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**Doing Business in a Neopatrimonial State: Factors of Systemic Uncertainty and Coping Strategies of International Businesses**

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**Evidence from Ukraine under Janukovytsch**

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**1. Introduction**

Modern states provide for a legal-institutional framework, businesses can rely on. Bureaucratic institutions and procedures are characterised by impersonality. They work in a legal-rational transparent, predictable and effective manner. At the same time, legal decisions are made according to abstract, general and non-retroactive laws. This ensures free competition, profit oriented trade and manufacturing, as well as equal opportunities. Modern states are thus characterised by a safe business environment. Beyond the OECD area, however, many countries are characterised by the coexistence and interaction of legal-rational institutions of modern states on the one hand and pre-modern patrimonial patterns of personal rule on the other hand. Such hybrid social and political orders are neither equally, nor entirely characterised by unsafe business environments. However, the mixture of formal and informal patterns is associated with specific factors of systemic uncertainty, businesses are confronted with.

There is a political science concept, dedicated to such hybrid types of statehood, which is called “neopatrimonialism”. The roots of neopatrimonialism go back to the studies of Max Weber, who drew a distinction between patrimonial systems of rule and modern ones (O’Neil 2007: 2). Patrimonialism is a traditional form of legitimacy and authority, characterised by a system of personal rule, clientelism and patronage. Today, patrimonialism does not exist in pure forms anymore, but mixes with modern forms of rule. This phenomenon was first seized by developmental studies of the late 1960ies and the early 1970ies (Erdmann 2012b: 44). As Zolberg (1969) and Eistenstadt (1973) applied the concept of patrimonialism to contemporary societies, they added the term “modern” or “neo” (Soest et al. 2011: 6). Put in global terms, neopatrimonialism is widespread. As Soest (2010) emphasises, neopatrimonialism is the prevalent form of organisation in non-OECD countries (Soest 2010: 2).

The concept as such still suffers from certain analytical vagueness. However, during the last couple of years, a number of efforts have been undertaken to clarify its nature (Erdmann/Engel 2007; Sindzingre 2010; von Soest 2010; Erdmann 2012a, b). Erdmann (2012b) comes up with a definition. As he states, neopatrimonialism refers to a system in

which two logics and institutional patterns exist next to one another: the patrimonial system of personal rule, clientelism and patronage and the legal-rational system of modern statehood (Erdmann 2012b). At the same time, the two spheres conflate. “The patrimonial system (of personal rule) penetrates the legal-rational system, twists its logic, functions and output (...), as formal and informal institutions and behaviour are intimately linked to each other in various ways and to varying degrees and this mixture becomes institutionalised” (Erdmann 2012b: 47 f.). In this regard, neopatrimonialism differs from “patrimonialism”, under which all power relations between ruler and ruled, political as well as administrative relations, are personal relations (Erdmann/Engel 2007: 105).

Neopatrimonialism does not stand for a particular institutional, social or economic system as such. It rather describes “a social and political order of conflicting modes of organisation and their legitimisation” (Robinson 2013: 137). It is a mode of organisation in which “the public and the private, the political and the economic, the individual and the collective, the ‘old’ and the ‘new’” overlap. In this context, certain groups of individuals dominate the system. Formally, they rule “within the framework of, and with the claim to, legal-rational bureaucracy or ‘modern stateness’.” (Erdmann/Engel 2007: 105) In fact, however, they appropriate gains, privatise public resources and use them for private consumption. (Sindzingre 2010: 4) In other words, formal state bureaucracies are infused with the particularistic politics of rulers (Soest et al. 2011: 4). Regarding the relation between neopatrimonialism and regime types, it is noteworthy that authoritarian regimes provide an appropriate basis for neopatrimonial rule. This is mainly, though not only, due to their specific structure of institutions and power relations (strong hierarchies, concentration of power etc.). However, authoritarian regimes are not necessarily dominated by neopatrimonialism (Soest 2010: 6).

Although the concept dates back to developmental studies on Africa of the early 1970ies, neopatrimonialism has increasingly been applied to other areas as well (Erdmann 2012b: 43). During the last couple of years, an increasing number of papers have been published on the post-Soviet region (cf. Fisun 2003, Franke et al. 2009, Laruelle 2012). At the same time, most studies deal with country specific social and political constellations of neopatrimonial rule. They primarily focus on how political leaders gain political support in exchange for public goods and services, which they privatise to distribute them to their clientele. Other studies use the concept as an independent variable for explaining an ill-functioning democracy or a poor policy outcome (Erdmann 2012b: 48). Recently, economic aspects have been taken into account (cf. Schlumberger 2008; Robinson 2013: 137). The aim of such studies is to analyse causalities of how neopatrimonialism leads into poverty traps (Sindzingre 2010: 3).

(International) Business aspects, however, have been largely disregarded. The lack of related studies is first of all due to a general lack of interdisciplinary approaches between political science and international business studies. Notwithstanding this, such a kind of interdisciplinary approach can deliver new in-depth insights into how factors of systemic uncertainty pose risks to (international) business operations. Although there are still no commonly agreed clear cut criteria defining neopatrimonialism, related studies regularly subsume factors such as institutional deficiencies, clientelism, cronyism, corruption, state capture, the personalisation of power and/or legal uncertainty as an integral part of neopatrimonialism. Regarding those factors, it is obvious that they do not only characterise a country’s political and economic system, but the business environment as well. In order to work successfully in such environments, enterprises have to cope with these risks. From the view of international business studies, “coping strategies” are methods or plans to minimise the uncertainty in the business environment.

