

Quarterly Enterprise Survey

No1 (3)
February 2003

- **Business climate expectations for the next 6 months have slightly improved.**
- **In the 1st quarter 2003, managers expect usual seasonal slowdown of business activity.**
- **Index of production expectation for the 1st quarter is close to zero.**
- **Positive production expectations of the previous quarter are not fulfilled again.**
- **Managers' perceptions of the regulatory environment quality remain low.**
- **Long-term credits are slowly becoming more accessible and affordable.**
- **Low demand, tax pressure, and regulations remain the main impediments to production growth.**
- **Indices of sales/purchasing price expectations have increased for the 1st quarter 2003.**

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 February 2003

Firms' performance: Q4'02 vs Q3'02

Firms' expectations: Q1'03 vs Q4'02

Business Climate: assessment for Feb'03, expectations for next 6 months

Indices of regulatory environment, assessment of current situation and changes over the last 12 months

GENERAL INDICATORS

Business climate

Although the values of business climate indices are still negative, two positive developments have been recorded:

- First, despite a dramatic drop in business expectation in October 2002, in the 4th quarter 2002 *index of current business situation* went down insignificantly (from -0.29 in Q3 02 to -0.33 in Q4 02).
- Second, in the 4th quarter 2002 *index of business expectations* has increased from -0.17 to -0.06. It happened mainly due to the shift of managers' assessments from neutral to positive (the share of managers with positive business expectations increased from 10.3% in Q3 02 to 20.6% in Q4 02), while the share of managers with negative expectations remained stable (27.5% and 28.1% respectively).

The increase in *indices of business climate* is observed across all industries, as well as all size- and ownership groups of enterprises.

Regulatory climate

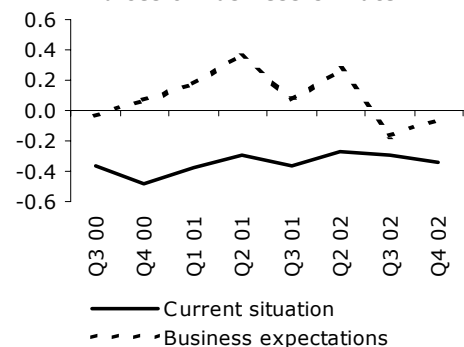
In the 4th quarter 2002, the share of firms that consider regulatory climate as a significant impediment to business development has increased to 38.8% (vs 30.5% in the 3rd quarter 2002).

In the list of impediments to production "unfriendly regulatory environment" still ranks third (see IMPEDIMENTS TO PRODUCTION).

Managers' perceptions of quality of regulatory environment are still low. The level of state interference in operational decisions of the firms constitutes the only exception: it has been decreasing over the last 12 months and presently is considered to be low (index value equals -0.50). The major drawbacks of current regulatory environment are related to:

- a high level of administrative corruption (50.6% of respondents perceive corruption to be high);
- complex and non-transparent regulations (55.4% of respondents);
- unpredictable changes in regulations (53.4% of respondents);
- low quality of governmental services (32.3% of respondents);
- insecurity of property rights (38.8% of managers believe that judicial system does not guarantee security of property rights);

Indices of Business Climate



Assessment of current level

	Kharkiv	Kyiv	Lviv	Odesa
Quality of government services	-0.20	-0.52	-0.25	-0.08
Level of corruption	0.31	0.67	0.35	0.47
Necessity of informal relations with public officials	-0.68	0.50	0.23	0.48
Security of property rights	-0.60	-0.50	-0.32	0.00
Predictability of changes in regulations	-0.44	-0.61	-0.45	-0.33
Simplicity and transparency of regulations	-0.43	-0.69	-0.52	-0.15

