

Quarterly Enterprise Survey

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- **Managers expect business climate to improve within the next 6 months.**
- **Managers of the small firms are less optimistic than those of large firms.**
- **Shortage of finance, tax pressure, and low demand still form the three main impediments to production.**
- **For the first time since 1998, the unfavorable regulatory climate ranks 4th in the list of impediments to production.**
- **Arrears of all kinds are expected to decrease further in the 3rd quarter of 2002.**
- **Although the importance of high interest rate as impediment to production has declined, managers still perceive loans as being unaffordable.**

GENERAL INDICATORS

Business climate

Managers of the enterprises in this survey have optimistic expectations for future economic perspectives in the next 6 months: 41.6% expect the business climate to improve while only 15.1% believe that it will deteriorate. Compared to the 3rd quarter of 2001 (the last round of this survey) the *index of business climate expectations* has increased from 0.07 to 0.27. However, managers of small firms (in terms of employment) are less optimistic than those of large firms.

In contrast to such positive expectations, managers' evaluation of the current business climate remains negative. 36.3% of the respondents assess the current business conditions as "bad" while only 8 % think they are favorable.

Regulatory climate

An increasing share of managers perceives the regulatory climate as unfavorable. Since the 2nd quarter 2001, the share of the firms that consider unfavorable regulatory environment to be an important impediment to production has almost doubled and reached 30%. This somehow contradicts the dynamics of the *indexes for regulatory rules* and *accounting reports problems*, which have constantly dropped since 4th quarter of 2000. Obviously, these indicators do not entirely reflect managers' perceptions of the regulatory climate.

On a regional level, the firms in Kharkiv face the fewest problems with accounting reports and the smallest number of regulations (both indexes equal 0.18) while both, the *index of accounting reports problems* and the *index of regulatory rules* are the highest in Kyiv (0.29 and 0.52). For Lviv, the index levels are 0.28 and 0.29 while for Odesa they equal 0.15 and 0.23.

Lending Climate

In the view of the managers, during the 2nd quarter of 2002 the banks have become more willing to provide both, short- and long-terms loans. However, the share of the firms considering loans to be affordable remains quite low. In other words, although interest rates have dropped during the last year, the overall cost of loans is still considered to be too high.

Across the small firms, only 17.5% can afford short-term loans. At the same time, the respective share for the group of firms with 250-500 employees is 44.2% and even 79.2% for those with 501-1000 employees. Thus, the lack of affordable loans appears to be one of the reason for the pessimistic general expectations of managers of the small firms as reported above.

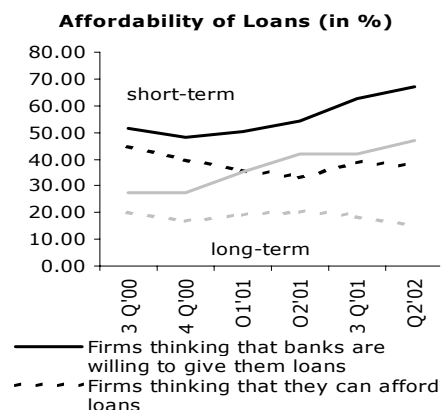
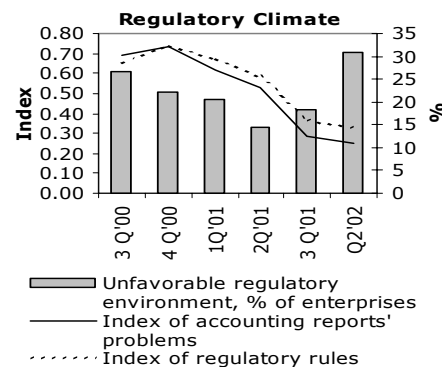
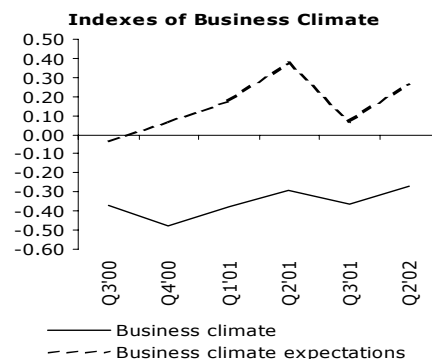
Quarterly Enterprise Survey was launched in January 1996. Since July 2002 the survey is done by the Institute of Economic Research and Policy Consulting.

