Ukrainian Enterprises in 2000

An IFC Survey of Ukrainian Business

Report by IFC Ukraine Business Development Project
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INTRODUCTION

The International Finance Corporation (member of the World Bank Group) has been one of the most active players in private sector development in Ukraine. IFC has been particularly active in the development of the small business sector through such programs as Small Scale Privatization (privatization of the vast majority of small businesses); Divestiture of Unfinished Construction Sites; Land Privatization and Agricultural Reform; Agri-Business; Mass Privatization (assisting enterprises undergoing voucher privatization); Corporate Governance; Leasing Reform. Since 1994 IFC has been heavily involved in providing direct services to Ukraine's emerging private sector through the Business Development Project, which established the Ukraine Consulting Network of 11 business consulting companies.

The Business Development Project has conducted annual surveys of the small and medium enterprise sector in Ukraine since 1996 to gauge the overall-enabling environment for SMEs. These surveys have been targeted towards analyzing the role that the state has in influencing the operating environment for domestic business in Ukraine, particularly small business. These surveys have been influential in stimulating real debate among policy makers and government on private sector development issues as well as used to monitor the progress of various reforms and changes in the business environment.

This report is published in both English and Ukrainian, however the English version will prevail in the event of any ambiguity. While every effort has been made to directly translate the English version into Ukrainian, in certain instances, form has been sacrificed to preserve substance.

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SAMPLE SELECTION AND METHODOLOGY

IFC's annual surveys have traditionally covered the small and medium sized business sector. The 2000 survey has been expanded to include medium and large firms, as well as different forms of firm origin (state-owned, privatized, and start-ups) to allow for better comparisons between different types of firms.

The survey has attempted to capture a representative picture of business in Ukraine's oblast capitals and has therefore surveyed firms in every single oblast capital in Ukraine as well as Kyiv and Simferopol, that are engaged in commercial activity. In order to construct the survey sample, manufacturing firms were used as the baseline. 1,005 manufacturing firms were selected, distributed proportionally amongst all cities based on their proportion of manufacturing firms in Ukraine (in any case not less than 20 manufacturing firms per city.) Please refer to Annex 1 for a full sample breakdown.

For non-manufacturing sectors, fixed quotas were used for each city, but also ensuring that the total number of firms in each sector was representative of the sector as a whole. This allows for comparisons across cities, but is not necessarily representative (with the exception of manufacturing) of sectors and overall business in each city. Further, it cannot be said that the findings of the survey reflect all business in Ukraine, nor that the proportions of each type of firm in the survey correspond to the overall breakdown of such firms in Ukraine.

The fixed quotas for each city were as follows:

- Construction: 6 firms
- Trade: 15 firms, including 4 wholesale and 12 retail
- Public Catering: 6 firms, including 4 cafes and 2 restaurants
- Transport: 1 freight and 4 passenger transport firms
- Telecommunications: 2 firms, including one internet service provider and one paging company. For Kyiv two vehicular communication firms were added.
- Other Services: 12 firms including a hotel, travel agency, commercial bank, insurance company, domestic service firms and public utilities.

Sectors

The sectors (given above) were selected so as to encompass as much business in Ukraine as possible and also to follow the breakdown used by the State Statistics Committee of Ukraine in compiling national statistics. Agriculture, which accounts for a significant proportion of economic activity in Ukraine, was not surveyed at all as, due its specific nature, comparisons with other sectors would have been difficult. Further state-owned and primarily state financed entities (so called budget organizations) were not surveyed. This class of entities include hospitals, educational establishments, *etc.*

Firms were selected based on their responses of what they considered to be their main area of business activity. Ukrainian firms in general are more diversified than their counterparts in more economically developed countries and it is not uncommon for large state-owned enterprises to have smaller, private (semi-independent from the parent enterprise) commercial entities in unrelated fields.

Firm Origin

Rather than attempt to provide information on different forms of firm ownership (14 legal forms of ownership were surveyed – *see Annex 1*), this survey looked at firm origin instead. All companies were divided into three different types according to their origin: state-owned, privatized, and start-ups.

State-Owned Firms

These are firms where majority ownership (not less than 50%), and hence control, is held by the government. Further state-owned enterprises have been divided into two categories, municipally owned and nationally owned. Municipally owned enterprises (*i.e.* communal ownership) include firms in all of the sectors surveyed (except telecoms.)

Privatized Firms

These are formerly state-owned firms where a controlling stake (not less than 50%) has been divested through the privatization process. There were a large number of firms privatized in the period 1992 – 1995 and consequently privatized firms have been further sub-divided into early and late privatized firms, January 1, 1996 being the cut-off date. 54.7% of all privatized firms in the sample were early privatizations.

Start-Up Firms

For comparison purposes the survey also included completely new private firms that were established (since the establishment of such firms was allowed in the late 1980's.) Again, similar to privatized firms, start-ups have been divided into early and late start-ups, with January 1, 1996 being the cut-off date. 38.7% of all start-ups in the sample were early start-ups.

Table 1
Sample by Sector, Firm Size and Firm Origin

	Firm Size			Firm Origin						Total
	Up to 50	51-250	More than 250	State-Owned		Privatized		Start-Ups		
				National	Municipal	Early	Late	Early	Late	
Sector										
Manufacturing	375	328	302	128	23	290	248	142	174	**1005**
Construction	96	55	18	14	3	45	28	40	39	**169**
Transport	40	35	40	12	22	22	27	7	25	**115**
Telecoms	44	2	4	7		1	2	14	26	**50**
Trade	362	45	11	10	7	72	57	76	196	**418**
Public Catering	134	11	0	18	3	26	30	26	42	**145**
Other Services	157	58	41	26	36	53	31	51	59	**256**
Total	**1208**	**534**	**416**							
Firm Size										
Up to 50				69	28	167	170	285	489	**1208**
51-250				63	20	187	146	59	59	**534**
More than 250				83	46	155	107	12	13	**416**
Total				**215**	**94**	**509**	**423**	**356**	**561**	**2158**

Pertinent Information

Medium and Large Trading Firms:

The sample contained medium and large trading firms. Typically these were supermarkets and larger wholesalers. There were also large state-owned enterprises in this sector.

State-Owned Public Catering:

There are still some state-owned public catering firms. Typically, large canteens and restaurants that belong to state-owned firms or are still majority owned by municipal governments.

Municipal Firms:

Across all sectors in this survey there are firms that have a majority stake held by municipal governments. These include hotels, service firms, food processing, manufacturing, metal works, taxi firms, *etc*. Some public utilities have also been included as they are also a component of local business and charge for their services.

Telecoms:
The telecoms sector was selected to compare firms in this dynamic, growth oriented, sector with other sectors in Ukraine. However, there are only a limited amount of firms that state that telecommunications is their primary field of activity. For example, there are only 7 national state-owned telecoms firms in our sample, no municipal telecoms firms, only 1 early privatized firm and 2 late privatized firms. The rest of the 50 telecoms firms surveyed were all start-ups. This is pertinent in comparing averages.

Sole Proprietors and Micro-Firms:
As this survey covered medium and large firms and attempts to draw comparisons between them, very small firms (less than 5 employees) and sole proprietors have not been surveyed. As with agricultural entities, very small firms, market traders and sole proprietors tend to have a different set off issues than larger more established firms.

EXECUTIVE SUMMARY

This report is based on a survey of Ukrainian enterprises and is designed to reflect as closely as possible the structure of business in Ukraine. The survey also covered the whole of Ukraine and therefore covers regional differences as well. This report is in four main sections: enterprise performance, barriers to market entry and expansion, use of information technologies and external business assistance.

2000 was the first year of GDP growth in Ukraine since independence and this was reflected in enterprise performance over the year. A larger proportion of Ukrainian firms were profitable in 2000 than in 1999 and there has been almost universal growth in value added activities. On the whole smaller firms were more dynamic, and more of them were profitable than larger firms. Further, start-up firms[1] generally performed much better than either state-owned[2] or privatized[3] firms.

Sales and Value Added Growth

According to survey data real sales increased by 28% over 2000. Reflecting improved purchasing power, the sectors that had the best sales growth were trade (sales growth of 46%), telecoms with 41%, and public catering (*i.e.* cafes and restaurants) with 38%. Sales growth favored smaller enterprises rather than larger ones, small firms (up to 50 employees) experienced sales growth of 38%, medium firms (51 – 250 employees) of 27%, and large firms (more than 250 employees) the same as medium firms at 27%. Start up firms who experienced 48% sales growth outperformed both state-owned and privatized firms who had 18% and 30% respectively.

The picture with value added is similar to sales growth. Overall value added increased by 11%. Trading firms outperformed all others with value added growth at 33%. In second place was the service sector at 23%. Both public catering and the transport sectors experienced a very slight contraction in value added over 2000 of almost 1%. Again start up firms were the best performers, collectively achieving 26% value added growth. Privatized enterprises as a whole performed worse than state owned firms with only 6% value added growth compared with more than twice as much at state-owned firms (13%.) However, there is a large difference between early and late privatized firms. Early privatized firms, who have had more time to restructure and adapt under new private ownership, saw value added growth rates of 14% compared with late privatized firms who saw value added shrink by 3%.

A more accurate comparison would be between privatized firms and national state-owned firms as they experience more competitive pressure than municipal firms. More municipal firms are monopolists or have a higher degree of market power than national state-owned firms. National state-owned firms experienced value

[1] Start-up firms in this report are defined as all newly created enterprises with majority of private ownership, *and* not as a result of privatization. In this report they are further divided into early and late start-ups, with January 1, 1996 being the cut-off date.

[2] State-owned firms are enterprises with not less than 50% stake hold by the state. In this report state-owned firms are split into two groups; nationally owned enterprises and municipally owned enterprises.

[3] Privatized firms are previously state-owned enterprises that run through privatization process and have a majority non-state ownership. In this report they are split into early and late privatizations, with January 1, 1996 being the cut-off date.

added growth rates of 12% compared with 14% for early privatized firms and –3% for late privatized firms.

Profitability

4% more enterprises were profitable in 2000, 64% compared with 60% in 1999. Again, a greater proportion of smaller enterprises were profitable (70%) compared with medium sized firms (56%) or large firms (53%). More start-up firms were profitable (76%) than either privatized firms (55%) or state owned firms (52%). The worst performing sector was transport with only 38% of firms profitable (up from 37% a year earlier.) The trade and services sector were the best with both sectors having 71% of firms profitable.

Exports

Only 20% of all companies exported in 2000, with exports accounting for 14% of the overall sales of all surveyed firms. A larger proportion of large firms exported their products (46%) compared with 23% of medium sized firms or 10% of small firms. Large firms also exported a greater proportion of their sales (16%) than either medium sized firms (6%) or small firms (5%). The best performers were privatized enterprises with around 20% of their sales exported. By far and away the most popular export market was the CIS with 14% of all Ukrainian firms (or 73% of all exporters) stating that that was their main export market, compared with only 5% of all firms who quoted Europe and the rest of the world as their main export markets.

Employment and Labor Productivity

Improved financial performance of surveyed firms was accompanied by a contraction in work forces of 3%. Only the telecoms sector experienced any significant job creation (6%). The construction sector contracted the most, losing over 8% of its work force. Start-ups again demonstrated their dynamism by employing an extra 4%, which was almost exclusively accounted for by late start-ups who employed an extra 8%. Amongst firm origin state-owned firms overall contracted the most, shedding on average 4.5% of their work forces.

Labor productivity at surveyed firms increased by 15% compared with 1999, with start-ups performing the best, increasing their labor productivity by 21%. Early start-ups (one fifth of all start-ups) increased their productivity by 30%. Start up service firms performed best of all experiencing 39% productivity growth. There was a very large difference in productivity growth between early and late privatized firms. Firms privatized prior to 1996 improved labor productivity by 19% whereas those privatized in 1996 and later experienced a drop in productivity of 1%. State-owned enterprises improved labor productivity overall by 18%, though this is probably due a proportionally greater reduction in work forces compared with firms in the private sector.

Budget Constraints

The softness of budget constraints (in this survey the degree to which enterprises can evade tax and payments for energy) has been acknowledged as one of the biggest problems in restraining further private sector development and restructuring in Ukraine. More state-owned firms had significant tax and energy arrears compared to firms in the private sector. 16% of state-owned firms compared with 9% privatized firms and an insignificant 1% of start-ups. Further the larger a company is the more likely it is to have budget arrears, with 12% of large firms in arrears, compared with only 2.7% of small firms. Further, a third of the sales of state-owned firms were in the form of non-monetary instruments (which can also

be considered to be a form of soft budget constraint, especially if the transaction is with a state-owned entity) compared with 17% of sales for privatized firms and 9% for start-ups.

Enterprise Restructuring

It is generally difficult to define enterprise restructuring as by definition it is a change from the old to the new and is unique to each enterprise. This survey defined restructuring as 13 activities related to changing products, technology, employment, markets and organizational structure over the last three years.

The survey shows that the most important factor influencing both enterprise performance and enterprise restructuring is the level of competition. The more competition a firm faces the greater the likelihood of sales growth and the greater the chance of restructuring. Hard budget constraints imposed on enterprises correlate with more intensive strategic restructuring, whilst soft budget constraints are more conducive to more passive forms of restructuring, for example labor contraction and asset disposal.

Firm origin also influences the likelihood enterprise restructuring. Unsurprisingly, the companies most actively restructuring or changing their operations in 2000 were privatized and start up companies. Early start-ups and late privatized companies were the most active at developing new products (58% and 47% respectively.) Start-ups were the best at attracting new clients, with over 40% doing so. Early privatized firms were the most likely to shed employees (50% of all early privatized firms), closely followed by late privatized firms (46%) and national state owned firms (45%.) Late privatized companies were the most active in changing their organizational structure with 22% doing so. On the whole nationally owned and municipally owned firms (together state owned firms) were the least dynamic and responsive in our survey.

Capital Expenditures and Working Capital

A relatively small proportion of firms experienced investment expenditure in 2000 (41%.) The likelihood of investment into fixed assets does not seem to be strongly dependent on firm origin. More start-up firms experienced investment expenditure (44%) followed by state-owned firms (40%) and then privatized firms (38%). A larger range was observed with firm size, ranging from 35% of small firms to 44% of medium sized firms to 52% of large firms experiencing investment into fixed asstes. The sector with the highest frequency of capital expenditure was telecoms with almost half of all telecoms firms (48%) investing into fixed assets.

New equipment and production facilities was the most popular form of investment expenditure into fixed assets. In 2000 28% of all firms bought new equipment followed by repairs of premises (23%). The most common source of investment financing was retained earnings and depreciation. 35% of all companies (or 86% of all companies experiencing fixed asset investment) financed their investment expenditures from retained earnings, followed by only 6% of all firms receiving bank credit for investment into fixed assets (with only 4% of small firms receiving bank credit.) Other sources of financing were not significant.

The picture with working capital is a little more optimistic with double the amount of firms receiving bank credit for working capital (13%) as did for fixed assets (6%.) though this is still very small indeed. 9% of small firms were able to secure bank credit for working capital compared with 25% of large firms. Amongst firm

origin, more privatized firms were able to secure bank credit for working capital than other classes of firms.

