

# Quarterly Enterprise Survey

No2 (1)  
November 2002

- **Business climate expectations for the next 6 months have deteriorated dramatically.**
- **Administrative corruption, complex and non-transparent regulations as well as instability of regulations are perceived as the weakest points of current business climate.**
- **Affordability of credits has increased, while willingness of banks to provide loan has lowered.**
- **Tax pressure, low demand and regulatory issues are the three main impediments to production growth.**
- **Positive production expectations for the 3<sup>rd</sup> quarter 2002 are not fulfilled.**
- **Index of new orders' expectations for the 4<sup>th</sup> quarter drops down considerably signaling possible worsening business activities in industrial sector.**
- **Production plans of small business become pessimistic.**

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

**In this issue: results of the survey conducted in October 2002**

**Firms' performance: Q3 02 vs Q2 02**

**Firms' expectations: Q4 02 vs Q3 02**

**Business Climate: assessment for Oct 02, expectations for next 6 months**

**New: Indices of regulatory environment, assessment of current situation and changes over the last 6 months**

## GENERAL INDICATORS

### Business climate

Both indicators of business climate have decreased: *index of current situation* has gone from -0.27 down to -0.29, and *index of business expectations* has dropped dramatically from 0.27 to -0.17. Importantly, for the first time since Q3 00, *index of business expectations* became negative. This reflects a considerable decrease in the share of managers with positive business expectations (10.3% in Q3 02 vs. 41.6% in Q2 02) accompanied by an increase in the share of managers with negative business expectations (27.5% vs. 15.1%, respectively). The decrease in *indices of business climate* is observed across all industries, as well as all size- and ownership groups of enterprises.

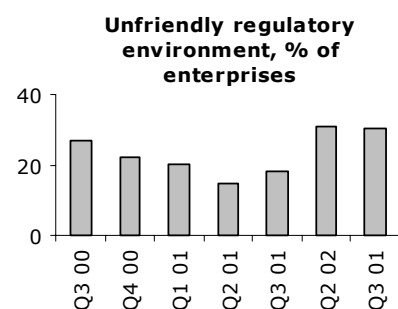
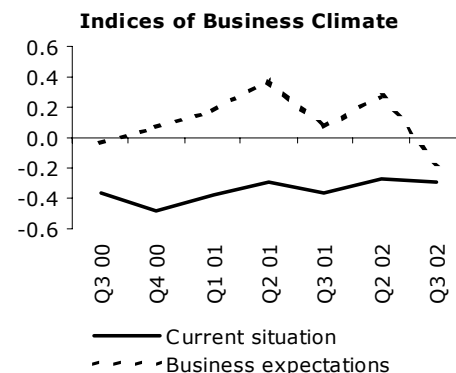
### Regulatory climate

Managers continue considering regulatory climate as a significant impediment to business development. Thus, 30.5% of them reported that "unfriendly regulatory climate" is an important impediment to production, and its position in the list of impediments to production still ranks third (see IMPEDIMENTS TO PRODUCTION).

This quarter we have widened the list of indicators of regulatory climate asking managers to assess their present level as well as changes during the last 6 months. The survey results are striking: managers perceive the quality of regulatory environment to be low across 11 indicators out of 13! Moreover, during the last 6 months the quality of regulatory environment has deteriorated across 12 indicators out of 13. The only exception in this rather pessimistic picture is the level of state interference in operational decisions of the firms, which is considered to be low (index value constitute - 0.27) and has been decreasing over the last 6 months.

The weakest points in the present regulatory environment seems to be related to:

- a) a high level of administrative corruption (62.7% of the managers perceive corruption to be high, and 50% of respondents believe that it has increased during the last 6 months) as well as a necessity to have informal relations with the representatives of public authorities (respective figures constitute 47.3% and 40.9%);
- b) complex and non-transparent regulations (45.7 % of managers consider simplicity and transparency of regulations to be low, and 43% of respondents think that it has decreased);





