

Quarterly Enterprise Survey

No2 (8)
May 2004

- The Industrial Confidence Indicator increased from -0.17 in February to -0.01 in May.
- The managers' expectations about future changes in the business climate remain rather pessimistic.
- The slowing of business activity recorded in the 1st quarter of 2004 was less than that in the 1st quarter of 2003.
- For the 2nd quarter of 2004 managers expect significant increases in production.
- After decreasing in February, tax pressures are again in first place on the list of impediments to production.
- Loans again became less accessible and affordable.
- Managers informed about increased competitive pressures.
- Prices increased to a greater extent than managers had expected.
- During the 2nd quarter managers expect continuing purchase price increases. Sales prices are expected to grow too, but to a lesser extent than purchase 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 2004

Firms' performance: Q1 04 vs. Q4 03

Firms' expectations: Q2 04 vs. Q1 04

Business climate: Assessment for May '04, expectations for the next 6 months.

GENERAL INDICATORS

Industrial confidence indicator

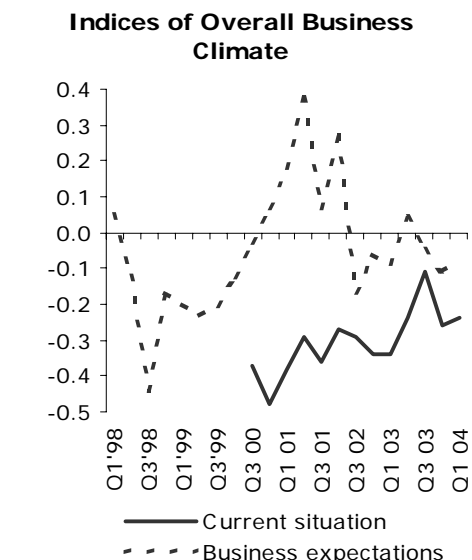
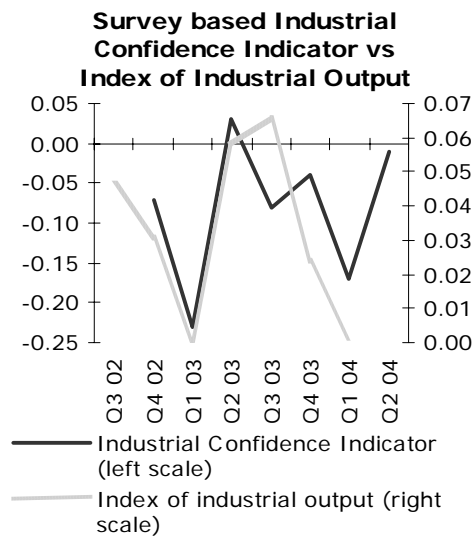
The *Industrial Confidence Indicator* has increased by 16 points, increasing from -0.17 for the 1st quarter to -0.01 for the 2nd quarter of 2004. This is due to increases in all three components of the indicator, namely production plans for the next 3-4 months, assessment of the volume of new orders, and assessment of finished goods stocks. The most significant growth was observed with respect to the production plans of enterprises (see PRODUCTION INDICATORS).

Business climate

The *index of the current situation* increased slightly (from -0.26 in February to -0.23 in May). At the same time the managers are rather more pessimistic than optimistic regarding the possibility of positive changes in the situation over the next 6 months. 27.6% of them think that the overall business climate will deteriorate and only 15.5% of the respondents expect the situation to improve. This is reflected in the value of the *Index of business expectations*, which is still negative (-0.08 vs. -0.11 in February), and applies to all industries, except - for the second quarter in a row - to construction materials where optimists exceed pessimists: 0.25 and 0.11. Non-negative index values were also recorded for the machinery building and light industries where optimists and pessimists balance each other (the respective values being close to zero).

