Quarterly Enterprise Survey

№ 1 (27)
March 2009

- **The Industrial Confidence Indicator decreased from -0.27 in November to -0.39 in February, 2009**
- **The second quarter in succession, most managers expect the deterioration of the overall economic situation in the next 6 months; however, the number of those expecting positive change increased from 4.2% to 10.6%.**
- **The tendency of the reduction of the volume of bank offers loans and demand for them continued in the 4th quarter.**
- **The vast majority of managers (68.0%) expect further reductions in production volumes over the next three months.**
- **The number of enterprises that have no stock of orders grew from 10.2% in August to 42.1% in February.**
- **Managers expect continued decline in the number of new orders in the 1st quarter.**
- **A significant reduction of employment on enterprises can be observed in the 4th quarter. Managers expect the trend to continue in the 1st quarter.**
- **Managers of enterprises expect that rates of growth in raw materials prices and sales prices will not change in the 1st quarter compared to the previous quarter.**

A panel of 300 manufacturing enterprises is used to monitor their managers' perceptions and expectations towards changes in general business climate and towards the indicators of company performance.

This issue presents the results of the survey conducted from January 26 to February 20, 2009

Performance: Q4' 08 vs. Q3' 08

Expectations: Q1' 09 vs. Q4' 08

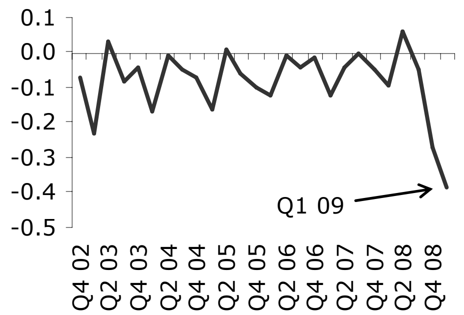
Business climate: Assessment for February 09, expectations for the next 6 months

GENERAL INDICATORS

Industrial confidence indicator

The *Industrial Confidence Indicator* decreased from -0.27 in the 4th quarter to -0.39 in the 1st quarter of 2009. It happened because of the significant deterioration of the production plans of the enterprises for the next 3 months (see PRODUCTION INDICATORS). The impact of this component was stronger than the influence of two other components of the *Industrial Confidence Indicator*. Specifically, the value of the component "the stock of finished goods" increased significantly (from -0.29 in the 4th quarter to -0.19 in the 1st), and the assessment of the volume of present orders deteriorated (from -0.72 to -0.79). Thus, these negative trends have resulted in reducing of the value of the total *industrial confidence indicator*.

Survey based Industrial Confidence Indicator

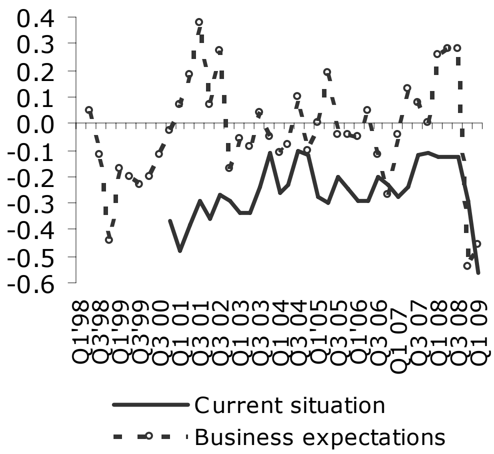


Business climate

The managers' assessment of the current overall economic situation worsened considerably: the value of the *index of the current situation* decreased from -0.29 to -0.56. It happened due to the growth of the share of polled managers who assess the business climate as poor one (from 39.5% in November to 60.6% in February). In addition, the share of those who consider the climate to be satisfactory has decreased (from 53.5% to 35.6%). The share of those who estimate it favorably has diminished from 7.0% to 3.8%. This is typical for enterprises of all industries, ownerships and sizes. Besides, the smaller the enterprise, the worse are the estimations of business climate.

Furthermore, the value of the *index of business expectations* increased slightly from -0.54 in November to -0.46 in February. It happened due to the growth of the share of the polled managers who anticipate positive changes (from 4.2% in November to 10.6% in February). At the same time, the percentage of those who expect neither positive, nor negative changes has slightly decreased (from 37.8% to 31.1%). Two quarters in a row the majority of polled managers (58.0% in November and 58.3% in February) expect the worsening of overall economic situation over the next six months.

