

Internet Development Opportunities for Small to Medium Sized Enterprises in Ukraine

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Abstract: It has been argued that the development of the small business sector in Ukraine is central to economic reforms and the creation of wealth and employment. Given the inherent instability and general weakness of the Ukrainian economy to date, there have been many structural and political obstacles to entrepreneurial activity and the development of small enterprises in a variety of business sectors. However, the relatively recent emergence of the Internet as a vehicle for business transformation has already provided opportunities for small to medium-sized enterprises (SMEs) in Ukraine to enter global markets. The extent to which this has been the case for developing economies is a continuing research issue, given that various studies have already identified tangible benefits for the growth of SMEs in developed economies. This paper looks at the development of SMEs in Ukraine and outlines the factors that have affected their growth. The paper then focuses on the role of the Internet in promoting the development of SMEs in Ukraine, and considers the facilitation of opportunities provided by the available infrastructure. Recent progress towards developing a better infrastructure to support entrepreneurial activity and SME growth are discussed, including the need for further research.

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1. Introduction

It is widely accepted that two main types of small business were in existence in the republics of the former Soviet Union: small enterprises and co-operatives (Isakova, 1997). Co-operatives were first established from 1986 onwards during the early stages of *Perestroika*, and they had significant privileges enabling them to operate successfully within the framework of the Soviet Union prior to its dissolution in 1991. Small enterprises in Ukraine effectively started in 1990 following a resolution affecting the development of small enterprises by the Soviet of Ministers of the Ukrainian SSR. This resolution stated that during their first two years of operation small enterprises were not required to pay any taxes. Ukraine immediately experienced a twenty-fold increase in the number of registered small enterprises. The owners of large state-owned enterprises were initially very active in launching small enterprises because this was particularly profitable at the time. Then in 1992 a law governing private property was introduced, and the number of small businesses began to grow mostly on the basis of private capital, gradually replacing co-operatives. By 1994 both were still in existence, but many co-operatives attempted to equate themselves legally with the status of small enterprises. Following the introduction in 1994 of the law on enterprises, profit tax levels were set at 30% for small enterprises. Ukraine subsequently saw a rapid decrease in the number of new small enterprises, detrimented by the

fact that by 1997 these enterprises had to pay 13 different taxes amounting to between 70 and 90% of their profit. This forced many firms to consider either bankruptcy or operating in the shadow economy. In total over 90,000 small enterprises were registered, but only 45,000 of them had reported as operating (figures cited in Isakova, 1997). According to official data for 1995 provided by the Ministry of Statistics in Ukraine, the level of small business growth in Ukraine not only lagged behind the developed economies, but also the transition economies. The slowdown of the small business sector from a high growth rate of 52% in 1991 to 0.8% in 1994 is important, given that by 1995 this sector still accounted for approximately 60% of Ukraine's GDP. Statistical data suggested that the majority of these small enterprises operated primarily in 'retail and catering' or 'transport', followed by 'industrial enterprises' and 'construction firms'. Note that this data does not include investment companies and funds as these are considered business infrastructure institutions by the Ministry of Statistics in Ukraine. However, based on the number of employees in these firms, they can be considered as small to medium-sized enterprises (SMEs) that have a major role to play in the economic development of Ukraine. This is consistent with the definition adopted by the European Commission that describes SMEs as companies that typically have less than 250 employees. Globally, SMEs contribute greatly to national economies e.g. in the USA where they

generate more than half of all employment (Baldwin et al., 2001). It is clear that the activity and development of SMEs in Ukraine will have an influence on the development of the Ukrainian economy in general.