Regulatory climate

The percentage of firms considering the regulatory climate to be a significant impediment to business development has decreased to 39.7% in May (from 44.2% in February). This is due to a decrease in all three components of this indicator — namely high regulatory burden, frequent changes in economic legislation and corruption (with 7.4, 7.4, and 4.1 points respectively). (See IMPEDIMENTS TO PRODUCTION). But it has to be mentioned that perceptions concerning the regulatory climate vary across size-groups. The number of large firms (more than 250 employees), which are unhappy about an "unfriendly regulatory climate", hasn't changed remaining at 50% for two quarters in a row. Among the small firms the importance of this impediment has increased (from 35.5% to 38.0%). In effect, its importance has decreased only for medium-sized firms (from 45.3% in February to 33.0% in May).



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Lending Climate

The indicators for the lending climate have slightly deteriorated, which applies to both short- and long-term loans.

Managers reported that the banks became less willing to provide short-term loans during the 1st quarter of 2004 compared to the 4th quarter of 2003 (48.0% vs. 57.2%). The affordability of short-term loans for enterprises also decreased: the share of firms considering short-term loans to be affordable dropped to 39.1% in the 1st quarter of 2004 from 45.4% in the 4th quarter of 2003.

A similar situation was noted for long-term loans with only one difference: the deterioration of the indicators for long-term loans was recorded for the second quarter in a row. The willingness of banks to provide long-term loans has decreased: the share of managers reporting banks to be willing to provide long-term loans has decreased from 53.5% (3rd quarter of 2003) to 40.4% (4th quarter of 2003), and finally to 33.2% (1st quarter of 2004). The affordability of long-term loans for enterprises has also declined: from 32.2% (4th quarter of 2003) to 21.3% (1st quarter of 2004).

Moreover according to the managers, interest rates have impeded production growth to a greater extent than in February. "High interest rate" has moved from 7th to 5th place in the list of impediments to production. Its absolute value has increased from 18.0% to 25.4% (see IMPEDIMENTS TO PRODUCTION).

PRODUCTION INDICATORS

As the managers had expected, business activity during the 1st quarter did slow down. But the 1st quarter 2004 slow down was less severe than that of the 1st quarter of 2003. The value of the *index of production* decreased relative to the 4th quarter but remained positive (0.11), indicating that the share of "increasing" enterprises exceeds that of "decreasing" firms by 11 points. The opposite had been noted at the beginning of 2003, when the share of "decreasing" enterprises had exceeded that of "increasing" ones by 15 points. This suggests with good probability that the industrial sector will grow more in 2004 than in 2003.

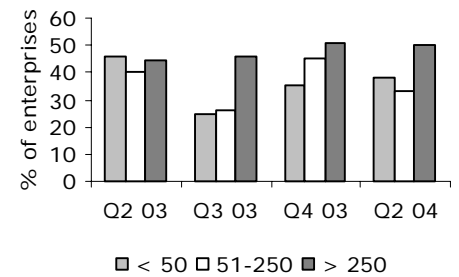
The highest value for the *index of production* was reported for wood processing (0.37), and the lowest one for light industries (-0.23). As usual the large companies (more than 1000 employees) experienced the most significant growth (0.37). For the second quarter in a row, the lowest index value was recorded for medium-sized firms (0.05). The index value for small firms is 0.12. The values of the *index of production* for private, privatised, and state-owned enterprises show no significant differences (0.12, 0.10 and 0.10 respectively).

Enterprises expect to increase production during the 2nd quarter. The *index of production expectations* is 0.44. 54.4% of the managers report that they expect growth in the volume of production and only 12.2% plan to cut the volume of output. The increase in value of the *index of production expectations* applies to all industries. An especially significant growth of the index was recorded for industries that are related to construction, such as construction materials (0.75) and wood processing (0.74). Large enterprises have the most optimistic production expectations (0.63). The production plans of small firms are positive but the lowest of all the size groups (0.29). Among ownership groups, state-owned firms have the most pessimistic production plans; their *index of production expectations* is 0.17. For privatised and private firms the respective index values are 0.48 and 0.44.