Indices of Overall Business Climate



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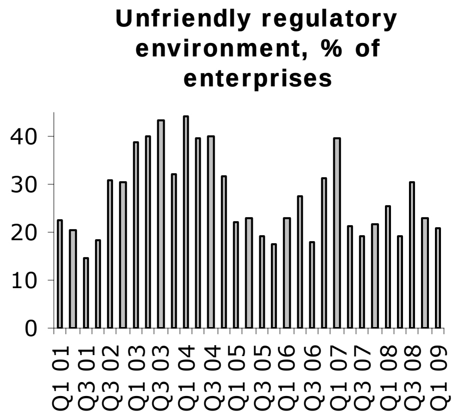
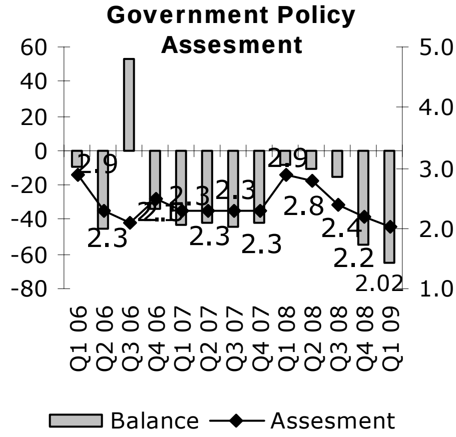
Regulatory climate



The share of managers, according to whom the unfriendly regulatory climate is a significant obstacle to the growth of production in their enterprises, reduced in February compared to November from 23.1% to 20.7%. This was done due to reduction of the values of two of the three components of the combined index of "unfavorable regulatory climate", namely: the high regulatory pressure and corruption (from 14.9% to 12.7% and from 8.1% to 3.8%, respectively).

The value of the third component of the combined *index of "unfavorable regulatory climate"* - frequent changes in economic legislation - increased more rapidly than thrice (from 1.8% in November to 5.6% in February). This demonstrates the significant growth of an unpredictability of business climate. It should be noted that the value of this index is not the same for companies of different sizes: it is the largest for medium-sized enterprises (7.2%) and the lowest for large (4.0%). For small businesses the value of the index equals 5.0%.

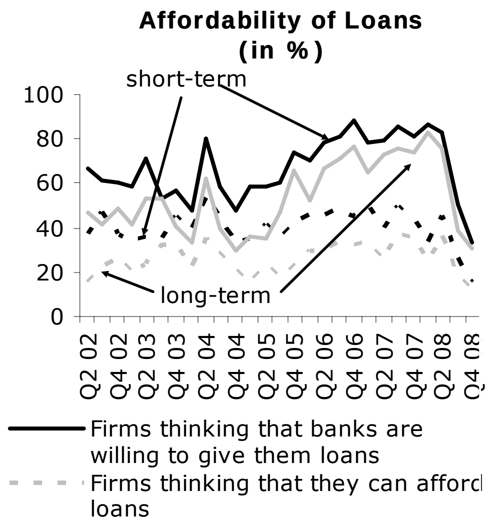
Assessment of the Governmental economic policy



Average rating of the Government by respondents decreased slightly in February compared to November and equals 2.02 points by a 5-point scale. According to the results of the survey, about two thirds (67.5%) of all surveyed managers evaluate the work of the Government negatively and only 2.4% assess it positively. For comparison: in November, 60.9% of respondents of the quarterly survey sample made a negative assessment and 6.4% made positive one. Besides, there remains still a large proportion of managers who are hesitating with formulating their opinions on the matter: 30.1% of respondents chose the option "difficult to answer" or did not respond to questions.

The poorest assessment of economic policy has been given in Lviv (1.85), then goes Kharkiv (1.91) and Kyiv (2.08); and the ones that evaluated economic policy most highly were the respondents of Khmelnytskyi (2.5).