2. Growth of the Small Business Sector in Ukraine

The majority of employees in the small business sector in Ukraine have predominantly worked in 'retail and catering' or in 'services to the population', and these have traditionally been considered the easiest for small business start-ups. In recent years, the 'research and development' sector (i.e. technology infrastructure firms) has been a relatively entry resistant sector for small businesses in Ukraine for various reasons. Although Ukraine has high research potential, the reduction of R&D allocation in the state budget combined with factors affecting the gradual transformation of scientific research has meant that the demand for intellectual products within Ukraine is less than the supply. This means that technology-based enterprises have often faced greater constraints to their development than firms involved in other activities. This does not mean that such firms do not operate in Ukraine, as they are arguably a major presence in the shadow economy. Some Ukrainian experts have estimated the 'legal to illegal' small business ratio in different sectors as follows: retail trade - 30:70, services - 40:60, manufacturing - 50:50 (Isakova, 1997), although it is known that authorities have since tried to close this deficit given the loss of tax revenues and the global perception of Ukraine as a place to undertake business (Yushchenko, 2006). There are various opportunities and threats for firms in these different sectors, and these have influenced the development of SMEs. The purpose of this paper is to consider the role of the Internet in developing entrepreneurial opportunities within such SMEs in Ukraine. The main opportunities for these firms have traditionally been as follows (Isakova, 1997):

- Greater business activity due to the legitimisation of private small business
- Until the late 1990s, a shortage in the marketplace of consumer goods and foodstuffs
- Great demand for business and professional services
- Abundance of a qualified and well educated labour force
- Low internal competition and niches in manufacturing and services
- Comparative independence from the former Soviet Union market
- High availability of natural and technological resources

It can be assumed that most of these opportunities are applicable to all sectors, but the availability of a highly qualified labour force and the availability of technological resources are particularly relevant for the development of technology-based enterprises. The main threats for small Ukrainian businesses have been described as follows (Klochko & Isakova, 1996):

- An absence of small enterprise legislation, with inconsistent and ineffective regulations
- Restrictive currency controls and burdensome taxation policies
- Low access to equity and loan capital due to lack of sources of capital, and an inadequately regulated banking system
- Poverty within some areas of the population
- High cost of commercial space/equipment
- Shortages of some necessary suppliers and raw materials
- Underdeveloped business and legal infrastructure
- Crime, corruption, bribery, racketeering
- Problematic relationships with large state enterprises
- Lack of government support programmes for SMEs

The technology sector has been particularly susceptible to these threats, thereby limiting the growth of technology-based enterprises. Isakova (1997) argued that one of the best ways to facilitate the transition to market and restore economic health in Ukraine would be to use technology to create value-added jobs and foster worldwide exports, achievable by generating innovation and diffusing new technologies. Until recently this aspect has not been possible because of the absence of customers, long-term loans, adequate banking and business infrastructure, and a lack of venture capitalists seeking involvement with Ukraine. This situation has been worsened by the lack of support organisations and foundations seeking to assist business innovation, which when coupled with uncertainty about intellectual property and the cost of patents may have acted as a deterrent for many entrepreneurs. More recently, some management consultants have given a more positive perspective on the investment and business potential of Ukraine, e.g. Arthur Andersen (2000) and Pricewaterhouse Coopers (2001). A lack of entrepreneurial activity has not been the case in developed economies where major technological changes and business opportunities have occurred, particularly during the emergence of Internet-mediated growth especially in the creative industries

within the 'digital economy', as described in the next section.

3. Internet Enterprises and the New Economy

One of the biggest challenges facing large and small enterprises in the developed world is the need to find ways to increase the value from their customers rather than from their products, and to gain revenue growth that is continued instead of purely short-term (Vandermerwe, 2000). The aim is to make customers want the services of a particular company as their sole or dominant choice because they provide superior value at lower cost, from which the company benefits by obtaining a deeper and broader share of customer purchases for longer periods of time. This 'economic transformation' has been driven by electronic business, and more specifically electronic commerce (e-commerce) that has provided a powerful way for many organisations to achieve tangible benefits based on web-enabled transactions and use of the Internet (Hartley & D'Cruz, 2001). It is clear that e-business has opportunities in terms of improving the efficiency and effectiveness of an organisation, but also has a more strategic and competitive aspect: the need to find and attract customers, fulfil their expectations with good customer service, and continue that relationship with them. This has meant that customer relationship management (CRM) is an area that has received much attention, and many small firms initially struggled to develop effective CRM systems (see Whittle, 1999; Phillips, 2000). This paper is particularly concerned with the growth of SMEs and the role of the Internet in facilitating new opportunities. The argument here for e-business is that it could help SMEs located in Ukraine to grow and compete with similar organisations throughout the world, a view supported by the experiences of SMEs in developed countries (e.g. McWilliams, 1995). There have been various guidelines and indicators proposed for the successful adoption of e-business (e.g. Warren, 2000; Baldwin et al., 2001) but implementing these and evaluating subsequent performance has been problematic (Laughlan, 2000). Some of the changes to political and technological infrastructure have made this a more realistic possibility for Ukraine, although there is still much to be done in terms of establishing a legitimate business infrastructure that customers and partners can rely upon. This includes the need for reliable and secure payment systems, timely and well monitored distribution systems, effectively regulated import and export arrangements, and better consumer protection. Large multinational organisations generally have the resources and established strategic business planning processes to account for these, but the smaller

