

# Quarterly Enterprise Survey

№ 3 (29)  
August 2009

- The Industrial Confidence Indicator decreased from -0,11 in April to -0.13 in July.
- The expectations of the enterprises managers about the change of the overall economic situation over the next six months deteriorated.
- The significance of the unfriendly regulatory climate as an obstacle to the production growth has further increased for the 2<sup>nd</sup> quarter in a row.
- According to the managers in the 2<sup>nd</sup> quarter the availability and the affordability of short-term loans remained unchanged, the long-term ones — decreased.
- Production growth in the 2<sup>nd</sup> quarter was lower than managers had expected.
- A half of the surveyed managers of enterprises have no intention to change the production over the next three months.
- Substantial increase in the number of new orders was observed in the 2<sup>nd</sup> quarter compared to the 1<sup>st</sup> one.
- The trend of employment reduction on enterprises has slowed down. Managers do not expect the trend to continue in the 3<sup>rd</sup> quarter.
- In the 3<sup>rd</sup> quarter managers expect the continuing rise of raw materials prices with about the same rates as in the 2<sup>nd</sup> quarter, whereas sales prices — with higher rates.

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.

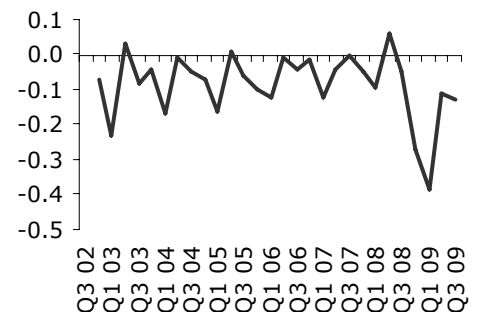
**This issue presents the results of the survey conducted from July 6 till August 3, 2009**

Performance: Q2' 09 vs. Q1' 09

Expectations: Q3' 09 vs. Q2' 09

**Business climate: Assessment for July' 09, expectations for the next 6 months**

Survey based Industrial Confidence Indicator



## GENERAL INDICATORS

### Industrial Confidence Indicator

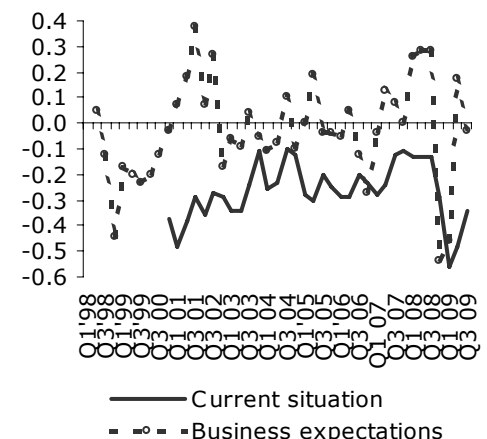
In July *the Industrial Confidence Indicator* made up -0.13. After the sharp increase in April compared to February by 28 points (from -0.39 to -0.11), it has decreased by 2 points in comparison to April. It happened mostly because of deterioration of the production plans of the enterprises for the next 3 months (see PRODUCTION INDICATORS). However, the negative impact of this component was particularly diminished by the improvement of two other components of *the Industrial Confidence Indicator*. In particular, there was some decrease in the value of the component "the stock of finished goods" (from -0.17 in April to -0.23 in July) and the value of the component "orders book" increased (-0.73 in April and -0.66 in July). So, such trends observed for the above two indicators could lead to increase of the total *Industrial Confidence Indicator*, if production expectations were more optimistic.

### Business climate

In July there was some improvement in the managers' assessment of the current overall economic situation compared to April: the value of *the index of the current situation* increased from -0.48 to -0.34. It happened due to the increase of the share of managers who assess the business climate as good one (from 1.8% in April to 8.0% in July) and simultaneously due to the decrease of the share of those who consider the climate to be poor (from 52.4% to 47.6%). The share of managers who estimate the business climate as satisfactory practically has not changed (45.8% in April and 44.4% in July). This is typical for enterprises of all industries, ownerships and sizes. Besides, the smaller the enterprise, the worse are the assessment of business climate.

