

Quarterly Enterprise Survey

No3 (5)
August 2003

- The manager's expectations regarding the overall business climate for the next six months have improved.
- The Industrial Confidence Indicator decreased from 0.03 in the 1st quarter to -0.07 in the 2nd quarter.
- The positive production expectations for the 2nd quarter have almost been met.
- The production expectations for the 3rd quarter remain positive, but are more pessimistic than those for the 2nd quarter.
- Managers anticipate some deceleration of domestic demand growth in the 3rd quarter.
- The willingness of banks to provide loans has increased. The affordability of loans has not changed significantly.
- Low demand, tax pressure, and unfriendly regulations are the main impediments to production growth.
- The indices for sales/purchasing price expectations remain without significant changes in the 3rd quarter.

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 July 2003

Firms' performance: Q2 03 vs. Q1 03

Firms' expectations: Q3 03 vs. Q2 03

Business climate: Assessment for July'03, expectations for the next 6 months

New: Presentation of the Industrial Confidence Indicator

GENERAL INDICATORS

Business climate

In July 2003 two positive developments were noted concerning the business climate. Firstly, the assessment of the current business situation has slightly improved. While the share of managers with positive expectations remains without change compared to May 2003 (5.6% and 5.0% respectively), the share of respondents that consider the current situation satisfactory increased and number of managers with negative expectations decreased (from 53.7% to 63.7% respectively and from 40.7% to 31.3%). The *index* value increased from -0.34 in May to -0.24 in July.

Secondly, the business expectations for the next six months have improved. The value of the *index of business expectations* has increased from -0.09 to 0.04. While the share of managers with negative expectations remains without significant change (19.0% in July and 21.2% in April), the share of managers with positive expectations almost doubled (from 11.3 to 20.9%).

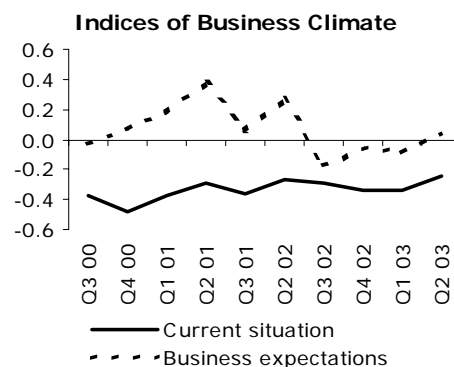
Increases in the *indices of business climate* were observed across all industries, and all size and ownership groups of enterprises.

Regulatory climate

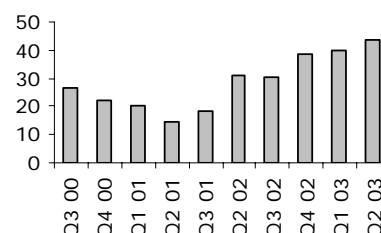
The share of firms that consider the regulatory climate to be a significant impediment to business development continued to increase during the 2nd quarter 2003 (to 43.4% from 40.4% in 1st quarter). This is due to an increase in one of the three components of this indicator, namely the high regulatory burden (from 27.2% in the 1st to 35.6% in the 2nd quarter). The other two components (corruption and stability/instability of the economic legislation) decreased slightly. (See IMPEDIMENTS TO PRODUCTION).

Lending Climate

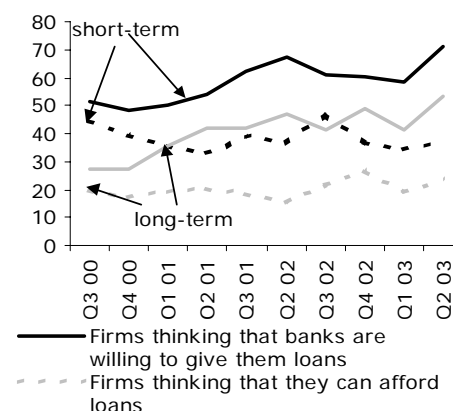
Managers report that the banks have become more willing to provide both short and long terms loans in the 2nd quarter. The share of firms considering loans to be affordable has also gone up. But the growth rates of these indicators are different: the managers' optimism about the willingness of banks to provide loans grew much faster than their optimism about the affordability of these loans for their firms. The difference between the indicators of affordability of credits, on the one hand, and the indicator of the willingness to provide loans, on the other hand, remains significant, indicating that the overall cost of the loans continues to be considered as high.