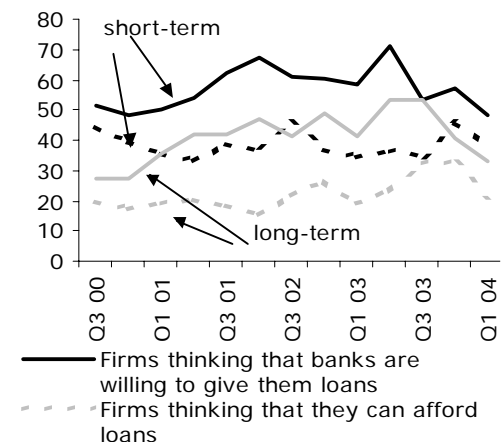
Demand, Sales, New Orders

The *index of sales* decreased from 0.33 to 0.12 confirming a seasonal slow down in business activity. Also, as our respondents had predicted at the end of 2003, the *index of domestic demand* decreased from 0.02 to -0.05. But the changes in the demand and in the production indicators demonstrate that the seasonal slow

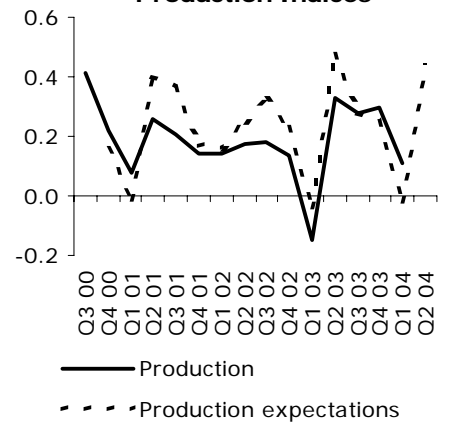
Unfriendly regulatory climate by size of firms



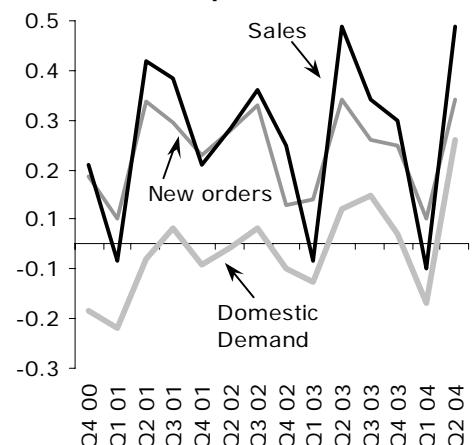
Affordability of Loans (in %)



Production Indices



Domestic demand: indices of expectations



down in business activity at the beginning of 2004 was less severe than in 2003. Thus, in contrast to the beginnings of previous years, the managers reported only a slow down in the increasing numbers for new orders. While the value of the *index of new orders* dropped from 0.32 to 0.23, it remains positive (the *index of new order* was close to zero for the same period of 2003). Also the share of managers perceiving the order stock to be low decreased from 70.2% (4th quarter of 2003) to 61.8% (1st quarter of 2004).

For the 2nd quarter of 2004, all demand indicators are predicted to increase. Demand expectations differ across the different industries. For the second quarter in a row the managers in the printing industry are the most pessimistic with respect of getting new orders during the next quarter (0.00), while the construction materials managers are the most optimistic (at 0.74).

Impediments to production¹

After the February decrease in the rate and in the absolute value of the impediment "excessive taxation" this item has returned its "traditional" first place in the list of impediments to production in May. This indicates that the managers' hopes for improvements deriving from the tax system reform have not come true. The second position in the list is occupied by the "low demand" impediment. The third one is "unfriendly regulatory climate".

Three impediments have increased in importance. Besides excessive taxation, the impediments "high interest rate" and "high competitive pressure" have gone up in importance.

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. Thus, the value of the capacity utilization index has decreased from 0.23 to 0.10. However, the managers plan to increase the capacity utilization in the 2nd quarter: the respective *index of expectations* equals 0.35. 46.6% of all enterprises have excess production capacities.

