Quarterly Enterprise Survey

No4 (6)
November 2003

- **The Industrial Confidence Indicator increased from –0.08 in the 2nd quarter to -0.04 in the 3rd quarter.**
- **While the managers' assessments of overall business conditions have improved, their forecasts of future business conditions became more pessimistic.**
- **Managers consider that the growth of domestic demand and their positive production expectations for the 3rd quarter were fully met.**
- **The production expectations for the 4th quarter continue to be positive.**
- **11 out of 13 possible impediments to production growth have declined in importance.**
- **Tax pressures, low demand, and unfriendly regulations are the main impediments to production growth.**
- **The affordability of long-term loans has increased significantly.**
- **Growing purchasing prices alarm managers: the index of purchasing price expectations increased during the 4th 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 October 2003

Firms' performance: Q3 03 vs. Q2 03

Firms' expectations: Q4 03 vs. Q3 03

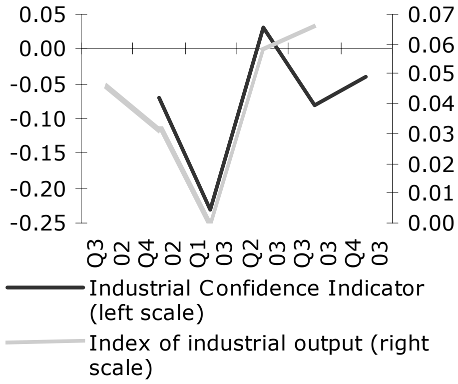
Business climate: Assessment for October'03, expectations for the next 6 months

GENERAL INDICATORS

Industrial confidence indicator

We recorded an increase in the *Industrial Confidence Indicator* in the 3rd quarter compared to the 2nd quarter: from –0.08 to –0.04. This is due to higher expectations by the managers concerning their order books. The other two components of the indicator (production expectations and assessment of the stock of finished goods) remain without significant changes.

Survey based Industrial Confidence Indicator vs Index of Industrial Output



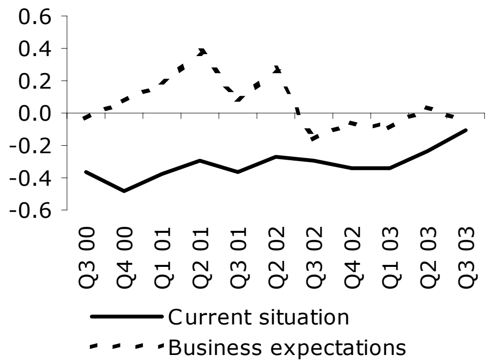
Business climate

The managers' assessments of the current overall business situation continued to improve. While the share of negative assessments still exceeds the share of positive assessments, the *index of the current situation* increased from –0.24 in July to –0.11 in October. Improved assessments of the overall business situation are recorded for all industries with exception of printing (decreased) and heavy industry (no change).

At the same time the managers became more pessimistic about the future overall business climate for the next 6 months. The *Index of business expectations* dropped from 0.04 to –0.05 indicating that more firms have negative expectations rather than positive ones. This was observed in all industries with the exception of machine building.

The values of both indices changed due to changes in the share of respondents with positive assessments/anticipations. A threefold increase in the share of managers with a positive assessment of the current economic conditions was recorded compared to July (14.9% and 5.0% respectively), while the share of managers with positive expectations for the next 6 months decreased (12.6% vs. 20.9%).

Indices of Business Climate



Regulatory climate

The share of firms that consider the regulatory climate to be a significant impediment to business development decreased in the 3rd quarter 2003 (to 32.0% from 43.4% in the 2nd quarter). This is due to a decrease in two components of this indicator (high regulatory burden and stability/instability of the economic legislation) (See IMPEDIMENTS TO PRODUCTION). But in contrast to previous quarters there are significant differences between the perceptions of small, medium and large businesses. The above-mentioned drop has been recorded only for small and medium-sized firms. Large firms

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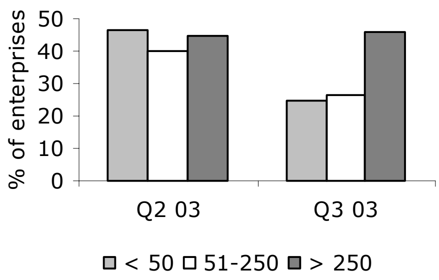
perceive no changes. More than 40.0% of the management of large firms continues to see the regulatory climate as a significant impediment to production growth.