Firms were more optimistic about investment spending in 2001. 58% of firms plan to have investment into fixed assets in 2001 with 20% of them planning to obtain bank credit to finance investment.

Taxation

Surveyed firms quoted taxation issues as the main constraint for market entry and expansion. Instability of tax legislation ranked as the biggest tax problem followed by tax burden in second place.

The average number of taxes paid by all Ukrainian companies is 11, ranging from 9 for small firms to 14 for large firms (out of a total of 17 national and 6 local taxes and duties that were applicable to surveyed firms.) This represents an overall tax burden of 24% of sales, with most firms somewhere around this level. Trade firms had the least with 19% of sales turnover paid in tax and construction firms the highest with 28%. However, in terms of value added, the figures are very different. Over half (53%) of value added or wealth creation of all firms was paid in tax with the service sector having the highest value added tax burden (60%.) In terms of firm size this ranged from 44% for small firms to 52% for medium sized firms to 56% for large firms. The level of tax burden that firms stated was tolerable was half of the actual value at 27% of value added. This is perhaps one of the reasons that 16% of all turnover was concealed from taxation and the state.

Unfair Competitive Practices

As effectively functioning markets and oversight in Ukraine is still nascent, the issue of anti-competitive business practices is still prevalent in Ukraine. Out of general business barriers this issue ranks fourth, behind taxation, low demand and inflation, with all firms reporting some form of anti-competitive behavior. In addition to firms experiencing unfair competition from shadow activities and competitors receiving more favorable tax treatment, the biggest impediment quoted by all sectors (except manufacturing) was privileged permits/ permissions given to competitors by local authorities. This was the most acute form of anti-competitive behavior across all sectors. However, looking at firm size, this issue was only in second place behind privileged access to credit which ranked first for both medium and large sized firms. The anti-competitive barriers ranked third and fourth for all firms were privileged access to clients and subsidies to competitors from the national government.

Main Regulatory and Administrative Barriers to Business Development

The regulatory and administrative environment does not appear to have significantly changed over the last year. Ukrainian companies still complain of taxation problems and the very large role that the state plays in regulation and otherwise interfering in the operations of business.

Out of all regulatory and administrative issues, the most acute in 2000 was frequently changing business legislation, quoted by 94% of all respondents. In second place by severity customs procedures which, however, only applied to 44% of all firms. In third place by severity, obtaining permits and permissions (which was applicable to 86% of all firms.) Out of the choices presented firms ranked business registration procedures last.

Unofficial Payments

All firms surveyed had to make some sort of unofficial payments in dealing with regulatory and administrative issues. 23% of all surveyed firms had to make unofficial payments in obtaining permits and permissions, 15% in obtaining licenses, 15% in product certification. 28% of all firms had to make unofficial payments in relation to inspections and 39% of all firms had to make some form of 'voluntary' contribution to municipal or charitable funds.

Time Tax

The survey shows that the average amount of work time that senior company management spent on various dealings with the state amounted to 16% over 2000. Small and medium firms spent about the same amount of time (15% and 16% respectively) on dealing with the state, whereas larger firms spent about 20% of their time. Among cities the largest time tax was in Lugansk with 21%, followed by Ivano-Frankivsk with 20%. The smallest time tax out of all oblast capitals was in Uzhgorod with only 9%, and there small firms had a time tax of 7%, and medium firms had the lowest level of time tax in Ukraine at only an average of 5% of senior management time.

Licensing

Due to the fact that a large sample of both private and state-owned, small, medium and large enterprises were surveyed, it is difficult to analyze this issue as different firms face different licensing requirements. The survey instead asked firms whether they felt that business licensing presented an obstacle to business development. 72% of all firms had to undergo licensing in 2000, of which 42% felt that it presented a significant or major constraint to business development. 15% of these firms had to make unofficial payments in obtaining licenses.

The most difficult licensing environments (according to the respondents) were to be found in Simferopol (54% stated that licensing was a significant or major barrier), followed by Dnipropetrovsk (53%.) The best environments were to be found in Chernigiv (26%) , and Lutsk (28%.)

Permits and Permissions

86% of all firms faced the need to obtain permits/ permissions over 2000, of which 44% stated that permits and permissions presented either a serious or major barrier to market entry. The most problematic permits and permissions were in connection with land and construction. 58% of all companies felt that it was difficult or very difficult to obtain a permit for the allocation of a land plot, followed by 43% of all firms who complained about the procedures for receiving permits and permission for construction.

Inspections

The overall level of state inspections of business in Ukraine has not declined over 2000. Across all firms the average number of inspections in 2000 was 14.4, with small firms experiencing 11.5 inspections, medium sized firms 16.8 inspections and large firms 20.4 inspections over the course of 2000. The average total duration of all inspections was 26.6 days. Notwithstanding the fact that small firms had fewer inspections than large firms, smaller firms had a much greater inspections burden. Micro firms (less than 10 employees) had more than 20 times more inspections per employee than very large firms (more than 500 employees.)

Inspection Consequences

44% of all surveyed firms faced some sort of sanction from inspecting bodies. Of these, the most widespread was the use of 'kartoteka' (direct debit of fines and arrears from a company's bank account) faced by 18% of all companies. This was followed by repeated inspections in second place quoted by 17% of all firms and frozen bank accounts in third place quoted by 13% of all firms. The average duration of kartoteka was 171 days, firm assets seized as tax collateral – 174 days and frozen bank accounts - 95 days.

Barriers to Receiving Financing and Credit

The biggest barrier to receiving commercial financing was high interest rates, followed by lack of long term credit. Medium sized firms put lack of long term credit in first place as their biggest problem with obtaining financing. In third place for all firms was the issue of collateral requirements.

Computer and Internet Use

Three quarters of all surveyed firms had at least one computer (on average 1 computer for 20 employees) and around a third of all firms had some sort of internet access, with more larger firms (52%) having access than medium sized firms (31%) or small firms (27%.)

The biggest barriers to internet access were the low quality of phone lines and the high price of internet services. Internet use in Ukraine is still primarily passive with 80% of companies using internet access for email and 77% for obtaining news and information.

MAIN ISSUES IN BUSINESS DEVELOPMENT IN UKRAINE

This report is based on a survey of 2,158 companies located in every oblast center in Ukraine and is therefore geographically representative. Further, it attempts to capture a representative picture of business[4] in Ukraine and therefore surveyed small (5 to 50 employees), medium (51 to 250) and large (more than 250) companies; state owned, privatized and start up companies. State owned companies were divided into municipal enterprises[5] and nationally owned companies. Privatized enterprises were divided into early and late privatized companies with January 1, 1996 being the cutoff. Privatized enterprises were defined as those that had a majority non-state ownership (*i.e.* not less than 50% privately owned.) Similarly startups were divided into early and late startups, with January, 1 1996 as the cut off date. Please refer to Annex 1 for a full explanation of the survey methodology used.

This survey looked at enterprise performance over 2000 and attempts to capture the main issues and problems faced by Ukrainian businesses. Broadly speaking, the main barriers facing Ukrainian firms can be divided as follows:

- Demand side restrictions: Low purchasing power, low demand.
- Macroeconomic instability: High and changing interest rates, inflation, exchange rate volatility.
- Micro-level non-financial constraints: legal-institutional issues (taxation and regulatory climate), market failure due to anti-competitive practices, access to infrastructure, difficulty in sourcing inputs, criminal pressure.
- Micro-level financial constraints: access to external financing, high cost of capital, underdeveloped financial markets.
- Corruption

Survey respondents were asked to rate what they considered to be the most important issues hindering their development and further growth. Fig.1 below shows the distribution of responses for 10 major business barriers in Ukraine.

There is almost total unanimity across all firms on the major barriers facing business development, irrespective of firm size or firm origin. The issue of taxation emerged as the biggest barrier for all sectors and also for small, medium, large, state and private companies as well. This confirms previous research carried out by IFC and other organizations, that consistently ranks taxation as the biggest business headache in Ukraine. As this report will later show, the biggest problem with taxation is not just high tax rates, but large number of different taxes and duties and frequently changing tax regulations, leading to inspections, unofficial payments and shadow economic activities. Again there is unanimity across the whole sample on the instability of the taxation regime in Ukraine as the main problem with taxation in Ukraine.

[4] Certain classes of firms were not surveyed, in particular agricultural producers and state financed enterprises (health care, educational establishments, *etc*.)

[5] More correctly 'communally owned' enterprises that are engaged in commercial activity, including transport, cafes and restaurants, construction firms, manufacturing firms, shops, hotels, *etc*.

Figure 1
Rating of Barriers Hindering Business Development in Ukraine[6]
(distribution of responses for all firms)

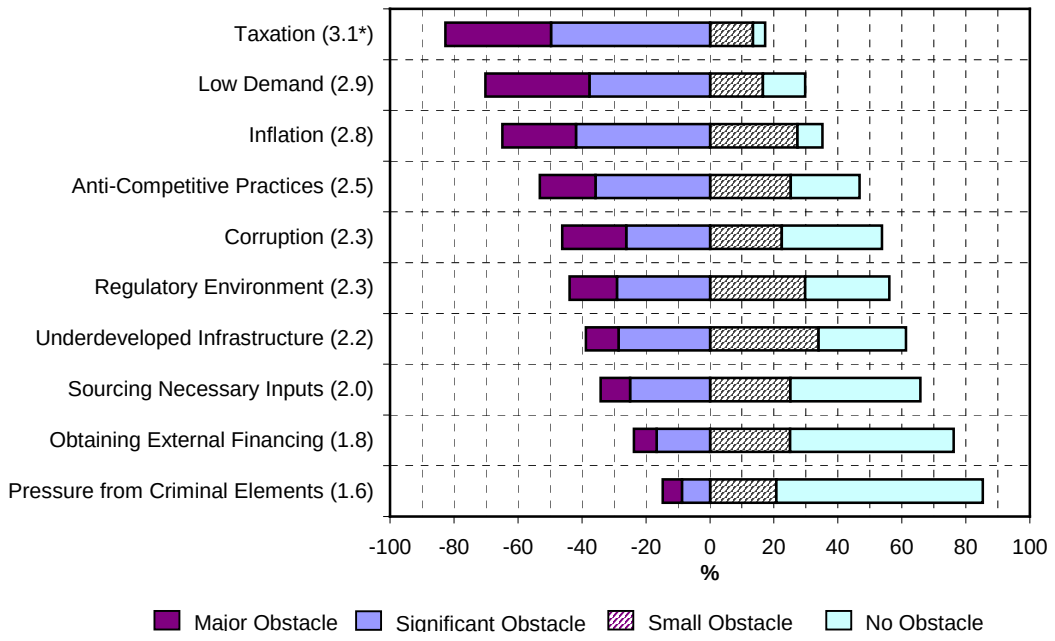


*Figure in brackets give the average score of answers on a 4-point scale from 1 – no obstacle to 4 – major obstacle, for each obstacle listed

Across all firms, general macroeconomic conditions, as characterized by low demand and inflation,[7] were cited as being the next most important issues for Ukrainian business. It is probable to assume that higher input prices in Ukraine have lead to cost-push inflation over 2000 leading to producers attempting to pass on higher costs to consumers. Low demand is ranked in second place for firms in the survey.

This is followed by Ukrainian firms complaining of anti-competitive behavior, discriminatory practices and a non-level playing field for all. The issue of corruption ranked as next most important in fifth place. This is followed by the general regulatory environment and access to infrastructure. Interestingly, in general firms ranked access to external financing almost in last place. Given the low level of investment, retained earnings and credits, in Ukraine, this is very surprising indeed and implies that the administrative, regulatory and business environment is much more important to the immediate operations of Ukrainian businesses than obtaining financing.

No real differences are observed between private or state companies amongst the rating of the main business problems in Ukraine, and in most cases the responses of state owned enterprises are identical with the responses of the entire sample. There was only one exception, and that is the issue of corruption. State owned enterprises ranked corruption as eighth most important compared to the whole sample ranking of fourth.

[6] Please refer to Table 21 for breakdown of main barriers by firm size and origin and Table 80 for sectoral breakdown.
[7] Inflation for 1999 - 19%, for 2000 - 26%.

ENTERPRISE PERFORMANCE

Financial Performance

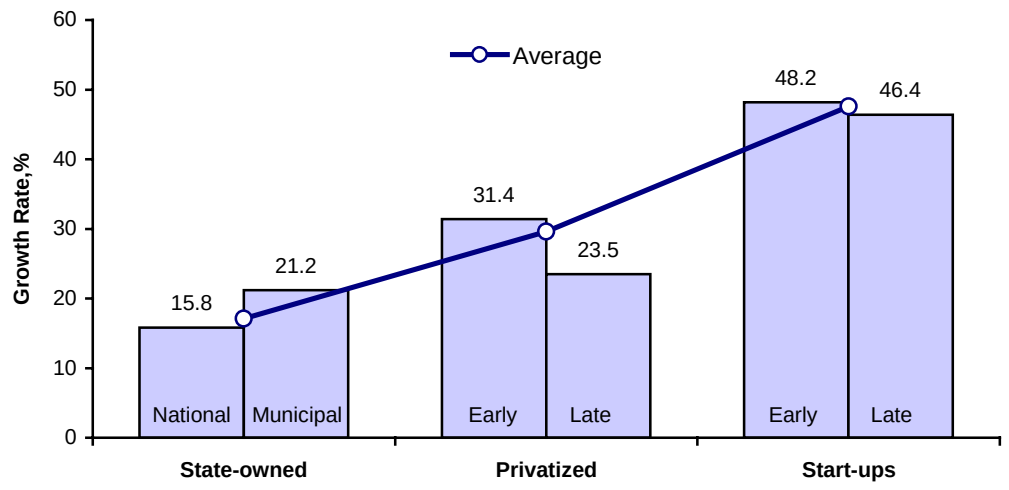
2000 was the first year of economic growth in Ukraine. Overall the results correspond well with national statistics on economic growth. The real volume of sales and value added of surveyed enterprises grew on average by 28% and 11% respectively.

The three best performing sectors by sales in descending order were trade, telecommunications and public catering (see Table 2.) The general service sector experienced the lowest growth rate at 15%. More encouraging was that overall sales growth was skewed towards smaller firms (38%), compared with medium and large firms which experienced an average sales growth rate of 27%.