At the same time, the managers' expectations concerning the future changes in the business climate deteriorated. *The index of business expectations* decreased from 0.17 in April to -0.03 in July. The index decline results from a simultaneous drop in the share of "optimists"

Indices of Overall Business Climate



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(from 33.6% in April to 23.3% in July) and the growth in the share of “pessimists” (from 21.7% to 28.9%). Also, the share of managers that expect neither positive, nor negative changes of overall economic situation over the next six months increased (44.7% in April and 47.8% in July).

### 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 July compared to April from 37.7% to 49.0%. It happened due to the substantial rise of the value of one of the three components of the composite indicator of “unfavorable regulatory climate”, namely: the high regulatory pressure (from 25.5% to 39.1%). Both absolute value and change of this indicator are not the same for enterprises of different sizes. The most significant increase in the number of managers considering high regulatory pressure to be an important obstacle to their business activity was observed in the group of medium-sized enterprises (from 18.5% in April to 39.6% in July). Then go large-sized enterprises (the respective share increased from 25.0% to 35.6%) and small enterprises (from 33.3% to 40.8%).

The value of the second component of the composite indicator of “unfavorable regulatory climate” — frequent changes in economic legislation — decreased almost by half (from 19.0 in April to 10.5% in July). However, the value of the third component — the “corruption” for the time being remains without changes (14.3% in April and 14.7% in July). (See IMPEDIMENTS TO PRODUCTION GROWTH).

### Assessment of the Government Economic Policy

Average rating of the Government activities by respondents in July practically did not change compared to April and remains low (2.17 points vs. 2.14 points by a 5-point scale). According to the results of the survey, among interviewed managers the share of those who evaluate the work of the Government negatively in July remains the same as in April (62.0%). However, the share of those who assess positively to the work of the Government increased from 4.8% to 6.7%. Besides, there still remains a large share of managers who hesitate with formulating their opinions on the matter: almost every third respondent (31.4%) chose the option “difficult to answer” or did not respond to the question.

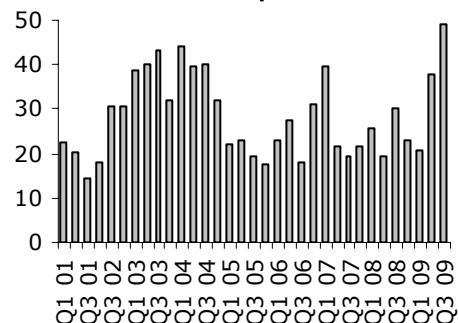
The assessments of the Government activities depend on the regional location of the enterprises. The poorest assessment of economic policy has been given in Lviv (1.65), then goes Kyiv (2.12), Khmelnytsky (2.30) and Kharkiv (2.38). The highest evaluation of the Government activities is given in Sumy (2.46 points).

### Lending Climate

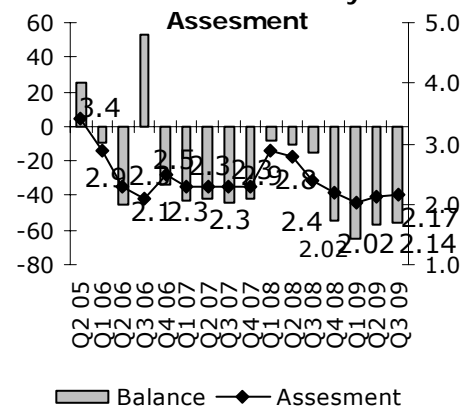
In the 2<sup>nd</sup> quarter the lending climate on the one hand is characterized by the unchanged volume of offers of short-term bank loans, and also by its diminution for the long-term ones. The share of managers who believe that banks are willing to provide short-term loans to such enterprises like theirs made up 33.5% in the 1<sup>st</sup> quarter and 34.1% in the 2<sup>nd</sup> quarter. The values of the corresponding indicator for long-term credits amounted to 29.2% and 22.7% respectively.