Unfriendly regulatory climate by size of firms



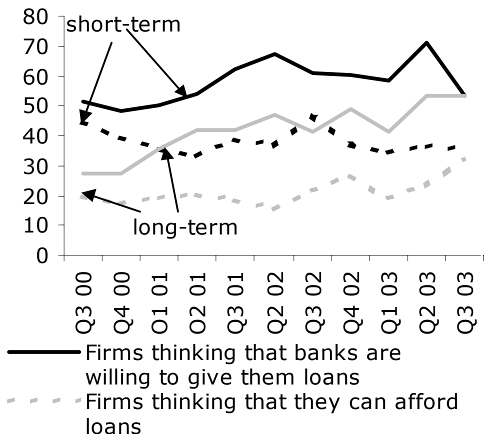
Lending Climate

Managers report that the banks have become less willing to provide short-terms loans in the 3rd quarter, while their willingness to provide long-term loans did not change.

The share of firms considering short-term loans to be affordable has not changed. In contrast the affordability of long-term loans has significantly increased. The level of affordability of both types of loans is similar for the first time. 34.9% and 32.3% of the respondents stated that their firms could afford both short- and long-term loans.

Both, the difference between the affordabilities of long- and short-term loans and the willingness of banks to provide such loans have decreased, which indicates that the overall cost of long terms loans starts to be considered as lower.

Affordability of Loans (in %)



PRODUCTION INDICATORS

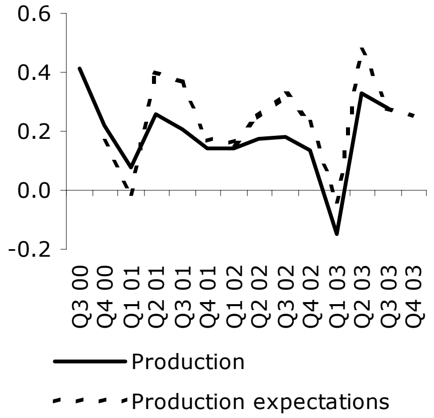
The tendency for the actual indicator not to match the expected one did not apply in the 3rd quarter. As the managers had expected, the *index of production* for the 3rd quarter was 0.28, i.e. slightly less than for the 2nd quarter (0.33) due mainly to a decline (from 51.6% to 48.0%) of the share firms reporting increased production.

The highest *index of production* values were reported for the wood (0.42) and food processing industries (0.34). Companies with 501 to 1000 employees experienced the most significant growth. The index values for small firms were lowest again (0.10). The values of the *indices of production* for private and state firms are significantly higher than the value for privatised ones (0.48 and 0.50 respectively vs. 0.20).

The *index of production expectations* for the 4th quarter is 0.25, which is slightly lower than the 3rd quarter value (0.28). The main reason for the decrease is a lower number of firms with positive production expectations and a rise in the number of firms with negative expectations. Thus, during the 4th quarter 41.6% of the respondents expect to increase production and 20.8% foresee a decline. The corresponding values for the 3rd quarter were 43.0% and 15.5%.

The positive value of the *index of production expectations* applies to all industries, with exception of the heavy and construction materials industries (both with values at -0.04) and the food industry (0.00). The highest index values were recorded for the machinery building (0.39) and light industries (0.47). The largest enterprises (more than 1000 employees) are the most optimistic ones with respect to their production plans (their index equals 0.53). The production plans of the small and medium firms are significantly lower (with index values at 0.08 and 0.10).

Production Indices



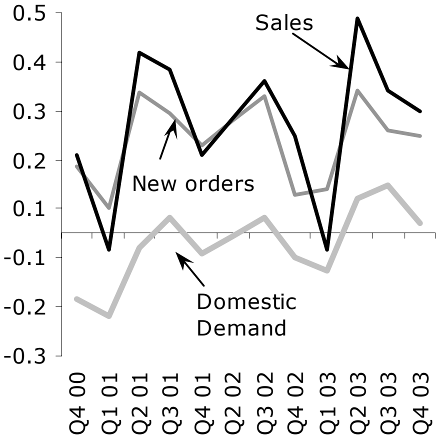
Demand, Sales, New Orders

Managers reported increased domestic demand. All indices show demand to have grown in the 3rd quarter compared to the 2nd quarter:

- The value of the *index of new orders* went up from 0.22 to 0.29.
- The *index of assessment of the order books* increased from –0.62 to –0.47. 43.0% of mangers consider the volume of orders to be quite normal for this time of year. For the 2nd quarter the respective value was 33.0%.
- The *index of domestic demand* rose from 0.01 to 0.12.

