

Quarterly Enterprise Survey

№ 4 (26)
December 2008

- The *Industrial Confidence Indicator* decreased from -0.05 in August to -0.27 in November.
- The value of the *Index of business expectations* dropped significantly and amounts to -0.54 in this quarter.
- The share of firms considering the regulatory climate to be a significant impediment to business development has decreased.
- According to respondents, both loan offer and demand are decreasing.
- Managers predict the decrease of production output during the next three months.
- Respondents predict production demand decrease in the next quarter and cut down their production plans.
- Unstable political situation has moved to the top of the list of impediments to production along with low demand and tax pressure.
- Managers indicate that raw material prices and sales prices have increased while in the 1st quarter slow down of prices' growth are expected.

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 from October 27 to November 18, 2008

Firms' performance: Q3 08 vs. Q2 08

Firms' expectations: Q4 08 vs. Q3 08

Business climate: Assessment for November 08, expectations for the next 6 months

GENERAL INDICATORS

Industrial confidence indicator

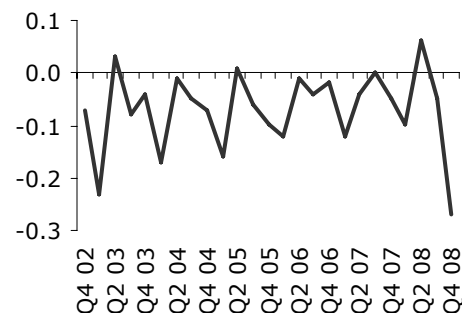
The *Industrial Confidence Indicator* decreased from -0.05 for the 3rd quarter of 2008 to -0.27 for the 4th quarter which is the lowest value since 2003. Just as in the previous quarter the indicator decrease is essentially due to deteriorating production plans for the next three months (see PRODUCTION INDICATORS). However, the other two components of the indicator (production expectations and assessment of the stock of finished goods) have also significantly decreased. The assessment of the volume of present orders has worsened: from -0.64 for the 3rd quarter to -0.72 for the 4th quarter. As to the third component of the indicator – the stock of finished goods – after its increase in the previous quarter it has decreased again to the 2007 level and amounts to -0.29 .

Business climate

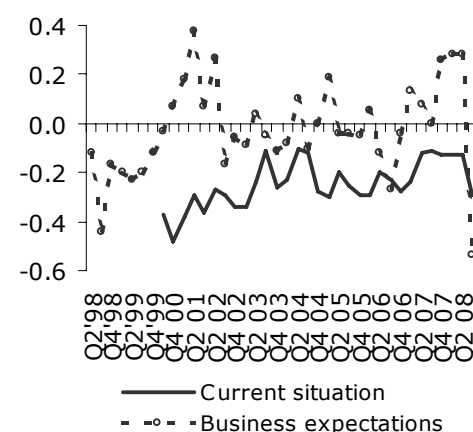
The *index of the current situation*, which reflects the managers' assessments of the overall economic situation, compared to the 2nd quarter, has decreased by more than half, and amounts to -0.29 . The index is depended from the industry branch and varies from region to region. Thus, while the index for Kharkiv and Kyiv enterprises amounts to -0.22 , almost all Khmelnytsky enterprises assessed the economic situation in the country as negative: the index amounts to -0.92 . Moreover, the index is lower for the enterprises of light, heavy and wood processing industries (-0.4 , -0.39 and -0.5 respectively).

The value of *Index of business expectations* in the 3rd quarter of 2008 is the lowest since 10 years and amounts to -0.54 . 38% of enterprises have given a pessimistic forecast of the overall economic situation during the next six months and only 3% of enterprises were optimistic, while 22% of respondents complain about impossibility to provide with such forecast for such long period. Like the *index of the current situation* the value of the *index of business expectations* varies from region to region in which the enterprise is situated. Managers of Kyiv and Lviv enterprises are the least optimistic (the index amounts to -0.66 and -0.63 respectively), while managers of Kharkiv enterprises, although having the highest index value (which still is low: -0.39), have mainly reported that the situation would not change in the nearest future.