	Changes during the last 6 months				Assessment of current level			
	Up	0	Down	Index	High	Norm	Low	Index
Quality of government services	7.0	55.3	37.7	<b>-0.20</b>	5.1	50.8	44.1	<b>-0.29</b>
Possibility of the firms to influence the content of laws	26.2	61.1	12.8	<b>0.07</b>	29.2	45.8	25.0	<b>0.01</b>
Level of corruption	50.9	45.9	3.1	<b>0.27</b>	62.7	34.3	3.0	<b>0.36</b>
Necessity of informal relations with public officials	40.9	56.7	2.4	<b>0.22</b>	47.3	47.9	4.8	<b>0.26</b>
Security of property rights	9.6	59.9	30.5	<b>-0.13</b>	4.8	52.9	42.3	<b>-0.27</b>
Predictability of changes in regulations	4.9	53.7	41.4	<b>-0.27</b>	8.3	45.1	46.6	<b>-0.28</b>
Simplicity and transparency of regulations	3.6	53.4	43.0	<b>-0.31</b>	2.7	51.6	45.7	<b>-0.35</b>
Time spent by the managers in dealing with public officials	32.2	60.1	7.7	<b>0.21</b>	25.4	62.1	12.5	<b>0.12</b>
Number of irregular State Tax Administration (STA) inspections	19.7	67.7	12.6	<b>0.08</b>	19.8	70.9	9.3	<b>0.11</b>
Number of irregular inspections (excluding STA)	22.4	65.3	12.3	<b>0.10</b>	24.2	70.8	5.0	<b>0.19</b>
Level of state interference in the operational decisions of the firm	7.8	63.2	29.0	<b>-0.17</b>	5.3	55.5	39.2	<b>-0.27</b>
Incentives for the firms to be involved in tax evasion	31.0	61.2	7.8	<b>0.23</b>	<b>42.7</b>	38.9	18.3	<b>0.24</b>
Possibilities of the firms to evade taxes	15.7	71.1	13.2	<b>0.02</b>	18.8	38.9	<b>45.3</b>	<b>-0.13</b>

- c) unpredictability of changes in regulations (46.6% of managers point out that changes in regulations are hard to be predicted, and 43% of the respondents believe that situation has become worse over the last six months);
- d) low quality of governmental services (44.1% of respondents consider it to be low, and 37.7% of managers report its decrease)
- e) low security of property rights (42.3% of managers believe that judicial system does not guarantee security of property rights, and 30.5% of respondents report a deterioration of the situation over the last 6 months).

42.7% of respondents report high incentives to evade taxes. However, 45.3% of managers admit that possibilities of tax evasion are presently low.

### Lending Climate

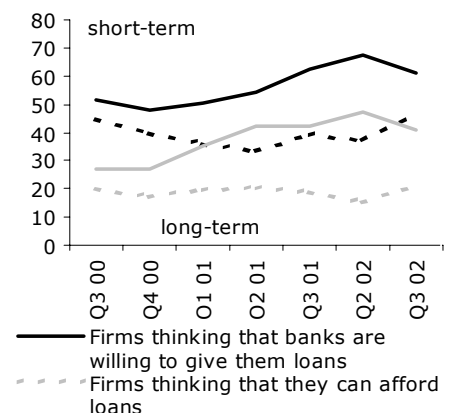
Managers report that in the 3<sup>rd</sup> quarter banks have become less willing to provide both short- and long- terms loans. At the same time, the share of firms considering loans to be affordable has gone up. However, the difference between the indicator of affordability of credits, on the one hand, and the indicator of bank willingness to provide loan, on the other hand, is still significant indicating that the overall cost of the loans continue to be considered as high.

The perceptions of bank loan's affordability vary across the firms of different size, though showing general positive trend. In the 3<sup>rd</sup> quarter 2002, the share of managers of small firms who consider short-term loans to be affordable has increased from 17.5% to 27.9%. At the same time, the respective indicators for the sub-sample of firms with 250-500 employees as well as for large enterprises (more than 500 employees) have increased to 57.1% and 84.0%.

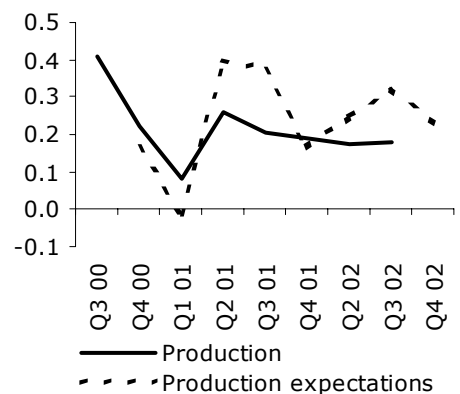
### PRODUCTION INDICATORS

Positive production expectations of the managers for the 3<sup>rd</sup> quarter are not fulfilled. Though *index of production* is positive (0.17) and shows continuing growth of output in industrial sector, its value is significantly less than expected (July's *index of production*

Affordability of Loans (in %)



Production Indices





expectation was 0.32). This has been recorded for all industries. For heavy industry production index has become even negative.