For the 4th quarter 2003, all demand indicators are positive, indicating the share of firms expecting the indicators to increase outweighs the share of firms expecting the opposite. But the values

Domestic demand: indices of expectations



of all demand indicators are lower than for the 3rd quarter, which means that the upward trend in demand is expected to decelerate by the end of year. There are significant differences between the demand expectations of city and oblast located enterprises. The *indices of new orders*, *demand* and *sale expectations* indicate pessimism by mangers of enterprises located outside the big cities regarding domestic demand. Thus, the indices for city and oblast located firms are 0.37 and −0.13 (sales), 0.26 and 0.02 (new orders), and 0.07 and −0.13 (domestic demand) respectively.

Impediments to production[1]

The declining values of 11 out of 13 possible impediment indicators signal an improvement in the business climate. This evidence correlates with the managers direct assessments of the business climate (see BUSINESS CLIMATE). The most significant drop was observed for "Shortage of demand" (-16.4%). Together with the demand indicators mentioned above (see DEMAND, SALES, NEW ORDERS), this indicates that demand increased during the 3rd quarter. Apparently, this growth of demand is the major reason for the managers' optimism concerning the current business situation.

Only two impediments saw increases in their values, meaning that they rose in importance in the minds of the managers. The growth of the price for raw materials recorded this quarter is reflected in the increasing importance of the shortage of raw materials as an impediment to production. Also, resent political events contribute to the increased "unstable political situation" value.

Capacity utilization

Higher values of the *capacity utilization index* and of the *index of capacity utilization rate* indicate increased levels of capacity utilization. 2/3 of the enterprises expecting an increase in production in the 4th quarter also plan on an increased capacity utilization. The remaining third of the firms are going to increase production without capacity utilization growth.

Inventories

Against the background of growth in demand, the enterprises not only increased their outputs but also their stocks of finished goods. The *index of finished goods stock* increased from −0.20 to −0.08. This tendency will continue during the 4th quarter.

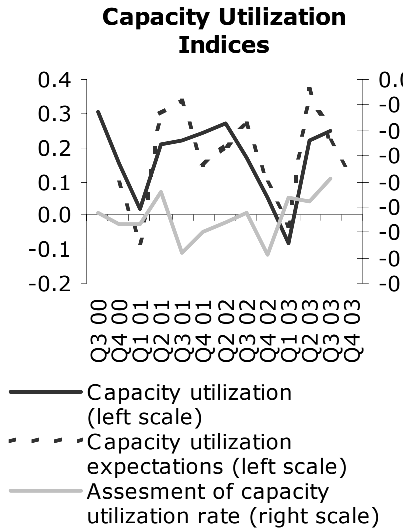
The *index of raw materials stock* did not change significantly compared to the 2nd quarter (-0.12 vs. −0.15). The reduction in the stock of raw materials has been observed across all surveyed industries excepting the light (0.00), wood processing (0.04) and food (0.11) industries. The lowest value of the index was recorded for machinery building (-0.31). At the same time, the share of enterprises that consider their stocks of inputs to be sufficient decreased from 69.5% in July 2003 to 41.6% in October 2003. In the 3rd quarter two thirds of all managers expect neither a decrease nor an increase in input stocks.

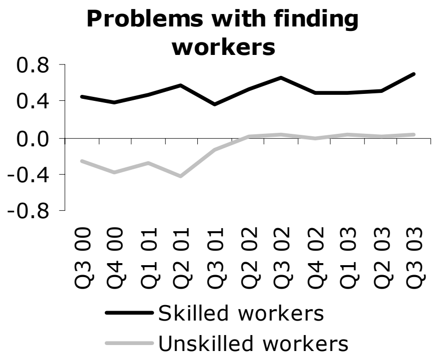
Employment

No significant changes were recorded with respect to employment. The vast majority of the firms kept the workforce at the level of the previous quarter. At the same time the number of managers perceiving the workforce level to be low doubled (from 10.4% in July to 20.6% in October). In spite of this the managers do not plan to change the labour force during the 4th quarter: the *index* continues to be close to zero (-0.01).