On the other hand, according to respondents, the affordability of short-term loans for the enterprises in the 2<sup>nd</sup> quarter practically did not change compared to the 1<sup>st</sup> quarter. In particular, the share of managers considering their enterprise can afford to take loans made up 22.5% in the 1<sup>st</sup> quarter and 20.7% in the 2<sup>nd</sup> one. The value of the corresponding indicator for long-term loans fell from 17.5% to 12.4%.

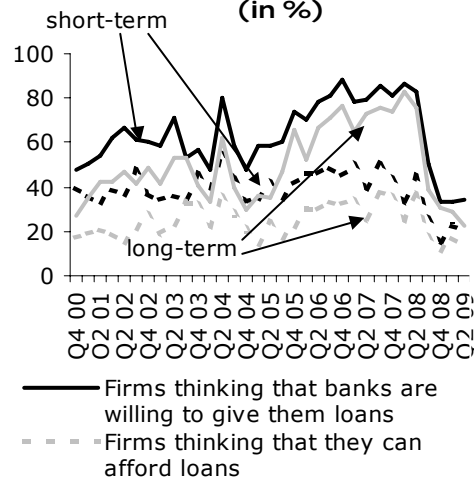
**Unfriendly regulatory environment, % of enterprises**



**Government Policy Assessment**



**Affordability of Loans (in %)**



### PRODUCTION INDICATORS

As managers expected, the industrial production growth accelerated in the 2<sup>nd</sup> quarter. The value of *index of production* considerably increased from -0.54 in the 1<sup>st</sup> quarter to 0.10 in the 2<sup>nd</sup> one. However, the growth of production in the 2<sup>nd</sup> quarter was lower, than managers had expected. Thus, *the index of expected production* for the 2<sup>nd</sup> quarter made up 0.22.

The managers of the enterprises from all industries inform about the growth of production in the 2<sup>nd</sup> quarter. The highest values of *index of production* have been recorded for the enterprises of food and light industries (0.26 and 0.15 respectively), and the lowest ones – for enterprises of wood processing (-0.38) and printing (-0.34) industries. The most considerable growth of production is observed for large enterprises (501-1000 employees). The value of the respective index increased from -0.61 in the 1<sup>st</sup> quarter to 0.29 in the 2<sup>nd</sup> one. Managers of medium and small enterprises report about less significant revival of production compared to the 1<sup>st</sup> quarter (from -0.53 to 0.02 and from -0.67 to -0.16, respectively). Increase of the value of *index of production* has been recorded for firms of all forms of ownership. It is highest for the privatized enterprises (0.04), for the state and private ones it amounts to -0.03 and -0.10 respectively.