Lending Climate



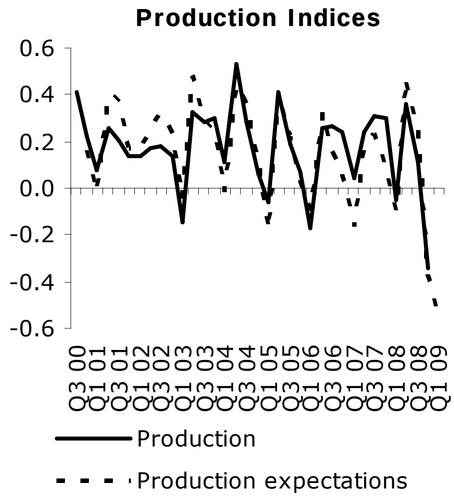
The lending climate has deteriorated in the 4th quarter, and it is characterized by two trends. On the one hand, the volume of offers of bank loans continued to decrease. The percentage of managers who believe that banks are willing to provide short-term loans to enterprises like theirs decreased significantly from 50.3% in the 3rd quarter to 33.1% in the 4th one. The value of the corresponding indicator for long-term loans fell from 38.7% to 30.7%.

On the other hand, the availability of loans for the enterprises diminished according to respondents, which may be explained by the deteriorating financial and economic situation in the enterprises (see FINANCIAL INDICATORS). In particular, the number of managers who believe that their company can afford to take loans, decreased respectively for short-term loans from 25.7% in the 3rd quarter to 15.6% in the 4th, and for the long-term ones - from 16, 8% to 11.4%.

PRODUCTION INDICATORS

As the managers expected, further slowing of production growth was observed in the 4th quarter. The value of *index of production* has fallen from 0.11 in the 3rd quarter to -0.34 in the 4th. Moreover, the fall of the production in the 4th quarter was slightly lower than managers had expected. Thus, the *index of expected production* equaled -0.38 in the 4th quarter, and the actual value of the index for this quarter is -0.34.

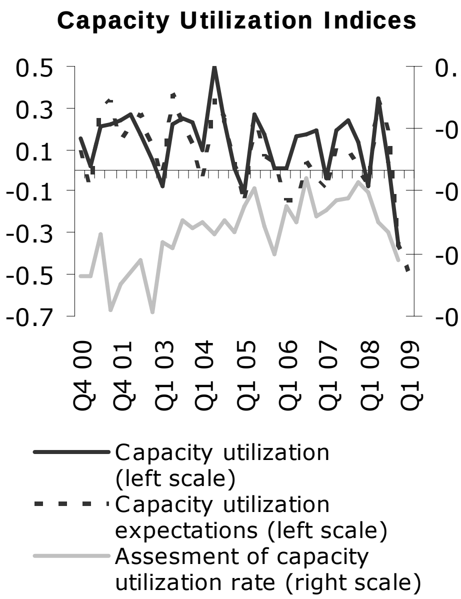
The managers from all industries inform about the reduction of production in the 4th quarter. The lowest value of *index of production* has been recorded for the production of construction materials industry (-0.68) and the highest one – for the food industry (-0.16). The reduction of production turns out most considerable for large enterprises (over 1000 employees). The value of corresponding index decreased from 0.33 in the 3rd quarter to -0.70 in the 4th. Managers of small and medium enterprises observe less significant reduction in production compared to the 3rd quarter (from -0.06 to -0.33 and -0.09 to -0.37, respectively). Reduction of the value of *index of production* has been recorded for enterprises of all forms of ownership. It is lowest for the privatized enterprises (-0.36); for state and *de novo* private ones it amounts -0.28 and -0.29 respectively.



Managers of enterprises expect further slowdown of production growth in 1st quarter of 2009. *The index of expected production* for the next quarter decreased from -0.38 (for the 4th quarter) to -0.56 (for the 1st quarter). A record number of respondents - more than two thirds (68.0%) - plans to reduce output in the 1st quarter of 2009, 24.2% have no intention to change volumes and only 7.7% plan to increase production activity. Such a tendency to reduction of the volume of industrial production is typical for all businesses regardless of industry, ownership, size and regional location.

Capacity utilization

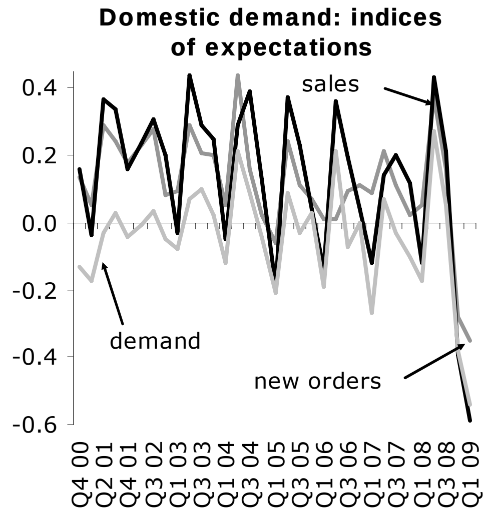
Traditionally, changes in the *index of capacity utilization* and in the *index of expected changes in capacity utilization* match the changes in indices of *production* and ones of the *expected changes in production*. Thus, the value of the index *of capacity utilization* drastically decreased from 0.04 in the 3rd quarter to -0.35 in the 4th one. More than half of the polled managers (56.6%) reported low capacity use (on average 62%). In the 1st quarter of 2009 managers expect the slowdown of production growth and, therefore, plan to reduce the use of capacity: the index of expectations is -0.49.