Unfavorable regulatory environment, % of enterprises



Affordability of Loans (in %)



PRODUCTION INDICATORS

The positive expectations of the managers for the 2nd quarter were almost met. The *index of production* increased from -0.15 (1st quarter) to 0.33 (2nd quarter). This happened due to an increase in the share of enterprises with risen production (from 29.6% to 51.6%) and a decrease in the share of firms with declined production (from 42.6% to 21.9%). For the fourth time in a row now, the value of the *index of production* was lower than managers had expected (May's *index of production expectations* was 0.48).

The increase in production has been reported for all sectors and sizes of enterprises. The value of the *index of production* for private firms is significantly higher than that for state-owned enterprises (0.46 and 0.10 respectively).

During the 3rd quarter 43.0% of respondents expect to increase production and only 15.5 % of them foresee a decline in output. However, compared to the expectations for the 2nd quarter the number of firms with positive production expectations has gone down, while the number of firms with negative expectations remained stable. This is reflected in the value of the *index of production expectations*. The *index of production expectation* for the 3rd quarter is 0.28, suggesting that industrial firms hope to increase their production volume, however the index value is lower than that for the last quarter (0.48).

The positive value of the *index of production expectations* applied to all industries, with heavy industry recording the lowest index value (0.19). Based on company size, enterprises with 501-1000 employees are the most optimistic with respect to their production plans (their index equals 0.48). In contrast to the two previous quarters, the most pessimistic expectations are recorded for the largest enterprises (more than 1000 employees). The *index of production expectations* for this group is only 0.07.

Demand, Sales, New Orders

Managers reported receiving many new contracts during the 2nd quarter. The value of the *index of new orders* went up from 0.03 in the 1st quarter to 0.22 in the 2nd quarter. 65.2% of managers consider the volume of new orders to be low and 33.0% consider it to be quite normal for this time of year. For the 1st quarter the respective values were 60.3 and 36.7%.

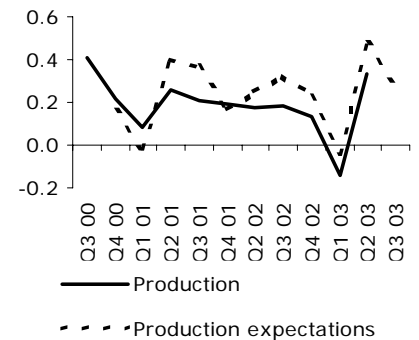
For the 3rd quarter 2003, the *index of new order expectations* is 0.21 indicating the share of firms expecting increases in the number of orders is greater than the share of firms expecting decreases in demand. It is alarming however, that the managers' demand expectations for the 3rd quarter are lower than they were for the 2nd (0.21 and 0.29 respectively). This expected slowing of the increase in demand has an impact on the productions plans of the enterprises (See PRODUCTION). This trend was recorded for all enterprises throughout the industry.

Impediments to production¹

The lack of orders/sales/demand, excessive taxation, and the unfriendly regulatory climate remained the three most frequently mentioned impediments to production. While the rank of the impediments did not change, the frequency of the indicators has increased significantly. Outdated technology, the high regulatory burden, and the lack of orders/sales/demand have increased in importance by more than 5 percentage points (+10.3, +8.4 and +8.1 respectively).

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.