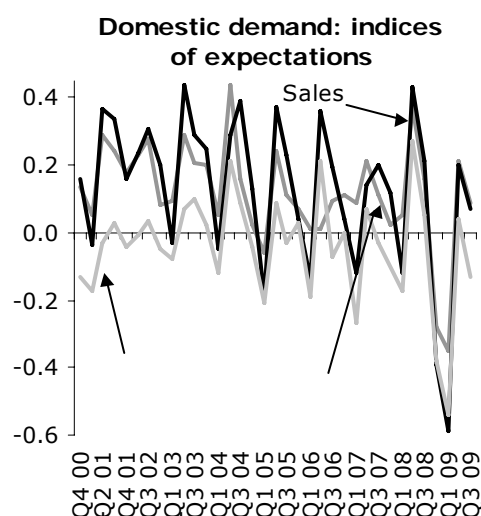
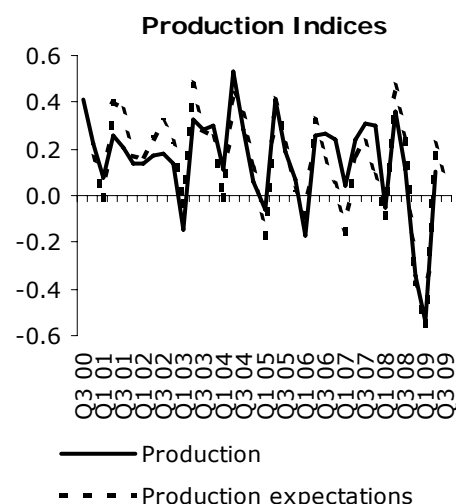
In the 3<sup>rd</sup> quarter managers of enterprises have no plan to significantly increase their production. *The index of expected production* decreased from 0.22 (for the 2<sup>nd</sup> quarter) to 0.05 (for the 3<sup>rd</sup> quarter). Every second surveyed firm (50.0%) plans no changes in the volume of production for the 3<sup>rd</sup> quarter compared to the 2<sup>nd</sup> quarter, 26.5% have intention to increase output and 23.5% plan to reduce the production volumes (for comparison: in the 2<sup>nd</sup> quarter the output gained in 38.6% of firms).

Compared to other fields of industry the most optimistic production plans have the enterprises of food (0.25) and construction materials (0.14) industries. The attitudes of the managers do not significantly depend on the size of the firm: *the indices of production expectations* for small, medium and large-sized firms are equal to 0.05, 0.00 and 0.04 respectively. Private-owned firms have the most optimistic production plans compared to other types of ownership: *their index of production expectations* is equal to 0.13, while the respective values for state and privatized firms make up 0.03 and 0.02.

### Demand, Sales, New Orders

After the reduction of domestic demand, observed since October 2008, the improvement in indicators of demand was registered in the 2<sup>nd</sup> quarter of 2009:

- the value of *the index of domestic demand* increased by 38 points (from -0.67 in the 1<sup>st</sup> quarter to -0.29 in the 2<sup>nd</sup>). 17.1% of polled managers informed about growth in demand and 48.3% – about its decline (in the previous quarter these indicators were equal to 4.7% and 74.5% respectively).
- in the 2<sup>nd</sup> quarter the volume of sales noticeably increased compared to the 1<sup>st</sup> quarter: the value of the corresponding index significantly went up from -0.58 to 0.09.
- managers also noted increase in the number of new orders: the value of *the index of new orders* has grown up from -0.40 in the 1<sup>st</sup> quarter to 0.05 in the 2<sup>nd</sup>.
- the share of managers assessing the portfolio of orders as a satisfactory one slightly increased to 26.9% in July compared to 24.3% in April. On the contrary, the share of companies those have no stock of orders fell from 40.4% in April to 31.6% in July.



Against the background of encouraging trends according to the results of the survey in the 2<sup>nd</sup> quarter, managers' expectations concerning demand for the following 3-4 months are very careful. In particular, *the index of expected demand* for the 3<sup>rd</sup> quarter has the negative value again and it is less, than the respective value for the 2<sup>nd</sup> quarter (-0.13 vs. 0.04). *The index of expected sales* is also less, than it was for the 2<sup>nd</sup> quarter (0.07 vs. 0.2).

In the 3<sup>rd</sup> quarter more than a half of the managers (57.4%) do not expect significant changes in the number of new orders compared to the 2<sup>nd</sup> quarter: *the index of expected new orders* makes up 0.09. Managers of construction materials industry are most optimistic about receiving new orders in the 3<sup>rd</sup> quarter (0.21), while the most pessimistic are the managers of light (-0.12) and printing (-0.11) industries.

### Impediments to Production Growth

Traditionally low demand (65.9%) and excessive taxation (49.2%) took first and second places in the ranking of obstacles for production growth. Although the absolute value of the obstacle "low demand" remains high, but its diminution by 2.1% completes to our arguments about the improvement of demand situation in the 2<sup>nd</sup> quarter (see DEMAND, SALES, NEW ORDERS).