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	Changes during 2002				Assessment of current level			
	% of enterprises			Index	% of enterprises			Index
	Up	0	Down		High	Norm	Low	
Quality of government services	2.5	74.2	23.3	-0.21	1.1	66.7	32.3	-0.31
Possibility of the firms to influence the content of laws	12.4	79.3	8.3	0.05	17.9	36.6	45.5	-0.20
Level of corruption	40.0	57.9	2.1	0.32	50.6	44.8	4.6	0.38
Necessity of informal relations with public officials	26.7	71.0	2.3	0.23	32.8	37.4	29.4	0.03
Security of property rights	5.1	68.2	26.6	-0.20	2.2	59.0	38.8	-0.34
Predictability of changes in regulations	1.8	64.2	33.9	-0.29	3.4	43.3	53.4	-0.47
Simplicity and transparency of regulations	1.4	60.1	38.4	-0.36	3.2	41.4	55.4	-0.51
Time spent by the managers in dealing with public officials	20.6	75.7	3.7	0.17	21.8	60.5	17.7	0.05
Number of irregular State Tax Administration (STA) inspections	30.5	69.4	10.1	0.13	24.7	68.6	6.6	0.21
Number of irregular inspections (excluding STA)	17.6	77.9	4.5	0.14	22.1	73.7	4.2	0.19
Level of state interference in the operational decisions of the firm	5.3	66.3	28.4	-0.22	7.0	33.5	59.5	-0.50
Incentives for the firms to be involved in tax evasion	13.6	75.9	10.5	0.03	24.6	44.7	30.7	-0.01
Possibilities of the firms to evade taxes	3.7	74.5	21.8	-0.13	5.2	45.1	49.8	-0.33

24.6% of the respondents report high incentives to evade taxes. However, 49.8% of managers admit that possibilities of tax evasion are presently low.

Perceptions concerning the quality of regulatory environment vary across regions. In Kyiv they are worse than in the other regions.

Lending Climate

In the 4th quarter 2002, a positive development is observed with respect to long-term credits: the share of firms considering long-term loans to be affordable has gone up. At the same time, managers report that banks have become more willing to provide long-term loans.

Willingness of the banks to provide short-term loans has not changed, while affordability of short-term loans for the enterprises went down. However, in both cases the difference between the indicator of affordability of credits, on the one hand, and the indicator of bank's willingness to provide loan, on the other hand, is still significant indicating that the overall cost of loans are still considered to be high.

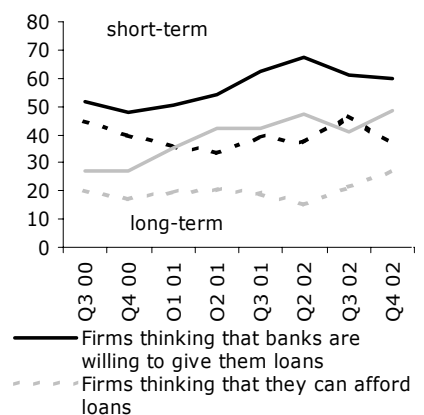
PRODUCTION INDICATORS

Index of production is positive (0.13), though lower than in the 3rd quarter (0.18) indicating usual seasonal slowdown of business activities. At the same time, it is alarming that the second quarter in a row the value of *index of production* is lower than expected by managers (October's *index of production expectations* was 0.23). The same phenomenon was observed in the previous quarter (see QES #2, 2002). This holds for all industries except for machine building and printing.

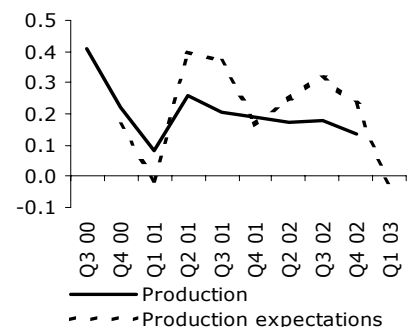
The value of *production index* varies by industries. The highest values are recorded for light industry (0.38) and machine building (0.36). The lowest value is observed in construction materials industry (-0.52).

