Quarterly Enterprise Survey

No2 (4)
June 2003

- **Managers do not expect any significant changes in the overall business climate for the next six months.**
- **Managers are very optimistic about growth in production output during the 2nd quarter.**
- **Managers continue to view the quality of the regulatory environment as very low.**
- **Loans are again becoming less accessible and affordable.**
- **Low demand, tax pressure, and regulations remain the main impediments to production growth.**
- **The financial situation of the firms is expected to improve**
- **The indices for sales/purchasing price expectations have decreased in the 2nd quarter 2003.**

A group of 300 manufacturing firms is used to monitor their managers' perceptions of changes in the business climate and company performance.

<u>In this issue: Results of a survey conducted in April/May 2003</u>

Firms' performance: Q1 03 vs. Q4 02

Firms' expectations: Q2 03 vs. Q1 03

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

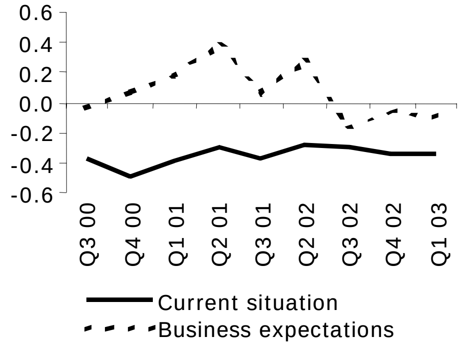
GENERAL INDICATORS

Business climate

The value of both indices remains without significant changes. Thus, *index of current situation* has the same value as in the previous quarter (-0.34), and value of *index of business expectations* continue to be close to zero (-0.08 vs -0.06 in February 2003). However, the composition of the *index of business expectations* has changed. The numbers of managers with negative and those with positive expectations have both decreased (from 28.1 to 21.1% and from 20.3 to 11.3%, respectively). At the same time, the share of managers expecting no change in the business climate has risen from 51.3 to 67.7%.

This tendency is observed across all industries, as well as all size and ownership groups of enterprises with the exception of firms with 501-1000 employees. Their business expectations are the most optimistic ones (with an index value of 0.17).

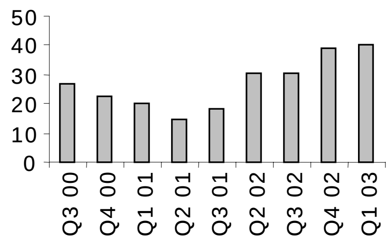
Indices of business climate



Regulatory climate

The share of firms that consider the regulatory climate to be a significant impediment to business development continued to increase during the 1st quarter 2003 (to 40.4% from 38.8% in 4th quarter 2002). This is mainly due to an increase in one of the three components of this indicator, namely the high regulatory burden (from 23.7% in the 4th quarter 2002 to 27.2% in the 1st quarter 2003). The other two components (corruption and stability/instability of the economic legislation) remained without significant changes (see IMPEDIMENTS TO PRODUCTION).

Unfavorable regulatory environment, % of enterprises

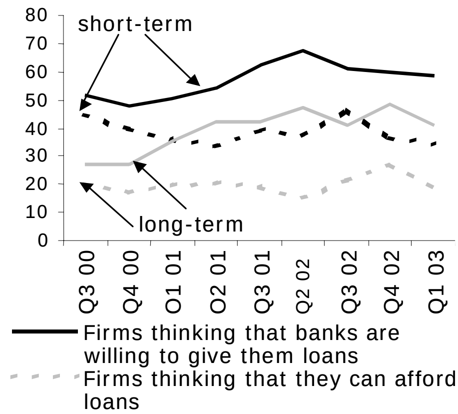


Lending Climate

In the 1st quarter 2003, the share of firms considering short and long term loans to be affordable has gone down (though, with respect to short term loans, the decline was rather insignificant). At the same time, managers report that banks have become less willing to provide both types of loans.

Importantly, the difference between the indicator of affordability of credits, on the one hand, and the indicator of the bank's willingness to provide loans, on the other hand, is still significant indicating that the overall cost of loans is still considered to be too high.