enterprises have a different set of issues that need to be considered, as discussed in the next section. When coupled with the global downturn and recent financial/energy crises, this has not made the outlook for smaller organisations in Ukraine any brighter, and they continue to face challenges that make the need to use technology to reduce their costs and increase access to global customers even more important.

4. The Impact of the Internet on Small Business Sector

There have been various studies into the impact of the Internet on business transformation in large companies (e.g. Dutta & Segev, 2001), but less research has specifically focused on the implications for SMEs. Baldwin et al. (2001) suggested that SMEs are associated with the relative quality of their customer service, generally an aspect that many larger companies cannot match. This comparative advantage can be of tremendous benefit to SMEs as Internet technology now allows SMEs in geographically disparate locations to attract and retain customers they would otherwise not have been able to reach at all. It can be argued that despite varying estimates, the majority of SMEs in developed countries have Internet access. Barriers to greater and more effective use of Internet technology within these SMEs typically includes lack of time and an absence of specialised technical expertise. However, opportunities for SMEs provided by the Internet include export generation, niche marketing, better information technology utilisation, and development of strategic partnerships/alliances. The Internet influences the way that SMEs can communicate with contacts and customers, the way they manage information, and also how they project their image. This change often means that business processes and operations impact on different levels including external contacts, the industry, internal organisation, administration and manufacturing tasks, and will influence areas such as productivity, information retrieval, communication, knowledge management and the environment (Baldwin et al., 2001; Hamill & Gregory, 1997). The governments of many developed countries such as Britain, USA and Ireland have heavily invested in plans to develop the underlying technical infrastructure and encourage greater usage of e-commerce by SMEs over the coming years. Similarly, the government of Ukraine officially promotes the process of 'informatisation' i.e. the general penetration of IT into state-owned enterprises, educational bodies and Ukrainian society. In addition, there has been legislation introduced to improve the environment for small businesses in Ukraine. Sikorsky (2002) reports on measures for deregulation of entrepreneurial activity (decree no.

817 in July 1998) that orders many governmental/state bodies to ensure support and development of entrepreneurial activity. Similarly, measures to provide for support and development of enterprise (decree no. 906/2000 in July 2000) stipulated personal liability for officials that adopt decisions that worsen the business environment. This was clearly progressive, and as the underlying business and legal infrastructure develops, so will the adoption of e-commerce and the creation of Internet-mediated opportunities. However, even if an infrastructure that promotes entrepreneurial activity is available, not all SMEs will adopt the Internet for the same purposes. The success of Internet-enabled commerce is an area of substantial research in developed economies, for example Daniel & Myers (2000) conducted a study of UK SMEs to consider how e-commerce adoption has already realised appreciable benefits in organisations. The report from their study considered the responses of 688 companies, and considered the reasons for and impact of e-commerce on the activities of these companies. The main findings were:

- The main reason for companies to adopt e-commerce is to differentiate themselves from competitors and improve relationships with customers, e.g. services to customers (63% of respondents), brand building (42%), to find new customers (41%), and to hold dialogue with customers (38%)
- The rationale for e-commerce adoption is similar across different sized companies, although companies with more than 100 employees are more likely to want to use e-commerce to hold a dialogue with customers, or to communicate and share knowledge within the company
- Most SMEs are yet to realise significant benefit from their e-commerce adoption, and e-commerce is predominantly bringing benefits to internal communication between employees and customers (almost 90% of respondents) and finding external information (almost 80%)
- Very few SMEs have found significant benefits from using e-commerce to find suppliers (less than 7% of respondents) or recruit staff, suggesting that larger competitors still have an advantage here
- Fewer companies are taking orders online (28%) and even fewer are receiving payment online for goods sold (13%) or purchasing online (12%), this suggests many are taking a staged approach to e-commerce adoption from low risk customer-focused activities to more complex tasks
- Factors stated for the successful adoption of e-commerce include senior management support,

staged implementation, and a clear understanding of how e-commerce can benefit the business