Index of productions expectations for the 1st quarter of 2003 is close to zero (-0.06). The share of firms with positive as well as negative production expectations has gone down, while the share of firms that don't plan any changes in production volume has doubled

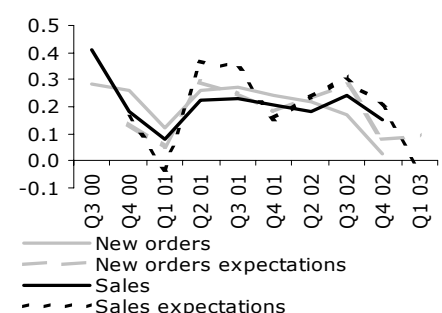
Affordability of Loans (in %)



Production Indices



Sales Indices, New Orders Indices



(50.2% vs 22.6).

The negative values of *index of production expectations* are recorded for all industries. Across the firms of different size, it is the group of large enterprises with more than 1000 employees, which is more optimistic concerning production plans. Respective index value is positive (0.28).

Demand, Sales, New Orders

In the 4th quarter 2002, *index of new orders* has not changed significantly and remained quite low (0.03). Moreover, 78.0% of enterprises consider the volume of new orders to be low. Low values of index are recorded in all industries except for construction materials, where it decreased significantly due to seasonal factors (-0,22).

For the 1st quarter 2003, *index of new orders expectations* is statistically close to zero (0.09) indicating seasonal sagging of business activity in the manufacturing sector.

Impediments to production¹.

The share of enterprises reporting different impediments to production has gone up across 11 indicators out of 13. At the same time, the rank of main impediments did not change significantly.

- As in the previous period, shortage of demand and excessive taxation are reported as impediments to production by more than 2/3 of respondents;
- More than 1/3 of respondents consider unfriendly regulatory climate, high competitive pressure and high interest rates as serious barriers of business development;
- 1/4 of respondents complain about outdated technology and shortage of input inventories;
- More than 1/10 of respondents report liquidity problems, bad access to credits, shortage of skilled workers, and unstable political situation;
- Problems with energy supply and shortage of capacities close the list of impediment to business development reported by less than 1/10 of respondents.

Capacity utilization

As usually the patterns of *capacity utilizations index* and the *capacity utilization expectations index* are similar to those of production and productions expectations indices (see above). The share of enterprises with excess capacities has increase by 13.6 percentage points (from 55.5% to 69.1%).

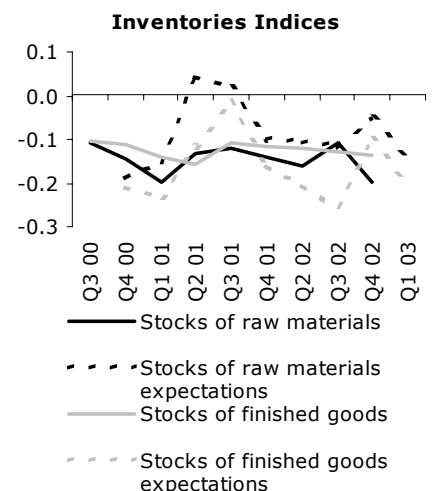
Inventories

Across all surveyed industries a reduction in stock of raw materials has been observed (index value is -0.20). The lowest values of *index of stock raw materials* are recorded for printing (-0.38), construction materials (-0.33), wood processing (-0.30) and food industries (-0.25). At the same time, the share of enterprises that consider stocks of inputs to be sufficient increased from 52.8% in October 2002 to 66.8% in February 2003. The majority of respondents (65.3%) do not plan significant changes in stock of inputs for the next quarter. The corresponding index equals -0.14.

In the 4th quarter, stocks of finished goods also continue to decline, which is reflected in a negative value of respective index (-0.13).