For the 4<sup>th</sup> quarter, *index of production expectations* constitutes 0.23 indicating that industrial firms intend to increase their production volume. However, it is alarming that compared to the 3<sup>rd</sup> quarter the share of firms with positive production expectations has declined from 43.3% to 37.6%.

Across industries, the most optimistic expectations are registered for light industry (*index of production expectations* is 0.50), while in construction materials and printing industry production is expected to decrease (the *indices* for both industries are -0.16). There are significant variations in *index of production expectations* across the firms of different size. While for the groups of large firms it reaches the highest values (0.29 for the firms with 501-1000 employees; 0.34 for the firms with 250-500 and more than 1000 employees), for the medium-sized firms (50-250 employees) it remains positive but goes down to 0.20, in case of small firms the value of *index of production expectations* becomes negative (-0.06).

**Demand, Sales, New Orders**

In the 3<sup>rd</sup> quarter, the enterprises have received more new orders compared to the 2<sup>nd</sup> quarter (*index of new order* is 0.23). This is recorded for all industries except for heavy (-0.03) and printing industries (-0.04).

Despite the positive value of *index of new orders*, it is alarming that almost 2/3 of respondents assess the volume of new orders to be low. The share of firms that expect an increase of new orders in the next quarter goes down significantly which is reflected in a sharp decrease of *index of new orders expectations* from 0.28 (for the 3<sup>rd</sup> quarter) to 0.08 (for the 4<sup>th</sup> quarter). Taking into account the deterioration of general business expectations this fact can be considered as a signal of sagging business activity in Ukrainian industrial sector.

**Impediments to production**

In October’s survey we have introduced several changes in the list of the impediments to productions redefining some of the categories (e.g. unfriendly regulatory climate) and adding others, e.g. liquidity problems, access to credits, high competitive pressure (see the fourth column of Table). In spite of this alteration the top impediments to production haven’t undergone significant changes Excessive taxation has remained on the top of the list. Shortage of demand/new orders has increased in its importance (+5.8 percentage points) and holds the second position.

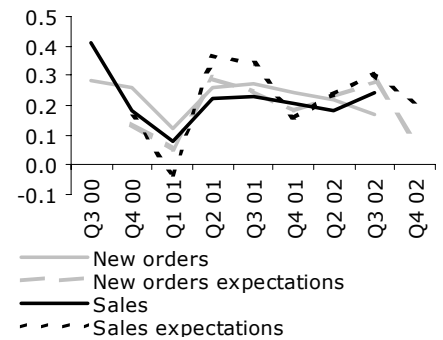
“Unfriendly regulatory climate” turns to be the third on the list of impediments to production. Importantly, this time we have changed the methodology of calculating the indicator of “unfriendly regulatory climate” In the questionnaire, instead of one general category we have inserted three factors namely (1) high regulatory burden due to a large number of inspections, unclear procedures etc., (2) frequent changes in regulations, and (3) corruption. Presently, general indicator of “unfriendly regulatory climate” reflects the share of firms, which have selected at least one of these three factors as impediment to production. As we can see, the different method of calculation has not effected the position of the indicator in the list of impediment to production, i.e. it still ranks 3<sup>rd</sup>.

Importantly, in the 3<sup>rd</sup> quarter there is a sharp increase in the share of firms, which consider “unstable political situation” as a significant impediment to production. The respective indicator has gone up from 7.9% to 12.2%.

**Capacity utilization**

The patterns of *capacity utilizations index* and the *capacity utilization expectations index* are similar to those of production and productions expectations indices (see above). Although the share of enterprises with excess capacities has decreased by 5.4 percentage