Inventories

The share of enterprises that consider their output stocks to be low increased from 30.2% in February to 48.2% in May. The *index of finished goods stock* decreased from -0.16 to -0.12. The negative index value indicates that more firms decreased rather than increased their stocks. This applied to all industries with the exceptions of the machine building and heavy industries. For the latter a positive index value was recorded for the second quarter in a row (0.08 in February and 0.19 in May). The most significant decrease in the stock of finished good was recorded for printing (-0.32).

During the 2nd quarter enterprises don't plan to increase their stocks of finished goods: the index of expectations is -0.24.

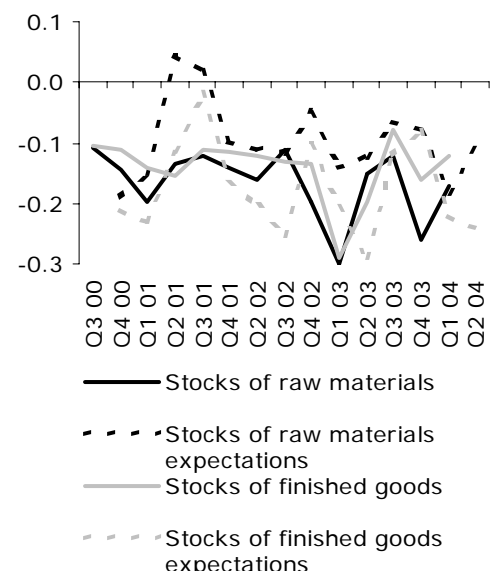
During the 1st quarter of 2004 the stock of raw materials decreased to a lesser extent than during the 4th quarter of 2003: the *index of raw material stocks* increased from -0.26 to -0.17. The lowest values of the index were recorded for the wood processing (-0.42) and food processing industries (-0.34).

The slowing tendency for raw material stocks to decline will continue during the 2nd quarter of 2004: the index of expectation is -0.11. The construction materials industry plans for the largest increase in

Impediments to production

	Q3 03	Q4 03	Q1 04	Q1 04 vs. Q4 03
Excessive taxation	53.7	42.1	59.4	17.3
Shortage of demand	53.0	61.2	56.9	-4.3
Unfriendly regulatory climate	32.0	44.2	39.7	-4.5
High regulatory burden	27.6	29.5	22.1	-7.4
Changes in economic legisl.	3.4	27.3	21.4	-7.4
Corruption	4.5	5.8	1.7	-4.1
High competitive pressure	27.2	32.0	35.9	3.9
Shortage of raw materials	29.9	24.8	21.7	-3.1
Outdated technology	16.4	23.0	22.8	-0.2
High interest rate	21.6	18.0	25.4	7.4
Shortage of skilled workforce	18.7	16.5	14.5	-2.0
Liquidity problems	11.9	10.4	10.0	-0.4
Access to credits	8.2	9.0	8.7	-0.3
Shortage of capacities	4.5	7.9	6.5	-1.4
Unstable political situation	13.8	6.8	3.6	-3.2
Problems with energy supply	3.7	3.2	1.8	-1.4

Inventories Indices



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.

raw material stocks: the index of expectation has a positive value (0.30).

Employment

No significant changes were recorded with respect to employment. In spite of a decrease in production the vast majority of firms kept their workforces at the levels of the previous quarter. The number of managers perceiving the workforce level to be satisfactory is 79.5%.

The share of managers planning to increase their labour force during the 2nd quarter of 2004 exceeds those planning reductions: the *index of expectations* is 0.04. The most active plans regarding hiring of workers are recorded for the wood processing, construction materials, and light industries.

The share of firms reporting workers on forced leave decreased from 11.8% in February to 6.1% in May. No change is expected for the 2nd quarter (the *index of forced leave expectations* is 0.00).

The problem of finding highly qualified workers continues to increase in importance. 74.5% of all managers reported increased problems with hiring skilled workers. Finding unskilled labour is less difficult: 16.2% of the managers noted that the process had become more difficult, 75.3% considered it unchanged, and 8.4% feel that hiring unskilled workers had become less difficult.