Impediments to production

	Q1 03	Q2 03	Q3 03	Q3 03 vs. Q2 03
Excessive taxation	58.9	59.4	53.7	**-5.7**
Shortage of demand	61.3	69.4	53.0	**-16.4**
Unfriendly regulatory climate	40.4	43.4	32.0	**-11.4**
High regulatory burden	27.2	35.6	27.6	**-8.0**
Changes in economic legisl.	12.5	10.7	3.4	**-7.3**
Corruption	7.3	3.6	4.5	**+0.9**
Shortage of raw materials	26.1	26.7	29.9	**+3.2**
High competitive pressure	35.9	37.7	27.2	**-10.5**
High interest rate	27.9	28.8	21.6	**-7.2**
Shortage of skilled workforce	16.4	19.9	18.7	**-1.2**
Outdated technology	18.5	28.8	16.4	**-12.4**
Unstable political situation	11.1	10.7	13.8	**+3.1**
Liquidity problems	10.1	13.5	11.9	**-1.6**
Access to credits	10.1	9.3	8.2	**-1.1**
Shortage of capacities	3.1	7.1	4.5	**-2.6**
Problems with energy supply	5.9	3.9	3.7	**-0.2**

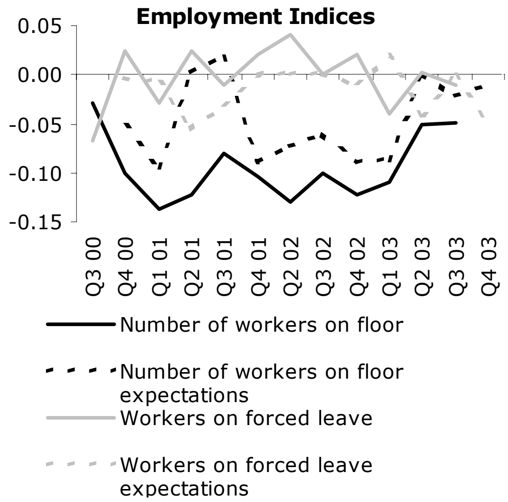




[1] Since October 2002, the category "unfriendly regulatory climate" has been broken into three factors, namely (1) high regulatory burden due to a large number of inspections, unclear procedures etc., (2) frequent changes in regulations, and (3) corruption. The general indicator "unfriendly regulatory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

The share of firms reporting workers on forced leave continues to increase slightly (9.8% in May, 11.3% in July, and 14.3% in October). No significant changes are expected for the 4th quarter (the *index of forced leave expectations* is at –0.05).

The problem of finding highly qualified workers continues to increase in importance. The value of the *index of hiring highly qualified workers* increased again (from 0.51 to 0.69) due to a significant increase in the number of managers reporting increasing difficulties with finding skilled workers (from 57.5% to 71.1%). Finding unskilled labour is less difficult. The respective index value remains close to zero (0.03).

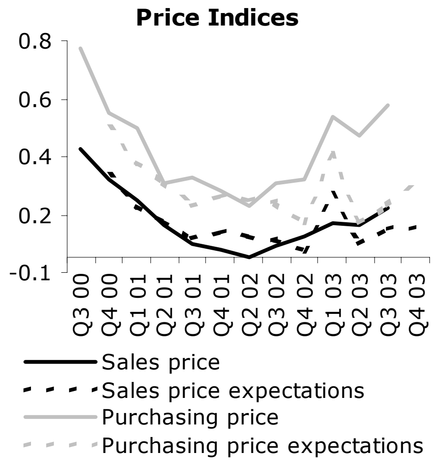


FINANCIAL PERFORMANCE INDICATORS

Prices

The managers' expectations regarding a decline of input prices were not fulfilled for the second quarter in a row. Quite the contrary, input prises continued to rise. The *index of purchase prices* increased from 0.42 in the 2nd quarter to 0.53 in the 3rd quarter. 54.3% of managers reported purchase price increases and only 1.8% noted decreases. The prices for outputs also increased, though to a lesser extent than expected. The *index of sales prices* increased to 0.17 from 0.11 in the 2nd quarter.