Affordability of Loans (in %)



PRODUCTION INDICATORS

More firms reported decreased production rather than increased production during the 1st quarter 2003. The *index of production* equals –0.15. This has been reported across all sectors except for the food industry. However, the index is affected by the firm's type of ownership. The value of the *index of production* for private firms is significantly higher than that of state enterprises (-0.05 and –0.21

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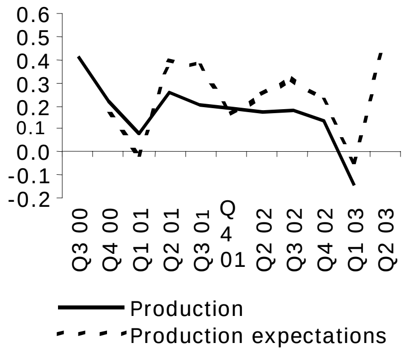
respectively).

After having been pessimistic about production expectations for the previous three quarters, the managers finally became optimistic in May 2003. The number of firms with positive expectations has gone up significantly, while fewer firms now have negative production expectations. Thus, about 2/3 of the enterprises hope to increase their production, and only about 1/10 of managers expect their production to decline. The *index of productions expectations* for the 2nd quarter of 2003 is 0.48: The highest value since the fall of 2000!

The sharp increase in the *index of production expectations* was recorded for all industries. The printing industry recorded the lowest index value (0.04). Based on company size, large enterprises with more than 1000 employees continue to be the most optimistic concerning production plans, with an index value of 0.70. Production expectations of state and privatised firms do not differ very much, while the expectations of private firms are significant higher.

Production Indices

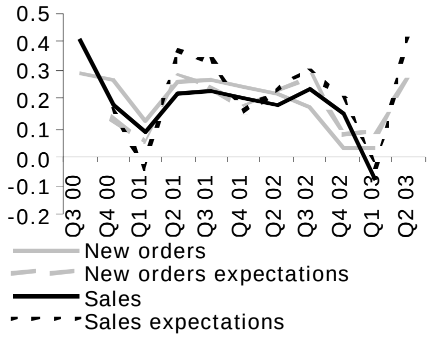


Demand, Sales, New Orders

The value of the *index of new orders* had declined in the 4th quarter 2002, and has remained at the same low level for the 1st quarter 2003 (0.03). However, the managers now assess the volume of new orders more optimistically. Thus, 36.7% of the managers consider the volume of new orders to be quite normal for this time of year, and 60.3% of respondents consider it to be low. For the 4th quarter 2002 the respective values were 21.3 and 78.0%.

For the 2nd quarter 2003, managers expect a growth in demand. The *index of new order expectations* is 0.29 indicating a seasonal up swing of business activity in the manufacturing sector.

Sales indices, new orders indices



Impediments to production[1]

The lack of orders/sales/demand, excessive taxation, and the unfriendly regulatory climate remained the three most frequently mentioned impediments to production. However, the frequencies for the first two impediments are lower compared to the 4th quarter 2002. Overall, the frequencies for 9 out of 13 possible impediments have declined. This indicates a slight improvement in the business climate, although the managers' direct assessments of the business climate did not change (see BUSINESS CLIMATE). At the same time, the frequencies for shortage of a skilled workforce, shortage of raw materials and for unfriendly regulatory climate have increased. This emphasizes that the regulatory climate - as a part of the overall business climate - continues to be an important impediment to business development.

Impediments to production

	Q3 02	Q4 02	Q1 03	Q1 03 vs. Q4 02
Shortage of demand	59.9	71.8	61.3	**-10.5**
Excessive taxation	59.9	71.5	58.9	**-12.6**
Unfriendly regulatory climate	30.5	38.8	40.4	**+1.6**
High regulatory burden	17.4	23.7	27.2	**+3.5**
Changes in economic legisl.	9.4	13.1	12.5	**-0.6**
Corruption	7.7	8.2	7.3	**-0.9**
High competitive pressure	26.8	38.1	35.9	**-2.2**
High interest rate	26.5	37.8	27.9	**-9.9**
Outdated technology	20.9	26.8	18.5	**-8.3**
Shortage of raw materials	17.8	24.7	26.1	**+1.4**
Liquidity problems	9.4	17.5	10.1	**-7.4**
Access to credits	10.1	15.1	10.1	**-5.0**
Shortage of skilled workforce	14.3	13.7	16.4	**+2.7**
Unstable political situation	12.2	11.7	11.1	**-0.6**
Problems with energy supply	5.2	5.8	5.9	**+0.1**
Shortage of capacities	3.5	4.8	3.1	**-1.7**

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). 49.1% of enterprises have excess production capacities.