Unfriendly regulatory climate rose to the third position in the list of impediments. The importance of this obstacle has further increased for the second quarter in a row. In July, it was in the highest point for 13 years since the survey is conducted (49.0%)! It should be noted that the value of this indicator is not the same for differently sized firms. It is the lowest for large-sized firms (43.3%). The unfriendly regulatory environment is a more significant problem for small and medium firms: 50.0% of polled managers in small firms and 51.5% of managers in medium ones confirm this.

Unstable political situation moved to the fourth place. The importance of this barrier slightly decreased: from 42.9% in April to 39.1% in July.

Also, the relevance of liquidity problems slightly decreased for enterprises: the number of surveyed managers, according to which the lack of working capital is a barrier for production growth, decreased from 39.8% to 36.4%.

The percentage of respondents noting "high competitive pressure" as a barrier for production growth, after increase in April, dropped in July from 33.8% to 25.2%.

On the contrary, the relevance of the availability of bank loans slightly increased in July (from 17.3% to 24.8%), and the barrier "high interest rates" still remains considerable (18.6% in April and the same percent in July).

The importance of the problem of energy supply decreased considerably in July. The percentage of respondents who considered it to be a major obstacle to production growth, reduced almost by half (from 15.6% in April to 8.5% in July).

In addition, it should be noted that the further reduction of the importance of the obstacle "shortage of skilled workers" (from 4.8% to 3.5%) was observed in July. However, the absolute values of the outdated technologies problem and shortage of production capacities slightly increased from 3.9% to 5.8% and from 1.7% to 3.9%, respectively.

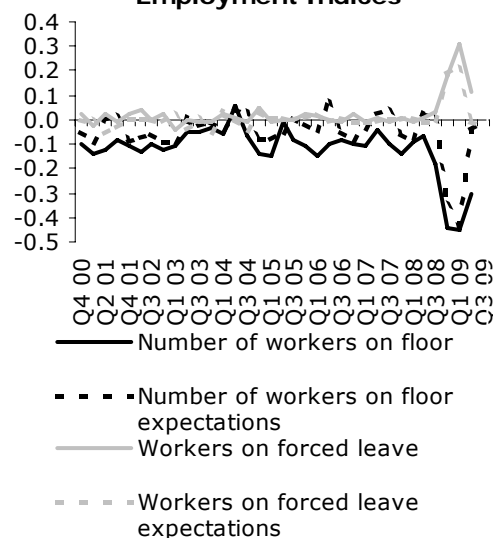
### Employment

The trends of the 2<sup>nd</sup> quarter evident the situation of employment at enterprises is gradually stabilized. Thus, the decrease of reduction rates for the level of employment was observed: the value of *the index of employment* rose to -0.30 in the 2<sup>nd</sup> quarter from -0.45 in the 1<sup>st</sup> one. The share of managers who believe that the level of employment in their companies is satisfactory for the existing volumes of production increased from 64.6% in April to 67.8% in

### Impediments to production growth

	Q4 08	Q1 09	Q2 09	Q2 09 vs. Q1 09
Low demand	75.1	68.0	65.9	-2.1
Excessive taxation	49.3	50.2	49.2	-1.0
Unfavorable regulatory climate	20.7	37.7	49.0	+11.3
High regulatory burden	12.7	25.5	39.1	+13.6
Corruption	3.8	14.3	14.7	+0.4
Changes in economic legislation	5.6	19.0	10.5	-8.5
Unstable political situation	41.8	42.9	39.1	-3.8
Liquidity problems	41.3	39.8	36.4	-3.4
High competitive pressure	24.4	33.8	25.2	-8.6
Access to credits	25.4	17.3	24.8	+7.5
High interest rates	20.2	18.6	18.6	0
Shortage of raw materials	22.1	19.5	17.1	-2.4
Problems with energy supply	22.5	15.6	8.5	-7.1
Outdated technologies	6.6	3.9	5.8	+1.9
Shortage of capacities	2.8	1.7	3.9	+2.2
Shortage of skilled workforce	15.0	4.8	3.5	-1.3

### Employment Indices



July.