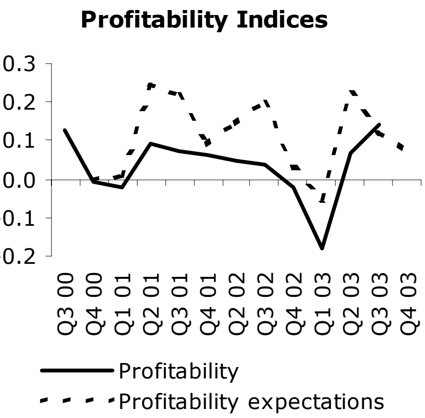
For the 4th quarter managers expect a rise in input prices. The *index of purchase price expectations* rises to 0.27 from 0.19. At the same time the respondents predicted sales prices to remain more or less stable, with 80.8% of them not expecting any sales price changes. The *index of sales price expectations* is 0.10.



Profitability

The *index of profitability* increased from 0.07 in the 2nd quarter to 0.14 in the 3rd quarter due to a drop in the share of firms with decreased profitability (from 25.9% to 21.3%). The share of firms with increased profitability remained unchanged (32.0% and 32.9% respectively).

However, the profitability expectations for the 4th quarter are worse: while the share of managers predicting decreased profitability for their firms goes down to 15.0%, the share of managers expecting the profitability to increase also drops (to 21.1%). The decrease in the *index of profitability expectations* from 0.13 to 0.07 reflects this.



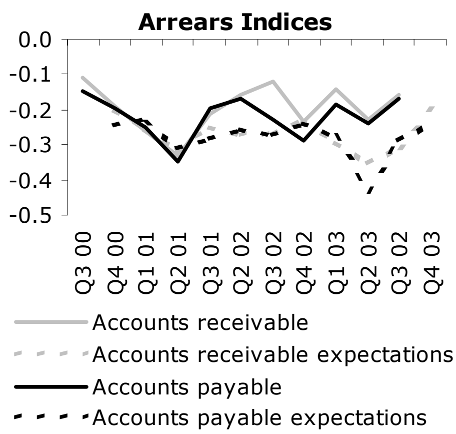
Barter

22.5% of the surveyed firms use barter transactions. The *indices for barter* and *barter expectations* have negative values, suggesting a continuous decline in barter operations (both are –0.12).

Arrears

The number of firms reporting decreased arrears exceeds those who reported increased arrears, indicating that inter-enterprise arrears continue to decrease. But it is noteworthy that the balance declined in the 3rd quarter: for accounts receivable from 23% to 16%, and for accounts payable from 24% to 17%. This happened due to a decrease in the share of enterprises with decreased arrears and an increase in the number of firms reporting no change with respect to inter-enterprises arrears. The managers do not plan to accelerate the decrease in arrears during the 4th quarter.

19.3% of the respondents reported tax arrears. 22.1% of the surveyed firms have wage arrears. Both indices are close to zero indicating no changes compared to the previous quarter. During the 4th quarter enterprises intend to decrease rather than increase these arrears. 44.2% of those who have tax arrears plan to reduce them and 15.4% expect their arrears to increase. The corresponding data for wage arrears are 47.6% and 12.7%.



COMPETITIVE PRESSURES[2]

Overall, firms report a decrease in the level of competitive pressures from Ukrainian producers. The *index* decreased from 0.24 in July to 0.16 in October 2003. This is true for all industries with the exception of food and construction materials. The managers of the latter reported increased competitive pressures. The highest competitive pressure was recorded for the food industry.

The *index of competitive pressures* from Russian / CIS producers continues to decrease (-0.42, -0.54, and –0.57 for May, July, October respectively). In contrast the *index of pressure* from other foreign producers has slightly increased but its value is still low (-0.67, -0.67, and –0.63 for the last three quarters).

Index of competitive pressure from Ukrainian producers

Industry	Q2'03	Q3'03
Heavy	0.36	0.08
Machine build.	-0.13	-0.26
Wood proc.	0.30	0.10
Construct. mat.	0.25	0.29
Light industry	0.34	0.28
Food processing	0.52	0.53
Printing	0.60	0.44

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, %

	Q3'03
Fewer than 50	28.9
51 — 250	38.9
251 — 500	14.6
501 — 1000	10.7
Over 1000	6.8

Regions, %

Lviv	26.8
Kyiv	33.2
Kharkiv	32.1
Odessa	7.9

Industries, %

	Q3'03
Heavy[4] industry	8.9
Machine building	27.5
Wood processing	7.1
Construction materials	8.9
Light industry	11.8
Food processing	23.2
Printing	8.9
Other	3.6

[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.

[4] The heavy industry sector includes energy, chemicals, metallurgy, and fuel.