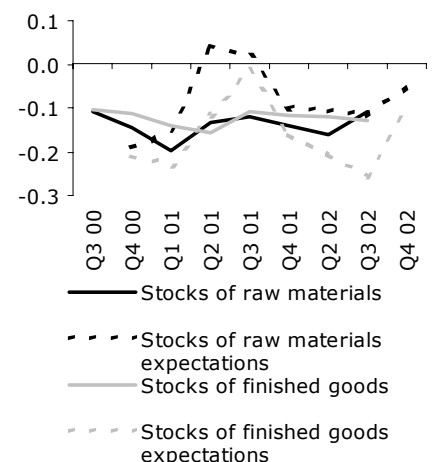
**Sales Indices, New Orders Indices**



**Impediments to production**

	Q3 01	Q2 02	Q3 02	Q3'02 vs Q2'01
Excessive taxation	74.6	65.5	59.9	<b>-5.7</b>
Shortage of demand	61.5	54.1	59.9	<b>+5.8</b>
Unfriendly regulatory climate	18.2	30.7	30.5	<b>-0.2</b>
High regulatory burden			17.4	
Changes in economic legisl.			9.4	
Corruption			7.7	
High competitive pressure			26.8	
High interest rate	36.8	24.1	26.5	<b>+2.4</b>
Outdated technology	23.7	16.9	20.9	<b>+4.0</b>
Shortage of input inventories	15.5	13.4	17.8	<b>+4.4</b>
Shortage of skilled workforce	11.7	16.6	14.3	<b>-2.3</b>
Unstable political situation	8.9	7.9	12.2	<b>+4.3</b>
Access to credits			10.1	
Liquidity problems			9.4	
Problems with energy supply	11	4.5	5.2	<b>+0.7</b>
Shortage of capacities	1.4	3.1	3.5	<b>+0.4</b>

**Inventories Indices**





points, it is still very high (55.5%).

**Inventories**

Across all surveyed industries a reduction in stock of raw materials has been observed (index value is -0.11). The share of managers who consider the stocks of inputs to be low has increased from 42% to 45%. Next quarter the majority of respondents (67.4%) do not plan significant changes in stock of inputs for the next quarter. The corresponding index equals -0.05.

In the 3<sup>rd</sup> quarter, stocks of finished goods also continue to decline, which is reflected by a negative value of respective index (-0.12). In the 4<sup>th</sup> quarter, the majority of enterprises (62.7%) plan to keep their stocks of finished good constant. *Index of stocks-of-finished-goods expectations* is lower than in the pervious quarter and equals -0.10.

**Employment**

In the 3<sup>rd</sup> quarter 2002, the enterprises have continued to reduce the number of workers on floor (index of employment constitutes -0.10). This tendency seems to prevail also in the 4<sup>th</sup> quarter (index of employment expectations is -0.09). No significant changes are recorded for the indicators of forced leave. The share of enterprises with workers on forced leave have not changed. The share of workers on forced leave in total employment has also remained on the same level (16,7%) *Index of forced leave* is 0.00. No significant changes are expected for the 4<sup>th</sup> quarter (*index of forced-leave-expectations* is -0.01).

While the problem of hiring highly-qualified workers becomes more acute, enterprises seem to have no serious difficulties in finding unskilled labor (the respective indices equal 0.65 and 0.04).

**FINANCIAL PERFORMANCE INDICATORS**

**Prices**

In the 3<sup>d</sup> quarter, both price indices have shown positive values *Index of purchase prices* is 0.26, and *index of sales prices* is 0.04. However, in the 4<sup>th</sup> quarter managers don't expect a raise in sales or purchase price. This holds for the firms across all industries and size groups. The managers of the largest firms even plan to decrease sales prices (the respective *index* of this group is -0.07).

**Profitability**

The share of enterprises with increased profitability is almost equal to the share of firms with some drop in profitability (31.5% and 27.3% respectively). *Profitability index* for the 3<sup>rd</sup> quarter constitutes 0.04. No significant changes in profitability are expected in the next quarter. Managers are becoming more pessimistic in their profitability expectations: though the corresponding *index* for the 4<sup>th</sup> quarter remains positive, it drops from 0.20 down to 0.03. It is a consequence of a considerable decline in the share of firms with positive profitability expectations (from 31.5% to 19.0%).

**Barter**

In the 3<sup>rd</sup> quarter 2002, the share of firms with barter transactions has not changed significantly compared to the 2<sup>nd</sup> quarter (29.2% vs. 32.4%). Indices for barter and barter expectations have negative values indicating continuing decline in barter operations.