Production Indices



Sales Indices, New Orders Indices



Impediments to production

	Q4 02	Q1 03	Q2 03	Q1 03 vs. Q4 02
Shortage of demand	71.8	61.3	69.4	+8.1
Excessive taxation	71.5	58.9	59.4	+0.5
Unfriendly regulatory climate	38.8	40.4	43.4	+3.0
High regulatory burden	23.7	27.2	35.6	+8.4
Changes in economic legisl.	13.1	12.5	10.7	-1.8
Corruption	8.2	7.3	3.6	-3.7
High competitive pressure	38.1	35.9	37.7	+1.8
High interest rate	37.8	27.9	28.8	+0.9
Outdated technology	26.8	18.5	28.8	+10.3
Shortage of raw materials	24.7	26.1	26.7	+0.6
Liquidity problems	17.5	10.1	13.5	+3.4
Access to credits	15.1	10.1	9.3	-0.8
Shortage of skilled workforce	13.7	16.4	19.9	+3.5
Unstable political situation	11.7	11.1	10.7	-0.4
Shortage of capacities	4.8	3.1	7.1	+4.0
Problems with energy supply	5.8	5.9	3.9	-2.0

Capacity utilization

As usual, the patterns of the *capacity utilizations index* and the *capacity utilization expectations index* are similar to those of the production and production expectations indices (see above). 51.3% of enterprises have excess production capacities.

Inventories

The *index of raw materials stock* is -0.15 . A reduction in the stock of raw materials has been observed across all surveyed industries with the exceptions of light industry (0.15). The lowest value of the index was recorded for the wood industry (-0.33). At the same time, the share of enterprises that consider their stocks of inputs to be sufficient increased from 50.9% in May 2003 to 69.5% in July 2003. In the 3rd quarter managers expect a slower decrease in input stocks. The corresponding index is -0.07 .

During the 2nd quarter 2003, stocks of finished goods also continued to decline, which is reflected in the negative value of this index (-0.20). The *index of stocks of finished goods expectations* is higher than in the previous quarter and equals -0.11 .

Employment

As managers had expected, the tendency to reduce the work force has slowed down (*index of labour force* increased from -0.11 in the 1st quarter to -0.05 in the 2nd quarter). For the majority of firms the number of workers meets their firms' needs. Thus, the number of managers perceiving the work force level to be satisfactory increased from 76.1% in May to 81.7% in July. During the 3rd quarter managers do not plan to change the labour force: the index is close to zero (-0.02).

At the same time the share of firms reporting workers on forced leave increased slightly from 9.8% in May to 11.3% in July. It should be noted that the number of firms with more workers on forced leave equals the number of those with fewer. No significant changes are expected for the 3rd quarter (the *index of forced leave expectations* is at -0.04).

The problem of hiring highly qualified workers continues to be acute. The value of the *index of hiring highly qualified workers* increased from 0.48 to 0.51, i.e. more managers report increasing difficulties with finding skilled workers. Finding unskilled labour is less difficult. The respective index value remains close to zero (0.02).

FINANCIAL PERFORMANCE INDICATORS

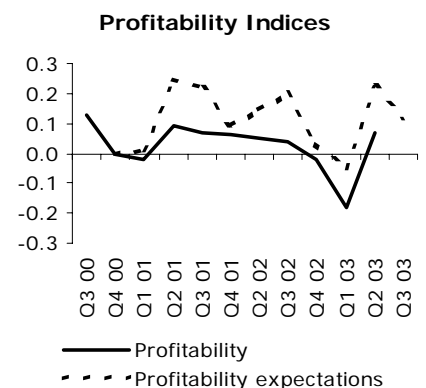
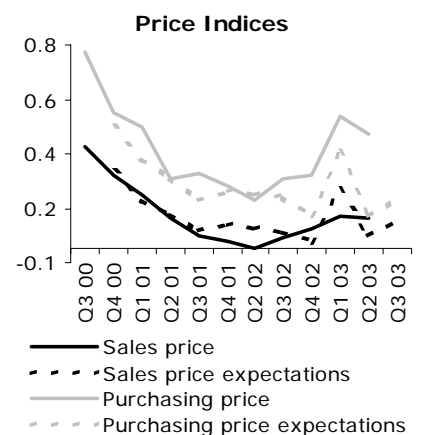
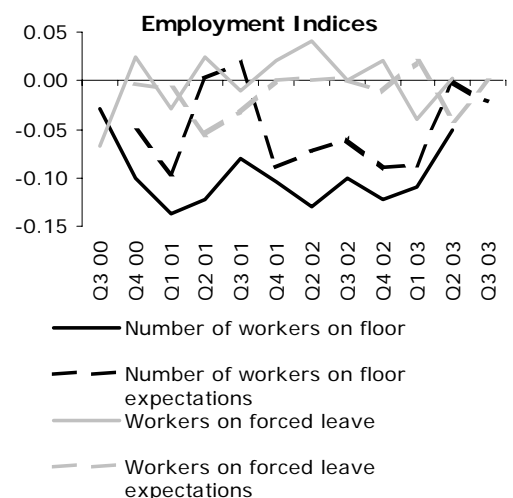
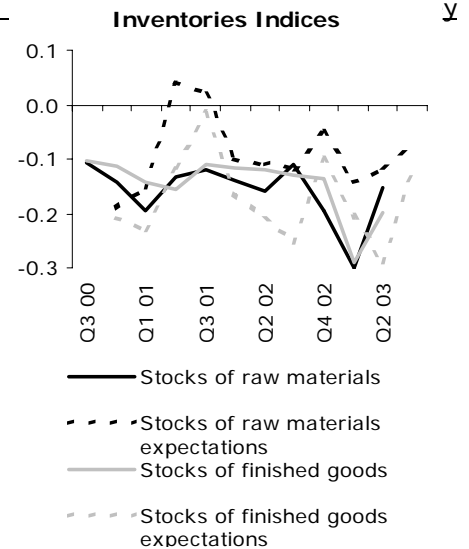
Prices