- The industry that leads e-commerce usage is the IT and communications sector
- Regional variations are not clear, although greater benefits and e-commerce adoption have been reported in and around the UK capital
- Younger companies are more likely to be using e-commerce than older established companies, but this lead is only slight as older firms now appreciate the value of electronically-mediated forms of business

These findings are interesting if they are considered with respect to the economic conditions and factors affecting SME growth in Ukraine. SMEs in Ukraine are likely to have very different experiences as they grow, given that they have not had the same stable and reliable infrastructure that underpins the business activities of UK SMEs. Indeed the Digital Britain (2009) interim report looks at how the UK infrastructure can be further enhanced to improve the social and economic benefits of ICT networks. For Ukraine, the reasons for e-commerce and e-business adoption may perhaps be similar, but it is necessary to consider the business environment of Ukraine where capital is often difficult to obtain, equipment and business premises costly, and legal and consumer protection in need of further development. Many UK SMEs have adopted e-commerce and reported benefits from business-to-consumer (B2C) activities rather than business-to-business (B2B) activities. These benefits are consumer-oriented such as improvements in communication with customers and raising brand awareness, or internal such as finding external information or customers, sharing knowledge within the company, etc. According to Daniel & Myers (2000) study, very few UK SMEs reported benefits associated with reducing costs of administration, staff management and supplier relationships, mostly due to the comparative scope of operations within these companies. That is probably no longer the case with remote working, videoconferencing, Skype, wireless networks, the need to reduce energy costs of local data centres and data management that are all benefited by technological advances and use of Internet infrastructure. SMEs in Ukraine are also likely to consider consumer-based activities as a priority as these are most likely to generate much needed revenue streams, but the number of customers having access to the Internet within Ukraine and developing countries is significantly smaller than in the UK and other developed countries. Telecommunications in Ukraine were under

government control and penetration by foreign operators was slow and problematic (Mishustin, 2002). Given the limitations of technical infrastructure, Ukrainian SMEs initially adopted e-commerce for reasons more likely to be rooted in potential access to foreign markets, raising product and brand awareness, and finding particular competitive niches within which they can operate. Although technology-based SMEs within Ukraine have been slow to develop, there are now numerous companies possessing technical expertise and suitably qualified people able to contribute to the growth of SMEs, e.g. by developing 'front-end' systems and content often located on overseas web servers. These sites need to be designed to reflect the multi-lingual and multi-currency requirements of a global market, and also specific cultural and social factors that have been described as 'psychic distance' (Dicht et al., 1990). Whether or not Ukrainian SMEs will choose to take a cautious and staged approach to e-commerce and e-business adoption with government support similar to that of UK SMEs is not clear, given the uncertain yet dynamic changes occurring in Internet technology and electronic business generally. As the technological infrastructure in Ukraine develops to facilitate global access to e-business and the digital economy, these companies must have appropriate 'back-end' billing, distribution and inventory systems if they are to avoid many of the problems faced by companies in developed countries. Additionally, the focus of much of the current electronic business activity in developed countries is on electronic marketplaces and trading exchanges that link related companies to their suppliers, which potentially includes SMEs. Research is needed to investigate whether Ukrainian SMEs are aware of these issues, and to explore the rate of e-commerce and e-business adoption within Ukrainian SMEs further.

