

Quarterly Enterprise Survey

№ 2 (28)
May 2009

- The Industrial Confidence Indicator increased significantly from -0,39 in February to -0,11 in April.
- The expectations of the enterprises managers as to the change of the overall economic situation over the next six months considerably improved.
- The share of managers who consider the regulatory climate to be an obstacle to the production growth increased significantly compared to February.
- According to the managers of enterprises in the 1st quarter the loans accessibility remained unchanged while the affordability of the loans for enterprises increased.
- Managers of enterprises plan significant growth of production volumes over the next three months.
- In the 2nd quarter managers expect substantial growth in the number of new orders.
- In the 1st quarter the trend of employment reduction on enterprises continued, although in the 2nd quarter managers expect the increase of employment level.
- Managers expect that growth rates of raw materials prices and sales prices will not change significantly in the 2nd quarter compared to the previous one.

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 April 6 to 30, 2009

Performance: Q1' 09 vs. Q4' 08

Expectations: Q2' 09 vs. Q1' 09

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

GENERAL INDICATORS

Industrial confidence indicator

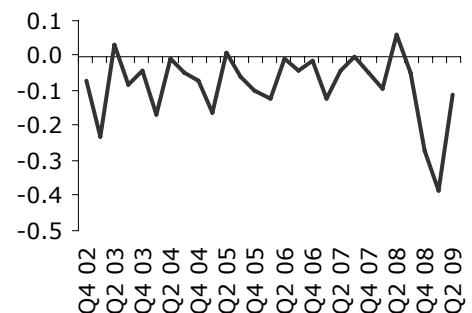
In April the *Industrial Confidence Indicator* equals -0.11. After the decrease in February 2009 compared to November 2008 by 12 points (from -0.27 to -0.39), it has sharply increased by 28 points in comparison to February. It happened because of the significant improvement of the production plans of the enterprises for the next 3 months (see PRODUCTION INDICATORS). The impact of this component was considerably stronger than the influence of two other components of the *Industrial Confidence Indicator*. There was some increase in the value of the component "the stock of finished goods" (from -0,19 in February to -0,17 in April) and the value of the component "assessment of the volume of present orders" remained practically unchanged (-0,79 in February and -0,73 in April).

Business climate

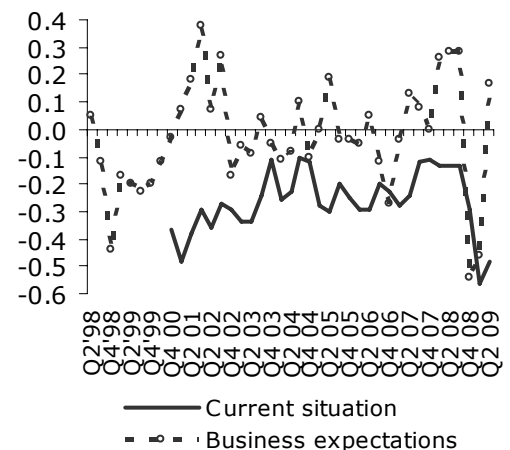
In April there was some improvement in the managers' assessment of the current overall economic situation compared to February: the value of the *index of the current situation* increased from -0.56 to -0.48. It happened due to the decrease of the share of managers who assess the business climate as poor one (from 60.6% in February to 52.4% in April). Additionally, the share of those who consider the climate to be satisfactory has increased (from 35.6% to 45.8%). The share of those who estimate it favorably has diminished from 3.8% to 1.8%. This is typical for enterprises of all industries, ownerships and sizes. Besides, the smaller the enterprise, the worse are the estimations of business climate.

At the same time, the managers' expectations as to the positive changes in the business climate improved significantly. The value of the *index of business expectations* increased by 63 points (from -0.46 in February to 0.17 in April). It happened due to the considerable growth of the share of the managers who anticipate positive changes (from 10.6% in February to 33.6% in April). Also, the percentage of those who expect neither positive, nor negative changes has slightly increased (from 31.1% to 44.7%). While the share of managers that expect the worsening of overall economic situation over the next six months considerably decreased from 58.3% in February to 21.7% in April.