Demand, Sales, New Orders

After the reduction of domestic demand, which took place in the 3rd quarter of 2008, a further deterioration in indicators of demand is being experienced in the 4th quarter. In particular, corresponding index values diminished considerably from 0.02 to -0.50. In the 1st quarter of 2009, managers (65.3%) predict decline in demand for products of domestic market oriented industries. The value of the *index of expected demand* is -0.54.

According to respondents, the volume of sales has decreased notably in the 4th quarter compared to the 3rd quarter: the value of the corresponding index fell from 0.10 to -0.38. Managers expect a further decrease in this indicator in the next quarter: *the index of expected sales* equals -0.59.



Respondents also noted reduction in new orders in the 4th quarter. The value of the *index of new orders* has dropped from 0.01 in the 3rd quarter to -0.23 in the 4th. The percentage of managers who assess the stock of orders as a satisfactory one, fell from 22.8% in the 3rd quarter to 18.5% in the 4th.

It should be noted that 42.1% of all surveyed managers reported that their companies have no stock of orders. For comparison: there was four times less of such cases (10.2%) in the first half of the year.

More than a half of the respondents (52.3%) expect further reduction in the volume of new orders during the next three months. The index of expected new orders dropped to -0.28 (for the 4th quarter) to -0.35 (for the 1st quarter). Managers of timber (-0.60), light (-0.60) and printing (-0.50) industries were most pessimistic about getting new orders in the 1st quarter of 2009.

Impediments to production growth[1]

By estimations of managers, low demand (75.1%) and excessive taxation (49.3%) took first and second places in the ranking of obstacles for growth in the 4th quarter. Unstable political situation moved to the third place. The importance of this barrier slightly decreased (from 46.6% to 41.8%) in the 4th quarter after a sudden growth in the 3rd quarter.

Problems of liquidity remain very relevant for enterprises: the number of surveyed managers, according to which the lack of working capital is a barrier for production growth, almost did not change compared to the 3rd quarter and amounts 41.3%.

Also, the relevance of the problem of access to loans continued to grow in the 4th quarter (from 22.2% to 25.4%), and the importance of the obstacle "high rate of loans" increased (from 18.1% to 20.2%), indicating deterioration of climate in the lending market (see LENDING CLIMATE).

The importance of the problem of energy supply increased considerably in the 4th quarter. The percentage of respondents who considered it to be a major obstacle to production growth, increased almost threefold (from 8.1% in the 3rd quarter to 22.5% in the 4th), which may be explained by the rise of energy prices.

Furthermore, it should be noted that the further reduction of the importance of the obstacle "shortage of skilled workers" (from 17.6% to 15.0%) is observed in the 4th quarter.

Therefore, such negative processes as the decline of demand indices, high tax pressure, unstable political situation, problems of liquidity, cutback of the availability of bank loans and others are the characteristics of the course of the financial and economic crisis in late 2008 - early 2009.

Impediments to production growth

	II 08	III 08	IV 08	IV 08 to III 08
Low demand	59.7	71.9	75.1	+3.2
Excessive taxation	55.2	43.9	49.3	+5.4
Unstable political situation	7.2	46.6	41.8	-4.8
Problems of liquidity	18.2	42.1	41.3	-0.8
Loans accessibility	17.7	22.2	25.4	+3.2
High competitive pressure	42.5	29.0	24.4	-4.6
Problems with energy supply	9.4	8.1	22.5	+14.4
Shortage of raw materials	31.5	28.1	22.1	-6.0
Unfavorable regulatory climate	30.4	23.1	20.7	-2.4
High regulatory burden	**23.8**	**14.9**	**12.7**	**-2.2**
Changes in economic legislation	**2.2**	**1.8**	**5.6**	**+3.8**
Corruption	**9.4**	**8.1**	**3.8**	**-4.3**
High interest rates	37.0	18.1	20.2	+2.1
Shortage of skilled workforce	34.8	17.6	15.0	-2.6
Outdated technology	16.0	5.9	6.6	+0.7
Shortage of capacities	5.0	5.4	2.8	-2.6