Given this background, Ukraine is a suitable case to draw on. Since the breakup of the Soviet Union, the country can be regarded as a classic case of neopatrimonialism. This holds true despite of the fact that rulers and their clientelistic networks have changed over time. After winning the presidential election in 2010, Yanukovich empowered his system of personal ties, centred on his family and rooted in the region of Donetsk. In the period that followed, a “winner-takes-all” behaviour, extreme forms of rent-seeking, massive wealth inequalities and fierce elite competition contributed to an increasing instability of this system (Fisun 2012: 2 f.). In March 2014, Yanukovich was overthrown. At the same time, this system posed major risks to international enterprises operating in the country. Due to high economic growth rates, many of them operated quite successfully in the years before 2008. This held true despite an unsafe business environment, characterised by legal uncertainty, corruption and red tape. However, since the outbreak of the global economic crisis in 2008, profit margins have shrunk, while the aforementioned factors remained the same or have even increased. Accordingly, coping strategies have become even more important than before.

This chapter of the edited volume examines the concept of “security” from an interdisciplinary perspective between political science and international business studies. It also focuses on how international businesses cope with security risks. It additionally highlights the role of “memory” and “memorisation” in this context, although only as a secondary aspect. In the following, the terms “safe” vs. “unsafe” and “certain” vs. “uncertain” are used as “synonyms” for “secure” vs. “insecure”.

More specifically, from the view of political science, chapter two of this contribution looks at different social and political orders (modern states, patrimonialism, neopatrimonial states), asking how to operationalize “security” respectively “insecurity” for doing business in each context. The main focus is, however, on neopatrimonial states. The aim is to substantiate that the mixture of formal and informal patterns is associated with specific factors of systemic uncertainty, businesses are confronted with. While this chapter is theoretically oriented, the following two chapters are empirically oriented. Chapter three analyses the neopatrimonial system of Ukraine under Yanukovich in general and discusses country specific factors of systemic uncertainty in particular. Chapter four unveils what coping strategies international businesses drew on in order to cope with these factors of systemic uncertainty. The conclusions are eventually drawn in chapter five.

The theoretical part of this paper refers to the concept of neopatrimonialism, particularly to those publications that combine political and economic aspects. The empirical part draws on 32 qualitative interviews in total, carried out by the City of Vienna Competence Team Black Sea Region in February and March 2013. Eight interviews were carried out in Vienna and one in Bratislava. 23 out of 32 interviews were conducted with Austrian/International business representatives from companies of varying sizes, active in different sectors such as transport, chemistry, construction, technology, infrastructure, telecommunication, finance and banking. The other interview partners were academics, journalists and civil society activists. All interviews were conducted face to face.

## **2. Security for Doing Business and Factors of Systemic Uncertainty**

In modern states, the concept of security for doing business relates to the principle of comprehensive integration of any public power in the legal system. The formal polity

constitutes the entire political sphere and the administration. Informal institutions<sup>1</sup> do exist too. However, formal and informal institutions are mutually supportive. The polity is based on the rule of law, which is “a system of impersonal, abstract, general and non-retroactive rules, governed by the ‘principle of legality’” (Gosalbo-Bono 2010: 243). It refers to both, the civil law legal system and the common law legal system. This provides for a rational system, businesses can rely on when officials and/or competitors infringe on rights. It also ensures the maximum predictability of officials' (politicians, bureaucrats) behaviour. Given this background, bureaucracies work in a rational, predictable and effective manner. Operations take place in line with objective standards. (Jung 1995: 136 f) There is, in particular, full predictability and transparency in regards to tenders, licensing and any fees charged. Since the private and the public spheres are clearly separated from each other, the relationship between businesses and politicians/the bureaucracy is, moreover, characterised by impersonality. This ensures free competition, profit oriented trade and manufacturing as well as equal opportunities.

Patrimonial systems provide for security as well, although according to their own logic. Under patrimonialism, there is no differentiation between the private and the public sphere (Erdmann/Engel 2007: 105). Power relations between ruler and ruled are all personal relations, both in the field of politics and the administration. In other words, power is characterised by personal domination (Sindzingre 2010: 4). The system is dominated by a patron, who appoints the administrative apparatus, which is, in turn, responsible to this strongman. The ruler delegates jurisdiction to deputies, who hold a certain degree of discretionary power. Actions are generally arbitrary. They are based on subjective reasoning and follow ad hoc procedures. At the same time, operations are mostly informal or off the record. Important orders are often given orally. In official procurement and sales, verbal agreements are used. As administration is a means of clientelistic politics, benefits are reward for personal connections with political leaders. In other words, rules are applied with partiality. (Brinkerhoff/Goldsmith 2002: 6-8) Under such conditions, security depends on and is secured best through personal connections to the leader.