Table 2
Real Sale Growth Rates in 2000
(% weighted year on year average change)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	31.6	29.3	28.3	19.2	31.1	42.7	**28.5**
Construction	35.4	14.4	11.4	-17.8	20.0	39.6	**18.6**
Transport	39.4	4.4	14.5	21.8	2.2	41.2	**17.1**
Telecoms	50.8	39.6	20.0	19.5	-6.5	41.9	**40.9**
Trade	42.9	64.6	32.0	17.5	30.1	59.2	**45.8**
Public Catering	48.6	7.7		-10.2	45.4	47.6	**38.2**
Other Services	40.3	10.7	16.1	12.9	3.7	53.2	**15.0**
Average	**37.5**	**26.6**	**26.8**				
Firm Size							
Up to 50				9.3	15.9	49.8	**37.5**
51-250				9.8	24.1	49.1	**26.5**
More than 250				18.8	31.0	25.8	**26.8**
Average				**17.1**	**29.6**	**47.6**	***27.7***

Figure 2
Real Sale Growth Rates in 2000 by Firm Origin
(% weighted year on year average change)

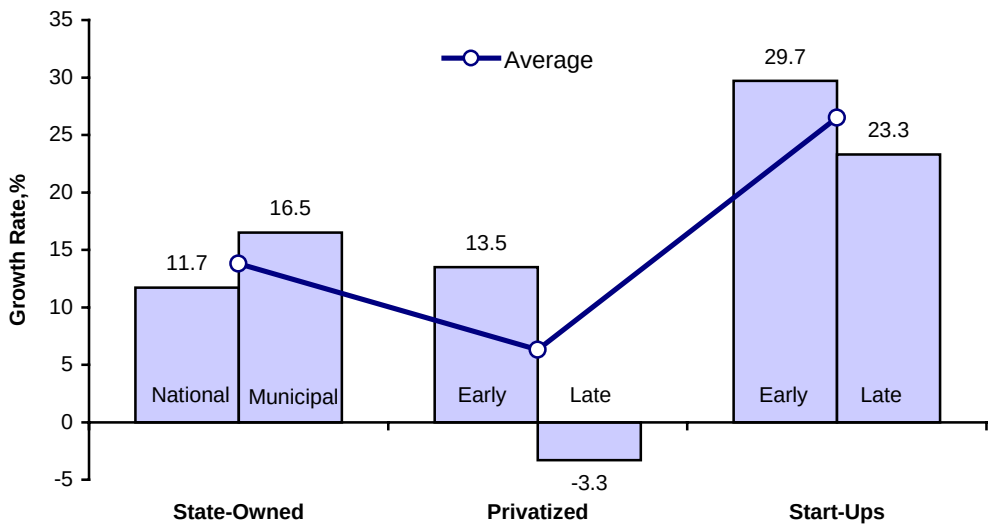


However, results of value added growth differ from the sales picture. Value added provides an assessment of wealth creation in an economy and at the firm level. In terms of value added growth the best three performers were trade, services and telecommunications (see Table 3). The worst in terms of value added growth rates was transport with almost zero. The average rates of growth in value added for each size group of enterprises were approximately at the same level – about 11%.

Table 3
Value Added Growth Rates in 2000
(% weighted year on year average change)[8]

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	1.9	-0.9	10.7	13.8	5.0	20.0	**8.5**
Construction	24.2	13.2	-20.2	-30.1	8.9	36.0	**3.5**
Transport	4.2	4.5	-2.5	9.0	-8.6	0.5	**-0.2**
Telecoms	37.8	8.9	20.0	15.4	-24.0	12.6	**12.4**
Trade	15.3	64.1	27.1	-7.2	21.5	47.4	**33.4**
Public Catering	12.8	-20.7		-43.3	16.7	8.1	**-0.9**
Other Services	16.6	24.5	22.4	17.9	20.5	48.2	**22.5**
Average	**10.5**	**10.8**	**11.2**				
Firm Size							
Up to 50				-44.2	8.2	24.6	**10.5**
51-250				6.4	0.7	29.5	**10.8**
More than 250				17.4	7.5	19.5	**11.2**
Average				**12.8**	**6.3**	**26.5**	***11.0***

Figure 3
Value Added Growth Rates by Firm Origin
(% weighted year on year average change)



On the whole the private sector outperformed the state sector in sales growth in 2000. Sales growth for the private sector was 32% (privatized firms and start-ups) versus 17% for state-owned firms. However, the state sector did better as a whole in value added terms compared with sales growth. Municipal enterprises did well with value added growth of

[8] Value added growth rate was calculated by using the real sales growth data provided by respondents in 2000 compared with 1999 and the shares of material costs in sales in 1999 and 2000.

17%.[9] Late privatized companies that are probably still undergoing more intensive restructuring, fared worse in value added growth than early privatized companies and lowered the average figures for privatized firms as a whole.

Probably the most appropriate comparison to make is between early privatized firms, who have already had time to undergo some restructuring and national state-owned firms (more direct competition.) Here we find that early privatized firms as a whole have performed a little bit better than the state-owned firms. This is encouraging as it shows that on an aggregate level within a particular sector privatization does lead to improved efficiencies, especially if it is borne in mind that in a lot of cases those firms still left in state ownership are more attractive or have a higher degree of market power than firms that were privatized earlier.

Table 4
Profitable Enterprises in 1999
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	67.8	49.1	51.4	51.4	48.3	74.0	**56.5**
Construction	58.3	58.2	66.7	25.0	53.5	72.9	**59.2**
Transport	68.8	30.3	17.5	15.2	31.9	76.0	**37.1**
Telecoms	76.3	100.0	75.0	80.0	50.0	80.6	**79.1**
Trade	65.9	65.9	63.6	53.3	58.7	70.3	**65.8**
Public Catering	55.6	63.6	-	57.1	46.3	65.0	**56.3**
Other Services	72.5	69.6	43.9	58.1	59.5	78.6	**66.9**
Average	**66.1**	**52.9**	**48.5**				
Firm Size							
Up to 50				58.2	53.9	72.8	**66.1**
51-250				56.1	45.1	73.6	**52.9**
More than 250				36.2	51.9	78.3	**48.5**
Average				**48.3**	**50.2**	**73.1**	***59.2***

Table 5
Profitable enterprises in 2000
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	71.2	51.4	56.3	53.1	52.7	76.6	**60.2**
Construction	65.2	65.5	61.1	29.4	58.3	78.9	**64.8**
Transport	70.0	25.0	17.5	14.7	31.9	74.2	**38.4**
Telecoms	83.3	100.0	100.0	100.0	66.7	84.6	**85.1**
Trade	72.2	69.0	54.5	58.8	67.4	74.1	**71.4**
Public Catering	59.1	90.9	-	66.7	52.7	67.2	**61.5**
Other Services	74.8	71.4	53.7	62.9	66.7	78.1	**70.6**
Average	**70.5**	**55.9**	**52.8**				
Firm Size							
Up to 50				61.5	61.7	75.6	**70.6**
51-250				56.1	48.9	75.9	**55.9**
More than 250				41.7	55.6	82.6	**52.8**
Average				**51.5**	**55.4**	**75.8**	***63.5***

Given the sales and value added growth, the proportion of profitable firms has grown by 4% to 64% of all enterprises in 2000. Moreover, more firms were profitable across all sectors, sizes and irrespective of firm origin. The largest proportion of profitable firms were

[9] 2 municipal enterprises were excluded from the averages. One a monopolist electricity utility with value added growth of 208% and the other a monopolist fuel utility with value added growth of 164%.

in telecoms, small firms and start-ups. Conversely, the largest proportions of loss making enterprises were to be found in transport (62% of all transport firms) and state-owned companies (48%).

Exports

The vast majority of surveyed enterprises (80%) did not export their products. The proportion of exporters among large enterprises is five times greater than among small firms. Less than 10% of small firms exported any products.

The international competitiveness of Ukrainian firms (as measured by the prevalence of non-CIS exports) is still very low (see figure 4). For example, 4 times as many large firms perceive CIS countries to be their major markets than Europe and the rest of the world, implying that firms still tend to follow more traditional export markets.

An average of almost 14% of the combined sales of all surveyed enterprises is exported (see table below.) As expected, larger firms export a greater proportion of their output than smaller firms, by a factor of three. By firm origin, privatized firms exported more than three times more of their output (20%) than either state-owned or start-ups.

Figure 4
Distribution of Exports
(% of all firms)

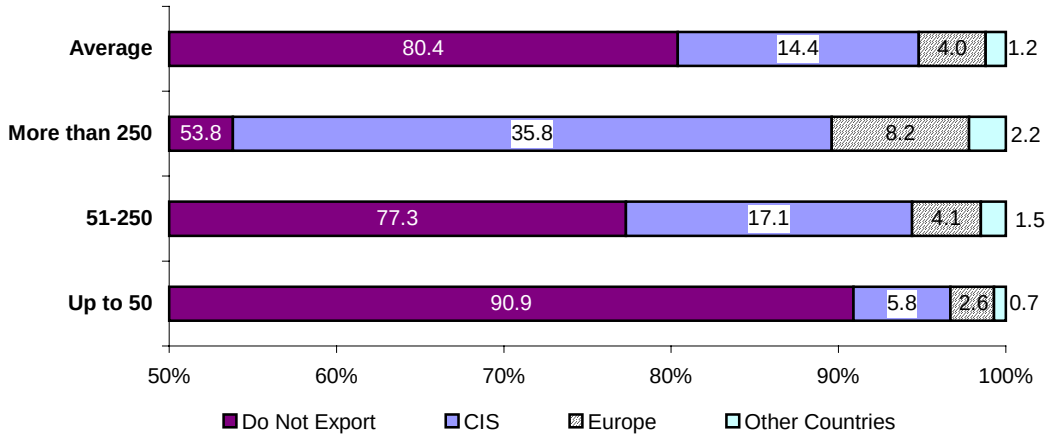


Table 6
Volume of Exports in 2000
(% of total sales of all firms in each group)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	8.2	8.5	18.4	8.1	21.9	8.1	**16.9**
Construction	3.1	1.0	1.0	0.1	2.3	1.3	**1.6**
Transport	12.2	2.0	7.2	0.9	10.4	23.0	**7.2**
Telecoms*	2.2	14.8	5.0	15.8	0.3	13.0	**12.8**
Trade	0.7	0.0	9.2	0.0	5.4	0.6	**2.5**
Public Catering	12.8	0.0	-	0.0	19.0	0.0	**9.3**
Other Services	1.8	0.3	0.0	0.0	0.0	2.0	**0.2**
Average	**5.2**	**5.7**	**16.4**				
Firm Size							
Up to 50				2.9	10.4	3.7	**5.2**
51-250				2.0	6.9	7.8	**5.7**
More than 250				6.5	22.7	14.2	**16.4**
Average				**5.7**	**20.0**	**6.2**	***13.6***

*High export figures for the telecoms sector may be explained by international data traffic counting as exports, and the diversified nature of telecoms companies (also have other lines of business.)

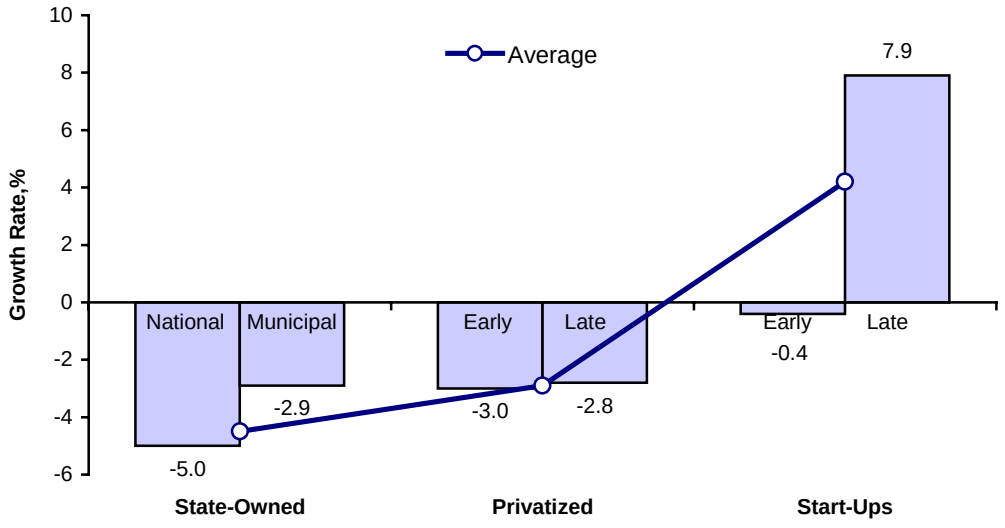
Employment and Labor Productivity

Economic growth in 2000 was not accompanied by job growth at existing enterprises. Despite a rosier financial performance outlook most surveyed companies shed employees, though the data is insufficient to determine the direction of the causal link between job creation and enterprise performance. The average downsizing across the whole sample amounted to 3%. The only exceptions were in telecoms, trade and services and private sector start-ups in general (see Table 7). However, only late start-ups experienced positive job growth (see Figure 5). Internet service providers and mobile communication companies in the telecommunications sector were the only ones experiencing positive job growth irrespective of company size.

Table 7
Employment Growth Rates in 2000
(% weighted year on year average change)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	-5.4	-7.1	-2.7	-5.3	-1.9	-4.2	**-3.2**
Construction	-11.4	-7.6	-8.2	-14.8	-15.2	20.1	**-8.3**
Transport	-28.9	-16.6	-4.4	-4.5	-10.7	0.8	**-6.0**
Telecoms	7.7	44.7	4.0	-1.6	0.0	33.4	**5.9**
Trade	-0.5	5.4	-2.9	-5.8	-5.1	9.7	**0.4**
Public Catering	0.0	-7.6		-13.4	-4.4	6.5	**-2.4**
Other Services	1.4	-1.0	0.9	1.1	-1.1	6.7	**0.7**
Average	**-4.2**	**-6.3**	**-2.7**				
Firm Size							
Up to 50				-14.8	-12.3	3.9	**-4.2**
51-250				-5.1	-9.0	3.6	**-6.3**
More than 250				-4.4	-1.7	4.8	**-2.7**
Average				**-4.5**	**-2.9**	**4.2**	***-3.1***

Figure 5
Employment Growth Rates in 2000
(% weighted year on year average change)



The survey shows that, as a result of negative net job creation, greater restructuring and increases in sales and value added, labor productivity at Ukrainian enterprises has increased in 2000. Table 8 below shows changes in labor productivity. All surveyed sectors experienced labor productivity growth which averaged 15%. The best performers were trade (33%), services (22%) and construction (13%). Public catering performed the worst with productivity increasing by only 1.5%. Medium sized firms fared the best with average productivity of 18%, consistent with them proportionally shedding the most employees (by 6%).