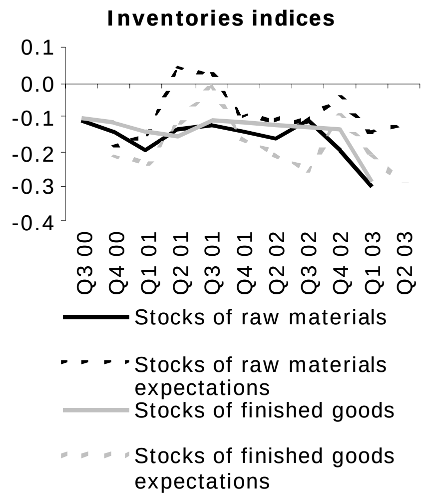
Inventories

Across all surveyed industries a reduction in the stock of raw materials has been observed (the index value is –0.30). The lowest value of the *index of raw material stocks* was recorded for the food industry (-0.42). At the same time, the share of enterprises that consider their stocks of inputs to be sufficient decreased from 66.8% in February 2003 to 50.9% in May 2003. About 2/3 of the

[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.

respondents (62.5%) do not plan significant changes to their input stocks for the next quarter. The corresponding index equals –0.12.

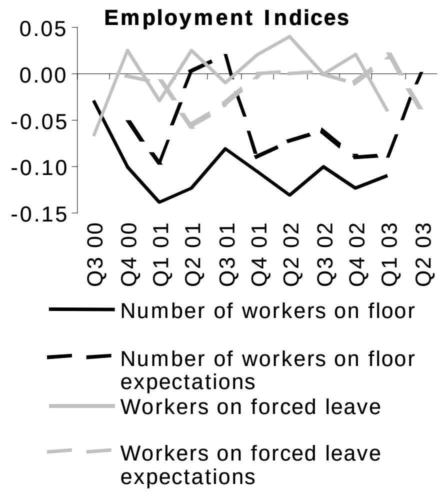
During the 1st quarter 2003, stocks of finished goods also continued to decline, which is reflected in the negative value of this index (-0.23). The *index of stocks of finished goods expectations* again dropped relative to the pervious quarter, now equalling -0.29.



Employment

In addition to the positive production expectations the employment tendency recorded is also encouraging. The tendency to reduce the workforce seems to slow down: During the 2nd quarter, the number of firms expecting to cut their workforce equals those with the opposite expectation (the value of the *index of expectations* equals zero). Also, the share of enterprises having workers on forced leave has decreased (from 16.7% in February to 9.8% in May). Moreover, the actual number of workers on forced leave has slightly decreased, as reflected in the negative value of the *index of forced leave* (–0.04). No significant changes are expected for the 2nd quarter (the *index of forced leave expectations* is also at –0.04).

The problem of hiring highly qualified workers continues to be acute. 51.6% of the managers report increasing difficulties with finding skilled workers. The value of the *index of hiring highly qualified workers* is 0.48. Finding unskilled labour is less difficult; the majority of respondents do not report any changes compared to the 4th quarter 2002. The respective index value is 0.04.

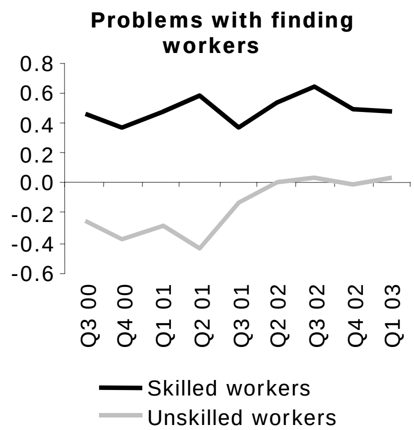


FINANCIAL PERFORMANCE INDICATORS

Prices

During the 1st quarter 2003, managers reported sharp rises in the prices for inputs - even higher than what they expected during the 4th quarter 2002. The prices for outputs also increased, though to a lesser extent than expected. The *index of purchase prices* equals 0.49, the *index of sales prices* 0.12.

These price growth tendencies seem to slow down during the 2nd quarter 2003. Managers expect prices to be more stable. The values of the indices for both purchase and sales price expectations have decreased. The *index of purchase price expectations* is 0.12, and the *index of sales prices expectations* 0.05.



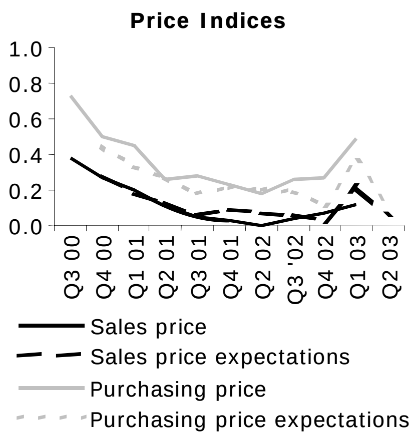
Profitability

The dynamic of profitability was worse than managers expected. The actual index value for the 1st quarter 2003 is –0.18, while the *index of expectations* for the same time period was 0.03. Only 18.2% of all enterprises have increased their profitability during the 1st quarter 2003.