While the formal polity of modern states is laid down in the constitution and respective laws, memory and memorisation play decisive roles in the transmission of practices of patrimonial rule. This is generally supported by the informal character of patrimonial orders, not drawing on written rules and regulations. At the same time, power relations involve individuals or groups drawing on traditionalism to perpetuate their domination (Sindzingre 2010: 4). In this context, patrimonial systems derive basic legitimacy with reference to traditions and related norms and values. Such practises take place in neopatrimonial systems as well, when formal rules are relativized or entirely ignored with reference to traditions. This is, for example, particularly evident in the context of corruption, when officials justify bribery with a local culture of gifts and favours. In fact, however, they use such arguments to systematically abuse public power to sustain their status and wealth.

Neopatrimonial systems are characterised by private actors having captured political and legal institutions, political processes and policies. Their aim is to realise their particularistic interests by accumulating power and ever more wealth. For that reason, formal institutions are more or less systematically abused, side-stepped, ignored, or even tailored to fit the rulers' interests. Laruelle (2012), for example, speaks of state “capture” and “predation” as defining elements of neopatrimonialism (Laruelle 2012: 305). Sindzingre (2010) takes a similar view, explicitly addressing the capture of political processes, policies and legal institutions by

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<sup>1</sup> Informal institutions are “socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels” (Helmke/Levitsky 2004: 727).

private actors. At the same time, such constellations are characterised by the overlapping between the political elite and business groups. A term used in this regard is “cronyism”, meaning that firms are politically connected to the government, enjoying “benefits that unconnected firms do not.” (Sindzingre 2010: 10)

Neopatrimonial environments are not automatically associated with uncertainty. “Within this system, people have a certain degree of choice as to which logic they want to employ to achieve their goals and to best realise their interests” (Erdmann 2012b: 48). In other words, they can either draw on the formal legal-rational system of modern statehood or on the informal system of patrimonial rule. However, the mixture of formal and informal patterns is, at the same time, associated with specific factors of systemic uncertainty, businesses are confronted with.

One of those factors is institutional ambiguity. Ambiguity can appear both between formal and informal institutions and within/between formal institutions. Concerning the first case, Robinson (2013) points out that under neopatrimonialism, formal and informal rules are not mutually supportive but work against one another (Robinson 2013: 138). This results in uncertainty about which rules will be enforced (O’Neil 2007: 3). As Erdmann (2012) puts it, all actors are confronted with uncertainty “about which rules or which relationships are best applied or mobilised in any particular situation in order to achieve a specific goal – either the legal-rational (formal) or the patrimonial (informal)” one (Erdmann 2012: 48). A classic example for this uncertainty inherent to institutional ambiguity is bribing. According to informal rules, bribing might be rational in certain situations and constellations. However, corruption may also entail legal prosecution. In the worst case, it might even give ground for blackmailing. In other words, under such conditions, the “legitimate rules of the game” are unclear (O’Neil 2007: 3). Actions of state institutions and officials are not (fully) calculable (Erdmann/Engel 2007: 19). International companies are particularly prone to this form of uncertainty, since they are aliens in regards to local patrimonial systems and thus lack decisive insights into logical patterns of it. At the same time, there is no general code how to behave under such conditions, since neopatrimonial systems are never identical to each other. In fact, there is a fluent transition between the two poles of legal-rational and patrimonial rule in practise. In other words, the share of patrimonial vs. legal-rational domination always differs from country to country.

Ambiguity of formal institutions means that procedures, regulations and laws are unclear or even contradictory. This is due to the fact that ruling elites tailor them to fit their particularistic interests. This form of arbitrariness is strongly associated with legal uncertainty. While the legal/constitutional framework provides for legal certainty in theory, legal decisions are in practise not always, not comprehensively or not at all made according to abstract, general and non-retroactive laws. The result is that international companies have to deal with a lack of security and predictability. In this context, political-judicial trials are a popular strategy for harming or getting rid of competitors. As Robinson (2013) highlights, in such constellations, foreign investment is impeded by weak property rights and high transaction costs. At the same time, property and contract rights are secured best through personal connections. However, the development of such is highly costly to “outsiders”. (Robinson 2013: 138)

This leads to another factor of systemic uncertainty international businesses are confronted with, which is systematic favouritism. It means that private actors systematically use public office to foster the business interests of the ruler himself or the ruler’s clientele, while impeding initiatives by actors not part of the ruler’s network. Systematic favouritism is a non-

monetary form of corruption. In this context, rulers distribute licenses, contracts and public projects to their own business networks. As a result thereof, political elites accumulate ever more wealth. They often control significant shares of the national economy (Robinson 2013: 138). Systematic favouritism poses a major risk to international businesses as certain markets are freely accessible only at first sight. Own businesses of the ruling elite are favoured while international companies suffer from difficulties in gaining any (sustainable) access to such networks. However, once they have succeeded in becoming part of local networks, they can gain major benefits. Such relationships are most likely, when the ruling elite and international businesses benefit from win-win constellations. However, they are, at the same time, prone to uncertainty. If (international) actors violate against the logic of the respective patrimonial system, and/or if the cooperation loses attractiveness, they might lose their position. As the rule of law is weak, this might lead to expropriation without compensation in the worst case.

