic and economic considerations, Western companies often choose to establish their own production or business unit in Ukraine. In order to succeed, the foreign company must – as a minimum – contribute with management,

technology (i.e. machinery), know-how and capital.

The physical basis for a production or business unit is the industrial production buildings and machinery. While machinery and tools are imported from the EU, buildings have to be built, bought, or rented locally.

### Building, buying, or renting?

Until recently, most of the companies in Ukraine chose to buy existing buildings, primarily because: 1) the legal rules and regulations protecting the ownership are roughly in place in Ukraine and are rather well-functioning 2) all necessary technical approvals are either in place or need only minor adjustment, 3) any undertaken renovation works will add value to the buildings 4) the buildings can be sold, or they can be used for further investment loans. However, the 5<sup>th</sup> and most important factor is the timeline of establishment – buying a facility shortens production start-up from one-and-a-half to two years spent on green-field to six-eight months needed to brown-field.

Obviously, renting a facility is another option, but there are both pros and cons. On the positive side, renting will not require any large

initial investment costs, and any possible exit options

are not that problematic. Additionally, the legal rules and regulations protecting the tenants are actually starting to function rather well.

However, extensive and expensive renovation work is always needed. This will only benefit the owner, and the hope to offset these costs from the rent payments is often crushed by reality. Moreover, the growing demand for production premises and increasing prices for rents, utilities, etc. will cause the contract to be frequently re-negotiated.

Recently, the green-field has become a solution as well. Though the costs involved are relatively high compared with local living standards and although it takes a long time to start-up (one-and-a-half to two years), the company will get an optimum prize per square meter / quality ratio. Obviously, if opting for this solution, the obtaining of a land plot that fits the requirements becomes the main obstacle.

In short, when initiating outsourcing or investment projects in Ukraine, the foreign company must carefully consider its own capabilities.