The vast majority of managers (87.0%) do not expect any significant changes of employment in the 3<sup>rd</sup> quarter. The value of *the index of expected employment* equals to zero. This is typical for enterprises of all industries, ownerships and sizes.

The share of enterprises with part time job decreased from 49.3% in the 1<sup>st</sup> quarter to 38.0% in the 2<sup>nd</sup> quarter. The value of the corresponding index diminished considerably from 0.31 to 0.11. Managers expect a further decrease of this indicator (-0.02) in the 3<sup>rd</sup> quarter. The percentage of enterprises with partial employment will decrease to 34.7%.

According to the polled managers, it became more difficult to find qualified staff in the 2<sup>nd</sup> quarter. The value of the corresponding index rose from 0.13 to 0.17. In particular, 38.6% of respondents indicated that the search for skilled workers became difficult in the 2<sup>nd</sup> quarter, while 20.5% of the polled noted the facilitation of their search. According to the respondents' estimations, the search of the unskilled workers has also become more difficult in the 2<sup>nd</sup> quarter. The value of the corresponding index increased from -0.47 to -0.16.

### FINANCIAL PERFORMANCE INDICATORS

#### Prices

In the 2<sup>nd</sup> quarter the prices of raw materials continued to rise with higher rates than managers had expected. Thus, the value of *the expected index of raw materials prices* for the 2<sup>nd</sup> quarter was 0.32, and the value of the actual index for this quarter is 0.38.

In the 2<sup>nd</sup> quarter sales prices also continued growing, though with lower pace than managers had expected. Thus, the value of *the expected index of sales prices* for the 2<sup>nd</sup> quarter was 0.19, and the value of the actual index for this quarter is 0.13.

For the 3<sup>rd</sup> quarter managers predict the rising of raw materials prices with about the same rates as in the 2<sup>nd</sup> quarter, while the rising of sales prices — with higher rates. *The index of expected purchase price* is 0.35 for the 3<sup>rd</sup> quarter, and *the index of the expected sales price* amounts to 0.19.

#### Profitability

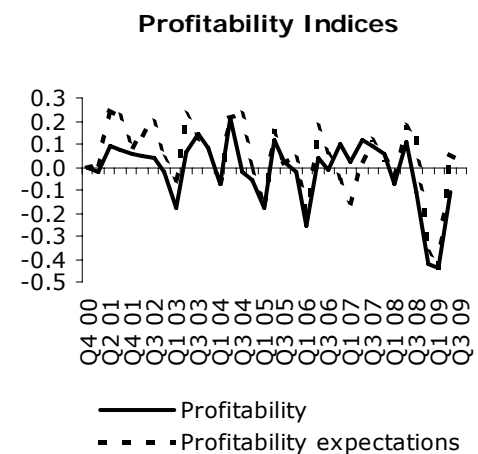
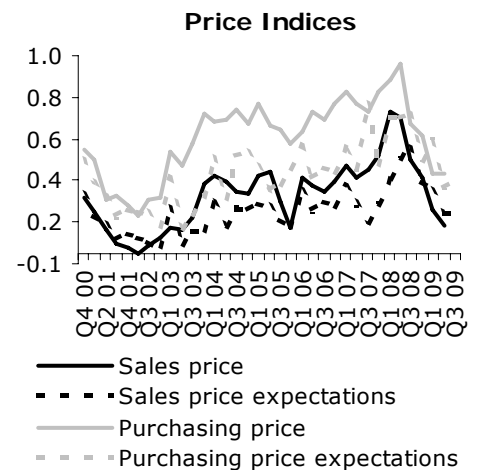
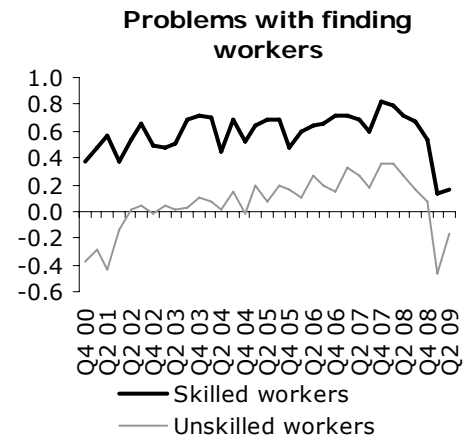
The value of *profitability index* increased from -0.44 in the 1<sup>st</sup> quarter to -0.11 in the 2<sup>nd</sup>. Besides, in the 2<sup>nd</sup> quarter financial results of companies were worse than the managers had expected. Namely, *the index of the expected profitability* on the 2<sup>nd</sup> quarter was 0.06, and the actual value of the index for this quarter is -0.11. 32.4% of the surveyed managers indicated a deterioration in financial results; they did not change in 51.0% of the enterprises, and 16.7% of managers noted that the financial results of their enterprises improved during the last three months. In the previous quarter these indicators were equal to 52.2%, 43.0% and 4.8% respectively.