Another factor of systemic uncertainty international businesses are confronted with is corruption in monetary form. As Bratton and Van de Walle's (1997: 63-68) point out, corruption is an integral part of neopatrimonial orders, going hand in hand with the (informal) concentration of power and systematic clientelism (Soest et al. 2011: 7). Systemic corruption means that members of the ruling elite (both politicians and bureaucrats) use their authority to sustain their status and wealth by demanding for/collecting bribes systematically. In other words, corruption is systemic. In such environments, international companies are confronted with demands for entrance fees, kickbacks as well as payments necessary to ward off unjustified claims by tax authorities, the security service or the customs authority (etc.). In this context, corruption is always associated with a significant degree of arbitrariness and a lack of predictability, even if certain "going rates" apply. Moreover, corruption is a major risk to Western companies for the reason that such practises are in conflict with their compliance standards.

### **3. Doing Business in Ukraine under Janukovytsch: Factors of Systemic Uncertainty**

The neopatrimonial system of Ukraine dates back to the early nineties, when property was distributed to clan-like structures. This led to the emergence of powerful business groups which simultaneously strengthened their political power. (Robinson 2013: 143) During this period, a country-specific form of neopatrimonial order emerged. Though the respective constellation changed over time (with critical junctures in 2004 and 2010), basic patterns stayed the same to a high degree. However, after the overthrow of Janukovytsch in March 2014, it remains to be seen whether/to what extent the system will change.

According to Fisun (2003), characteristic features of this system are the "wide strata of neopatrimonial rent-seeking actors, acting together with/or in place of governmental institutions via clientelistic networks of patronage and pork barrel rewards", as well as a high level of competition. The author therefore characterises the system as "oligarchic neopatrimonialism" (Fisun 2003: 6). (cf. Franke et al. 2009: 80) However, this does not imply that "oligarchs" are the only stakeholders in this system. Apart from the fact that the term "oligarch" is ill-defined, government officials, regional politicians of networks, entrepreneurs and "wealthy businesspeople" are major players as well. (cf. Pleines 2012: 128) The central broker is the president. He maintains "a system of personal ties, (...) based first and foremost on regional (...) unity, as well as on present-day rent-seeking interests." He maintains power by capturing state resources and redistributing them to his own clientelistic network. (Fisun 2012: 3) At the same time, the modes of organisation and their legitimisation are characterised by a "struggle for control over the post-Soviet state and economy" (Fisun 2012: 3).

After winning the presidential election in 2010, Janukovytsch started to strengthen his system of personal ties, centred on his family, rooted in the region of Donezk. This went together with the reconstruction of the informal system. Supporters of the former president Yutshchenko (such as Kolomoyskyi) and of Prime Minister Timoshenko (such as Taruta, Haiduk and Zhevago) were deprived of their influence (Schneider-Deters 2012: 290). At the same time, Janukovytsch tried to incorporate and balance other segments of informal patron-client networks (Fisun 2012: 2), such as the ones around the two “oligarchs” Firtash (RosUkrEnergogroup) and Akhmetov (System Capital Management Group). However, even more than his predecessors, Janukovytsch used his presidential power for “a zero-sum ‘winner-take-all’” (Fisun 2012: 2) game. He reduced cooperation with other networks to the necessary minimum and dedicated himself to promote the business activities of his closest family circle, particularly the one of his oldest son Alexander (Interview XVII). By doing so, he accumulated ever more wealth at a high pace and was perceived to finally becoming an oligarch himself.

The interview partners were well informed about this constellation. Such issues received comparably high public attention in Ukraine under Janukovytsch, not least since people were confronted with its consequences in their daily lives. A journalist from Kiev explained “we live in a society of informal institutions”, while formal institutions remain underdeveloped in practise. (Interview XV) However, some company representatives emphasised that they only learned about this constellation after the market entry. As an international business representative put it, “for us from the West, the state structure of Ukraine looks strange. It is a mixture of oligopoly and clan-networks.” (Interview XXIII)

The study of a well-known local think tank revealed that the consequences of this constellation had detrimental effects on the country’s business climate. According to the head of this think tank, 90 % of the problems international businesses faced could be explained by three factors. They were firstly corruption, secondly the low quality of the judiciary and weak rule of law and thirdly administrative barriers. As he further stated, 80 % of Western investors would increase their business, if those three factors were solved. (Interview XXI) The assessment by a company representative of a multinational engineering company differed only slightly. “The top three of the biggest problems we have are, firstly corruption, secondly the country’s bad infrastructure and thirdly weak legal certainty.” (Interview XXV)

Systematic favouritism was a core feature of this system. As the senior researcher of a Kiev based research institute put it, “the entire economic sphere is based on interpersonal connections.” It is a system in which “property and power are interconnected. Using power to obtain property is not a crime in this logic. The ones who are linked to the rulers get privileges.” (Interview XXX) Similarly, the head of a local think tank stressed out that “everybody tries to capitalise on their social contacts. Gaining political influence means you will get preferential treatment, particularly when you have access to the president.” (Interview XXI) As a member of the “State Committee for the Fight against Organized Crime and Corruption” highlighted, the state has systematically been privatized to generate privileges. “They” developed “a scheme” in order “to place their people inside government agencies.” Now “they run the system.” They “influence public procurement”, “develop policies” and “make regulations” (...) “according to their particularistic needs.” (Interview XXXII)

The country representative of an international company for basic materials and capital goods identified favouritism in four different fields and ways. Firstly, in the context of privatization of state enterprises, secondly the refund of tax paid in export business, thirdly state subventions, particularly in the field of coal mining, and fourthly “unfriendly takeovers” of

companies (Interview XXIII). However, other interview partners stated that favouritism was centred in the field of public procurement (Interviews XIX, XXI and XXXI). A Kiev based investigative journalist reported regular cases when members of the Janukovytsch-network used state tenders to strengthen their businesses, while independent enterprises had no chance to win the tender (Interview XVII).