Survey based Industrial Confidence Indicator



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, increased in April compared to February from 20.7% to 37.7%. At the same time it is worth mentioning that the both absolute value and change of indicator vary by enterprise's size:

- in the group of small enterprises the number of managers who consider the unfriendly regulatory climate to be a significant obstacle to the production growth increased more than in three times (from 13.8% in February to 43.7% in April) and is the highest compared to other groups of enterprises;
- in the group of medium-sized enterprises the number of the polled managers, according to whom the unfriendly regulatory climate is a significant obstacle to the production growth, increased from 22.9% in February to 35.9% in April;
- in the group of large enterprises the number of managers who estimate the unfriendly regulatory climate as an important obstacle to the production growth remains stable (28.0% in February and 30.8% in April).

The number of respondents who consider the unfriendly regulatory climate as a significant obstacle to the production growth increased due to the sharp rise of the values all three components of the combined index of "unfavourable regulatory climate", namely: the high regulatory pressure (from 12.7% to 25.5%), frequent changes in economic legislation (from 5,6% to 19,0%) and corruption (from 3,8% to 14,3%). (See IMPEDIMENTS TO PRODUCTION GROWTH).

Assessment of the Government Economic Policy

Average rating of the Government activities by respondents in April practically didn't change compared to February and remains very low (from 2.14 points to 2.02 points by a 5-point scale). According to the results, vast majority of the managers of the enterprises (62.0%) evaluate the work of the Government negatively and only 4.8% assess it positively. For comparison: in February 67.5% of respondents of the quarterly survey sample made a negative assessment and 2.4% – a positive one. Besides, there still remains a large share of managers who hesitate with formulating their opinions on the matter: every third respondent (33.2%) chose the option "difficult to answer" or did not respond to the question.

The assessments of the Government activities are considerably related to the regional location of the enterprises. The poorest assessment of economic policy has been given in Lviv (1.64), then goes Kharkiv (2.16) and Kyiv (2.31). The highest evaluation of the Government activities is given in Khmelnytsky (2.40).

Lending Climate

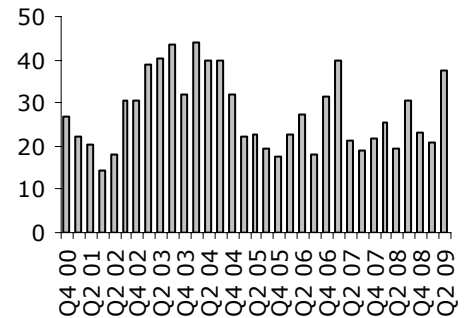
The lending climate in the 1st quarter on the one hand is described by the unchanged volume of offers of bank loans. The percentage of managers who believe that banks are willing to provide short-term loans to such enterprise as in the 4th quarter was 33.1% and in the 1st quarter equals 33.5%. The values of these indicators for long-term loans were 30.7% and 29.2% respectively.

On the other hand, according to respondents, the availability of loans for the enterprises in the 1st quarter has slightly increased. In particular, the share of managers who believe that their enterprise can afford to take loans increased respectively for short-term loans from 15.6% in the 4th quarter to 22.5%, and for the long-term ones - from 11.4% to 17.5%.