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 July 2002

Firms' performance in the 2nd quarter of 2002, and

Business expectations for the 3^d quarter of 2002



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PRODUCTION INDICATORS

In the 2nd quarter of 2002, more firms have increased rather than decreased production. This has been reported across all sectors except for wood processing and printing. Thus, the positive level of the *production index* (0.15) indicates a continuous output growth in Ukrainian industry. Nevertheless, compared to the same quarter in 2001, the index has decreased, indicating a slowdown in growth rates.

For the 3rd quarter, the positive level of the *production expectation index* (0.28) reflects optimistic expectations of managers. However, the share of firms that expect an increase in production has remained unchanged so that the positive value is only caused by a smaller share of firms with negative expectations.

On a sectoral level, the expectations indexes have improved across all industries except for heavy industry and printing. Furthermore, managers of the large enterprises are more optimistic than those of the small firms.

Demand, Sales, New Orders

The enterprises received more new orders in the 2nd than in the 1st quarter. Thus the corresponding index is clearly positive (0.22). This is recorded for all sectors of industry except for printing (-0.24). In the next quarter, managers expect new orders to increase further (0.28) with the highest expectations in wood processing (0.57). This is consistent with a high level of the *sales expectations index* in the 3rd quarter (0.31).

Impediments to production

Shortage of finance, excessive taxation and the lack of orders/sales/demand have remained the three most frequently mentioned impediments to production. However, all three frequencies, in particular those of the last two, are below their levels of the 3rd quarter of 2001. Overall, frequencies of 8 out of 13 possible impediments have declined. This indicates a slight improvement in business climate.

"High interest rate" accounts for the largest decrease in frequency (-12.7 percentage points). This indicates a fall in the price of bank loans. Nevertheless, firms still perceive high interest rate as an important impediment to production. In particular, manufacturers of construction materials report this impediment more frequently than the others (36.0%).

16.6% of the managers still report a lack of skilled labor force. This problem is particularly acute for wood processing (30.4%) and machine building (23.3%).

20% of the firms consider strong competition with imported goods as a significant barrier to production. This frequency is particularly high for the light industry (45.5%).

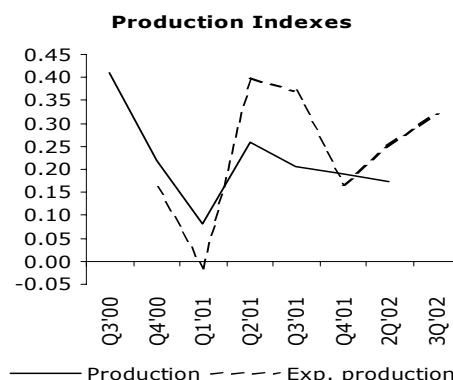
Capacity utilization

The pattern of the *capacity utilization index* and the *capacity utilization expectations index* is similar to the pattern of the *indexes of production* and *production expectations* (see above). The share of enterprises reporting excess capacities is still very high (60.9%).

Inventories

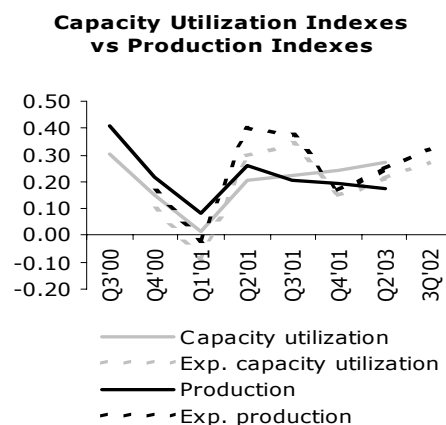
Managers report a reduction in stocks of raw materials. The corresponding index equals -0.16. This holds for all sectors except for manufacturers of construction materials, where also the highest value of production index is recorded for the 2nd quarter 2002. For the next quarter, managers expect this trend to continue so that the *expected stocks of raw materials* index is also negative (-0.12) with the only exemption of food processing firms (0.03).