Systematic favouritism means that independent businesses are automatically disfavoured, as they do not get access to sectors dominated by oligarchs and the ruling family. As the manager of a local subsidiary of an Austrian supplier for construction components emphasized, he has “no friends and contacts” at government level, which he would need to receive a public contract. “In this field, the game is too complicated and allowed for a certain group of people only. This is not only a barrier, but also a border you cannot cross.” (Interview XII) At the same time, independent companies are often confronted with regulative barriers (Interviews VI and XXXII). The country manager of an international pharmaceutical company complained about laws in the fields of product registration, fees and patent protection against international standards. “They were made because there is a very strong connection between political forces in this country and those who do business in this sector.” (Interview IX) Likewise, a country representative of an International Bank expressed he felt “disappointed” about “the few illusions his institute initially had” concerning the market entry in Ukraine. A key reason is that the state and the economy are “controlled by a few people” (Interview VI).

Notwithstanding this, at the time the interviews were carried out, the country’s banking industry was dominated by international banks (Interviews XX and XXX), though informal groups were regarded as having decisive influence (Interview III). In general, high profit sectors were under the control of oligarchs and “the family”. This holds traditionally true for heavy industries, coal and mining, engineering, metallurgy (Interview VIII) and, in addition to that, seaports and railways. (Interview XXX) Further fields were the energy sector, including renewable energy (Interview XVI), petrol stations, fertilizer plants (Interview VII), airlines (Interview III) as well as the local pharmaceutical market (Interview IX). The agricultural sector, in contrast, was not (Interview XVI) or only to a small degree influenced by “oligarchs” (Interview III), though it had recently attracted more attention (Interview VIII).

Nevertheless, state power was also actively used for deliberately causing damage to competitors. According to a member of the “State Committee for the Fight against Organized Crime and Corruption”, there were regular cases, where the state fiscal service, the police and security service were used “to develop the business of the family.” (Interview XXXII) Though difficult to verify, several business representatives reported second hand stories, how the secret service SBU, the police and tax agencies (Interviews II and IV), the national bank (Interviews III and VI) and the judiciary (Interview VII) had systematically been used to put pressure on independent businesses. A Western investor in real estate unveiled the case of an own 55 million USD investment project in Southern Ukraine that came under serious pressure, when a unit of the ministry of interior against organised and economic crime visited the construction site in order to demand for protection money in the amount of 300,000 USD. When they refused to pay, a public prosecutor initiated inquiries against the company. The conflict was finally solved by paying local intermediaries “a sum less than 300,000 USD”. (Interview VII) The country manager of an international car brand reported a case when drugs were put into his cars. He could solve the problem by paying a bribe of 1,000 USD in order to avoid the initiation of inquiries by a state prosecutor. “You have to stop such things in the very beginning. As soon as it proceeds by way of formal action, you are trapped. Then it will get really expensive or even, the game is over.” (Interview IV)



However, the general view was that big international companies were still less prone to such uncertainties than local ones (Interviews IV, VII, XXI and XXII). Nevertheless, the representative of an international insurance company emphasized, he had been fighting with “oligarchic structures” for more than six years, as he experienced “extreme pressure from all sides of politics to sell his business” (Interview V). The country representative of an international company from the transport sector reported, his company had to struggle with the withdrawal of an important licence, when they sold their shares in another company to a consortium, but not to an oligarch who was among the bidders (Interview I). Likewise, an international construction company was first awarded a contract by the city of Kiev to reconstruct a historical building. However, later they were confronted with the allegation their licences were not enough. “In my opinion, they tried to push us out as hard as they could.” This took place not only by “verbal threats” but also by undermining the company’s position as general contractor vis-à-vis subcontractors. (Interview XVIII). The country manager of an international car brand concluded that “in this country, it is not merely about doing and developing business.” In fact, “keeping the company alive, resisting the pressure of judicial and tax authorities, is already a huge success.” (Interview IV)

As the aforementioned cases reveal, there is a strong connection between favouritism and legal uncertainty. Given this background, an international lawyer stated that Ukraine suffered from “massive problems in terms of property rights” (Interview XXVIII). Likewise, a company representative complained that “investments of foreign companies are not safe.” The problem is that “profitable companies can be attacked by people in power”, relying on “very well educated lawyers”, using “exits in Ukrainian regulations.” (Interview XXIV)

The latter statement indicates that “systematic favouritism” and legal uncertainty are in turn connected to the ambiguity of formal institutions. In fact, under Janukovytsch, Ukraine featured a well-established system, with legislators constantly implementing new, contradictory or unclear laws. “There are no clear rules and people try to take advantage of that” (Interview XXIV). Laws “are so underdetermined that they can interpret them how they need. They are full of gaps. (...) This was done on purpose.” (Interview IV) This phenomenon referred to all areas of trade, economic and tax law as well as to administrative regulations. Nevertheless, the interview partners particularly often pointed to deficient tax and fire regulations. (Interviews III, V, VI, VII, VIII, IX, XIII and XXVII)