However, the profitability expectations for the 2nd quarter 2003 are rather optimistic. Only 8% of all managers predict a decrease in the profitability of their firms. 29.9% of managers expect profitability to increase. As a result, the *index of profitability expectations* has reached quite a high value (0.22). It was in the 3rd quarter 2001, when a similar value was last recorded.

Barter

The number of firms using barter transactions has not changed significantly during the 1st quarter 2003 (27.9% vs. 28.2% during the 4th quarter 2002). The *indices for barter* and *barter expectations* have negative values, suggesting a continuing decline in barter operations.



Arrears

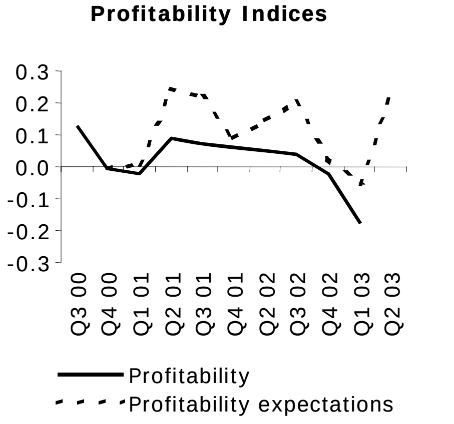
Inter-enterprise arrears continue to decrease, but more slowly than during the previous quarter. The *index of accounts payable* is –0.19, and the *index of accounts receivable* –0.14. For the 4th quarter 2002, the respective indices were –0.29 and –0.23. At the same time, expectations are improving for the 2nd quarter 2003. The *index of accounts payable expectations* is –0.43, the *index of accounts receivable expectations* equals –0.35.

By contrast, the values of the *wage and tax arrears indices* are nearly the same as in the previous quarter. This indicates a continued decline in tax and wage arrears. It seems that this tendency will continue during the 2nd quarter.

COMPETITIVE PRESSURES[2]

Overall, the firms report a decrease in the level of competitive pressures. The highest level of competitive pressure is reported with respect to Ukrainian producers. It went down from 0.32 in February to 0.16 in May 2003.

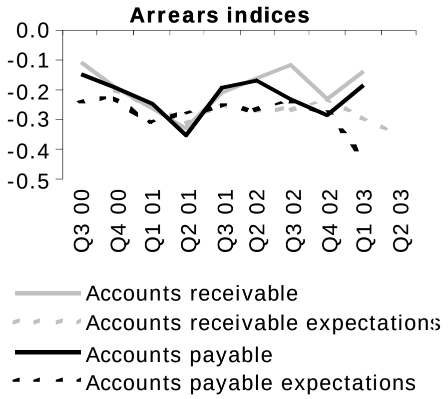
Competitive pressures from foreign producers are lower. Indices of competitive pressures from Russian/ CIS producers and from other foreign producers are negative (–0.42 and –0.67 respectively); their values have decreased compared to the previous period of observation (from –0.35 and –0.42 respectively).



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 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 kuziakiv@ier.kiev.ua.

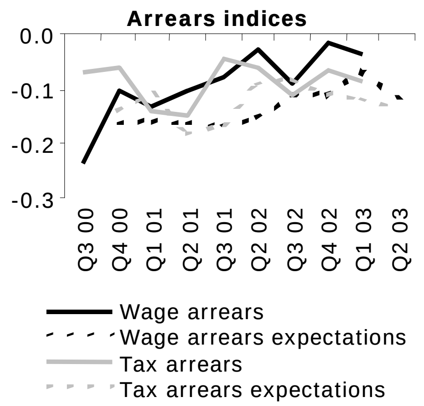


Appendix 2: Sample Characteristics

Number of employees, %	Q1'03
Fewer than 50	22.3
51 — 250	41.8
251 — 500	17.4
501 — 1000	9.1
Over 1000	9.4

Regions, %	
Lviv	26.1
Kyiv	34.1
Kharkiv	31.9
Odessa	8.4

Industries, %	Q1'03
Heavy[3] industry	10.1
Machine building	25.8
Wood processing	7.3
Construction materials	8.7
Light industry	12.5
Food processing	23.7
Printing	8.7
Other	3.1



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