Impediments to production

	Q2 02	Q3 02	Q4 02	Q4'02 vs Q3'02
Shortage of demand	54.1	59.9	71.8	+11.9
Excessive taxation	65.5	59.9	71.5	+11.6
Unfriendly regulatory climate	30.7	30.5	38.8	+8.3
High regulatory burden		17.4	23.7	+6.3
Changes in economic legisl.		9.4	13.1	+3.7
Corruption		7.7	8.2	+0.5
High competitive pressure		26.8	38.1	+11.3
High interest rate	24.1	26.5	37.8	+11.3
Outdated technology	16.9	20.9	26.8	+5.9
Shortage of inventories	13.4	17.8	24.7	+6.9
Liquidity problems		9.4	17.5	+8.1
Access to credits		10.1	15.1	+5.0
Shortage of skilled workforce	16.6	14.3	13.7	-0.6
Unstable political situation	7.9	12.2	11.7	-0.5
Problems with energy supply	4.5	5.2	5.8	+0.6
Shortage of capacities	3.1	3.5	4.8	+1.3



¹ Since October 2002 the methodology of "unfriendly regulatory climate" rank calculation has been changed. In the questionnaire, instead of one general category three are 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 that have selected at least one of these three factors as impediment to production.

Index of stocks-of-finished-goods expectations is lower than in the pervious quarter and equals -0.21.

Employment

In the 4th quarter, the enterprises have continued to reduce the number of workers on floor (*index of employment* constitutes -0.12). This tendency seems to prevail also in the 1st quarter 2003 (*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 third quarter in a row (16,7%) *Index of forced leave* is 0.02. No significant changes are expected for the 1st quarter (*index of forced-leave-expectations* is 0.02).

The value of index of hiring highly qualified workers went down from 0.65 in October 2002 to 0.45 in February 2003, and the share of enterprises reporting difficulties in finding qualified personnel remained high (57.2%).

FINANCIAL PERFORMANCE INDICATORS

Prices

Similar to the previous period, in the 4th quarter price indices were positive. *Index of purchase prices* equaled 0.27, and *index of sales prices* was 0.07. However, in the 1st quarter managers expect a significant raise in sales and purchase prices. *Indices of purchase and sales prices expectations* constitute 0.36 and 0.22 respectively.

Profitability

The share of enterprises with the decreased profitability exceeds that with the increased profitability (31.1% and 26.9% respectively). *Profitability index* for the 4th quarter constitutes -0.02. No significant changes in profitability are expected in the next quarter. Managers are rather pessimistic in their profitability expectations: the corresponding *index* for the 1st quarter remains close to zero (-0.05). Majority of respondents do not expect any changes.

Barter

In the 4th quarter, the share of firms with barter transactions has not changed significantly compared to the 3rd quarter (28.2% vs 29.2%). *Indices for barter and barter expectations* have negative values indicating continuing decline in barter operations.

Arrears

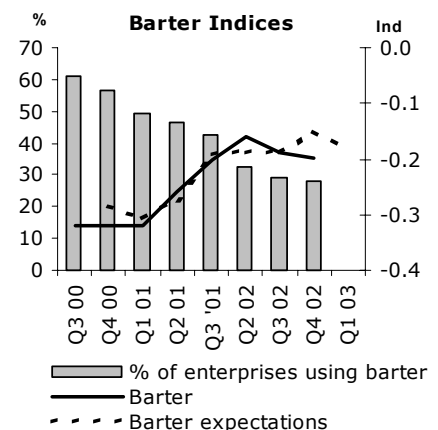
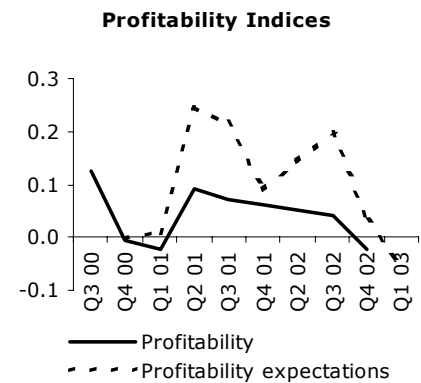
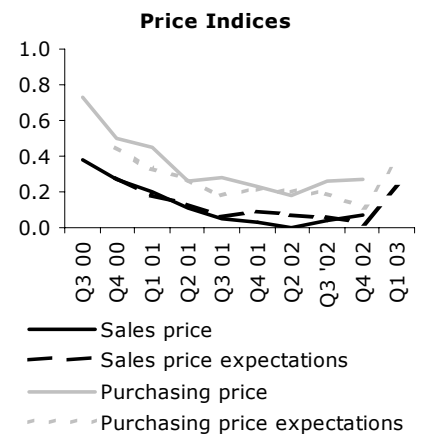
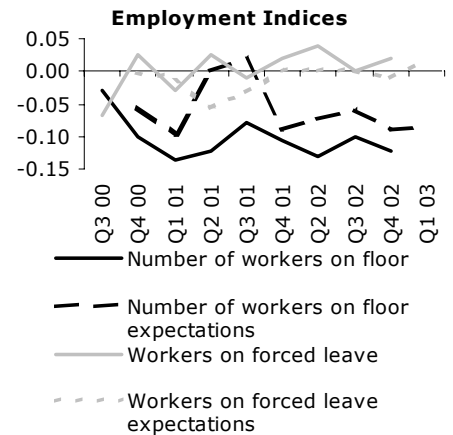
Inter-enterprises arrears continue to decrease. The *index of account payable* was -0.29 and the *index of account receivable* was -0.23. In the 3rd quarter, the respective indices were -0.23 and -0.12. Expectations for the 1st quarter indicate the continuation of this tendency.