5. Developing Infrastructure to Support Entrepreneurial Activity

This paper has looked at the importance of SMEs in Ukraine and outlined the factors that have affected their growth. The paper has also considered the role of the Internet in the development of SMEs, and considered the potential opportunities for Ukraine. The need for research into the extent to which Ukrainian SMEs have adopted e-commerce, e-business and Internet technologies has been emphasised, and implications put into context. There are various difficulties in conducting this research, particularly the availability of information and the readiness of SMEs to openly discuss their activities given the influence of the shadow economy in Ukraine. Many firms now have dedicated 24-hour

access to the Internet with acceptable transmission speeds, supplied to them at a low. Ukrainian SMEs have traditionally focused on faxes rather than email and file attachments, necessitated by a business culture that relies heavily on formal documentation and the security of signed documents. Email and Internet-based communications are now widespread, although arguably not to the extent that a relationship with customers can be fully managed via the Internet. Electronic customer payments and Internet-mediated banking systems are accessible (e.g. Nunan, 2001), but this is set against a global backdrop of recession, cybercrime and organised criminal activity. There is still a lack of trust in the banking infrastructure of the former Soviet Union owing much to historical and cultural precedents (Jones et al., 2000). The Internet is accessible to Ukrainian customers through the growing number of companies offering Internet and related services provision, although transmission speeds tend to be much slower and less reliable. Some SMEs have Ukrainian, Russian and occasionally English language web sites, and these are sometimes listed in a directory of business services or through business portals, and there are a large number of available domain names that can even be localised to individual Ukrainian cities. This demonstrates that many Ukrainian SMEs already have an awareness of the business opportunities created by the Internet, and this needs to be developed further. It has been argued that global Internet business transformation is not simply a matter of changing existing marketing channels involving a language translation process, but of effective content management and technical support underpinned by strong manufacturing and distribution capability (Heikkila, 2002). This is where many SMEs in the developed world have had difficulties, and has resulted in the emergence of companies that specialise in the globalisation of Internet activities through networks of affiliated companies. Ukrainian SMEs and entrepreneurs have the opportunity to become involved in this process by utilising such networks for enterprise development, and focusing on their capabilities and the development of relationships with customers and suppliers. The use of social networks and Web 2.0 is also an interesting area as sites such as 'odnoklassniki' have emerged to rival 'facebook.com' and 'linkedin.com' for useful social and business networking, and their business potential is yet to be fully evaluated, particularly with the advent of Twitter and converged mobile devices. An investigation into the factors that influence the development of web-based ventures was conducted by Cantarella (2001) which explored the background, education and supporting environment for the

founders of US-based enterprises. A similar study looking at developing economies such as Ukraine and emerging technologies is needed in order to put the findings into context, and is an opportunity for further research.

6. Summary

Much has been speculated about the role the Internet will play in developing countries in terms of how services to citizens are provided, and how entrepreneurial opportunities similar to developed nations can be created. This is an important issue for individual government policy, particularly as bodies such as the World Bank and the World Trade Organisation are in favour of greater global e-commerce regulation within less restrictive international e-business and trade frameworks (Hallett, 2002; Hartridge, 2002). According to Risaburo Nezu, Director of Science, Technology and Industry at the Organisation for Economic Co-operation and Development (OECD), there is “a need for governments to create an open, predictable and transparent telecommunications market, backed up by open, free foreign investment regimes” (Nezu, 2002). There are some nations within the developing world that have been particularly successful in supporting this, i.e. the lack of initial intervention in the activities of Indian SMEs by its government resulted in the opportunity for India to be considered a potential ‘IT Superpower’ (Barker, 2000). Numerous IT-related projects in the developed world are now successfully outsourced to the mature software industry in India, even though India continues to struggle to retain its best people. India has the largest pool of English-speaking IT professionals outside the US, and the Indian government has adopted a liberalising and deregulated policy that encourages overseas high-tech companies to locate in India. Some of India’s comparative success can also be attributed to Indian companies with government support establishing effective strategic alliances with local and overseas partners, and attracting direct foreign investment enhancing their entrepreneurial activities (D’Cruz, 2008). Despite political, cultural and business infrastructure problems, SMEs in Ukraine and the former Soviet republics have similar opportunities given the wealth of intellectual and technological resources they have at their disposal, assuming any prior negative images of problematic project delivery and systematic business corruption can be overcome and protectionism deterred (McCue, 2007; Project Eye, 2009). It is likely to be an issue of the value of the products and services that these companies can offer, and investment into the infrastructure to support entrepreneurial activity. Coupled with this

will be the speed at which Internet-based practices are adopted within competitive international frameworks that ultimately dictate success or failure.

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