



Quarterly Enterprise Survey

No2 (16)
May 2006

- Industrial confidence indicator increased from -0.12 in January to -0.01 in May.
- The managers' expectations about future changes in the business climate improved slightly.
- The slow-down of production in the 1st quarter was higher than expected by managers.
- Managers expect a significant growth of production in the 2nd quarter.
- Managers expect an increase in new orders in the 2nd quarter.
- Banks became less willing in the 1st quarter to provide long terms loans.
- The percentage of firms considering the regulatory climate to be an impediment to production has slightly increased.
- During the 2nd quarter managers expect a slow down in increase of purchase and sale prices.

A group of 300 manufacturing firms is used to monitor their managers' perceptions of changes in the business climate and company performance.

In this issue: Results of a survey conducted in April-May 2006

Firms' performance: Q1 06 vs. Q4 05

Firms' expectations: Q2 06 vs. Q1 06

Business climate: Assessment for May '06, expectations for the next 6 months.

GENERAL INDICATORS

Industrial confidence indicator

The industrial confidence indicator increased. Its value grew up by 11 points in May compared to January (from -0.12 to -0.01). It is explained by a significant improvement of firms' production plans for the next 3 months (see PRODUCTION INDICATORS). Finished goods stocks increased, however the value of this index continues to be negative. The third component of the industrial confidence indicator – assessment of order books – remained practically the same low.

Business climate

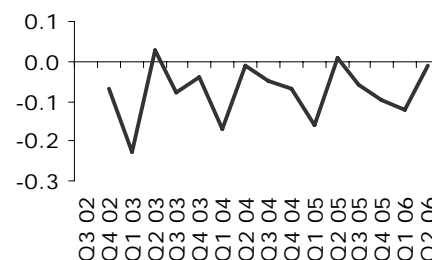
The assessment of business climate by firms remained unchanged and low. The respective index value was equal to -0.29 in February and in May. This is attributed to the seasonal trend: during the whole period of observations a decrease of business climate assessment is observed in the 4th quarter compared to the 3rd quarter persisting in the 1st quarter as well. This is typical for firms of all industries, ownership types and sizes. Furthermore, the smaller is the enterprises, the lower are assessments of business climate.

The expectations of changes in the business climate improved slightly. The index of business climate expectations increased from -0.05 in February 2006 to 0.05 in May 2006. This increase was due to a slight growth in the percentage of managers expecting positive changes (from 19.8% to 22.1%) and a drop in percentage of "pessimistic" managers (from 26.6% to 19.0%). But more than half of managers (58.9%) continue to expect neither positive nor negative changes in the next six months. Traditionally, the worst expectations are those of small firms (-0.16). The best are observed for enterprise with 251-500 workers (0.20).

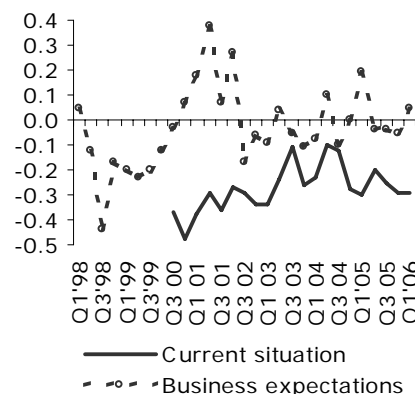
Regulatory climate

The percentage of firms considering the regulatory climate to be a significant impediment to business development has increased compared to February making up 27.5%. It happened due to increase in main component of the combined indicator "unfriendly regulatory climate", namely "hard regulatory burden". The share of firms pointing to "hard regulatory burden" as an impediment increased from 14.3% to 21.4%. The second and third components of the "unfriendly regulatory climate" indicator – the "frequent changes in legislation" and "corruption" has not changed practically. (see IMPEDIMENTS TO PRODUCTION).

Survey based Industrial Confidence Indicator



Indices of Overall Business Climate



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Lending climate

The lending climate is characterised by decreasing in supply of bank loans, on the one hand. The share of managers considering banks as willing to provide loans to a firm like their decreased from 74.3% to 70.0% for short-term loans. The respective indicator for long-term loans declined from 66.0% to 52.2%.

On the other hand, the respondents think that the availability of loans for firms rather increased than decreased. Thus, the share of managers who agreed that their firm can take a short-term loan increased from 41.1% in February and 46.2% in May 2006. The respective value for long-term loans was equal to 22.3 % in February and 29.6% in May.