Survey based Industrial Confidence Indicator



Indices of Overall Business Climate



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Regulatory climate

The share of firms that consider the regulatory climate to be a significant impediment to business development decreased to 30.4% in the 2nd quarter and to 23.1% in the 3rd quarter bringing the value of the *indicator "unfriendly regulatory climate"* to the level of the end of 2007. The decrease of the index value is due to changes in values of its components. Thus, the share of enterprises pointing to hard regulatory burden, corruption and frequent changes in legislation as an impediment to production growth decreased compared to the 2nd quarter from 23.8% to 14.9%, from 9.4% to 8.1%, and from 2.2% to 1.8% respectively.

Assessment of the Ukrainian government's economic policy

The average mark that is given by respondents to the government policy in the 3rd quarter (according to five grades scale) is 2.2, which is slightly lower than during last two quarters (when the mark was 2.4 - 2.8). At the same time, the share of respondents who hesitated with formulating their opinions remains considerable: 33% of respondents chose the option "difficult to answer" or didn't answer the question, which is, however, 15% less than in the 2nd quarter of 2008. So, the level of certainty of respondents as to the government policy assessment has been constantly growing during three quarters.

As usual, government policy assessment proved to be variable from region to region in which an enterprise is situated. Almost all respondents from Lviv, Kharkiv and Khmelnytsky gave a negative assessment of the government's policy (marks close to 1, 1.2).

Lending Climate

The difference between the banks' willingness to provide loans and the enterprises' ability to afford them was growing again in the 3rd quarter while all the indicators dropped to the level of the end of 2004 – beginning of 2005. At the same, time the volume of loan offer and demand has sharply decreased. The share of firms pointing to banks' willingness to provide both short-term and long-term loans to such enterprises as theirs has decreased from 82.9% in the 2nd quarter to 50.3% and from 75.5% to 38.7%. Managers' assessment of the affordability of loans has significantly changed. The willingness to take short-term and long-term loans was expressed by respectively 25.7% (45% in the 2nd quarter) and by 16.8% of respondents (36.5% in the 2nd quarter).

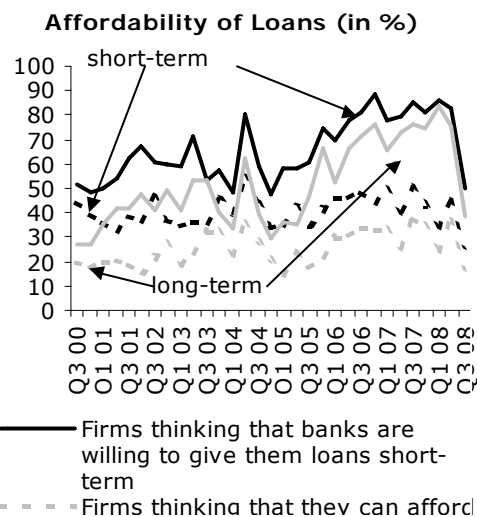
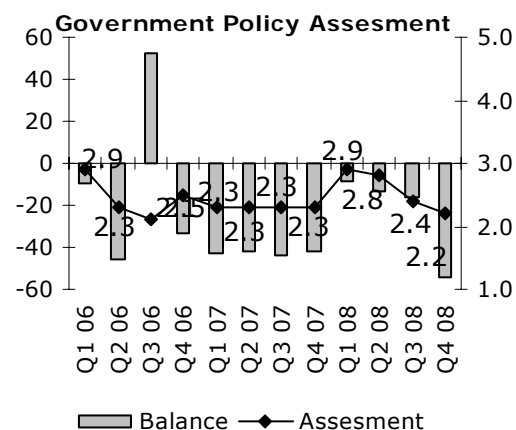
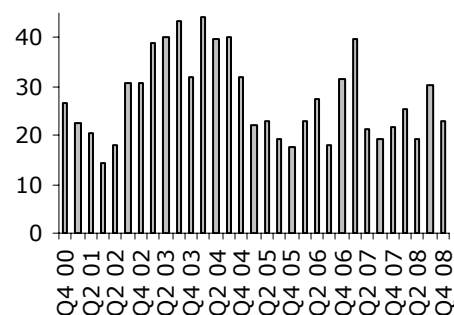
PRODUCTION INDICATORS

In the 3rd quarter it became clear that there had been no significant changes in production output during last three months. It doesn't, however, match the forecast given by managers in the previous quarter, for the majority of enterprises were expecting for production growth. The value of the *index of production*, compared to the 2nd quarter, dropped from 0.36 to 0.11. However, it should be taken into account that the assessment of production changes that have been reported, compared to the 2nd quarter, depends on the industry branch, the region and the size of an enterprise.