FINANCIAL PERFORMANCE INDICATORS

Prices

The rise in prices was much greater than managers had expected three months ago. Though in February only 47.8% of our respondents expected the input prices to grow during the following three months, 66.8% of all managers actually confirmed increased prices post fact in May. The *index of purchase prices* is 0.63. A similar situation has been recorded for sales prices: 28.4% of all managers expected price rises, but 39.2% confirmed actual rises three months later. The *index of sales prices* increased to 0.37 from 0.33.

For the 2nd quarter managers expect input as well as output prices to rise more slowly. 80.4% of respondents plan to keep their sales prices the same, 4.4% of managers forecast a decrease in sales prices and only 15.3% of respondents intend to increase prices. The *index of sales price expectations* went down to 0.13 from 0.25. The managers' forecasts for input price drops are less optimistic: almost 1/3 of all respondents still expect prices to grow. The *index of purchase price expectations* is now 0.26.

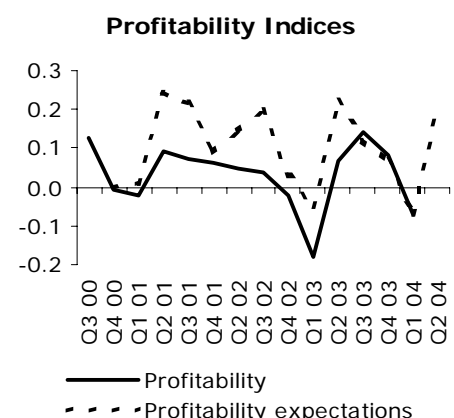
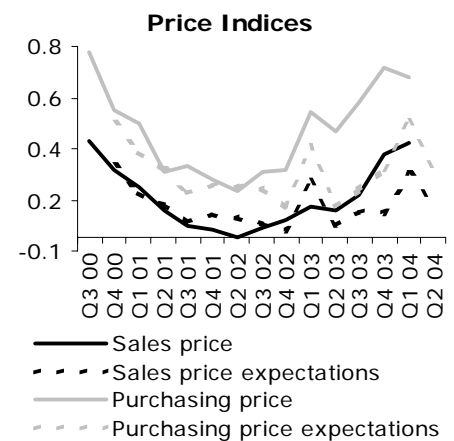
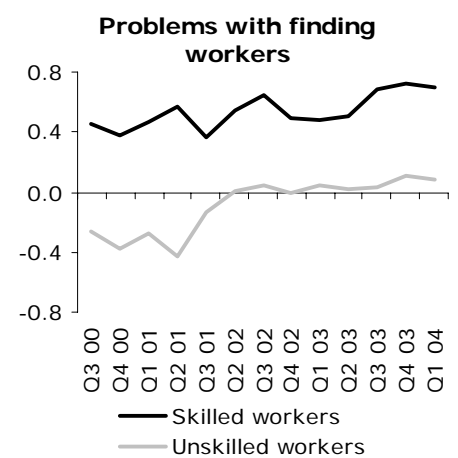
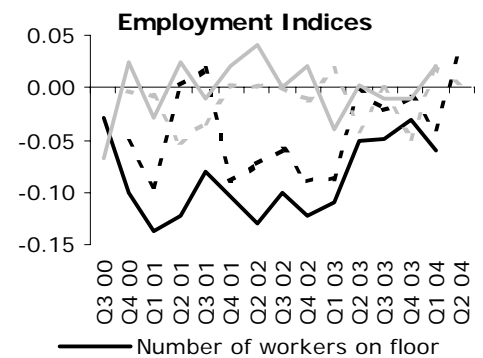
Profitability

As the managers had predicted, the *index of profitability* decreased from 0.08 in the 4th quarter of 2003 to -0.07 in the 1st quarter of 2004 due to a drop of the share of firms with increased profitability (from 32.3% to 19.4%), and an increased number of firms with poorer financial results (from 25.1% to 29.5%). Significant differences between industries were noted. The most significant profitability improvements were observed for wood processing (0.05), the worst financial results were reported for printing (-0.35).