PRODUCTION INDICATORS

As expected by managers, the production growth rates decreased in the 1st quarter, moreover the situation was worse than they predicted. The *index of production* decreased to -0.17 in the 1st quarter 2006 from 0.07 in the 4th quarter 2005 and became negative (meaning that the share of firms with decreased production was higher than the share of firms with increased production), its value is lower than the *index of production expectations* for the 1st quarter (-0.09). Decrease in the *index of production* is observed every year during this period and results from the seasonal trend towards slow-down of economic activity during winter months.

The highest *index of production* values were recorded for printing (0.35) due to increased demand on printing during election in March 2006. The lowest value was recorded for the construction materials and light industries (respectively -0.36 and -0.33). Reduction of production was reported by firms of all sizes excluding the biggest ones – the share of "growing" firms exceeded the share of "falling" ones (0.11) in the group of firms with over 500 employees. The value of the *index of production* for *de novo* private and state-owned firms was the highest compared to privatised ones (respectively 0.06, -0.05. and -0.22).

Firms plan to intensify significantly their economic activity in the 2nd quarter. The *index of production expectations* increased from -0.09 in the 1st quarter to 0.33 in the 2nd quarter. Almost every second firm (47.4%) plans to increase production in the 2nd quarter compared to the 1st quarter and only 14.8% intend to reduce production.

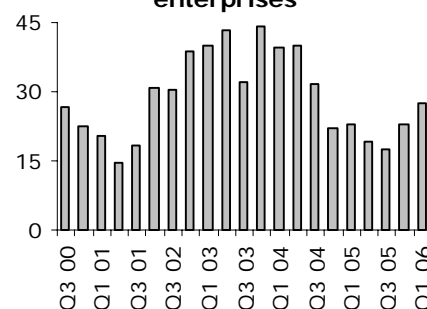
Increase in the *index of production expectations* was reported in all the industries. Optimism of managers grows with the size of the firm: *indices of production expectations* for small, medium-sized and large firms are equal to 0.15, 0.39, and 0.38 respectively. Among the firms of different types of ownership, *de novo private* firms and the privatised firms have the most optimistic production plans: their *index of production expectations* is equal to 0.47 and 0.39 respectively, whereas the respective values for state-owned make up -0.09.

Demand, sales, new orders

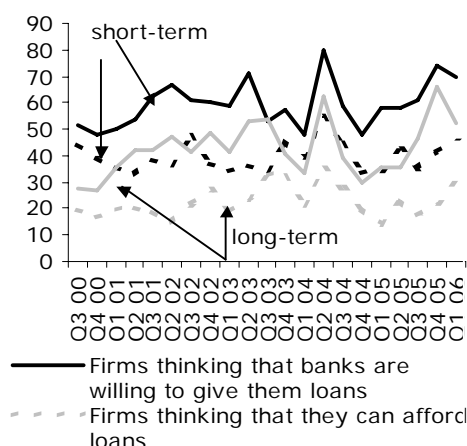
Reduction of production volumes resulted from declining demand. The *index of new orders* decreased from 0.13 in the 4th quarter 2005 to 0.12 in the 1st quarter 2006. The *index of sales* for the same period decreased from 0.07 to -0.14. The share of managers estimating the volume of orders as normal accounts to 33.7%.

Managers expect that all the demand indicators will significantly improve in the 2nd quarter. Managers in the construction materials industry and wood processing are most optimistic about obtaining of new orders in the 2nd quarter (0.77 and 0.43 respectively). Managers in the printing are most pessimistic (-0.39).

Unfavorable regulatory environment, % of enterprises

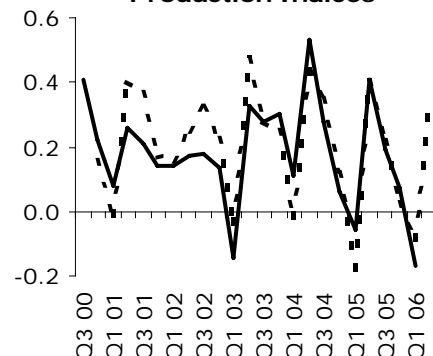


Affordability of Loans (in %)



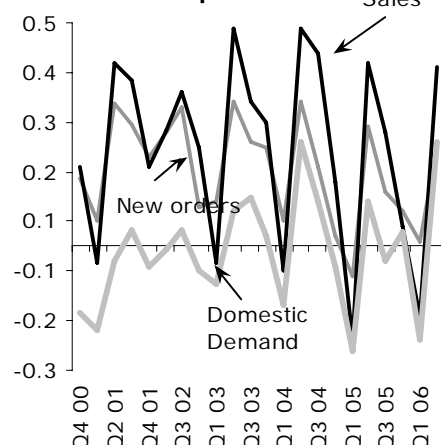
— Firms thinking that banks are willing to give them loans
 - - - Firms thinking that they can afford loans

Production Indices



— Production
 - - - Production expectations

Domestic demand: indices of expectations



Impediments to production¹

The major impediments to production continue to be the low demand, tax burden and the high competitive pressure. Compared to the 4th quarter, the last two ones gained: the tax burden (+9.4%) and high competitive pressure (+2.7%). The fourth position in the list of impediments to production has been taken by the liquidity problems the fourth quarter in a row. The significance of its impediment for the managers is rather the same as in the 4th quarter of 2005.