While the respondents from Kyiv and Kyiv region enterprises reported the production growth (index amounts to 0.47), many managers from Lviv and Khmelnytsky pointed to its decline (-0.32 and -0.54).

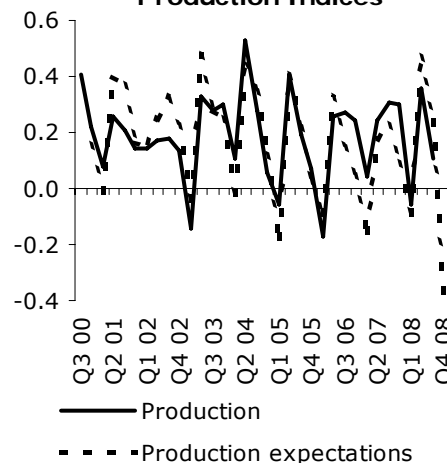
The highest value of the index was recorded for food industry enterprises (0.4) and the lowest - for light industry enterprises (-0.24). As in the previous quarter managers of large enterprises (501-1000 workers) give higher assessment of changes in production activities (0.68) than respondents from small and medium size enterprises (0 and 0.22 respectively). As in the previous quarter the index of production for the enterprises situated in regional centers is three times higher than for those situated in the regions.

Unfriendly regulatory environment, % of enterprises



— Firms thinking that banks are willing to give them loans short-term
 - - - Firms thinking that they can afford

Production Indices



The *index of production expectations* for the next quarter is - 0.38, which reflects a significant deterioration of production plans, compared to the 2nd quarter. In fact, every second enterprise in the selection has plans to reduce production output in the next quarter. Such a tendency is observed throughout all enterprises regardless of their parameters: the share of those reducing production plans is prevailing everywhere over those planning to increase production activities.

Demand, Sales, New Orders

The *index of domestic demand* equals zero that means no significant changes of demand have occurred since last three months. However, the index value, compared to the last quarter, dropped significantly (0.24 in the 2nd quarter). Managers predict a decrease in demand in the next quarter (46% of respondents pointed to that).

The value of the *index of new order expectations* is -0.38.

Sales will decrease accordingly. While, according to respondents, the volume of sales didn't change significantly in the 3rd quarter (sales index is 0.1 while the *index of sale expectations* in the previous quarter was 0.21), managers predict its decrease in the next quarter: the *index of sale expectations* is -0.38.

Same assessments apply to the evolution of the *index of new orders*. The value of the *index of new orders* in the 3rd quarter equals to zero and enterprises expect the order books to decrease during the next quarter. 48% of respondents believe that the volume of new orders will remain at the same level in the 4th quarter and 38% predict its decrease. The index of new order expectations is -0.28.

IMPEDIMENTS TO PRODUCTION¹

The lack of demand, excessive taxation and high competition were usually mentioned as the three most impediments to production. Survey results carried out in October-November of 2008 registered a significant change in the list of impediments. Though the lack of demand remains at the top of the list, it is for the first time that unstable political situation moved to the second position. Yet the importance of this impediment increased in 7 times (from 7.2% to 46.6%). Excessive taxation ranks third in the list (43.9%). The share of respondents considering liquidity problems as an impediment increased from 18.2% to 42.1%. Enterprises also point to loans affordability getting more complicated.

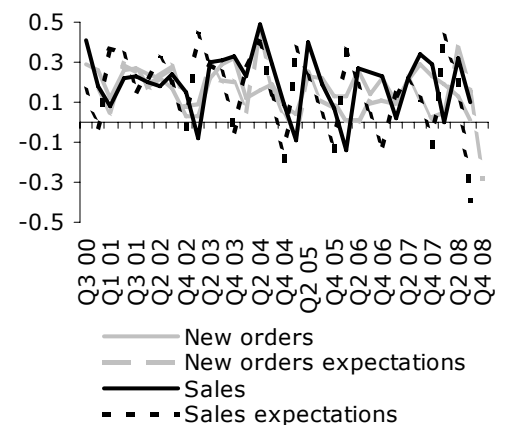
With worsening political situation, lack of demand, liquidity problems and lesser loan affordability, the importance of other impediments decreases. It should be noted that the importance of impediment "lack of qualified workforce" decreased almost by half. It is another evidence that the economic crisis is deepening fast in the real sector.