Table 8
Labor Productivity Growth Rates in 2000*
(% weighted year on year average change)

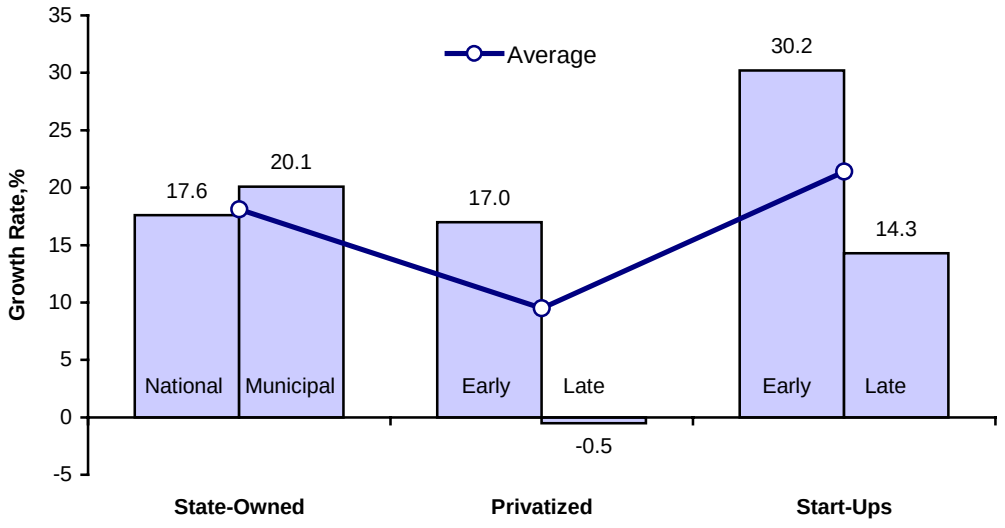
	Firm Size			Firm Origin			
	Up to 50	**51-250**	**More than 250**	**State-Owned**	**Privatized**	**Start-Ups**	**Average**
Sector							
Manufacturing	7.7	6.7	13.8	20.5	7.1	25.3	**12.1**
Construction	40.2	22.6	-13.1	-18.0	28.4	13.2	**12.9**
Transport	46.6	25.4	2.0	14.1	2.4	-0.2	**6.1**
Telecoms	28.0	-24.8	15.4	17.3	-24.0	-15.6	**6.2**
Trade	16.0	55.6	30.8	-1.4	27.9	34.4	**32.9**
Public Catering	12.7	-14.2	-	-34.6	22.1	1.5	**1.5**
Other Services	15.1	25.7	21.3	16.6	21.8	38.9	**21.7**
Average	**15.4**	**18.2**	**14.2**				
Firm Size							
Up to 50				-34.5	23.3	20.0	**15.4**
51-250				12.0	10.7	25.0	**18.2**
More than 250				22.9	9.4	14.0	**14.2**
Average				**18.1**	**9.5**	**21.4**	***14.6***

*Calculated as value added growth ratio (1999-2000) divided by employment growth ratio (1999-2000).

At an aggregate level, over 2000 state-owned enterprises improved labor productivity more rapidly than private firms – by 18% compared to the 13% average for all private firms. This is probably due to state-owned enterprises reducing their work forces more so than other companies. However the picture is more interesting if the data is disaggregated (*see Figure 6 below*). Companies with the highest productivity growth were early start-ups (30%). Followed by municipal enterprises (20%). Early privatized companies performed similarly

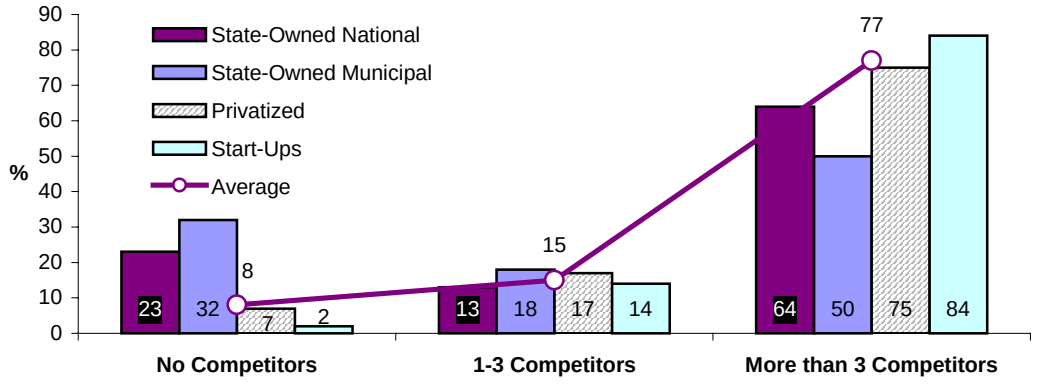
to nationally owned state enterprises increasing their productivity figures by 17% and 18% respectively.

Figure 6
Labor Productivity Growth Rates in 2000
(% weighted year on year average change)



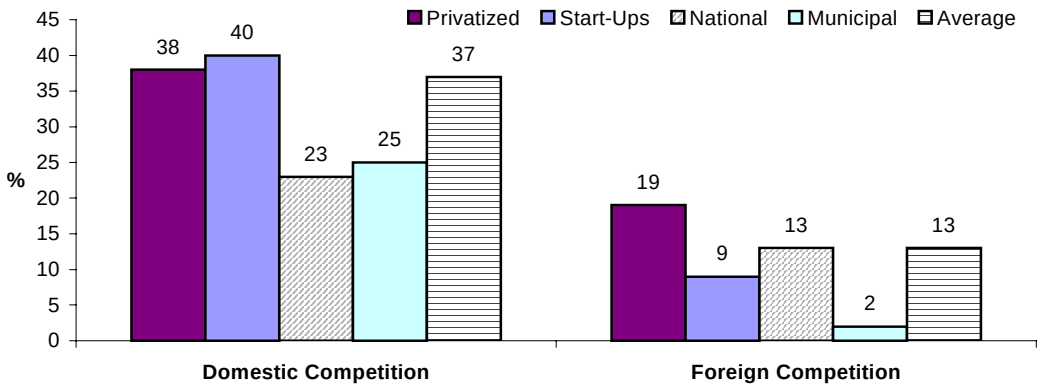
Competition

Figure 7
Number of Competitors
(% of all firms)



Start up enterprises operate in the most competitive environment - only 2% of new entrants have no competitors (see Figure 7). Further, start-ups experienced the most domestic competitive pressure, compared with privatized and state-owned firms (see Figure 8.) Privatized enterprises on the other hand faced the most foreign competitive pressure. As expected, municipal enterprises experienced the smallest competitive pressure (32% of the group are monopolists).

Figure 8
Pressure from Domestic and Foreign Competitors
(% of the total of each type of enterprise who stated significant and very significant competition)



Softness of Budget Constraints

In a fully functioning market environment enterprises are led by market prices, supply and demand, and the relation between revenues and expenditures. Imposition of hard budget constraints on firms implies that enterprises bear full responsibility for their actions, in particular, they make all of their payments to the state in full and on time, receive no state subsidies or credits on preferential terms to finance operational and capital expenditures, and cannot influence the legislative and regulatory environment exclusively in their favor. In addition enterprises should expect that these conditions will not change in the future. Hard budget constraints are therefore one of the more important mechanisms that a government has in determining a level playing field for all and stimulating enterprise efficiency. The violation of any of the above mentioned principles means that an enterprise operates under conditions of soft budget constraints.

For the purposes of our survey soft budget constraints at the enterprise level were defined by the presence of significant tax and/or energy arrears. Table 9 below shows the proportion of enterprises that reported that they were in significant arrears to the state and/or energy suppliers.

Table 9
Firms with Significant Tax and/or Energy Arrears*
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	3.5	12.2	10.9	15.2	10.4	2.2	**8.6**
Construction	3.1	12.7	22.2	11.8	16.4	0.0	**8.3**
Transport	7.5	14.3	12.5	20.6	10.2	3.1	**11.3**
Telecoms	0.0	0.0	25.0	14.3	0.0	0.0	**2.0**
Trade	1.4	0.0	0.0	17.6	0.0	0.7	**1.2**
Public Catering	3.0	0.0	-	9.5	1.8	1.5	**2.8**
Other Services	3.2	5.2	19.5	15.9	6.0	0.9	**6.3**
Average	**2.7**	**10.3**	**12.3**				
Firm Size							
Up to 50				12.4	3.9	1.0	**2.7**
51-250				13.3	12.6	1.7	**10.3**
More than 250				19.2	9.2	8.3	**12.3**
Average				**15.5**	**8.5**	**1.3**	***6.4***

*In answering the question on presence of tax and/or energy arrears firms were given 4 options: 'none', 'insignificant', 'manageable' and 'hopeless'. For the purposes of the table 'manageable' and 'hopeless' were aggregated.

Whilst there is significant variation between sectors, the data shows significantly less small firms have significant arrears to the state than either medium or large firms. As can be observed more larger state owned enterprises experience soft budget constraints than other types of firms. In fact almost 12 times as many state owned firms than start-ups are likely to have significant tax and energy arrears. This has very obvious implications for state revenues.

The use of non-monetary instruments in transactions can also be considered to be a type of soft budget constraint especially as it relates to fiscal discipline of enterprises.

Table 10
Volume of Sales Using Barter, Off-sets, Bills of Exchange and Other Non-monetary Instruments
(% of sales, weighted)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	14.7	17.4	22.9	33.8	16.9	11.6	**21.9**
Construction	21.3	29.1	21.8	12.7	30.6	18.7	**24.4**
Transport	23.3	14.7	7.9	9.1	11.0	20.7	**11.2**
Telecoms	6.0	5.0	58.6	48.2	15.0	5.0	**7.4**
Trade	6.3	3.0	15.9	12.1	7.7	7.4	**7.7**
Public Catering	8.7	2.0	-	4.4	11.3	1.9	**6.9**
Other Services	2.6	37.4	38.2	40.2	34.8	1.9	**36.0**
Average	**11.6**	**20.7**	**23.8**				
Firm Size							
Up to 50				23.1	10.3	10.3	**11.6**
51-250				35.4	19.8	6.0	**20.7**
More than 250				34.2	17.2	16.0	**23.8**
Average				**34.1**	**17.4**	**9.0**	***22.3***

Non-monetary instruments, which are by definition more opaque, often allow for transactions at non-market prices and minimizing or even evading taxes. For example, a large enterprise producing a non-competitive product and thereby with little cash flow, may use barter or mutual off-sets to cover energy debts at below-market prices which in turn distorts the true financial state of the firm.

On average state-owned firms had more non-monetary transactions than privatized firms, who in turn had more that start up firms. However, there were significant variations with for example, state owned transport and construction firms being more cash based than their counterparts in the private sector. Similarly there is tendency for larger firms to use more non-monetary instruments than smaller ones.

Enterprise Restructuring

According to the definition of Pohl *et al.*,[10] enterprise restructuring during the transition from a planned to a market economy is a complex process of changes at the firm level to support profitability under conditions of a continuously changing economic environment, technological progress and competition from other market participants. Existing economic literature on enterprise restructuring in transition defines at least two major types of restructuring activities: passive and strategic restructuring:[11]

Passive restructuring is imposed by new market environment on almost all enterprises regardless of firm origin. It includes the following measures influencing the short-term prospects of an enterprise: postponing production not demanded by the market, reducing costs by the sale or lease of idle assets, decreasing real wages and/or reducing the workforce.

Strategic restructuring include measures aimed at making an enterprise viable in the long run. The market value of an enterprise in this case is maximized by the development of new business strategies, organizational changes, investment into new production lines and technologies, new product development, expansion into new markets, etc. Strategic restructuring usually leads to an increase in output and new job creation.[12]

This survey attempts to reveal the intensity of restructuring, or alternatively firm dynamism (as some of these activities are not purely restructuring activities) at the enterprise level. Respondents were asked questions regarding both strategic and passive kinds of restructuring activity performed by their enterprise over the last three years. Table 11 presents a breakdown of restructuring activities by firm origin.

[10] Pohl, Gerhard, Robert E. Anderson, Stijn Claessens and Simeon Djankov (1997): Privatization and Restructuring in Central and Eastern Europe: Evidence and Policy Options. World Bank Technical Paper No. 368, The World Bank.

[11] See, for example, Irina Akimova, "Export Orientation and its Influence on Enterprise Restructuring in Ukraine", pp 209, ed. Hoffmann and Moellers, 2001.

[12] EBRD Transition Report 1999, pp.143-144.

Table 11
Restructuring by Firm Origin
(% of the total of each type of enterprise)

		Firm Origin						
		State-Owned		Privatized		Start-Ups		Average
		National	Municipal	Early	Late	Early	Late	
Strategic Restructuring	Developed New Products	36	22	45	47	54	39	**43**
	Improved Existing Products	41	24	50	44	55	43	**46**
	Changed Sales Channels	27	8	31	32	28	24	**27**
	Attracted New Major Clients	32	16	34	30	41	39	**34**
	Introduced New Technologies	26	30	31	28	34	24	**28**
	Purchased/ Leased New Assets	7	8	8	10	20	15	**12**
	Changed Major Suppliers	14	5	20	19	22	19	**18**
	Attracted New Employees	29	24	34	36	47	45	**38**
	Trained Employees in New Technologies	18	15	27	26	29	24	**25**
	Changed Legal Organizational Structure	11	10	8	22	5	8	**10**
Passive Restructuring	Discontinued Production of Old Products	17	5	23	18	15	9	**16**
	Sold/ Leased Out Excess Assets	26	19	32	25	9	6	**19**
	Shed Excess Labor	45	32	50	46	30	25	**38**

Development of new products is perceived by many economists as the most important sign of strategic restructuring since it reflects an enterprise's ability to meet changing demand and other market conditions. Early start-ups are clearly the most innovative, with over half developing new products and services. Privatized firms (irrespective of when they were privatized) also performed well in developing new products. State owned enterprises performed worst of all in adapting to changing market conditions though this could also be

more of a reflection of the fact that state owned enterprises tend to face less competition in general.[13]

On the whole the data shows start ups and privatized enterprises to be most dynamic in response to changing conditions, they were better at finding customers, developing new products, and creating new jobs. Passive types of restructuring, represented by discontinuation of old products and production and a reduction in excess labor, were also performed most frequently by privatized enterprises. Across all restructuring parameters surveyed, more privatized firms were active than state-owned firms, particularly in strategic restructuring.

The worst performers across almost all restructuring indicators were municipally owned enterprises, an important confirmation of the need to further reduce the role of city governments in local business.

Management Turnover

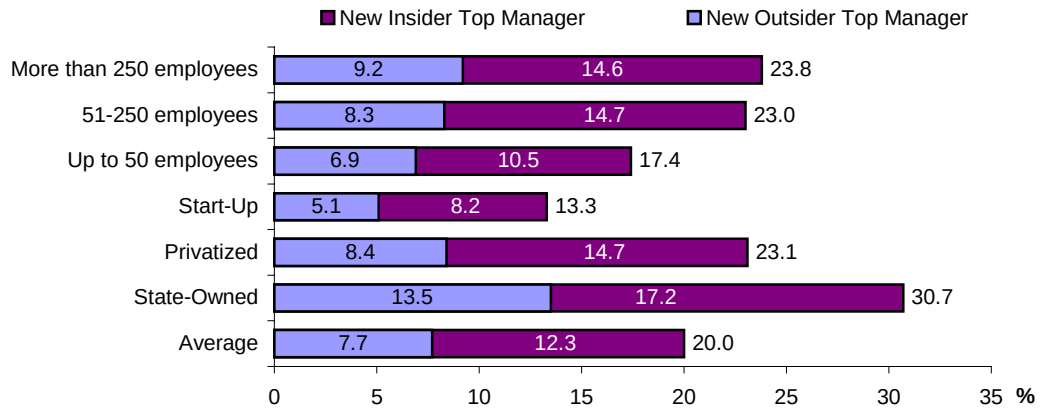
Another important component of enterprise restructuring (or enterprise dynamism) is the frequency with which key enterprise decision makers are changed, if at all. Company managers take all key operational decisions and are in a position to initiate restructuring. The role of outside professional company management (in the sense of taking key operational decisions) is still novel in Ukraine.