The share of enterprises considering the unfriendly regulatory climate as an impediment to production practically has not increased. Managers reacted to unclear economic policy and unsolved problems of political power redistribution caused by pre-election time. The share of respondents considering the unstable political situation as a barrier to production has increased second quarter in a row (from 4.0% in October 2005 to 13.6% in January 2006 and finally to 15.2% in May 2006). The impediments like high interest rate and access of credits gained more significance for managers also.

Employment

Against the background of decreasing production growth rates, a trend towards employment reduction is observed two quarters in a row. The value of the *employment index* is equal to -0.15. The share of managers perceiving the workforce level to be too high for available capacities has increased from 2.5% to 5.7%. In contrast, in the 2nd quarter, the firms forecast an increase in employment planning to increase production. The *index of expectations* value is positive and equals 0.07. This trend applies to all industries.

The share of firms reporting workers on forced leave is 6.7%. The respective index value is close to zero. No significant changes for this indicator are expected during the 2nd quarter.

According to managers, it became more difficult to find qualified staff. The opposite tendency is observed concerning non-qualified staff. The values of respective indices increased from 0.47 to 0.60 (qualified employees) and decreased from 0.17 to 0.1 (non-qualified employees).

FINANCIAL PERFORMANCE INDICATORS

Prices

Prices for inputs and finished goods continued growing with higher rates than end of 2005. Compared to the 4th quarter, the *index of purchase prices* grew up from 0.53 to 0.58, and the *index of sales prices* grew up from 0.12 to 0.37.

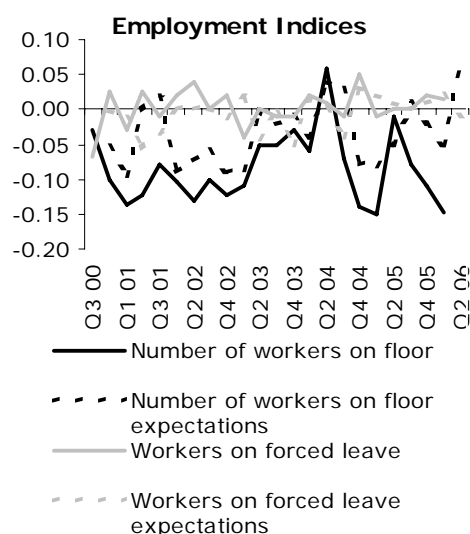
During the 2nd quarter managers expect a slow down in increase of prices. This concerns both sales and purchase prices. The rate of price growth in case of purchase prices the *index of expectations* for the 2nd quarter compared to the respective indicator of the 1st quarter is significant lower (0.36 vs 0.52). The *index of sale prices expectations* has decreased from 0.30 to 0.21.

Profitability

Production decline has certainly affected the financial performance results of firms. As expected by managers, the *index of profitability* decreased last quarter from -0.02 to -0.26. This means predominance of firms that had the worse financial performance

Impediments to production

	Q3 05	Q4 05	Q1 06	Q1 05 vs Q4 04
Shortage of demand	57.7	66.8	65.2	-1.6
Excessive taxation	49.1	42.9	52.4	+9.5
High competitive pressure	41.3	42.5	45.2	+2.7
Liquidity problems	40.2	36.8	37.6	+0.8
High interest rate	35.2	28.9	31.9	+3.0
Unfriendly regulatory climate	17.6	22.8	27.5	+4.7
High regulatory burden	11.4	14.3	21.4	+7.1
Changes in economic legisl.	5.7	9.3	10.0	+0.7
Corruption	2.1	2.9	3.3	+0.4
Shortage of raw materials	25.6	23.9	21.0	-2.9
Unstable political situation	5.0	13.2	15.2	+ 2.0
Outdated technology	23.8	26.1	12.4	-13.7
Shortage of skilled workforce	15.3	13.6	12.4	-1.2
Access to credits	6.0	1.4	7.1	+5.7
Shortage of capacities	5.0	11.4	6.2	-5.2
Problems with energy supply	2.5	7.1	3.8	-3.3



¹ Since October 2002, the category "unfriendly regulatory climate" has been broken into three factors, namely (1) high regulatory burden due to a large number of inspections, unclear procedures etc., (2) frequent changes in regulations, and (3) corruption. The general indicator "unfriendly regulatory climate" now reflects the share of firms that have selected at least one of these three factors as an impediment to production.

results over those that improved them. 40.2% of respondents reported worsening of financial performance results, 45.5% of firms had unchanged results, and only 14.4% of firms stated that their financial performance results improved.