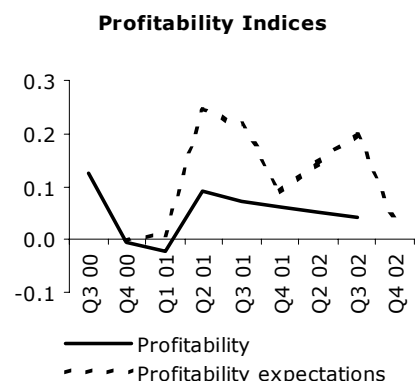
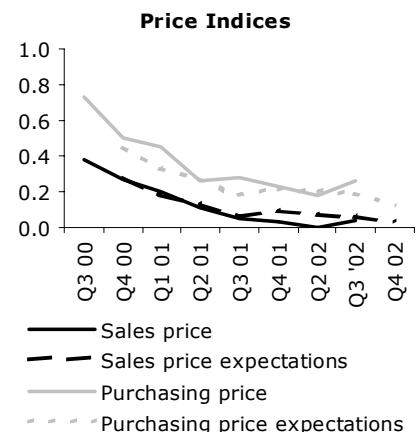
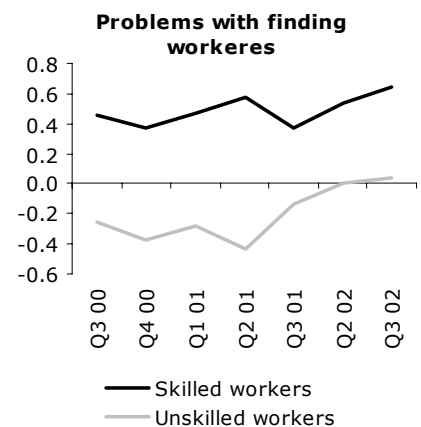
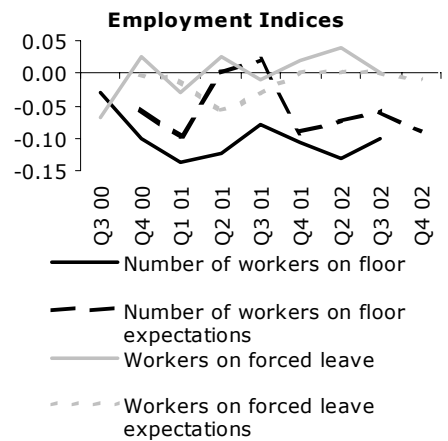
**Arrears**

In the 3<sup>rd</sup> quarter, arrears of all kinds continue to decrease. According to managers' expectations this tendency holds also for the next quarter.

**COMPETITIVE PRESSURE**

26.5% of the surveyed firms consider competitive pressure as an impediment to production (see IMPEDIMENTS TO PRODUCTION).

This time the managers have been asked to assess the level of



competitive pressure, which they face in their main markets from the producers of different geographical regions.

The highest level of competitive pressure is reported with respect to Ukrainian producers. 30.6% of all respondents assess it as „strong“, and another 44.4% of the firms consider it as „moderate“. The index value is 0.02<sup>1</sup>. The index’s value varies across industries as well as size of enterprise. Thus, the highest index’s values are recorded for printing (0.56) and food industry (0.35), the lowest ones are calculated for heavy industry (0.03) and machinery building (-0.36). The smaller is size of firms the more pressure they experienced from Ukrainian producers.

According to managers’ opinions the pressure from foreign producers is significantly lower. The irrespective indices of competitive pressure from Russian/ CIS producers as well as other foreign producers are -0.54 and -0.49. However, the values of these indices vary across industries. Thus, the highest level of competitive pressure from CIS and other foreign producers is reported in light industry (the respective indices are -0.42 and -0.14), machine building (-0.41 and -0.50), and heavy industry (-0.46 and -0.33).

### 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 is -0.30. Thus, a positive (negative) value for e.g. the production index indicates that the share of firms that increase production is higher (smaller) than the share of firms that decrease it. Any score roughly greater than +0.09 or less than -0.09 is statistically significant and different from zero at the 5% level. Further information concerning sample characteristics, questionnaire, index methodology and full data sets are available upon request at [kuziakiv@ier.kiev.ua](mailto:kuziakiv@ier.kiev.ua).

### Appendix 2: Sample Characteristics

Number of Employees, %		Industries, %	
	Q3 02		Q3 02
Less than 50	23.6	Heavy <sup>1</sup> industry	11.5
51 – 250	42.7	Machine building	25.3
251 – 500	14.9	Wood processing	7.6
501 – 1000	8.7	Construction materials	8.7
More than 1000	10.1	Light industry	12.5
<b>Regions, %</b>		Food processing	22.9
Lviv	26.0	Printing	8.7
Kyiv	33.7	Other	2.8
Kharkiv	31.3		
Odessa	9.0		

<sup>1</sup> The methodology of calculation for this index is the same with other indexes. Scale: -1 - no or weak pressure, 0- moderate, 1- strong.

<sup>2</sup> To the heavy industry sector the following sectors are included: energy, chemical industry, metallurgy, and fuel industry.