Employment

The *index of employment*, as in the 2nd quarter, equals to zero. 70% of respondents perceive the level of the index "number of employees involved in all operations of an enterprise" as satisfactory and 53% of managers don't predict any changes during the next three months.

The value of the *index of employment expectations* is -0.35 that reflects the trend to massive staff reduction at enterprises. Moreover, the index doesn't follow changes in various parameters of enterprises (size, industry branch, region, etc.).

Sales Indices, New Orders Indices



Impediments to production

	Q1 08	Q2 08	Q3 08	Q3 08 vs. Q2 08
Shortage of demand	55.8	59.7	71.9	+12.2
Unstable political situation	11.7	7.2	46.6	+39.4
Excessive taxation	46.2	55.2	43.9	-11.3
Liquidity problems	26.4	18.2	42.1	+23.9
High competitive pressure	32.0	42.5	29.0	-13.5
Shortage of raw materials	37.1	31.5	28.1	-3.4
Unfriendly regulatory climate	19.3	30.4	23.1	-7.3
High regulatory burden	16.8	23.8	14.9	-8.9
Corruption	1.0	9.4	8.1	-1.3
Changes in economic legist.	2.5	2.2	1.8	-0.4
Access to credits	7.1	17.7	22.2	+4.5
High interest rate	19.8	37.0	18.1	-18.9
Shortage of skilled workforce	25.4	34.8	17.6	-17.2
Problems with energy supply	17.8	9.4	8.1	-1.3
Outdated technology	7.6	16.0	5.9	-10.1
Shortage of capacities	3.6	5.0	5.4	+0.4

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 *index of hiring highly qualified workers* continued its gradual decrease for the third quarter running. In the 3rd quarter the index is 0.67 (0.72 in the 2nd quarter). However, such a value is perceived as rather high and illustrates difficulties in hiring an employee of the very qualification needed for the enterprise. In particular, 67.7% of respondents indicated that hiring qualified workers had become harder in the 3rd quarter, while only 1% of respondents noticed it was easier.

According to respondents, there are fewer difficulties in hiring unskilled workers. The value of respective index decreased in the 3rd quarter from 0.26 to 0.17. The majority of managers inquired (72%) believe there were no significant changes in hiring unskilled workers during the last quarter.

FINANCIAL PERFORMANCE INDICATORS

Prices

In the 3rd quarter prices of raw materials and finished goods, according to respondent's assessments, continued to increase, although at a lower pace than in the previous period. Compared to the 2nd quarter, the *index of raw materials prices* dropped from 0.91 to 0.62, while the *index of sale prices* decreased from 0.65 to 0.45.

In the 4th quarter managers expect further slowing down of prices growth rate, both for sales prices and raw materials prices. For raw materials prices the *index of expectations* for the 4th quarter is 0.34 and the *index of purchase price expectations* is 0.45.

Profitability

In the 3rd quarter the *index of profitability* dropped sharply from 0.11 to -0.11, which illustrates a bigger share of enterprises whose financial results worsened than those whose financial results improved.

24.1% of respondents reported the improvement of financial results. 37.7% of enterprises didn't register any change and 38.2% of managers reported worsening of financial results.

The negative value of the *index of profitability* is observed throughout all branches of industry, except food and printing industries. The most significant decline compared to the previous quarter was observed in woodworking industry (-0.42) and construction materials enterprises (-0.29).

In the 4th quarter managers predict a significant deterioration of financial results of their enterprises activities. The *index of profitability expectations* is -0.38.