Negative values of the *profitability index* were reported in all the enterprises size groups. The most significant worsening of the situation occurred in the enterprise with 250-500 employees (-0.43). In the 2nd quarter, managers expect improvement of financial performance results planning the increase of production. The value of the *index of profitability expectations* is positive and equal to 0.18.

COMPETITIVE PRESSURE²

According to managers, competition from domestic producers somewhat weakened: the *index of competitive pressure* from Ukrainian producers decreased from 0.27 in the 4th quarter 2005 to 0.19 in the 1st quarter 2006. This was observed in all industries with exception for light industry. The highest competitive pressure is recorded for food industry, and printing. Managers in the machine building industry reported about the lowest competitive pressure.

Managers think that the pressure from Russian/CIS producers and other foreign producers unlike from domestic producer has strengthened. The values of indices increased respectively from -0.56 to -0.40 and from 0.61 to -0.42.

Appendix 1: Methodology

All indices are calculated using the same methodology. For each positive answer we score +1, for each negative answer -1, and for each answer indicating no change we score 0. For example, if 20 respondents report an increase in production, 50 respondents report a decrease, and 30 report no change, the corresponding index level would be -0.30. Thus, a positive (negative) value, for instance for the production index, indicates that the number of firms increasing their production is greater (less) than the number of firms decreasing it. Any score approximately greater than +0.09 or less than -0.09 is statistically significant at the 5% level.

The industrial confidence indicator is defined as the arithmetic mean of the answers to the questions on production expectations, assessments of the order books and assessment of the stock of finished products (the latter with an inverted sign)³.

For further information concerning the sample characteristics, the questionnaire, the index methodology and full data sets please contact Oksana Kuziakiv (kuziakiv@ier.kiev.ua).

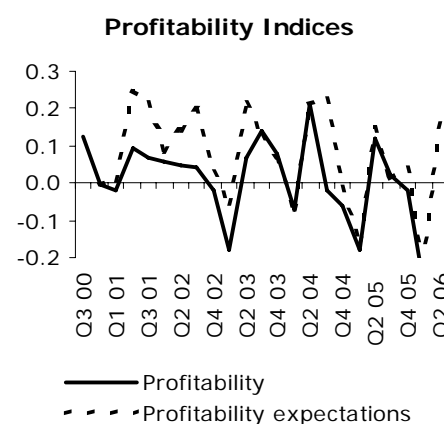
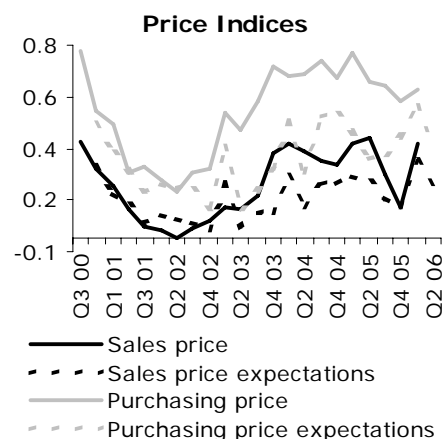
Appendix 2: Sample Characteristics

Number of employees, %	Regions, %		Industries, %				
	Q1'06	Q1'06	Q1'06	Q1'06			
Fewer than 50	29.3	Lviv	27.2	Heavy ⁴ industry	9.4	Food processing	25.7
51 — 250	41.3	Kyiv	30.8	Machine building	27.5	Printing	8.3
251 — 500	14.1	Kharkiv	32.6	Wood processing	6.9	Other	2.9
501 — 1000	8.7	Odessa	9.4	Construction materials	7.2		
Over 1000	6.5			Light industry	12.0		

² The methodology of calculation for this index is similar to that for the other indices. Scale: -1 - no or weak pressure, 0 - moderate, 1 - strong.

³ For details see: The Joint Harmonized EU Programme of Business and Consumer Surveys.

⁴ The heavy industry sector includes energy, the chemical industry, metallurgy, and the fuel industry.



Index of competitive pressure from Ukrainian producers

Industry	Q3'05	Q4'05	Q1'06
Heavy	0.40	0.35	0.21
Machine build.	-0.20	-0.12	-0.26
Wood proc.	0.26	0.26	-0.07
Construct. mat.	0.42	0.26	0.17
Light industry	0.51	0.19	0.30
Food processing	0.63	0.58	0.54
Printing	0.46	0.71	0.50