The managers' expectations regarding a decline of input prices were not fulfilled. In May 79.0% of respondents expected that prices would not change during the next 3 months, but in July only 48.4% of managers reported that the input prices had remained unchanged, 46.2% of them reported purchase price increases. The prices for outputs also increased, though to a lesser extent than expected. The *index of purchase prices* equals 0.42, the *index of sales prices* 0.11 (the *index of expectations* for the 2nd quarter were 0.12 and 0.05 respectively).

For the 3rd quarter managers again expect prices to be more stable. The values of the both indices of expectations have decreased. The *index of purchase price expectations* is 0.19, and the *index of sales price expectations* 0.11.

Profitability

The share of firms with increased profitability has gone up and the share of firms with decreased profitability has declined (from 18.2% to 32.0% and from 34.1% to 25.9% respectively). But the dynamic of profitability was again worse than managers had expected. Thus, the actual index value for the 2nd quarter is 0.07, while the *index of expectations* for the same time period was 0.22.



However, the profitability expectations for the 2nd quarter are still optimistic: 12.9% of the managers predict a decrease in the profitability of their firms, 26.3% expect the profitability to increase. The positive *index of profitability expectations* (0.13) reflects this. But it is alarming that the expectations for the 3rd quarter are more pessimistic than the expectations for the 2nd quarter were: the *index of expectations* dropped from 0.22 to 0.13.

Barter

The number of firms using barter transactions has not changed significantly during the 2nd quarter (27.0% vs. 27.9% during the 1st quarter). The *indices for barter* and *barter expectations* have negative values, suggesting a continuous decline in barter operations (-0.15 and -0.14 respectively).

Arrears

The *index of accounts payable* and the *index of accounts receivable* dropped, indicating that inter-enterprise arrears continue to decrease (from -0.19 to -0.24 and from -0.14 to -0.23 respectively). But the sources of these changes differ. Thus in the case of receivables it happened due to a drop in the share of firms with increased arrears and a rise in the share of firms with decreased arrears, while for payables only a decline in share of the firms with growing arrears was recorded. The managers expect this tendency to hold true for the 3rd quarter as well.

By contrast, the values of the *wage and tax arrears indices* are nearly the same as for the previous quarter. However, they are negative indicating that the share of enterprise with decreased arrears exceeds the share of firms with the opposite behaviour. It seems that this tendency will continue during the 3rd quarter.