Directors could be disciplined in different ways, in particular, by enterprise owners and external factors. Company directors are appointed by enterprise owners who could have different objectives. For instance, the objectives of insider owners (workers or existing managers) are quite different from the objectives of the outsiders - direct and portfolio investors or government representatives. Among the major external factors influencing management turnover according to the survey are market structure (*i.e.* competition) and degree of softness of budget constraints.

On average, each fifth enterprise changed its top management over last three years. At the same time 7.7% of surveyed companies attracted new top managers from outside. Evidence of the latent state of the managerial talent market is the relatively low influx of new outside managers into privatized enterprises – only 8.4%. The high proportion of management turnover at state-owned enterprises is probably explained by administrative and/or political decisions rather than market pressures. The table below shows by firm size and origin those firms that changed their management, as well as showing whether they were insiders or outsiders.

[13] For comparisons between the state and private sectors in enterprise restructuring it is better to use only nationally owned enterprises as representative of state enterprises due to the specific market conditions under which municipal enterprises operate (product homogeneity and high degree of market power.)

Figure 9
Management Turnover
(% of all firms)



The telecoms sector experienced the highest rate of attracted managerial talent, however the general manufacturing sector also experienced substantial management turnover (23%), especially so with state owned enterprises (65.5% of all state owned manufacturing companies.)

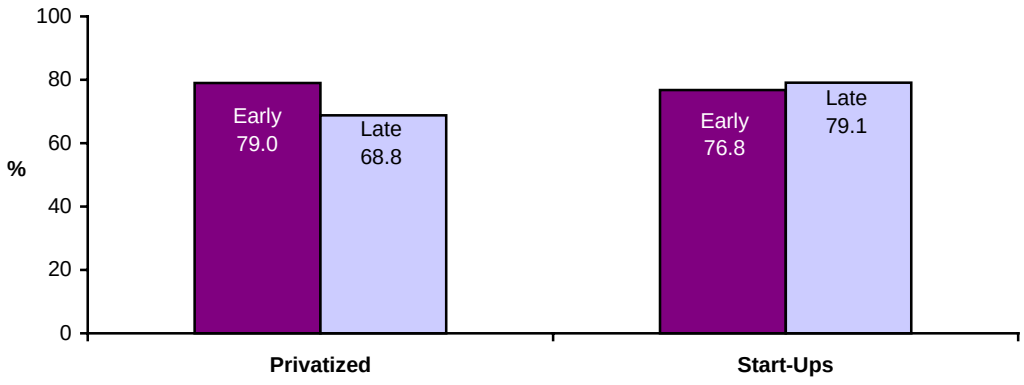
A possible reason for the relatively low level of influx of new outside managers into privatized firms could be that enterprise ownership is more dispersed, and therefore the chances of a majority owner are reduced. Another possible reason is the dominance of inside owners in an enterprise rather than outside owners, thereby increasing the chances for insider management.

Table 12
Ownership Dispersion at Privatized Enterprises and Start-ups
(% of all private firms)

	Holders of Major Stakes, %*				Total
	One (State)	One (Private)	Two-Three	More than Three	
Privatized	**1.7**	**13.8**	**22.0**	**62.5**	**100.0**
Early	1.6	12.2	18.0	68.2	**100.0**
Late	1.9	15.5	26.8	55.8	**100.0**
Start-ups	**0.5**	**43.5**	**36.3**	**19.6**	**100.0**
Early	0.9	35.7	38.9	24.5	**100.0**
Late	0.4	48.3	34.5	16.9	**100.0**

*Refers to holders of the largest relative stakes. The state could very well have the largest single, though minority, share.

Figure 10
Privatized Enterprises and Start-ups with Dominant Inside Owners*
(% of total in each firm origin group)



*Controlling stake with management and/ or employees.

A statistical analysis (*see Annex 2 for more information*) revealed that there are several main factors that increase the probability of the appointment of new outside management. In order of significance these are: the presence of outside owners, an increase in the number of competitors and the probability that management will change increases with the presence of significant tax and/or energy arrears.

Start-ups change their managers the least frequently. More than twice as many state-owned firms compared have changed their management as start-ups. Ownership concentration appears to have no significant influence on the probability of management turnover.

Factors That Influence Enterprise Performance

An important objective of the survey was to determine what relationship, if any, exists in Ukraine between enterprise performance and various internal and external factors influencing enterprises. This follows on from similar research carried out by EBRD in 1999[14] where they examined enterprise performance in the medium term (over three years) in 22 transition countries.

EBRD Business Environment and Enterprise Performance Survey
Main Results:

- *Sales growth is higher for those firms experiencing significant pressure from foreign competitors, but is not higher for firms reporting significant pressure from domestic competitors. Firms with 1-3 competitors have much higher sales and productivity growth than firms with no competition or very strong competition. Pressure from foreign competitors and customers is a significant source of sales and productivity growth. Competition contributes to the growth of firms through its impact on the development of new products and technologies.*
- *Strategic restructuring at the firm level is conducive to sales and productivity growth. The launch of new products and the upgrading of existing ones are closely linked with sales growth. At the same time the influence of switching suppliers and firm reorganization on sales growth is very weak;*
- *Soft budget constraints measured by the presence of tax arrears leads to a slower expansion in sales.*

[14] Business Environment and Enterprise Performance Survey. EBRD Transition Report 1999.

The analysis in this report (*see Annex 2 for regression analysis*) used the same approach as in EBRD's survey and showed that, in the short term (over one year), the following factors are related to enterprise performance:

- Significant domestic competition is associated with increasing sales. However, significant foreign competition leads to a slight decrease in real sales volumes;
- When control is made for other factors, firm origin status does matter for financial performance. Start-ups and privatized enterprises performed better than state-owned companies in terms of sale growth whilst municipal enterprises outperformed nationally owned state enterprises in terms of value added growth;
- Strategic restructuring measures have different effects. New product development correlates with a reduction in sales and value added, whilst improving existing products is associated with increasing sales. Changing sales channels increases the volume of sales and value added. Attracting new clients leads to higher value added volumes. Changing major suppliers correlates with a reduction in value added. Training employees to meet new technologies and attracting new employees is associated with an increase in value added. Changing a firms organizational structure correlates with a decrease in value added (however, it is not clear why);
- The consequences of passive types of restructuring are varied as well. Ceasing old production increases a firm's value added. Sale/lease of excessive assets is associated with a reduction in real sales. Reducing the workforce correlates with a reduction in value added. This is a positive sign if accompanied by productivity growth;
- The short term influence of soft budget constraints on firm financial performance is unclear.

Factors That Influence Enterprise Restructuring

Some restructuring measures in the short term are associated with increasing sales and value added, others with a decrease. However, other research carried out in this field that uses a more long term approach and simple common sense indicate that restructuring, especially strategic restructuring, is a precondition for improving competitiveness and sustainable growth of an enterprise. Therefore, this report seeks to analyze which factors are the most conducive for restructuring at the firm level.

According to the EBRD Business Environment and Enterprise Performance Survey[15], the degree of enterprise restructuring in transition economies in general is positively influenced by the level of competition experienced by firms, hard budget constraints, presence of concentrated outside private owners and quality of the investment climate in the particular country.

Studies of the Ukrainian corporate sector have drawn similar conclusions. Research carried out by the London Business School[16] found that outsider rather than insider firm ownership leads to greater restructuring activity, notably with respect to products (*i.e.* adjustment to quality, product mix, structure of sales by region and sales outlets) and inputs (reducing waste in material inputs, energy, changing suppliers.) The German Advisory Group on Economic Policy[17] concludes that enterprise restructuring is triggered by an increase in competitive pressure, especially by exposure to foreign competition, changes in top

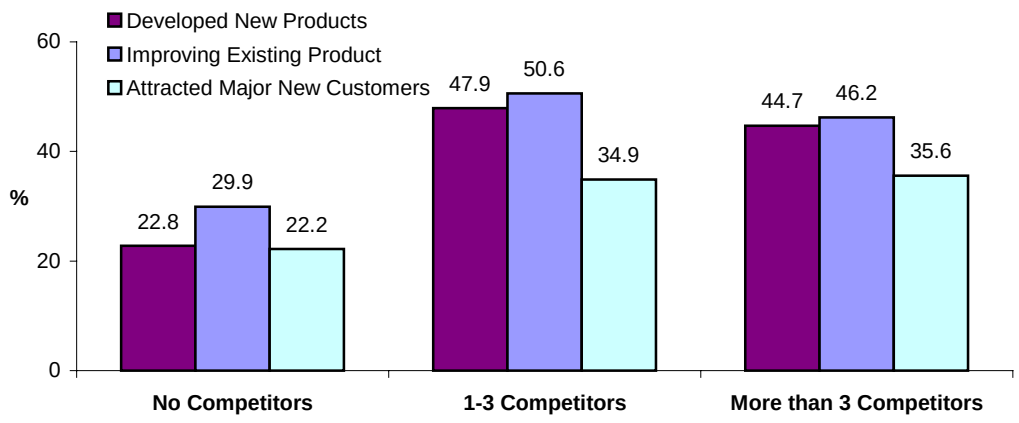
[15] EBRD Transition Report 1999.
[16] Estrin Saul, and Rosevear, Adam, Enterprise Performance and Corporate Governance in Ukraine. Journal of Comparative Economics, 27, 1999, pp. 442-458.
[17] See, Irina Akimova, "Export Orientation and its Influence on Enterprise Restructuring in Ukraine", pp 206-232, Ukraine on the Road to Europe, ed. Hoffmann and Moellers, 2001.

management and training for enterprise staff. At the same time soft budget constraints significantly slow down restructuring activity.

Our survey generated sufficient data to explore the factors that influence enterprise restructuring. A regression analysis was employed to assess the influence of such variables as competition, firm origin and budget constraints on enterprise restructuring. The detailed results are presented in Annex 2.

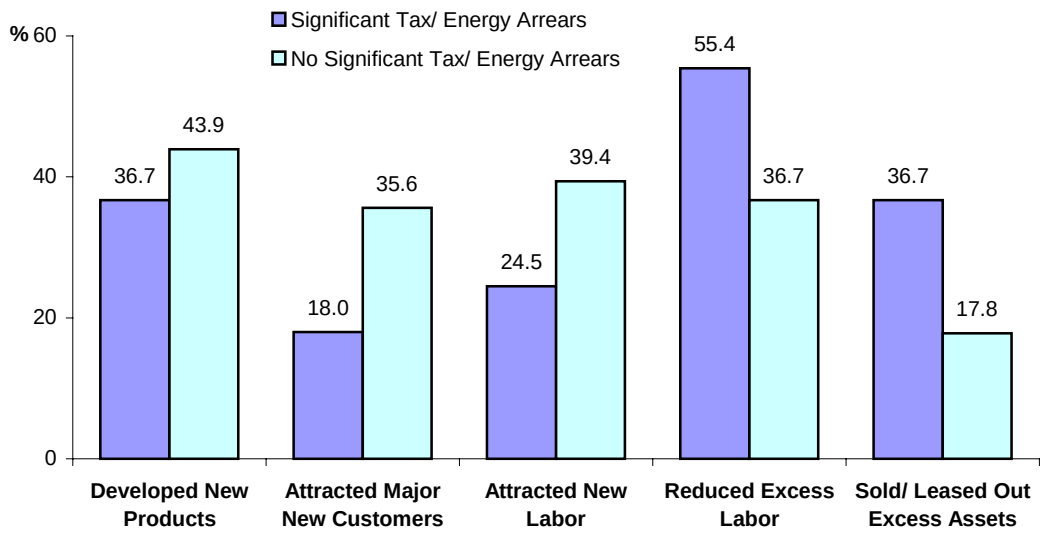
The analysis confirms that the most important factor associated with enterprise restructuring is competitive pressure. Further, pressure from foreign competitors seems to be much more important than pressure from domestic rivals. This accords well with previous research. Oligopolistic competition (1-3 competitors) promotes the development of new products and the improvement of existing products more so than other types of enterprise restructuring. Stronger competition (more than 3 competitors) has a larger influence, not on the development of new products, but on more frequently changing sales channels - *i.e.* more dynamic marketing. Facing competitive pressure, enterprises are more likely to look for new customers. Significant foreign competition pushes Ukrainian enterprises to innovate and introduce new technologies. Competition also acts as a strong influence on persuading enterprises to sell off or lease unwanted assets. Competition also seems to be the biggest motivator in reducing excess labor at an enterprise. The stronger the competition the more likely that an enterprise will shed excess labor.

Figure 11
Level of Competition and Strategic Restructuring
(% of all firms that performed strategic restructuring)



Statistical analysis shows that firm origin status does indeed correlate with enterprise restructuring. Less state-owned firms performed any restructuring measures than either privatized firms or start-ups. Privatized firms and start-ups are much more likely to provide training for their employees than state-owned enterprises. In addition, start ups are also the most frequent buyers of new assets and the major source of new jobs. Across all of the variables tested municipal enterprises introduce restructuring measures least of all. This may be explained by lack of the profit motive, by the higher degree of market power enjoyed by most of them at the city level and the presence of relatively stable local budget financing (*e.g.* for public transport.)

Figure 12
Softness of Budget Constraints and Restructuring
(% of all firms that restructured)



The analysis shows that soft budget constraints do indeed influence restructuring. The presence of soft budget constraints, approximated by tax and energy arrears, is associated with sluggish change at the enterprise level, except for contraction measures (*i.e.* passive forms of restructuring.) Soft budget constraints seem to significantly reduce the probability of introducing and improving products. Further the presence of soft budget constraints negatively correlates with improved marketing (*i.e.* less likely to find new customers.) Companies with arrears are also the least likely to employ new workers. However, they are associated with the shedding of excess labor and excessive assets.

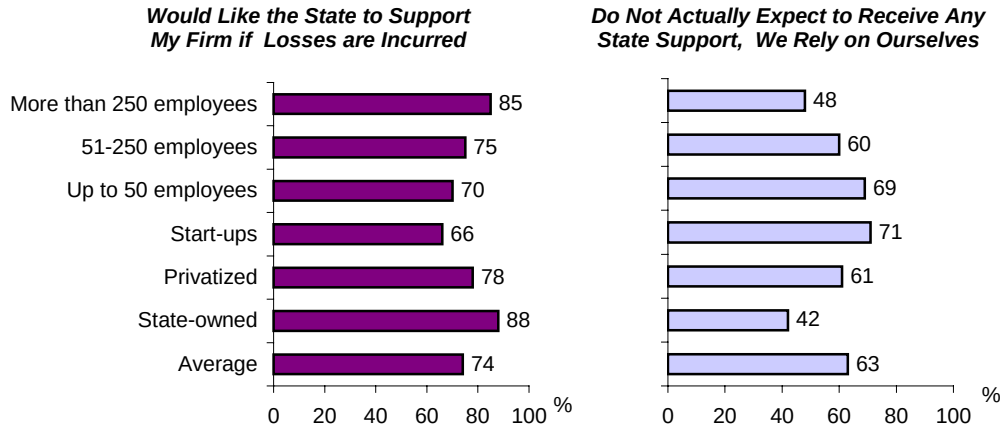
Paternalism

One of the more interesting aspects of this research was attempting to get an idea of the degree of 'paternalism', or expectation of state support, still prevalent in company management in Ukraine.