Employment

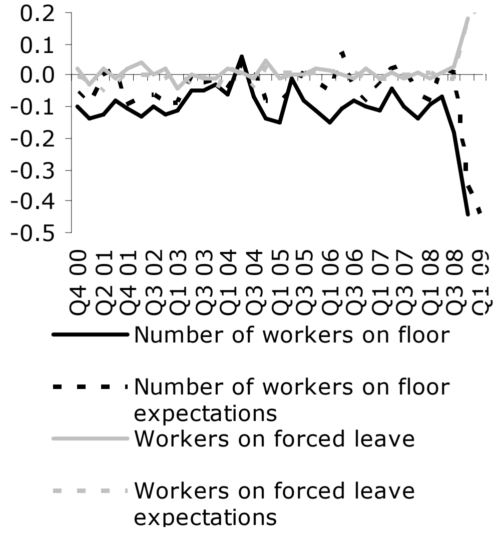
Throughout the slowing down of the rates of growth in production output there occurs the reduction of employment level. The value of the *index of employment* has decreased from -0.18 in the 3rd quarter to -0.44 in the 4th, indicating a significant reduction in the number of employees in enterprises. The percentage of managers who believe that the level of employment in their companies is satisfactory for the existing volume of production decreased from 69.7% to 62.6%.

In the 1st quarter of 2009, managers expect continued reductions in employment. The value of the *index of expected employment* is -0.44. Managers expect the most significant reduction of employment to take place in the construction materials industry: the value of the *index of expectations* is -0.56. Managers of enterprises give the most optimistic forecasts for employment in the 1st quarter for the printing industry. Here the *index of the expected employment* is the highest (-0.16).

The percentage of companies where workers are forced to leave or work part-time more than doubled compared to the 3rd quarter (from 28.6% to 58.7%). The value of the corresponding index rose from 0.03 to 0.18. Managers expect continued growth of this indicator (0.21) in the 1st quarter.

According to the polled managers, difficulties in the search of qualified staff weakened in the 4th quarter. The value of corresponding index decreased from 0.67 to 0.53. However, this

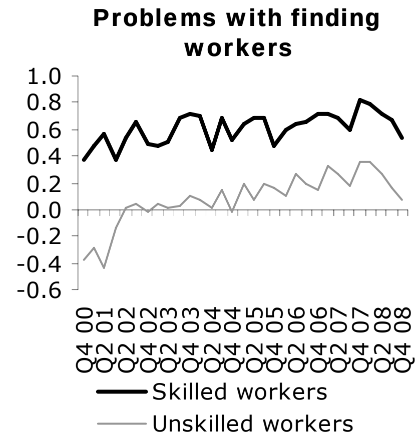
Employment Indices



[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.

value is still high and it shows that by the estimates of respondents, finding an employee of the right training required by the company is very difficult. In particular, 64.6% of respondents indicated that the search for skilled workers became difficult in the 4th quarter, while only 11.4% of the respondents noted the facilitation of their search.

According to respondents, the search of the unskilled workers has become much easier in the 4th quarter. The value of corresponding index significantly decreased from 0.17 in the 3rd quarter to 0.08 in the 4th one. More than half of the surveyed managers (56.8%) believe that there were not any changes to finding unskilled workers during the last quarter.

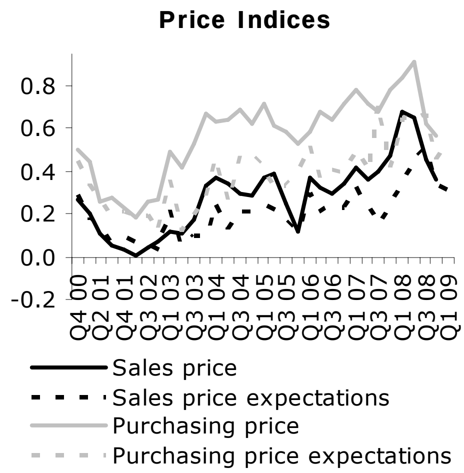


FINANCIAL PERFORMANCE INDICATORS

Prices

In the 4th quarter the prices of raw materials and finished goods prices continue to rise, with higher pace than managers had expected. Specifically, the value of the *expected index of prices of raw materials* for the 4th quarter was 0.45, and the value of the actual index for this quarter is 0.57. For sales prices corresponding indices equal 0.34 and 0.36.