The stocks of finished goods continue to decrease in the 2nd quarter 2002 and the index value is -0.12. In the 3rd quarter, a larger share



Impediments to production

	Q2'01	Q3'01	Q2'02	Q2'02 vs Q3'01
Shortage of finance	63.8	69.4	66.6	-1.8
Excessive taxation	63.6	74.6	65.5	-9.1
Shortage of demand	55.2	61.5	54.1	-7.4
Unfavorable regulatory environment	13.4	18.2	30.7	+12.5
High interest rate	31.0	36.8	24.1	-12.7
Strong competition with imported products	14.5	15.8	19.0	+3.2
Outdated technology	17.6	23.7	16.9	-6.8
Shortage of skilled workforce	10.3	11.7	16.6	+4.9
Shortage of input inventories	18.3	15.5	13.4	-2.1
Unstable political situation	7.9	8.9	7.9	-1.0
Problems with energy supply	4.5	11	4.5	-6.5
Shortage of capacities	2.4	1.4	3.1	+1.7
Nothing	2.8	4.8	7.9	+3.1



of firms expects a further reduction in the stocks of finished goods so that the corresponding *index of expectations* drops to -0.25. This again reflects managers' general optimism for the 3rd quarter of 2002.

Employment

In the 2nd quarter of 2002, the enterprises have reduced the number of workers on floor and increased the number of workers on forced leave. Notably, the latter happens significantly less frequently than a few years ago. Currently, only 28% of the firms in the sample report to have workers on forced leave while at the end of 1999 the same share was almost 66%.

The average period of forced leave is 1.9 months. However, 50% of all firms report a period of less than 2 weeks, and managers expect 32.4% of workers on forced leave to return on floor during the next 3 months. Thus, firms increasingly use forced leaves as a short-term adjustment measure to optimize production costs.

During the next quarter, the share of managers who plan to increase the number of workers on forced leave and those who plan to reduce it will be almost the same so that an increasing number of workers on forced leave is not expected.

At the same time, the enterprises continue to face problems with finding workers with appropriate qualifications. This has been constantly reported for the case of skilled workers. However, during the last quarter, for the first time since 1998 the share of firms that face problems finding even unskilled workers has also exceeded the share of those without such problems.

FINANCIAL PERFORMANCE INDICATORS

Prices

In the 2nd quarter of 2002, more managers face higher rather than lower purchasing prices. Thus, the *purchasing price index* is positive (0.18). For the 3rd quarter of this year 77.5% of all managers do not expect significant changes, so that the index of *purchasing price expectations* remains positive (0.19). This is recorded in all sectors of industry except for machine building (0.24) and light industry (0.25). Here, more managers expect purchase prices to grow.

In the 2nd quarter, 80.9% of the enterprises have not changed their sales prices, while only 10.1% of the respondents report higher and 9.0% lower prices. Thus, the *sales price index* equals 0. This holds for all sectors of industry. In food industry and wood processing, the *sales price index* is even negative (-0.15 and -0.04 respectively).