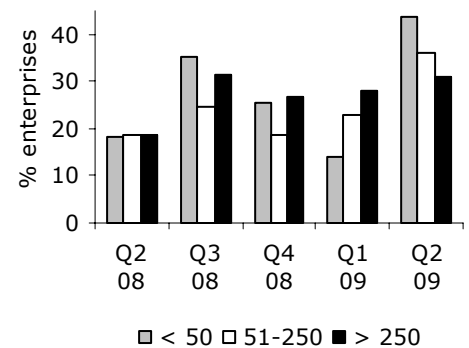
PRODUCTION INDICATORS

In the 1st quarter, as expected by the managers, further slowing of production growth was observed. The value of *index of production* considerably decreased from -0.34 in the 4th quarter to -0.54 in the 1st one. At the same time, the managers' forecasts proved to be

Unfriendly regulatory environment, % of enterprises

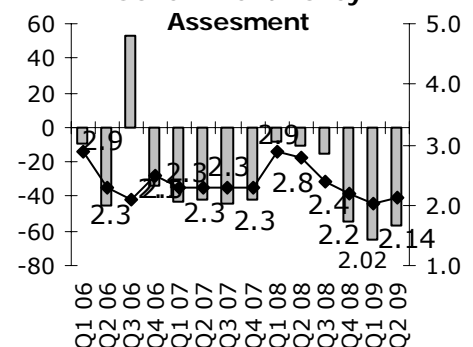


Unfriendly regulatory environment (up to enterprises' size)



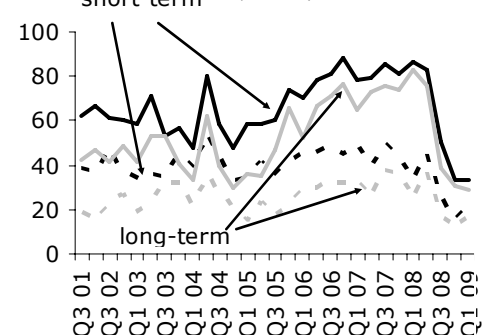
□ < 50 □ 51-250 ■ > 250

Government Policy Assessment



▬ Balance ◆ Assesment

Affordability of Loans (in %)



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

almost precise. Thus, the *index of expected production* for the 1st quarter equaled -0.56, while the actual value of the index for this quarter is -0.54.

The managers of the enterprises from all industries inform about the reduction of production in the 1st quarter. The lowest value of *index of production* has been recorded for the production of light industry (-0.88), and the highest one – for heavy and machine building industries (the value of *index of production* is the same for both industries and equals -0.47. The reduction of production turns out to be most considerable for large enterprises (501-1000 employees). The value of the respective index considerably decreased from -0.06 in the 4th quarter to -0.61 in the 1st. Managers of small and medium enterprises also report about significant decrease of production growth compared to the 4th quarter (from -0.33 to -0.67 and from -0.37 to -0.53, respectively). Reduction of the value of *index of production* has been recorded for enterprises of all forms of ownership. It is lowest for the state enterprises (-0.66), for the private and privatized ones it amounts -0.60 and -0.57 respectively.

As to the expectations of the managers of enterprises, for the first time over the past six months a noticeable growth of optimistic attitudes as to the enterprises production plans was recorded. In the 2nd quarter managers plan to significantly increase their production activities. However, such optimistic predictions as to the production intensification during the next three months may be related to the seasonal character of activities of the enterprises in some industries. *The index of expected production* for the next quarter considerably increased from -0.56 (for the 1st quarter) to 0.22 (for the 2nd quarter). 41.8% of the polled managers of enterprises plan to increase output over the next three months, 37.0% have no intention to change the production volumes and 21.27% plan to reduce the production activities. Such a tendency to increase the volume of production is typical for all businesses regardless of industry, form of ownership, size and regional location.