Such strategies were not only used to harm independent businesses. They were rather part of an omnipresent corruption system, affecting all-spheres of public life. It was a common strategy to establish bureaucratic hurdles and to provoke law violations in order to press money (Interviews II, VII, XIII, XXIV and XXXII). “The idea behind is that the more bureaucratic the system, the easier it is to collect bribes. This is why the bureaucracy of this country shows incredible things.” (Interview II) In this context, it was particularly popular to use tax audits and fire inspections to raise unjustified fees and fines (Interviews II, IV, V, VI, VII, XII, XIII and XXIV). Businesses not accepting this ran the risk of getting seriously impeded in their operations. In the worst case, production was stopped by local authorities, until the company paid (Interview XXVI). Corruption schemes also applied in the fields of licensing and registration. Consequently, the construction and real-estate sectors were particularly prone to that. As an international tax advisor concluded, “foreign investors have to fight a constant battle against the bureaucracy, tax and cartel authorities. They regard them as cash cows.” (Interview XVI)

At the same time, the judiciary was highly affected by corruption. “There is little sense going to court, because corruption prevails” (Interview I) Likewise, the country representative of an international insurance company revealed that as soon as a case ends-up at court, his company writes off the disputed amount of money. “You cannot win. We have lost a lot of money this way.” (Interview XXII) The general view was that verdicts could be purchased (Interviews I, IV, VI, VII, IX, XVIII, XIX, XX, XXII and XXXII). Though difficult to verify, a company representative stated that verdicts cost between 20,000 and 40,000 USD (Interview VII). However, another interview partner highlighted that, despite such schemes, foreign businesses had no chance to win, when members of the ruling elite were involved in legal disputes (Interview VII).

Likewise, under specific circumstances, there was still a chance of winning public tenders when paying bribes. A local anticorruption activist stated that in public procurement “going rates” between 30 and 50 % of the contract value applied (Interview XIX). The country representative of an international construction company said they withdrew from the contractor when they received the signal to pay between 15 and 17 % of the project value in cash (Interview XVIII). In other cases, foreign companies were asked to invest in social projects and infrastructure, thereby using local companies as contractors (Interview XXIV).

Many interview partners regarded corruption as a political phenomenon, rooted at all levels (Interview I, III and XXV). There was also a widespread view that corruption was controlled centrally (Interviews III, IV and XIII) or even as part of a pyramid system with the Janukovytsch family and close allies as final beneficiaries on the top (Interviews II, VII, X, XV, XXI, XXIV and XXXII). Others confirmed this, but stressed that the true picture would probably be more complex (Interview X, XVII). Irrespective of whether or not, international businesses perceived corruption as a financial burden and a high risk (Interviews IV and XVIII).

#### **4. Coping Strategies of International Businesses**

Western businesses responded to such security risks in different ways. Some big companies/MNCs were preparing to leave the country or took this step into consideration. However, most companies denied having such plans in the short- and mid-term. One smaller enterprise stated to be tied to their investments and therefore was not able to leave the country (Interview VII). Still others declared to be reasonably satisfied with their business operations in Ukraine, having found ways to cope with security risks. However, in terms of additional investments, most companies were reluctant (Interviews V, XXIII and XXIX). At the same time, the representative of an international consulting company specialised in Ukraine mentioned his company would also be a beneficiary of this difficult political and economic constellation (Interview III).

A strategy to cope with “systematic favouritism” and all its consequences is to do business with independent “private” partners. The aim is to interfere with politics as little as possible. (Interview VI) As the representative of an Austrian construction company admitted, they had decided not to take part in public tenders anymore. However, independent tenders were rare and hardly predictable. For that reason, the local office was equipped with the absolute minimum of managerial staff necessary to maintain basic operations. In case the company won a tender, they sent expats and employed workers for a limited period of time. (Interview XII) Nevertheless, doing business with private partners does not mean companies can entirely circumvent systemic corruption. As the company representative further stated, “you still need your building permit. They have the militia, their inspectors. They will all come to your construction site and ask for bribes.” (Interview XII)

Western companies offering high-tech products needed by local companies were in a comparably good position (Interview XXXI). The same held true in case of win-win constellations. “Western investors are tolerated when they fit into the business model of the nomenklatura or when they complement their interests” (Interview XVI). However, as the country manager of an international bank pointed out, in terms of reliable business cooperations, there were also severe differences between the individual oligarchs. While Akhmetov would be a good business partner relying on Western standards, they would not do any business with Kolomoyskyi or Firtash. (Interview XIII)

Some companies decided to shift their business activities into areas less affected by systematic favouritism. Eventually, businesses relying on high-tech and specific know-how were in a comparably safe position. This held particularly true for IT-companies, as well as for the consulting industry (Interviews III and XXXII). A case to point out is a smaller enterprise, tied to the Ukrainian market due to high investments done, which shifted their activities from real estate investments to consulting and facility management (Interview VII).