Against the background of an expected increase in production during the 2nd quarter the managers forecast a raise in profitability, too. The value of the *index of profitability expectations* increased from -0.07 to 0.21.

Barter

The share of firms reporting using barter transactions continues to decrease. It dropped from 17.6% in the 4th quarter of 2003 to 10.8% in the 1st quarter of 2004. The *indices for barter* and *barter expectations* have negative values, suggesting a continued decline in barter operations (-0.06 and -0.07 respectively).



Arrears

As managers had expected, the decrease of inter-enterprise arrears has slowed during the 1st quarter of 2004. The *index of accounts receivable* has increased from -0.19 to 0.00 and the *index of account payable* has risen from -0.20 to -0.16. This happened because the number of firms reporting higher arrears increased and those with lesser arrears dropped. During the 2nd quarter the managers intend to attempt to further decrease their arrears.

The share of respondents that reported tax arrears didn't change significantly (16.2 in May vs. 17.2% in February). At the same time the share of respondents reporting wage arrears has increased from 15.8% to 19.4%. But in terms of changes of these two phenomena nothing significant was noted. Both indices are close to zero indicating little change compared to the previous quarter.

During the 2nd quarter 40.5% of those who have tax arrears expect no changes in tax arrear and 56.8% expect their arrears to decrease. At the same time the enterprises intend to be more active with respect to reducing wage arrears: 71.4% of them plan to decrease wage arrears.

COMPETITIVE PRESSURES²

According to the managers, competition became stronger. For the third quarter in a row the *index of competition pressure* from Ukrainian producers has increased. The *index* increased from 0.34 in February to 0.36 in May. As in the February survey, the highest competitive pressure was recorded by the food industry (+0.69), the lowest one for machine building (-0.17).

The *index of competitive pressures* from Russian / CIS producers also continued to increase slightly (from -0.57 in October to -0.52 in February, to -0.50 in May). In contrast the *index of pressure* from other foreign producers has dropped from -0.62 in February to -0.69 in May.

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.

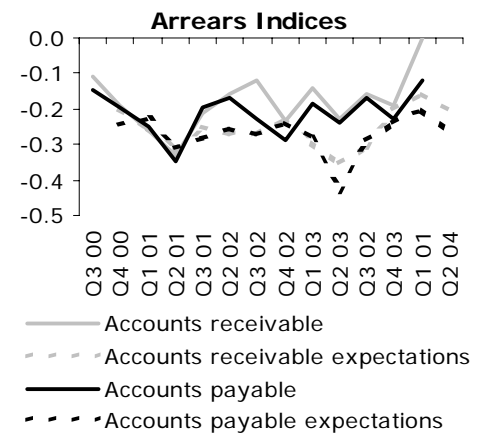
The industrial confidence indicator is defined as the arithmetic mean of the answers to the questions on production expectations, assessments of the order books and assessment of the stock of finished products (the latter with an inverted sign)³.

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

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, the chemical industry, metallurgy, and the fuel industry.



Index of competitive pressure from Ukrainian producers

Industry	Q3'03	Q4'03	Q1'04
Heavy	0.08	0.46	0.54
Machine build.	-0.26	-0.11	-0.17
Wood proc.	0.10	0.32	0.55
Construct. mat.	0.29	0.45	0.55
Light industry	0.28	0.50	0.28
Food processing	0.53	0.65	0.69
Printing	0.44	0.55	0.59

Appendix 2: Sample Characteristics

Number of employees, %	
	Q1'04
Fewer than 50	28.4
51 — 250	40.6
251 — 500	14.4
501 — 1000	9.7
Over 1000	6.8
Regions, %	
	Q1'04
Lviv	27.0
Kyiv	32.7
Kharkiv	32.4
Odessa	7.9
Industries, %	
	Q1'04
Heavy ⁴ industry	9.7
Machine building	27.7
Wood processing	7.2
Construction materials	7.2
Light industry	11.9
Food processing	25.3
Printing	8.3
Other	2.9