Demand, Sales, New Orders

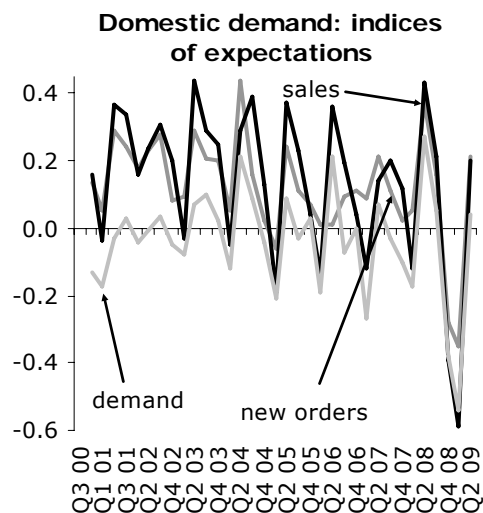
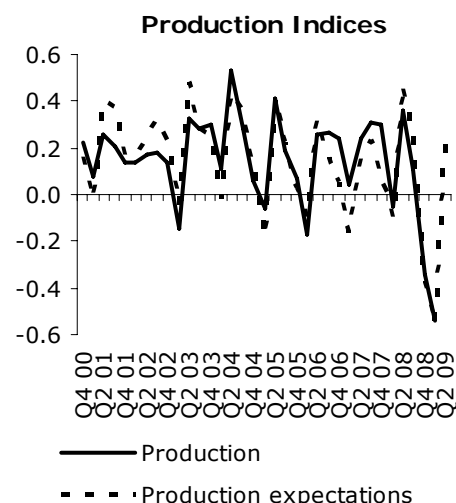
In the 1st quarter of 2009 the trend of deterioration in demand indicators continues. Thus, the respective index value diminished again (from -0.50 in the 4th quarter to -0.67 in the 1st). 74.5% of respondents informed about decline in demand and only 4.7% – about its growth. In this context for the first time since October 2008 an improvement of the managers’ expectations as to the demand has been recorded. In particular, in the 2nd quarter 31.0% of the polled predict growth in demand for the products of domestic market oriented industries, 40.2% – expect the situation to remain without change, and 28.8% believe that demand will continue to decline. The value of the respective *index* is 0.04.

According to the respondents’ estimations, in the 1st quarter the volume of sales noticeably decreased compared to the 4th quarter: the value of the corresponding index fell from -0.38 to -0.58. In the next quarter the managers of enterprises (41.2%) forecast a significant improvement of this indicator: *the index of expected sales* equals 0.20.

Respondents also noted reduction in new orders in the 1st quarter. The value of the index of new orders has dropped from -0.23 in the 4th quarter to -0.40 in the 1st quarter. At the same time the percentage of managers who assess the stock of orders as a satisfactory one slightly increased to 24.3% in April compared to 18.5% in February.

On the contrary, the percentage of managers who reported that their companies have no stock of orders hasn’t practically changed (40.4% in April and 42.1% in February).

Expecting substantial increase of internal demand in the 2nd quarter managers also forecast increase of the volume of new orders compared to the 1st quarter (from -0.40 to 0.21). Managers of light



(0.35) and construction materials (0.33) industries were most optimistic about getting new orders in the 2nd quarter while the most pessimistic were managers of printing industry (-0.07).

Impediments to Production Growth

Traditionally low demand and excessive taxation took first and second places in the ranking of obstacles for growth while outdated technologies and shortage of production facilities appeared at the end of the list. Unstable political situation and problems of liquidity took third and fourth places respectively.

The absolute value of the obstacle "low demand", which ranked first in the list, after increase in February in comparison to November, slightly dropped in April (from 75.1% to 68.0%). The increase of direct demand indices such as assessment of stock of orders and new orders evolution is also indicative of some improvement of the situation of demand in April.

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 February and amounts to 39.8%. This is indicative of unfavorable financial situation of enterprises caused by significant decrease of production during last two quarters.

The percentage of respondents noting "high competitive pressure" as a barrier for production growth increased from 24.4% in February to 33.8% in April.

On the contrary, the relevance of the availability of bank loans has decreased (from 25.4% to 15.6%) while the barrier "high interest rates" still remains considerable (20.2% in February and 18.6% in April).

The importance of the problem of energy supply slightly decreased in April. The percentage of respondents who considered it to be a major obstacle to production growth, after a sharp rise in February, decreased in April from 22.5% to 15.6%.

Furthermore, it should be noted that the further reduction of the importance of the obstacle "shortage of skilled workers" (from 15.0% to 4.8%) was observed in April. The importance of the problem of outdated technologies decreased almost by half in April (from 6.6% to 3.9%).