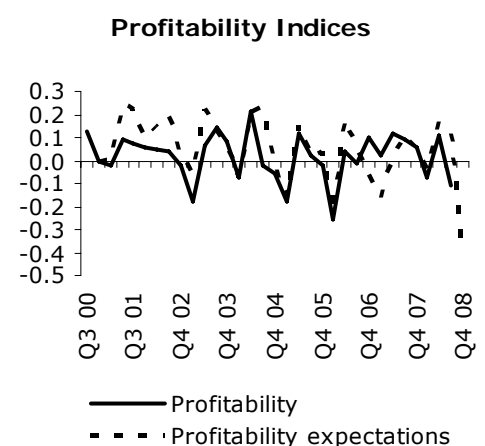
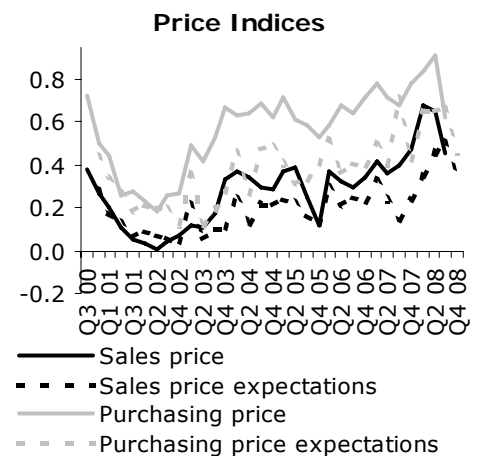
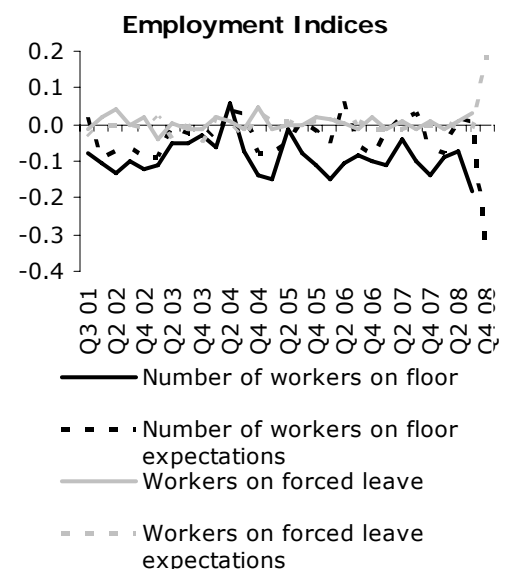
COMPETITIVE PRESSURES²

Firms report a moderate level of competitive pressures from Ukrainian producers during last three months. The value of the *index of competitive pressures* has been equal to zero during three quarters.

The *index of competitive pressures* from CIS producers is lesser than in the previous quarter and amounts to -0.68 (-0.51 in the 2nd quarter), which illustrates slackening of competition from that direction.

Regarding the *index of pressure* from other foreign producers its value has slightly decreased compared to the 2nd quarter and amounts to -0.69 (-0.60 in the previous quarter).

Thus, the main competitors for Ukrainian enterprises, according to their managers, are domestic producers: 31.3% of respondents perceive the level of competitive pressures from their side as high.



Index of competitive pressure from Ukrainian producers

Industry	Q2'08	Q3'08
Heavy	0.30	0.42
Machine build.	-0.58	-0.41
Wood proc.	0.00	-0.25
Construct. mat.	0.09	0.06
Light industry	0.17	-0.16
Food processing	0.42	0.26
Printing	-0.44	0.20

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.

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).

Size classification of enterprises is based on the number of workers. We sort out the following size groups of enterprises: small (up to 50 workers), medium (51-200 workers), large medium (251-500 workers), large (501-1000 workers) and largest (over 1000 workers). In certain cases, if there are no significant differences among groups, the latter three groups are classified as large-size enterprises.

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

Number of employees, %	
	Q3'08
Fewer than 50	29.3
51 – 250	41.3
251 – 500	14.1
501 – 1000	8.7
Over 1000	6.5

Regions, %	
Lviv	27.2
Kyiv	30.8
Kharkiv	32.6
Odessa	9.4

Industries, %	
	Q3'08
Heavy ⁴ industry	9.4
Machine building	27.5
Wood processing	6.9
Construction materials	7.2
Light industry	12.0
Food processing	25.7
Printing	8.3
Other	2.9

³ The heavy industry sector includes energy, chemicals, metallurgy, and fuel.