The negative value of *profitability index* is observed in all industries. The lowest values of index have been recorded for construction materials industry (-0.50) and wood processing industry (-0.46).

The vast majority of managers (70.1%) consider the financial results of their enterprises will not change significantly in the 3<sup>rd</sup> quarter compared to the 2<sup>nd</sup> one; 15.2% — expect an improvement and 14.7% — predict the worsening of financial performance. The value of *the index of expected profitability* is close to zero (0.02).

### COMPETITIVE PRESSURES

According to the managers of enterprises, the level of competitive pressure from domestic producers virtually did not change. The value of the corresponding index is -0.04 in the 1<sup>st</sup> quarter and -0.08 in the 2<sup>nd</sup>. Only the managers of printing companies report



the increase of pressure (from 0.07 to 0.19); and according to the managers of wood processing and heavy industries, competitive pressures, on the contrary, have decreased significantly. The value of the corresponding index dropped respectively from -0.09 to -0.55 and from 0.29 to -0.01.

However, managers note that the pressure from manufacturers in Russia/CIS countries and other foreign producers has slightly increased compared to the 1<sup>st</sup> quarter. The values of the indices grew up respectively from -0.55 to -0.37 and from -0.50 to -0.43.

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: 29.6% of respondents defined the level of competitive pressure from their side as 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 *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).

The general 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 indicator "unfriendly regulatory climate" reflects the share of firms that have selected at least one of these three factors as an impediment to production.

The methodology of calculation for the indices of competitive pressure is similar to that for the other indices. Scale: -1 — no or weak pressure, 0 — moderate, 1 — strong.

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](mailto:kuziakiv@ier.kiev.ua).

### Index of competitive pressure from Ukrainian producers

Industry	Q4'08	Q1'09	Q2'09
Heavy	0.38	0.29	-0.01
Machine build.	-0.62	-0.47	-0.47
Woodworking	-0.30	-0.09	-0.55
Construct. Mat	0.12	-0.10	-0.04
Light industry	-0.04	-0.09	-0.13
Food processing	0.23	0.34	0.31
Printing	0.13	0.07	0.19

### Number of employees, %

	Q2'09
Fewer than 50	37.8
51 — 250	39.0
251 — 500	10.4
501 — 1000	8.1
Over 1000	4.6

### Regions, %

Lviv	15.8
Kyiv	34.4
Kharkiv	27.8
Khmelnytsky	12.4
Sumy	9.7

### Industries, %

	Q2'09
Heavy <sup>1</sup> industry	10.4
Machine building	23.6
Wood working	5.0
Construction materials	12.7
Light industry	10.0
Food processing	21.6
Printing	12.0
Other	4.6

<sup>1</sup> The heavy industry includes metallurgy, chemical, petrochemical and fuel industries.