Employment

Against the background of production decrease the reduction of employment level at enterprises continued. The value of the *index of employment* in the 1st quarter (-0.45) remains at the same level as in the 4th quarter (-0.44). The percentage of managers who believe that the level of employment in their companies is satisfactory for the existing volume of production slightly increased from 62.6% in February to 64.6% in April.

In the 2nd quarter in the context of expectations of demand revival and output increase managers expect the increase of employment level. The value of the *index of expected employment* increased from -0.44 in the 1st quarter to -0.04 in the 2nd quarter. Managers of enterprises give the most optimistic forecasts for employment in the 2nd quarter for the light industry (0.13) and construction materials industry (0.11).

The percentage of companies where workers are forced to leave increased from 29.6% in the 4th quarter to 49.3 in the 1st quarter. The value of the corresponding index rose from 0.18 to 0.31. Managers expect decline of this indicator (-0.01) in the 2nd quarter. The percentage of enterprises with partial employment will decrease to 39.0%.

According to the polled managers, difficulties in the search of qualified staff weakened significantly in the 1st quarter. The value of

Impediments to production growth

	Q3 08	Q4 08	Q1 09	Q1 09 vs. Q4 08
Low demand	71.9	75.1	68.0	-7.1
Excessive taxation	43.9	49.3	50.2	+0.9
Unstable political situation	46.6	41.8	42.9	+1.1
Problems of liquidity	42.1	41.3	39.8	-1.5
Unfavorable regulatory climate	23.1	20.7	37.7	+17
High regulatory burden	14.9	12.7	25.5	+12.8
Changes in economic legislation	1.8	5.6	19.0	+13.4
Corruption	8.1	3.8	14.3	+10.5
High competitive pressure	29.0	24.4	33.8	+9.4
Shortage of raw materials	28.1	22.1	19.5	-2.6
High interest rates	18.1	20.2	18.6	-1.6
Loans accessibility	22.2	25.4	17.3	-8.1
Problems with energy supply	8.1	22.5	15.6	-6.9
Shortage of skilled workforce	17.6	15.0	4.8	-10.2
Outdated technologies	5.9	6.6	3.9	-2.7
Shortage of production facilities	5.4	2.8	1.7	-1.1



the corresponding index decreased from 0.53 to 0.13. The same applies to the search of unqualified workers. The value of the corresponding index decreased significantly from 0.08 to -0.47.

FINANCIAL PERFORMANCE INDICATORS

Prices

In the 1st quarter the prices of raw materials and finished goods prices continued to rise, though with lower pace than managers had expected. Specifically, the value of the *expected index of prices of raw materials* for the 1st quarter was 0.54, and the value of the actual index for this quarter is 0.38. For sales prices corresponding indices equal 0.31 and 0.21.

In the 2nd quarter managers expect the continuing rise of prices of raw materials and sales prices with about the same rates as in the 1st quarter. *The index of expected purchase price* for raw materials is 0.32 for the 2nd quarter, and *the index of the expected sales price* amounts to 0.19.

Profitability

Decrease in production naturally affected financial results of companies. And managers' forecasts proved to be true: the *index of the expected profitability* for the 1st quarter and the actual value of the index for this quarter coincided and amounted to -0.44. *Profitability index* remained at the same level (-0.42 in the 4th quarter and -0.44 in the 1st quarter).

More than a half of the surveyed managers (52.2%) indicated a deterioration in financial results; they did not change in 43.0% of the enterprises, and only 4.8% of managers indicated that the financial results of their enterprises improved during last three months. 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 (-0.67), light industry (-0.67) and woodworking industry (-0.63).