An approach to cope with the risk of expropriation refers to property. Some companies avoided to add assets in the country (Interview I and IV). (cf. Leitner et al. 2014) “My office is rented, also the building for the call centre. We have not built any facility. This was a conscious decision. We do not work like this in other countries.” (Interview I) Another related strategy is to set up a local branch instead of establishing a fully operating local subsidiary. Subsequently, the core processes are left with the parent company in the home country (Interviews I and IX). (Leitner et al. 2015)

Other companies preferred to outsource activities to local business partners. Such cooperations were particularly frequent in the field of sales and distribution. In this context, local business partners often act as redistributors, drawing on their local business networks (Interviews XI and XVI). Besides, they also provide for security, as they know which rules and which relationships are best applied or mobilised, particularly when there is ambiguity between formal and informal institutions. (Interviews XX and XXV) At the same time, they can handle corruption claims, which keeps “your company clean from inside at least” (Interview XXV). As the country manager of an international car brand put it, “you need a local partner dealing with the issues you do not want to know about. (...) You know he has to do things, not compatible with your norms and values.” (Interview IV) At the same time, some company representatives emphasised that establishing joint ventures with local partners is again a risky undertaking, as there is “no basis of trust” (Interview IV), and moreover, no legal system to rely on in case of conflicts or fraud (Interviews IV and VII).

There is the alternative to address oneself to local “consulting companies” or “lobbyists”. (Interviews II, IV, V, VI, VII, XIII, XX, XXIV, XXVII and XXXI). Such “companies” are in fact one man enterprises, operated by locals with personal contacts to high-ranked officials. They act as brokers or intermediaries. Many of them used to be state officials or managers of state enterprises themselves (Interviews II, VI, XXVII, XXXI and XXXII), some of them already in Soviet times. These persons can “open the door” and connect people to the highest level of the neopatrimonial order, which is, in the local context, also referred to as “Krysha” (Interviews VII, XIII and XXX). By doing so, they can provide protection. They defend attacks by officials, judges and local businessmen. “You do not have any networks. You do not know how this culture of bribing works. And you do not know where to go. So basically what you need, you need somebody, who provides you with these services.” (Interview XXXII) However, such practises entail a high risk of fraud (Interview XIII). Moreover, informal networks are prone to instability (Interviews XII and XVIII). As an international company representative put it, when a new president comes into power, your informal

network will break away. As a result of that, companies not only face the challenge of rebuilding their networks, but they rather have to cope with hostilities and attacks by the new people in power, who regard them as a friend of their enemy (Interview II).

Such brokers are also there to handle corruption claims. In this regard, one can speak of a strategy to outsource corruption. “Western companies pay consulting companies for paying illegal money. By doing so, they can avoid that ‘unofficial fees’ show up in their reports. This way they keep clean” (Interview XIII). Likewise, an international company representative declared they would not bribe “big sums” themselves, as this is “dangerous and criminal.” They only pay “operational money” up to 20,000 Euro, as in the case of manipulated fire inspections. “When things become too big, we engage our lawyer, telling him we do not want to hear and know anything about it.” (Interview IV) Another case to point at is an international construction company, having engaged a “customs broker”. “We do not need to worry, who will ask for money. He knows everything and he will pay. In the end, we will only get a hefty bill.” (Interview XIII)

Nevertheless, most companies surveyed denied paying bribes. Some of them argued it would not be possible due to their compliance laws and due to audits (Interviews XI, XXIII, XXVII and XXVIII). Others feared of losing their reputation (VIII). Another argument was that there is an element of uncertainty inherent to corruption. As the company representative of an international construction company put it, it is a vicious circle leading to additional claims and, as such, an incalculable financial risk (Interview XVIII, also Interviews IXXII, XXVI and XXVII). Others highlighted, bribing might entail legal prosecution or might even give ground for blackmailing (Interviews II, XXII), though you can again pay your way out of it (Interview III). Yet others argued that they are transparent and compliant with local law and, as a result of that, do not offer any basis for corruption claims (Interviews XIII and XIV). Another company representative declared they would be the subcontractor, and as such not exposed to corruption claims, which does not hold true for the main contractor (Interview XII). Yet others argued they could refuse paying any bribes, as they rather convince with high quality (Interviews IX, XI, and XII). In contrast, others stressed that corruption is part of the system and as such impossible to avoid (Interviews II, XXI, XVIII and XXIX). “Recently, a German expat from the pharmaceutical industry told me they would never bribe. I can only smile about this. The one, who brings ethics into play, should not go to Ukraine.” (Interview VII)

Another coping strategy is to attract as little attention as possible. This can be done by keeping operations on a smaller scale (Interview XIII), by not advertising publicly and not giving any interviews to media (Interview II). The strategy to attract no attention also applies vis-à-vis the tax administration. This entails neither to declare high profits, nor losses (Interviews XII and XIII). Besides, the amount of money in Ukrainian bank accounts should not exceed day to day needs (Interview IV). This is, nevertheless, no guarantee that the tax administration will not start any manipulated attack. As some company representatives expressed, in such cases, they fight against the attack in all judicial instances. The goal is to tire out the opponent, which makes future attacks less likely. (Interviews XIII, XIV and XXIV) However, apart from this specific case, International companies avoid going to court in Ukraine. Some MNCs prevented from having trials under Ukrainian law by choosing a third country as the place of jurisdiction (Interview XVIII).