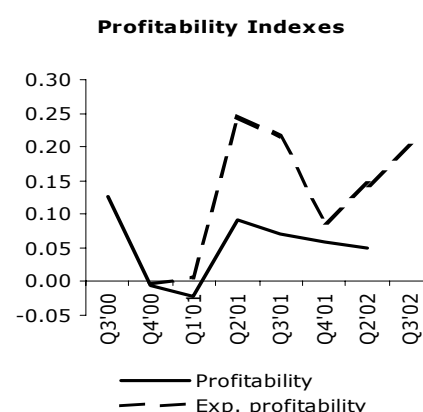
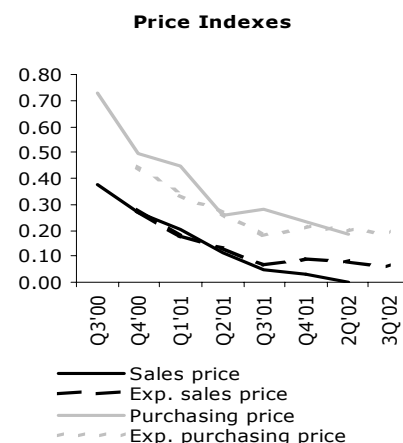
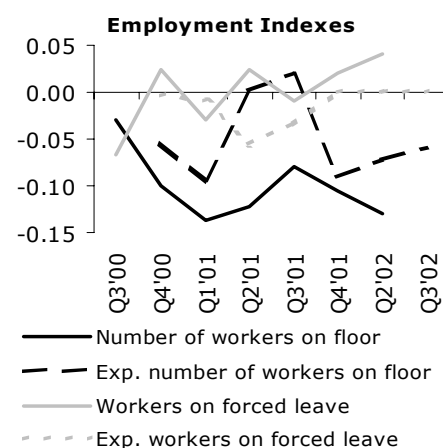
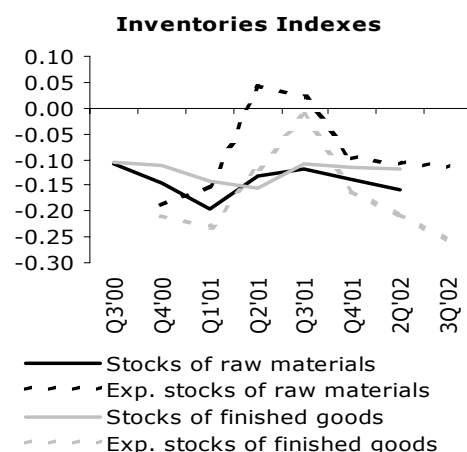
Managers expect stable sales prices for the 3rd quarter as well. While 87.8% of the firms do not plan any changes, only 8.7% expect sale prices to increase.

Profitability

Compared to the previous observation, the index of *profitability* is not increasing significantly. While almost one third of all managers report a decrease in profitability (27.9%), a slightly higher share observes an increase (33.8%) so that the overall index remains positive (0.06).

Managers' future expectations for profitability are more optimistic. Thus, in line with anticipated increases in production and sales the *profitability expectations index* for the 3rd quarter increases to 0.2.

The *profitability expectations index* varies significantly across firms of different size. However, unlike e.g. the *production expectations index*, the *profitability expectations index* does not increase with the firm's size. Instead, while the small firms with less than 50 employees record the lowest value (0.11), it is the medium-size firms with the workforce of 51-250 that score the highest index values (0.24), whereas the *profitability expectations index* for the





large firms with more than 500 employees is somewhat smaller (0.19).

Barter

Roughly one third (32.4%) of the enterprises have used barter transactions in the 2nd quarter of 2002, down from approximately 60% in 2000. For the 3rd quarter, 31.4% of the firms still plan to use barter. However, since an increasing share of managers expect to use less barter transactions the *Barter expectations index* goes down to -0.19.

Arrears

In the 2nd quarter arrears of all kinds continue to decrease. The average term of wage arrears decreases from 4 months in the 2nd quarter of 2001 to 3.2 months in the 2nd quarter of 2002. During the same period, the number of enterprises that report wage arrears decreases from 40% to 26.5%. The share of enterprises with tax arrears is 26.2%, down by 6% compared to the 2nd quarter of 2001.

In the 3rd quarter of 2002, managers expect all kinds of arrears to decrease further. For wage and tax arrears, this is due to both, a lower share of managers who plan to expand them, and an increasing share of those who plan to reduce them. For expected receivables and payables, only the share of managers who plan or expect a further increase goes down.

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.

Appendix 2: Sample Characteristics

Number of Employees, %		Industries, %	
	Q2'02		Q2'02
Less than 50	22.1	Heavy ¹ industry	11.7
51 – 250	43.8	Machine building	25.2
251 – 500	14.8	Wood processing	7.9
501 – 1000	9.0	Construction materials	8.6
More than 1000	10.3	Light industry	11.4
Regions, %			
Lviv	25.9	Food processing	23.4
Kyiv	34.1	Printing	8.6
Kharkiv	31.0	Other	3.1
Odessa	9.0		

¹ To the heavy industry sector the following sectors are included: energy, chemical industry, metallurgy, and fuel industry