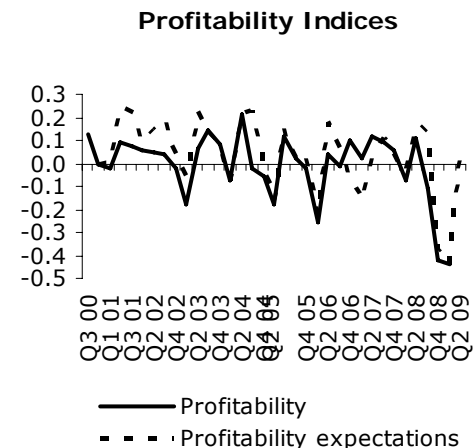
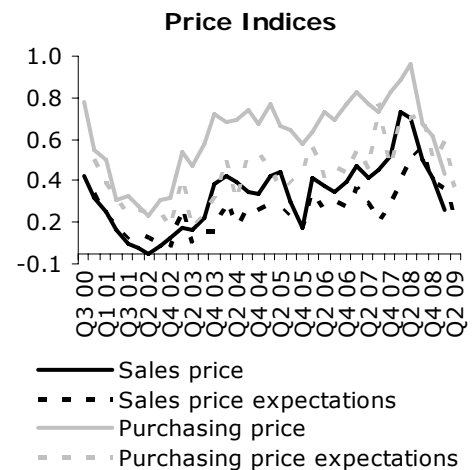
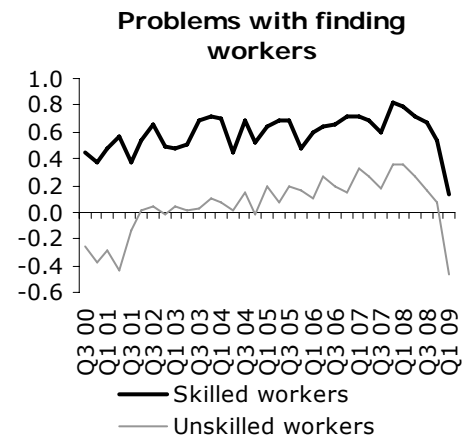
Expecting production growth, managers project the improvement of financial results of enterprises in the 2nd quarter. The value of the *index of expected profitability* rose significantly to 0.06. 24.9% of managers predict improvement of financial performance, 17.3% expect deterioration and more than a half of respondents (57.8%) do not expect significant changes.

COMPETITIVE PRESSURES

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 -0.08 in the 4th quarter and -0.04 in the 1st quarter. Only the managers of woodworking companies report significant increase of pressure (from -0.30 to -0.09); and according to the managers of the construction materials industry, competitive pressures, on the contrary, have decreased. The value of the corresponding index dropped from 0.12 to -0.10.

However, managers note that pressure from manufacturers from Russia/CIS countries and other foreign producers decreased significantly compared to the 4th quarter. The values of the indices dropped respectively from -0.36 to -0.53 and from -0.29 to -0.50.

Although competitive pressure from producers of CIS and other countries decreased, but the main rivals of Ukrainian enterprises, as estimated by their managers, are domestic producers: 32.3% of respondents defined the level of competitive pressure from their side as strong.



Index of competitive pressure from Ukrainian producers

Industry	Q3'08	Q4'08	Q1'09
Heavy	0.42	0.38	0.29
Machine build.	-0.41	-0.62	-0.47
Woodworking	-0.25	-0.30	-0.09
Construct. Mat.	0.06	0.12	-0.10
Light industry	-0.16	-0.04	-0.09
Food processing	0.26	0.23	0.34
Printing	0.20	0.13	0.07

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 *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.

Number of employees, %	
	Q1'09
Fewer than 50	37.2
51 – 250	39.8
251 – 500	10.0
501 – 1000	7.8
Over 1000	5.2

Regions, %	
Lviv	18.2
Kyiv	33.8
Kharkiv	37.2
Khmelnysky	10.8

Industries, %	
	Q1'09
Heavy ¹ industry	8.7
Machine building	23.4
Wood working	3.5
Construction materials	13.4
Light industry	11.3
Food processing	22.5
Printing	12.6
Other	4.8

¹ The heavy industry includes metallurgy, chemical, petrochemical and fuel industries.