In 1st quarter of 2009 managers expect the rising of prices of raw materials and sales prices with about the same rates as in the 4th quarter. *The index of expected purchase price* is 0.54 for the 1st quarter, and *the index of the expected sales price* amounts 0.31.

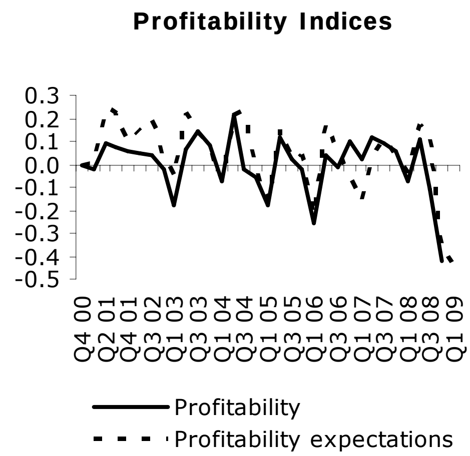


Profitability

Decrease in production naturally affected the financial results of companies. In the 4th quarter, they were worse than the managers had expected. Namely, the *index of the expected profitability* on the 4th quarter was -0.38, and the actual value of the index for this quarter is -0.42. *Profitability index* decreased from -0.11 in the 3rd quarter to -0.42 in the 4th. This means a significant prevalence of the shares of the companies that have worsened their financial results over those who improved theirs in the general distribution.

More than a half of the surveyed managers (51.2%) indicated a deterioration in financial results; they did not change in 36.8% of the enterprises, and 11.0% managers indicated that the financial results of their enterprises improved. Negative *index of profitability* is observed in all industries. The most drastic deterioration compared to the previous quarter is recorded at the enterprises of construction materials industry (-0.64).

Expecting a further slowdown in growth of production, managers projected the worsening of financial results of enterprises in the 1st quarter. The value of the *index of expected profitability* dropped to -0.44. 55.0% managers predict deterioration of financial performance and only 5.6% expect an improvement; 39.4% of respondents do not expect significant changes.



COMPETITIVE PRESSURES [2]

According to managers, the level of competitive pressure from domestic producers virtually did not change over the last three months. The value of the corresponding index is -0.10 in the 3rd quarter and -0.08 in the 4th. Only the managers of companies of machinery building report significant easing of pressure (from -0.41 to -0.62); and according to the managers of the construction materials industry and light industry, competitive pressures, on the contrary, have increased. Indices grew respectively from 0.06 to 0.12 and from -0.16 to -0.04.0,12 and з -0,16 to -0,04.

Index of competitive pressure from Ukrainian producers

Industry	Q3'08	Q4'08
Heavy	0.42	0.38
Machine build.	-0.41	-0.62
Wood proc.	-0.25	-0.30
Construct. mat.	0.06	0.12
Light industry	-0.16	-0.04
Food processing	0.26	0.23
Printing	0.20	0.13

[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.

However, managers note that the pressure from manufacturers in Russia/CIS countries and other foreign producers increased compared to the 3rd quarter. The values of the indices rose respectively from -0.65 to -0.36 and -0.67 to -0.29.

Although competitive pressure from producers of CIS and other countries increased, but the main rivals of Ukrainian enterprises, as estimated by their managers, are domestic producers: 29.3% of respondents identified the level of competitive pressure from their side as strong.

Number of employees, %

	Q4'08
Fewer than 50	37.6
51 — 250	39.4
251 — 500	10.3
501 — 1000	6.6
Over 1000	6.1

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.

Regions, %

Lviv	14.6
Kyiv	31.5
Kharkiv	42.3
Khmelnytsky	11.7

The *Industrial Confidence Indicator* is defined as the arithmetic mean of the *indices of production expectations*, *assessments of the volumes of new orders* 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.

Industries, %

	Q4'08
Heavy[3] industry	8.9
Machine building	24.9
Wood processing	4.7
Construction materials	13.1
Light industry	12.7
Food processing	21.1
Printing	9.4
Other	5.2

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