Decentralization of economic decision making lies at the essence of the transition from a planned to a market economy. Market reforms need to transfer the consequences of business decisions, including their benefits and costs, to the enterprise level and away from the state. Only under such conditions will private initiative promote proper restructuring and productivity growth instead of rent seeking activities (search for subsidies, privileges and preferential treatment) and other methods of market distortion.

The figure below shows the views of firm managers regarding the role of the state in the economy. The figure on the left shows the proportion of enterprises who would like to have the state support them should they incur losses (*i.e.* desire for support.) The second figure reflects the proportion of enterprises that do not actually expect to receive any real support from the government and rely on themselves only.

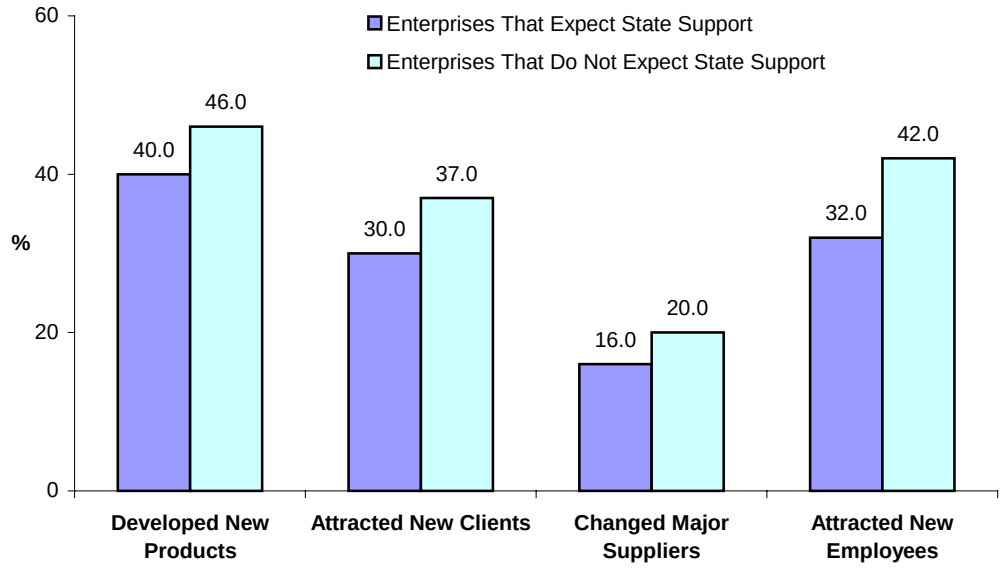
Figure 13
Expectation of State Support
(% of positive answers for all firms)



About three quarters of respondents (74%) would like the government to cover losses incurred by their firms or provide funds for investment. Another startling result is that two thirds of start up businesses would like to receive government support if they incur losses or if their businesses start to fail. These entrepreneurs should be amongst the most progressive supporters of enterprises and the primacy of the private sector. That these figures are so high is a very disappointing finding and demonstrates how much more work needs to be done on promoting market principles in Ukraine. At the same time 63% of managers do not expect in actual fact to receive any state support at all and rely on their own resources if losses are incurred. This figure may be considered as another indicator of restructuring at enterprise level. Not surprisingly, this independence from the state is the highest for start-ups and the lowest for state-owned companies. Moreover, expectations of government support positively correlate with enterprise size.

Based on the above results, it is interesting to see the relationship between the degree of paternalism and intensity of strategic restructuring. Without exception, those enterprises with lower levels of moral hazard experienced more strategic restructuring. The figure below compares those firms given in the second chart of Figure 13 and their corollary, *i.e.* firms who do and do not in actual fact expect to receive any government support if they incur losses. Strategic restructuring measures for the two different types of firms were compared and the results presented in Figure 14.

Figure 14
Intensity of Strategic Restructuring and Expectation of State Support
(% of the total of each type of enterprise)



Those firms with lower levels of moral hazard undertook more strategic restructuring than those who expect state support, or in other words the more independent an enterprise the better it is at adapting to change. This is consistent with the picture with profitability. Analyzing the responses between those who answered yes or no to the question of "We should rely only on ourselves" shows that 64% of those who answered yes were profitable in 1999. In 2000 this figure had increased to 69%. Of those who disagreed with the statement (*i.e.* do expect state support) 51% were profitable in 1999 and 53% in 2000. The data does show a link between profitability growth and expectations of paternalism, however this information is insufficient to show a causal link.

Capital Expenditures and Working Capital

A very important factor of the health of an economy is investment. Investments increase production potential, allow for job creation, and establish conditions for sustainable growth. The survey sought to identify the incidence of capital investment into individual firms and usage of investment funds.

Over 2000, 41% of surveyed firms experienced capital investment. Table 13 below shows the breakdown of companies who had investment expenditures over 2000 by sector, firm size and firm origin.

Table 13
Proportion of Enterprises That Experienced Fixed Capital Investment in 2000
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	41.1	41.5	54.6	47.0	40.6	52.4	**45.3**
Construction	32.3	45.5	44.4	29.4	35.6	41.8	**37.9**
Transport	40.0	42.9	42.5	29.4	46.9	46.9	**41.7**
Telecoms	45.5	50.0	75.0	42.9	33.3	50.0	**48.0**
Trade	28.8	46.7	45.5	35.3	26.4	33.2	**31.2**
Public Catering	33.6	45.5	-	14.3	32.1	42.6	**34.5**
Other Services	33.1	51.7	48.8	39.7	34.5	44.0	**39.8**
Average	**35.0**	**43.6**	**52.4**				
Firm Size							
Up to 50				23.7	26.4	40.1	**35.0**
51-250				37.3	38.0	64.1	**43.6**
More than 250				53.1	51.1	62.5	**52.4**
Average				**39.7**	**37.5**	**43.8**	***40.5***

There is small variation between firms of different origin in terms of frequency of investment expenditure. Naturally, start-ups are more frequent investors (44%) than state-owned firms (40%), and privatized companies (38%). This is also the case with capital-intensive sectors, such as telecoms (48%) and manufacturing (45%) compared with labor-intensive trade (31%) and public catering (34%). Larger enterprises are also more likely to experience capital expenditure than smaller firms (52% vs.35%.)

Table 14 shows what firms used capital investment for. Purchasing new equipment was the most popular form of investment with 28% of all firms doing so, whereas new construction projects the least with 9% of all firms investing into construction.

Table 14
Investment into Fixed Assets in 2000
(% of all firms in each firm origin group)

	National	Municipal	Privatized	Start-Up	Average
Investment Took Place	42.0	36.6	37.5	43.8	**40.5**
New Equipment	27.8	20.4	24.2	32.9	**27.9**
Repair of Premises	24.5	19.4	22.2	22.7	**22.5**
Repair of Equipment	21.2	20.4	19.2	11.2	**16.2**
Transport Assets	13.2	11.8	12.7	15.4	**13.8**
New Construction	9.0	7.5	9.3	9.6	**9.3**

Over 2000, retained earnings and depreciation was the major source of investment into fixed assets (see Table 15). 86% of firms who had investment expenditures did so from internally generated sources. In a very distant second place for sourcing investment capital were bank credits at 15% of those who experienced investment. Other forms of longer term financing were insignificant.

Table 15
Sources of Investment into Fixed Assets in 2000
(% of firms who had investment expenditures)

	National	Municipal	Privatized	Start-Up	Average
Retained Earnings and Depreciation	81.9	76.5	89.4	79.3	**86.4**
Bank Credit	19.0	6.0	15.7	13.5	**15.1**
Non-Bank Credit	0.0	0.0	4.5	6.3	**4.9**
Domestic Investor	2.1	20.5	6.1	4.9	**5.9**
State Funds	12.4	23.5	1.3	0.2	**3.0**
Leasing	2.1	0.0	3.2	1.9	**2.5**
Direct Foreign Investor	2.1	3.0	1.9	1.3	**1.7**
Portfolio Investor	1.2	3.0	1.3	1.5	**1.5**

Table 16 presents more detailed data on attracting bank credits for capital investment. More than twice as many large firms (11%) received bank credit than small firms (4%.) There is almost no variance within firm origin with around 6% of firms able to secure bank credit.

Over 2000, banks found most attractive telecoms firms, large trading firms, transport start-ups and large state-owned manufacturing enterprises.

Table 16
Proportion of Firms that Used Bank Credits for Investment into Fixed Assets in 2000
(% of all firms in each group)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	5.3	7.0	11.3	9.3	7.1	7.9	**7.7**
Construction	2.1	3.6	0.0	0.0	1.4	3.8	**2.4**
Transport	12.5	8.6	10.0	8.8	10.2	12.5	**10.4**
Telecoms	2.3	50.0	25.0	0.0	0.0	7.5	**6.0**
Trade	3.9	13.3	18.2	0.0	4.7	5.9	**5.3**
Public Catering	1.5	0.0	-	0.0	1.8	1.5	**1.4**
Other Services	4.5	3.4	7.3	4.8	3.6	5.5	**4.7**
Average	**4.2**	**6.9**	**10.6**				
Firm Size							
Up to 50				4.1	3.0	4.8	**4.2**
51-250				4.8	4.2	16.2	**6.9**
More than 250				9.2	11.5	8.3	**10.6**
Average				**6.5**	**5.8**	**6.3**	***6.1***

In terms of working capital financing the picture is a little more optimistic, with 13% of all firms managing to obtain short-term bank credit to finance working capital in 2000 (see Table 17). Again, obtaining short-term bank credits was easier for larger firms than for smaller ones: a quarter of all large firms managed to secure bank credit for working capital compared with only 9% of small firms. Among larger firms trading companies did especially well with 55% managing to obtain short-term bank credits.

Table 17
Proportion of Firms that Used Bank Credit for Working Capital in 2000
(% of all firms in each group)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Sector							
Manufacturing	11.7	11.6	27.5	17.2	17.1	14.9	**16.4**
Construction	5.2	12.7	5.6	5.9	11.0	5.1	**7.7**
Transport	10.0	11.4	10.0	11.8	8.2	12.5	**10.4**
Telecoms	2.3	0.0	50.0	14.3	0.0	5.0	**6.0**
Trade	12.2	35.6	54.5	11.8	20.9	13.6	**15.8**
Public Catering	2.2	0.0	0.0	0.0	3.6	1.5	**2.1**
Other Services	4.5	5.2	22.0	7.9	10.7	4.6	**7.4**
Average	**8.9**	**12.7**	**25.2**				
Firm Size							
Up to 50				6.2	8.6	9.4	**8.9**
51-250				10.8	11.1	18.8	**12.7**
More than 250				18.5	29.0	20.8	**25.2**
Average				**12.6**	**15.2**	**10.9**	***13.0***

Surveyed enterprises have more ambitious investment plans for 2001 compared with actual capital expenditures over 2000 (see Table 18). 58% of all respondents plan investment into fixed assets compared with the 42% in 2000. It remains to be seen whether this will actually take place. Privatized enterprises are the most ambitious in terms of investment projections with 60% planning to invest into fixed assets.

Table 18
Planned Investment into Fixed Assets in 2001 by Firm Origin
(% of total number of respondents in each group)

	National	Municipal	Privatized	Start-Up	Average
Investment Will Take Place	52.4	50.5	60.2	58.7	**58.4**
New Equipment	34.4	29.0	36.1	36.3	**35.7**
Repair of Premises	19.3	17.2	29.4	17.1	**22.8**
Repair of Equipment	24.1	24.7	22.8	10.8	**18.1**
Transport Assets	12.7	14.0	14.5	17.4	**15.5**
New Construction	9.0	8.6	11.7	14.0	**12.2**

Table 19 shows expected sources of investment over 2001. Firms are starting to look more at external sources – obtaining bank credits (19% of firms expecting investment compared with 15% in 2000) and attracting strategic investors - 8% of all firms expect a local investor in 2001 compared with the 6% in 2000, and 5% of all firms expect a foreign investor compared with 2% in 2000.

Table 19
Expected Sources of Investment into Fixed Assets in 2001 by Firm Origin
(% of firms who expect investment expenditures)

	National	Municipal	Privatized	Start-Up	Average
Retained Earnings and Depreciation	84.5	78.8	77.9	84.7	**81.3**
Bank Credit	19.8	12.9	20.6	18.1	**19.2**
Non-Bank Credit	0.0	0.0	3.3	4.6	**3.4**
Leasing	3.6	2.2	7.0	5.5	**5.8**
Domestic Investor	6.3	17.0	9.3	4.8	**7.5**
Foreign Investor	6.3	12.9	5.6	3.4	**5.1**
Portfolio Investor	1.7	4.4	1.8	0.9	**1.5**
State Funds	11.6	25.5	2.7	0.7	**3.6**

Enterprise Performance – Conclusions

Official statistics[18] show that Ukraine's GDP has grown by 6% over 2000 and this is reflected by the surveyed firms whose value added increased on average by 11%. On the demand side, external demand for Ukrainian goods grew much faster than internal demand. Export growth of goods reached 26% compared with domestic capital investment growth of 11% and growth in household expenditure of 10%.[19] Export growth was a result of increased overseas demand for Ukrainian products (particularly CIS markets) and the positive impact of currency devaluation, which took place in late 1998. Internal demand grew due to an expansionary monetary policy in 2000 as well as from the multiplier effect from export growth. Further, the government reduced wage and pension arrears in 2000 which has had a positive effect on household income.

This survey offers evidence that on the supply side, the Ukrainian economy has been improving as well. Firms are adapting to market conditions and there is evidence that restructuring efforts are paying off with growth in labor productivity. The survey sought to establish which groups of firms contributed most to economic growth and to determine what factors influence the pace of restructuring at the firm level.

Small firms experienced the highest sales growth in 2000 (see Table 20**Error! Reference source not found.**.) However, this was not accompanied by a respective increase in value added. Small firms experienced 11% value added growth, similar to medium sized and large firms. At the same time more small firms (70%) were profitable than medium sized (56%) and large firms (53%.) Medium sized firms demonstrated the highest growth in labor productivity (18%), mainly due to larger lay-offs of 6% on average.

Table 20
Summary Table of Changes in Financial Performance in 2000
(% year on year change)

	Real Sales Growth	Value Added Growth	Employment Growth	Productivity Growth
Sector				
Manufacturing	28.5	8.5	-3.2	12.1
Construction	18.6	3.5	-8.3	12.9
Transport	17.1	-0.2	-6.0	6.1
Telecoms	40.9	12.4	5.9	6.2
Trade	45.8	33.4	0.4	32.9
Public Catering	38.2	-0.9	-2.4	1.5
Other Services	15.0	22.5	0.7	21.7
Firm size				
Up to 50	37.5	10.5	-4.2	15.4
51-250	26.6	10.8	-6.3	18.2
More than 250	26.8	11.2	-2.7	14.2
Firm Origin				
All State-owned	17.1	12.8	-4.5	18.1
National	15.8	11.7	-5.0	17.6
Municipal	21.2	16.5	-2.9	20.1
All Privatized	29.6	6.3	-2.9	9.5
Early Privatized (up to 1996)	31.4	13.5	-3.0	17.0
Late Privatized (1996 and later)	23.5	-3.3	-2.8	-0.5
All Start-Ups	47.6	26.5	4.2	21.4
Early Start-ups (up to 1995)	48.2	29.7	-0.4	30.2
Late Start-ups (after 1995)	46.4	23.3	7.9	14.3
Average	**27.7**	**11.0**	**-3.1**	**14.6**

[18] State Statistics Committee of Ukraine.
[19] Authors' estimates.