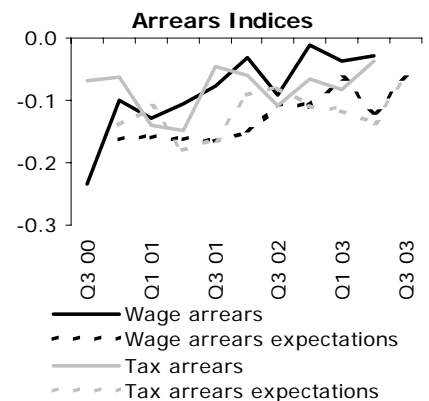
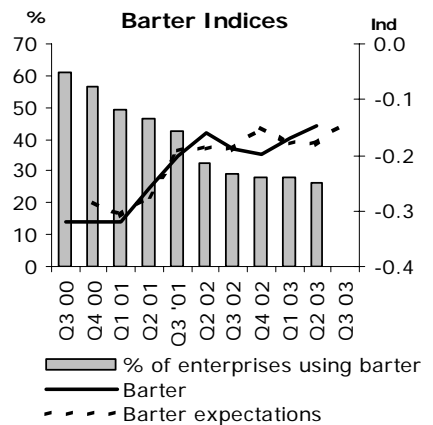
COMPETITIVE PRESSURES²

The firms report an increase in the level of competitive pressures with respect to Ukrainian producers. It went up from 0.16 in May to 0.24 in July 2003. The value of the index depends on the size and the type of the firms. Based on company size, the highest value (0.35) is recorded for medium-size firms (51-250 workers), the lowest one (-0.17) for the largest firms (more than 1000 workers). Across industries, managers in the printing and food industries reported the highest competitive pressures (0.60 and 0.52 respectively), while the lowest index value was recorded for machine building (-0.13).

Competitive pressures from foreign producers are lower. Indices of competitive pressures from Russian/ CIS producers and from other foreign producers are negative (-0.54 and -0.67 respectively). Moreover, the value of the former index has decreased compared to the previous period of observation (in May 2003 the respective indices were -0.42 and -0.67).

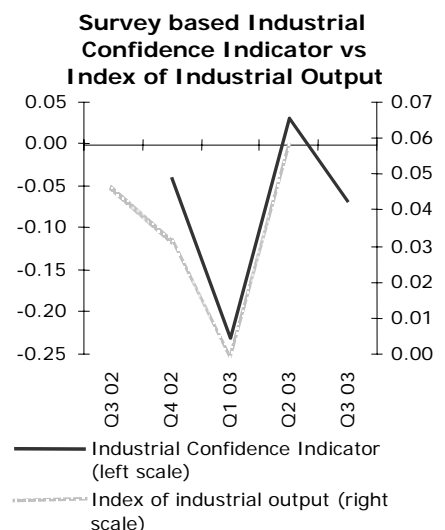
INDUSTRIAL CONFIDENCE INDICATOR

In addition to the results of the individual variables, we present this quarter the composite *industrial confidence indicator* as calculated in accordance with the European Commission methodology³. The indicator is defined as the arithmetic mean of the answers to the questions on production expectations, assessment of the order books and assessment of the stock of finished products (the latter with an inverted sign). In the 2nd quarter we recorded a drop in the Industrial Confidence Indicator in comparison to 1st quarter: from 0.03 to -0.07.



Index of competitive pressure from Ukrainian producers

Industry	Q1'03	Q2'03
Heavy	0.37	0.36
Machine build.	-0.05	-0.13
Wood proc.	0.10	0.30
Constr. mat.	0.41	0.25
Light industry	0.33	0.34
Food processing	0.54	0.52
Printing	0.57	0.60



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

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

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.

Further information concerning the sample characteristics, the questionnaire, the index methodology and full data sets are available upon request from Oksana Kuziakiv (kuziakiv@ier.kiev.ua).

Appendix 2: Sample Characteristics

Number of employees, %		Industries, %	
	Q2'03		Q2'03
Fewer than 50	21.6	Heavy ⁴ industry	9.2
51 — 250	42.2	Machine building	28.7
251 — 500	16.7	Wood processing	7.1
501 — 1000	8.9	Construction materials	8.5
Over 1000	10.6	Light industry	12.4
Regions, %		Food processing	23.4
Lviv	26.6	Printing	7.4
Kyiv	33.0	Other	3.2
Kharkiv	31.9		
Odessa	8.5		

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