In contrast, although the values of *wage and tax arrears indices* have negative signs, they are higher than in the previous quarter. It indicates a slowdown in rates of decline of tax and wage arrears. It seems that this tendency will continue in the next quarter.

COMPETITIVE PRESSURE

The firms report increase in the level of competitive pressure. The highest level of competitive pressure is reported with respect to the Ukrainian producers. It has gone up from 0.02 in October to 0.32² in February 2003. It varies across the enterprises of different size: the smaller the size of firms the higher competitive pressure they experience from the Ukrainian producers.

Competitive pressure from foreign producers is significantly lower. Though indices of competitive pressure from Russian/ CIS producers



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

as well as from other foreign producers are negative (-0.35 and -0.42 respectively), their values have increased compared to the previous period of observation (from -0.54 and -0.49 respectively).

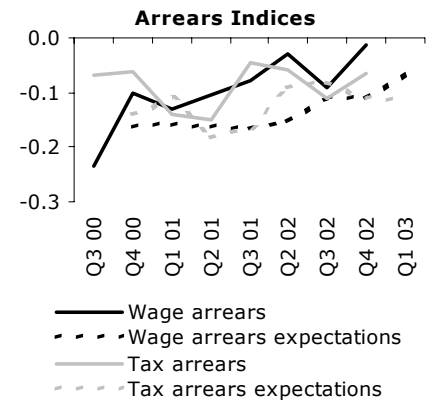
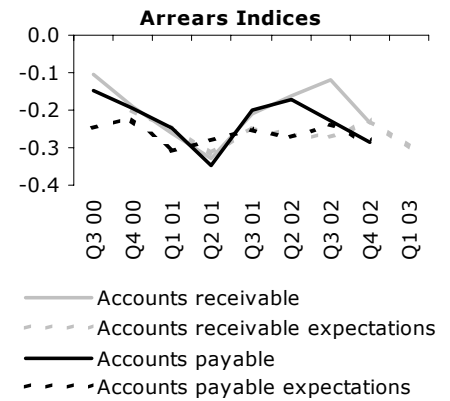
Appendix 1: Methodology

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 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.

Appendix 2: Sample Characteristics

Number of Employees, %		Industries, %	
	Q4'02		Q4'02
Less than 50	22.7	Heavy ³ industry	11.3
51 – 250	42.3	Machine building	25.4
251 – 500	15.1	Wood processing	7.9
501 – 1000	8.9	Construction materials	9.3
More than 1000	11.0	Light industry	12.0
Regions, %		Food processing	22.3
Lviv	25.8	Printing	8.2
Kyiv	34.0	Other	3.4
Kharkiv	30.9		
Odessa	9.3		



³ To the heavy industry sector the following sectors are included: energy, chemical industry, metallurgy, and fuel industry.