Start-ups showed the highest growth in sales, value added, employment and labor productivity compared to either privatized or state-owned firms. Further, significantly more start-ups were profitable (76%) than either privatized (53%) or state-owned firms (51%.)

On average value added and labor productivity grew faster at state-owned enterprises than at privatized enterprises, however it is instructive to disaggregate the data and look value added growth in more detail.

The overall results of the state-owned sector were considerably boosted by municipally owned firms in the survey sample. There is a much higher incidence of monopolists amongst municipal firms than with either national state-owned firms or with privatized firms. Further, municipally owned firms in general have a much higher degree of market power than either types of firms.

There is also a large difference amongst firms privatized before and after 1996. This is especially evident in value added growth and labor productivity growth, where early privatized firms performed very well whereas late privatized firms actually contracted. A possible reason is that early privatized firms have had more time to adjust, find an effective owner and implement strategic changes, whilst late privatized firms are still in the early stages of restructuring.

Comparison of national state-owned firms and early privatized firms is more appropriate as both groups operate in a similar market environment with similar competitive pressures and early privatized firms have already gone through the difficult transition to private ownership. Early privatized firms outperformed national state-owned firms in terms of real sales growth and value added growth. Labor productivity growth is similar for both privatized and national state-owned firms, though there was higher labor contraction at national state-owned firms of 5% compared with only 3% at privatized firms.

Hard budget constraints are imposed on Ukrainian business very unevenly. In particular, more state-owned enterprises have significant tax and energy arrears more often than their counterparts in private sector. The proportion of barter, mutual off-sets, bills of exchange and other non-monetary instruments in the transactions of state-owned enterprises is larger than in private companies as well.

The survey shows that competition is the most important factor in producing a positive effect on restructuring and enterprise performance. The number of competitors and the origin of competitive pressure are of great importance. The higher the level of competition, the sooner a business will restructure and increase sales. Innovation (*i.e.* new product development and introduction of new technology), which demands additional costs, is associated with a more moderate level of competition. Another important result is that pressure from foreign competitors is a much more powerful incentive to restructure than pressure from domestic rivals.

Statistical analysis shows that firm origin correlates with enterprise restructuring. Less state-owned firms performed any restructuring measures than their counterparts in the private sector. Soft budget constraints also influence enterprise restructuring. Soft budget constraints, approximated by tax and energy arrears, is associated less enterprise dynamism (*i.e.* less restructuring), except for contraction measures – shedding employees and assets. Soft budget constraints also reduce the chances of introducing and improving products.

Over the course of 2000, two fifths of surveyed companies experienced capital expenditures, or in other words invested in their own businesses. Reflecting the poor state of the Ukrainian investment environment, retained earnings and depreciation were the primary sources of investment, used by 86% of firms who experienced investment.

Investment capital was mostly used for purchase of new assets as reported by 28% of all respondents. Only 6% of all businesses were able to finance capital investment with bank loans, though the figure is higher for working capital. This shows the underdeveloped nature of the banking sector in Ukraine and banks' general reluctance to offer long term credit, preferring instead to offer short term credit, especially working capital for trade operations and manufacturing

Overall the survey provides good arguments in favor of further privatization. Privatized companies were more dynamic, restructured more frequently and more of them were profitable than state-owned firms. If it is also borne in mind that the state still owns some of the more attractive larger firms then this provides even more reason to privatize as they could perform even better in the private sector. The survey also shows that municipalities still retain a wide array of business interests, that should also be transferred to the private sector.

BARRIERS TO MARKET ENTRY AND EXPANSION

This section of the report analyses most of the barriers to business development given at the beginning of this report. For ease of reference, the information is again provided below along with firm size and firm origin breakdowns (*a full sectoral breakdown is provided in Annex 4.*) This section follows the main priorities given the main barriers listed below, in particular taxation, business regulations, unfair competition and issues of administrative corruption.

Table 21
Rating of Barriers Hindering Business Development in Ukraine
(for all firms)

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More than 250	
	Score*	Rank	score	rank	Score	rank	score	rank	score	rank	score	rank	score	Rank
Taxation	**3.1**	**1**	3.1	1	3.2	1	3.0	1	3.1	1	3.2	1	3.2	1
Low Demand	**2.9**	**2**	2.8	2	3.0	2	2.8	2	2.9	2	2.9	2	3.0	2
Inflation	**2.8**	**3**	2.8	3	2.9	3	2.7	3	2.8	3	2.8	3	2.8	3
Non-Level Playing Field/ Anti-Competitive Practices	**2.5**	**4**	2.3	4	2.6	4	2.5	5	2.5	4	2.5	4	2.4	4
Corruption	**2.3**	**5**	2.0	8	2.3	5	2.5	4	2.5	5	2.2	6	2.2	6
Regulatory Environment	**2.3**	**6**	2.3	5	2.3	6	2.4	6	2.4	6	2.2	5	2.4	5
Underdeveloped Infrastructure	**2.2**	**7**	2.2	6	2.2	7	2.3	7	2.3	7	2.1	7	2.2	8
Sourcing Necessary Inputs	**2.0**	**8**	2.1	7	2.1	8	1.9	8	1.9	8	2.1	8	2.2	7
Obtaining External Financing	**1.8**	**9**	1.8	9	1.8	9	1.7	9	1.8	9	1.8	9	1.8	9
Pressure from Criminal Elements	**1.6**	**10**	1.4	10	1.6	10	1.6	10	1.6	10	1.5	10	1.4	10

*Calculated as simple average using the following scale: 1 – no obstacle, 2 – small obstacle, 3 – significant obstacle, 4 – major obstacle.

Taxation

As taxation is consistently cited as one of the biggest obstacles faced by business in Ukraine (rated as the biggest problem in this survey), respondents were asked more detailed questions on this issue.

Figure 15 below shows the distribution and ranking of obstacles related to taxation. The overall scores are given on a four point scale with 1 – no obstacle to 4 – major obstacle.

Figure 15
Main Issues with Taxation
(distribution of responses for all firms)

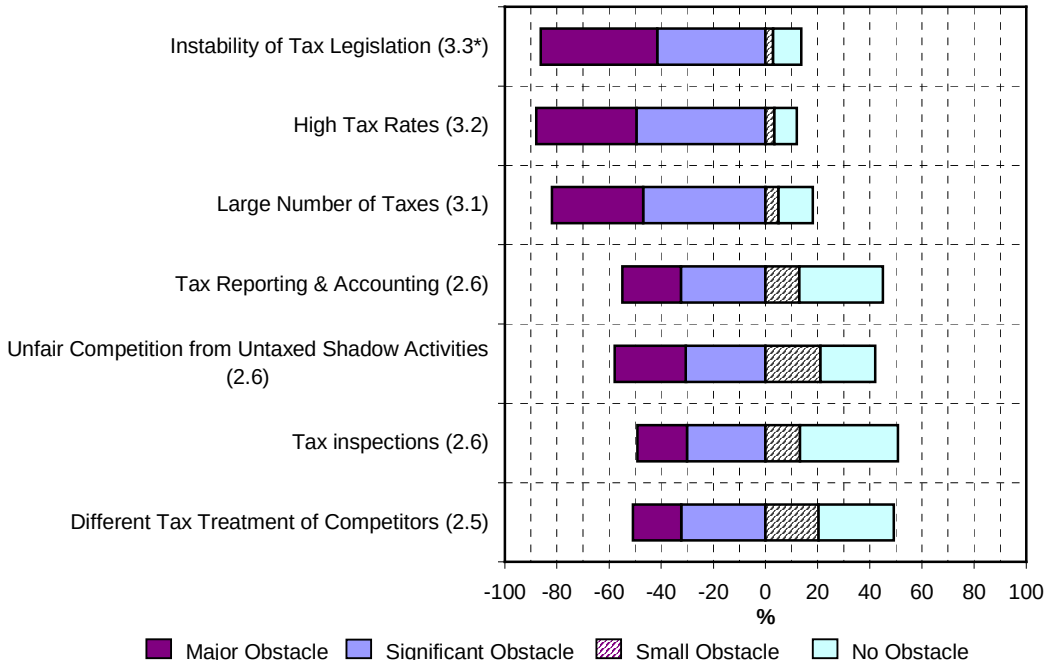


*Figure in brackets gives the average score of the answers on a scale on 1 – no obstacle to 4 – major obstacle for each obstacle listed.

Table 22
Main Issues with Taxation
(for all firms)

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More than 250	
	Score	rank	score	rank	Score	rank	score	rank	score	rank	score	rank	score	rank
Instability of Tax Legislation	**3.3**	**1**	3.3	1	3.3	2	3.3	1	3.3	1	3.3	2	3.3	1
High Tax Rates	**3.2**	**2**	3.2	2	3.3	1	3.2	2	3.2	2	3.3	1	3.3	2
Large Number of Taxes	**3.1**	**3**	3.1	3	3.2	3	3.0	3	3.1	3	3.2	3	3.2	3
Tax Reporting & Accounting	**2.6**	**4**	2.8	4	2.7	5	2.6	4	2.6	5	2.7	4	2.7	4
Unfair Competition from Untaxed Shadow Activities	**2.6**	**5**	2.5	6	2.7	4	2.6	5	2.6	4	2.7	5	2.5	6
Tax Inspections	**2.6**	**6**	2.7	5	2.5	7	2.5	6	2.5	6	2.5	7	2.7	5
Different Tax Treatment of Competitors	**2.5**	**7**	2.5	7	2.6	6	2.4	7	2.5	7	2.5	6	2.5	7

The problems with the tax environment in Ukraine can be broadly split into three main areas: instability of tax legislation; size of tax burden (which refers to tax rates, number of taxes, duties, payments and other tax-like payments and tax reporting procedures); and uneven tax distribution caused by different tax regimes and unrecorded 'shadow' activity.

Instability of Tax Laws and Regulations

Frequently changing tax legislation, regulations and reporting requirements have often been raised by businesses in Ukraine as one of their biggest taxation concerns. Whilst a detailed analysis of this legislative and regulatory instability is beyond the scope of this report, the authors have counted the number of changes in tax regulations over 2000. Over the last year there have been 110 changes to the tax regulations and laws in Ukraine, including the introduction and amendment of 31 laws, 28 Cabinet of Ministers resolutions, 28 State Tax Administration orders, 15 State Customs Committee orders, and other changes introduced by other state bodies. This number represents those changes that were published centrally in Kyiv and does not include internal instructions of state bodies or any local tax regulations.

Tax Burden

There are a large number of taxes and duties levied on Ukrainian businesses. Currently there are a total of 24 national taxes (of which 17 are applicable to surveyed firms) and 16 local taxes and duties (of which 6 are relevant.) In this report the word 'taxes' is taken to mean all forms of taxes, duties, and obligatory tax-like payments. The table below shows the average number of taxes paid by businesses by firm size and origin over 2000.

Table 23
Number of Taxes in 2000[20]

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Sector							
Manufacturing	10.0	12.6	14.3	12.8	13.0	10.4	**12.1**
Construction	10.0	11.5	16.8	10.1	12.7	10.1	**11.2**
Transport	10.3	12.5	12.7	12.9	12.4	9.4	**11.8**
Telecoms	8.4	17.0	13.0	11.2	9.0	8.8	**9.1**
Trade	9.7	12.2	14.7	10.2	11.2	9.5	**10.0**
Public Catering	8.7	12.0	.	8.4	9.4	8.8	**9.0**
Other Services	7.5	11.8	13.5	10.7	9.8	8.6	**9.5**
Average	**9.4**	**12.4**	**14.2**				
Firm Size							
Up to 50				10.1	9.9	9.1	**9.4**
51-250				11.6	12.6	12.4	**12.4**
More than 250				13.1	14.5	16.6	**14.2**
Average				**11.8**	**12.2**	**9.7**	***11.1***

As can been seen for Ukrainian businesses with this number of taxes, issues of accounting and reporting are a major administrative burden. On average Ukrainian businesses paid 11 different taxes. The largest number of taxes on average are levied on manufacturing enterprises with more than 12, the lowest levied on companies in the public catering and telecoms sectors (9). However, the sample contained manufacturing companies that paid up to 23 different taxes. According to the EBRD's survey of transition economies, Ukraine has the second highest number of principal national taxes in Eastern Europe and the CIS[21].

The data also shows that there is a tendency for larger firms to face more taxes and duties, however this is more as a result of smaller firms electing to move towards simplified systems of taxation, whereby various different taxes are unified. However, small firms in Ukraine still face too many taxes on average around nine.

[20] The table contains responses to the question, "How many taxes, duties and other obligatory payments into state/ local budgets and non-budgetary funds were made by your firm in 2000?"
[21] "Transition Report 1999", EBRD p.157

Quarterly business surveys conducted by a leading Ukrainian business newspaper[22] show that businesses reckon that the most problematic taxes, in descending order are, VAT, profit tax, payroll taxes. It is probable that VAT is ranked in first place due to the fact that it is more difficult to avoid than other taxes and also because of numerous problems that exist with VAT refunds (especially for exporters.) Payroll taxes are problematic due to high rates, however they are more easily evaded by paying employees in cash.

In order to assess the effects of a large number of taxes and high tax rates, the tax burden on firms was calculated. Table 24 below shows the proportion of taxes in relation to enterprise sales, weighted by sales volume. It is important to note that the survey did not attempt to assess tax incidence (distribution of tax burden between producers and consumers.)

Table 24
Enterprise Tax Burden
(taxes paid as % of gross sales, weighted)

	Firm Size			Firm Origin			
	Up to 50	**51-250**	**More than 250**	**State-Owned**	**Privatized**	**Start-Ups**	**Average**
Sector							
Manufacturing	23.5	29.7	22.5	26.9	22.0	28.7	**23.6**
Construction	26.1	28.0	28.6	28.8	26.5	29.8	**27.6**
Transport	34.5	26.9	19.3	27.7	22.2	18.1	**23.6**
Telecoms	33.2	15.1	15.0	23.9	26.3	16.4	**16.6**
Trade	23.1	13.7	17.4	18.7	15.0	21.8	**18.8**
Public Catering	30.1	13.0	-	15.2	22.5	32.8	**24.6**
Other Services	26.7	36.0	24.4	25.5	34.5	21.2	**26.7**
Average	**24.9**	**26.9**	**22.7**				
Firm Size							
Up to 50				33.5	24.8	23.7	**24.9**
51-250				37.8	26.2	22.5	**26.9**
More than 250				24.8	21.4	35.0	**22.7**
Average				**26.5**	**22.2**	**24.0**	***23.6***

The data shows that enterprises paid taxes of around a quarter of their sales. However, if the tax burden is expressed as a proportion of value added, then the burden is very high indeed at more than half of all value added (see table below.)

[22] "Bizness" newspaper, issue 7, 2001, pp. 37-38.