Concerning systematic favouritism, institutional ambiguity and systemic corruption, Western companies not only turned to local agents, but to international agencies as well (Leitner et al. 2015). As several company representatives noted, political pressure through embassies, national chambers of commerce, European Union institutions or high level home government

officials regularly turns out to be effective. Such institutions prepare lists of companies facing specific threats. They then address the problem at the highest diplomatic level. (Interviews I, II, III, IV, IX, XIV, XXI, XXVII and XXXII)

Finally, the recruitment strategy plays a major role when coping with security risks (cf. Leitner et al. 2015). In Ukraine, a company's most critical organisational departments are accounting and legal services (Interviews II, III and VII and XX). "You need a reliable accounting department; people that are well versed, as this is an area full of traps." (Interview II) "The accounting department is in position two in terms of significance to a company." (Interview III) As the country representative of an international bank explained, in accounting, he would employ three times as many people than in Austria (Interview XX).

In all these areas, international companies mostly employ locals, although they simultaneously aim at maintaining full control over organisational processes by expats (Interviews II, III and IX). In this context again, the reason is that only locals know which rules and which relationships are best applied or mobilised in any particular situation. (Interviews II, III, IX and XIII) As a company representative highlighted, only locals know the necessary networks and how to avoid or handle attacks by government authorities. "You need local personnel for all that. People who know how all these machinations work. Otherwise you can close down your company." (Interview XII)

## **5. Conclusions**

This chapter of the edited volume examines the concept of "security" in regards to different social and political orders, in particular to modern states, patrimonialism and neopatrimonialism. It specifically focuses on security for doing business. Modern states provide for a safe business environment, as they are characterised by the comprehensive integration of any public power in the legal system. The modern polity is defined by the constitution and respective laws. In contrast, under patrimonialism, rules are applied informally and with partiality. Security depends on and is secured best through personal connections to the leader. In this context, memory and memorisation come into play, as they play decisive roles in the transmission of practices of patrimonial rule. In neopatrimonial environments, in turn, international businesses have a certain degree of choice. They can either draw on the formal legal-rational system of modern statehood or on the informal system of patrimonial rule. Notwithstanding this, the mixture of formal and informal patterns is, at the same time, associated with specific factors of systemic uncertainty. They are in particular, systemic corruption, systematic favouritism and institutional ambiguity.

The empirical part of this chapter analyses these three factors of systemic uncertainty with reference to Ukraine under Janukovytsch. It also focuses on how international businesses cope with security risks. "Coping strategies" are methods or plans to minimise the uncertainty in the business environment. In this regard, the empirical data reveals three basic options. The first possibility is to minimise the exposure to factors of uncertainty inherent to the local neopatrimonial system. This can be done by doing business with independent "private" partners, creating win-win constellations, shifting business activities into safer business areas, avoiding to add assets in the country, setting up a local branch instead of establishing a fully operating local subsidiary and/or attracting as little attention as possible. The second option is to rely on local partners, who know which rules and which relationships are best applied or mobilised in the local neopatrimonial context. Related strategies aim at outsourcing activities to local business partners, employing locals and/or addressing oneself to brokers or intermediaries. Particularly the latter ones provide for security, by connecting businesses to the highest level of the neopatrimonial order, which is, in the local context, also referred to as "Krysha". The third option is to mobilise external agents in order to enforce the legal-rational

system of modern states, according to international standards. In this regard, international businesses regularly rely on embassies, national chambers of commerce, European Union institutions and/or high level home government officials.

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## **Interviews:**

I: Country Representative, International Company from the Transport Sector

II: Country Representative, International Company in the field of chemical distribution.

III: Country Representative, International Consulting Company.

IV: Country Manager of an International Car Brand.

V: Representative, International Insurance Company.

VI: Country Representative of an International Bank.

VII: Medium-sized Western Investor, Real Estate Sector.

VIII: Director of a Think Tank.

IX: International Pharmaceutical Company.

X: Political Scientist, International Anti-Corruption NGO.

XI: Managing Director of a Medium Sized International Technology Supplier

XII: Manager, Subsidiary of an Austrian Medium-sized Enterprise, Supplier for Construction Components.

XIII: Country Manager, International bank for real estate and infrastructure financing.

XIV: Country Manager, International bank.

XV: Journalist.

XVI: International Tax Advisor.

XVII: Investigative Journalist.

XVIII: Country Representative, International Construction Company.

XIX: Anti-Corruption Activist.

XX: Country Representative, International Bank.

XXI: Head of a local think tank.

XXII: Country Representative, International Insurance Company.

XXIII: Country Representative, international basic materials and capital goods company.

XXIV: Country Representative, International Manufacturer of Bricks.

XXV: Company Representative, Multinational Engineering Company.

XXVI: Regional Manager, Logistics Company.

XXVII: Manager, Manufacturing Company for Chemical Products.

XXVIII: Partner, International Law Firm.

XXIX: Manager, International Company for Paper and Packaging Material.



XXX: Senior Researcher, Local Research Institute.

XXXI: Country Representative, Multinational Engineering Company.

XXXII: Member of the State Committee for the Fight Against Organised Crime and Corruption.