Table 25
Enterprise Tax Burden[23]
(taxes paid as % valued added, weighted) [24]

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	43.0	61.7	55.9	47.1	60.2	59.3	**56.0**
Construction	42.3	49.4	60.0	52.6	49.6	49.2	**50.1**
Transport	92.9	54.8	44.2	58.1	51.5	56.3	**54.7**
Telecoms	43.4	21.7	15.8	29.6	32.3	23.4	**23.6**
Trade	40.6	17.3	30.5	51.4	21.2	37.1	**29.5**
Public Catering	55.1	17.6	-	21.7	39.5	57.4	**41.3**
Other Services	40.4	52.5	66.4	65.8	70.6	26.1	**60.3**
Average	**44.0**	**47.4**	**56.1**				
Firm Size							
Up to 50				63.3	40.2	42.8	**44.0**
51-250				65.6	48.2	37.4	**47.4**
More than 250				49.1	60.6	61.5	**56.1**
Average				**51.6**	**57.0**	**41.6**	***52.8***

Further, larger enterprises tend to pay out more in taxes relative to their value added, than smaller companies. These high tax burdens are unsustainable and are detrimental to investment and sustained economic growth and help to explain why Ukraine has such high levels of shadow economic activity.

Enterprises were then asked to estimate the level of taxation that they felt would not hinder their further development. Obviously, rational entrepreneurs will always seek to minimize their tax burdens and will therefore underestimate the level of taxation that they are able to bear. Nonetheless, it does provide an insight into what would make companies more comfortable with paying taxes. Respondents felt that it in general the tax burden should be cut in half to around 27% of value added.

Table 26
Bearable Taxes and Other Obligatory Payments
(bearable taxes as % of value added, weighted)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	20.6	27.6	31.3	30.9	30.4	24.9	**30.2**
Construction	16.5	20.5	23.6	15.5	20.0	24.0	**20.0**
Transport	17.4	20.8	17.9	17.4	18.2	19.9	**18.1**
Telecoms	13.7	11.5	8.4	14.1	47.4	11.4	**11.8**
Trade	17.7	8.8	12.0	16.5	10.1	15.9	**13.1**
Public Catering	20.0	5.7	-	6.9	19.8	13.0	**15.1**
Other Services	13.0	11.1	35.4	30.0	23.9	15.5	**26.5**
Average	**18.3**	**19.8**	**30.9**				
Firm Size							
Up to 50				17.0	16.8	18.9	**18.3**
51-250				13.0	24.2	16.7	**19.8**
More than 250				32.3	29.9	25.4	**30.9**
Average				**30.0**	**28.2**	**18.4**	**27.4**

[23] The tax burden was calculated as a weighted average of the responses to the question , "What per cent of gross sales was accounted for by all taxes paid by your firm?"
[24] Value added was calculated as sales less material costs. Respondents did not give actual sales figures, rather they selected out of various sales bands. The midpoint of each band was used in the above valued added calculations. It is important to note, that the data is that reported by respondents, and not independently verified.

Shadow Economic Activity

Three quarters of the entire sample responded to questions on concealed turnover. The primary question being "how much do similar enterprises to yours conceal from taxation?" Respondents were given the option of selecting from different levels of sales, given below. In order to make the data easier to understand the responses have also been combined to give a weighted (by sales) average across all oblast capitals in Ukraine. It is important to note that this information was given in an anonymous questionnaire and represents respondent's opinions of other firms similar to theirs. Table 27 below gives the breakdown of concealed sales by cities in order to allow the reader to draw comparisons with data given in this report. A weighted (by sales) average was developed for each city showing the overall average proportion of sales in that city concealed.

Table 27
Sales Concealed from Taxation
(% of all firms reporting concealed sales of firms similar to theirs)

	Concealed Sales							Weighted Average
	1-10%	11-20%	21-30%	31-40%	41-50%	51-60%	>60%	
City								
Vinnytsia	49.2	19.0	9.5	9.5	4.8	-	7.9	**11.2**
Dnipropetrovsk	39.0	14.3	15.6	6.5	15.6	3.9	5.2	**20.5**
Donetsk	41.8	12.7	10.9	12.7	12.7	3.6	5.5	**11.5**
Zhytomyr	49.2	16.9	8.5	13.6	8.5	3.4	-	**20.7**
Zaporizhya	39.6	22.9	16.7	8.3	2.1	4.2	6.3	**9.2**
Ivano-Frankivsk	46.2	13.5	11.5	17.3	5.8	3.8	1.9	**23.1**
Kyiv	39.0	15.8	13.7	8.9	8.9	3.4	10.3	**12.3**
Kirovograd	18.9	8.1	13.5	13.5	18.9	8.1	18.9	**29.6**
Lugansk	44.9	6.1	12.2	6.1	20.4	6.1	4.1	**9.9**
Lutsk	40.0	21.8	20.0	9.1	5.5	1.8	1.8	**17.9**
Lviv	33.3	16.7	15.4	9.0	9.0	6.4	10.3	**18.7**
Mykolayiv	23.8	20.6	23.8	14.3	6.3	4.8	6.3	**23.0**
Odesa	27.6	17.2	11.5	8.0	17.2	5.7	12.6	**18.4**
Poltava	33.9	12.5	12.5	8.9	12.5	16.1	3.6	**16.9**
Rivne	34.9	9.5	9.5	19.0	14.3	6.3	6.3	**16.7**
Simferopol	25.0	22.6	19.0	9.5	11.9	8.3	3.6	**10.9**
Sumy	24.3	27.0	13.5	8.1	16.2	5.4	5.4	**24.3**
Ternopil	43.9	30.3	7.6	7.6	1.5	4.5	4.5	**13.2**
Uzhgorod	36.2	5.2	17.2	5.2	19.0	8.6	8.6	**9.8**
Kharkiv	34.0	14.0	19.0	12.0	10.0	6.0	5.0	**22.6**
Kherson	34.1	20.5	18.2	13.6	6.8	2.3	4.5	**8.8**
Khmelnitsky	29.4	10.3	25.0	5.9	8.8	10.3	10.3	**18.6**
Cherkasy	44.4	13.3	17.8	6.7	8.9	-	8.9	**7.9**
Chernigiv	61.7	20.0	10.0	1.7	1.7	1.7	3.3	**8.8**
Chernivtsi	41.7	21.7	3.3	5.0	13.3	6.7	8.3	**20.9**
Average	**37.3**	**16.5**	**14.3**	**9.5**	**10.3**	**5.3**	**6.7**	***15.8***

No firm that answered this question stated that no sales were concealed. On average around 16% of all sales were concealed. What is more important here is not the actual percentage sales concealed but rather the regional and sectoral differences. The following table provides the same data as above broken down by sector, firm size and origin and shows the average level of concealed sales for each firm group.

Table 28
Firms With Sales Concealed from Taxation
(% of concealed sales, weighted by sales)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	18.3	20.9	14.0	10.7	15.7	22.1	**15.1**
Construction	19.3	28.5	14.3	11.0	22.5	24.8	**20.2**
Transport	17.7	15.5	17.1	11.6	19.4	23.7	**16.9**
Telecoms	14.7	5.0	5.0	6.6	25.0	13.4	**11.4**
Trade	18.8	28.6	18.0	12.6	14.9	25.4	**21.4**
Public Catering	22.9	18.8	-	20.8	20.7	23.4	**21.7**
Other Services	22.7	9.4	17.6	8.7	26.7	20.3	**15.2**
Average	**18.9**	**19.8**	**14.4**				
Firm Size							
Up to 50				12.4	15.9	21.1	**18.9**
51-250				8.8	21.6	25.7	**19.8**
More than 250				10.5	15.5	26.8	**14.4**
Average				**10.3**	**16.3**	**23.1**	***15.8***

State owned firms were able to conceal or otherwise misreport the least amount of sales, than private sector firms. This is probably due to a higher level of scrutiny from state bodies (witness the number of inspections, see Table 41). The highest level of shadow activity is observed in trade, public catering and construction and smaller firms are able to conceal more sales than larger firms.

Simplified Taxation

There are two systems of taxation in Ukraine: ordinary and simplified taxation. The ordinary tax system is composed of separate reporting and payment of all the taxes mentioned at the beginning of this section, including principal national taxes (corporate profit tax, value added tax, payroll taxes), numerous local taxes and other duties and tax-like payments. However, firms with up to 50 employees and turnover not exceeding UAH1 million can go over to one unified tax that replaces most of the principal taxes, including profit tax and contributions to the pension fund. Further, there are two unified tax rates; 6% of turnover with VAT payable separately as under the regular system of taxation or 10% of turnover, which exempts businesses from VAT.

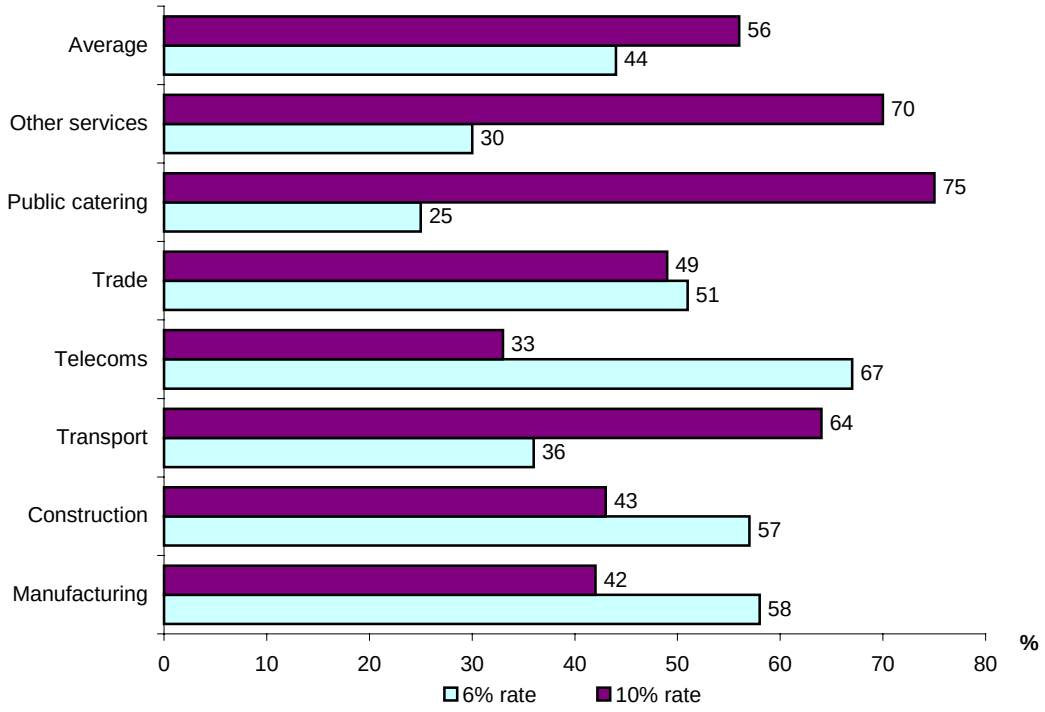
29% of all respondents reckoned that they were eligible for simplified taxation, however of these only half actually switched. Almost 19% of eligible firms intend to switch in the future. The table and figure below show the eligibility for simplified taxation and the choices made by firms in particular sectors.

Table 29
Eligibility and Transfer to Simplified Taxation

	Firms Who Stated That They Are Eligible (% of all small firms)	Switched to Simplified Taxation (% of eligible small firms)	Intend to Switch to Simplified Taxation (% of eligible small firms)	Do Not Intend to Switch to Simplified Taxation (% of eligible small firms)
Sector				
Manufacturing	48.3	43.1	22.1	34.8
Construction	47.9	50.0	23.9	26.1
Transport	52.5	66.7	28.6	4.8
Telecoms	50.0	40.9	18.2	40.9
Trade	51.7	39.0	19.3	41.7
Public Catering	61.2	64.6	9.8	25.6
Other Services	59.2	64.5	14.0	21.5
Average	**52.3**	**49.1**	**18.7**	**32.3**

Further, enterprises were asked if they had switched to simplified taxation whether they had selected the 6% (excluding VAT) or 10% (including VAT) tax rate.

Figure 16
Choice of Simplified Tax Rate
(% of firms that switched to simplified taxation)



Conclusions and Recommendations

Taxation issues are by far and away the biggest administrative and operational burden on enterprises in Ukraine. The penalties for full tax compliance in Ukraine are large indeed. Further, the high level of evasion is taken into account, firms that wish to be fully compliant are invariably at a competitive disadvantage with those who evade taxes (who are in effect subsidized.) On average more than half of enterprise value added needs to be paid out in numerous taxes and other obligatory payments. However, the biggest taxation issue in Ukraine is frequently changing tax reporting and accounting requirements that creates very real obstacles for firms.

Simply put, Ukraine taxation system contributes to a large unofficial economy, with the corresponding problems of corruption, lack of investment, unfair competition and much lower levels of response to market signals.

Based on the results of survey, it is clear that urgent tax reform is required, however this raises several issues. How to introduce taxation stability in an unstable transition economy? How to introduce an equitable and bearable taxation system, with an equal tax burden for all, regardless of sector, business activity, size or ownership? How to minimize the size of the shadow economy, which creates unfair competition and deprives the state of revenues?

Some steps that would be helpful are:

- Eliminate tax breaks and privileges, including special economic zones, and move to hard budget constraints for all firms regardless of ownership status.
- Eliminate or consolidate a large number of various taxes, duties and tax like payments, which contribute only small amounts to state revenues but which create a large burden on businesses. Drastically reduce the frequency of changes in tax regulations and tax rates, thresholds and reporting requirements. Adopt the new tax code currently under debate and them implement a freeze on further changes.
- Reduce marginal rates for principal taxes (VAT, profit tax, personal income tax), thereby freeing more capital for internal investment.
- Unify simplified and ordinary tax systems. Simplified taxation for smaller enterprise has generally been effective (rather smaller businesses have faced fewer accounting and reporting problems), but in the medium term, this uneven distribution of tax burden could lead to inefficient use of resources (*e.g.* large firms with higher productivity could suffer from a higher tax burden than smaller less efficient firms) and abuse (larger firms attempting to become simplified tax payers.) Simplified taxation also creates an income gap whereby small firms that are growing do not want lose their simplified tax status and move to higher levels of ordinary taxation. Either growth could be curtailed or more probably any extra income above simplified taxation thresholds will be concealed.
- As there will be a decrease in state revenues initially if number of taxes and tax rates are reduced, the government should carefully prioritize state expenditure and attempt to broaden the tax base.
- Introduce pension reform to change perceptions of contributions to the Pension Fund. At the moment pension contributions are perceived as additional income taxes. Personalized pension accounts will allow people to treat their pension contributions as personal savings and will make available more investment capital.

Unfair Competition

Companies in Ukraine, both foreign and domestic, consistently complain, of competitors using unfair practices. In our general rating (see Table 21), this problem was ranked fourth, over and above such issues as lack of financing and regulatory environment. Figure 17 below shows the importance assigned by all surveyed firms to different forms of anti-competitive practice, including privileged access to markets and key inputs, state subsidies and collusion of rivals.

Figure 17
Rating of Unfair Competitive Practices
(distribution of responses for all firms)

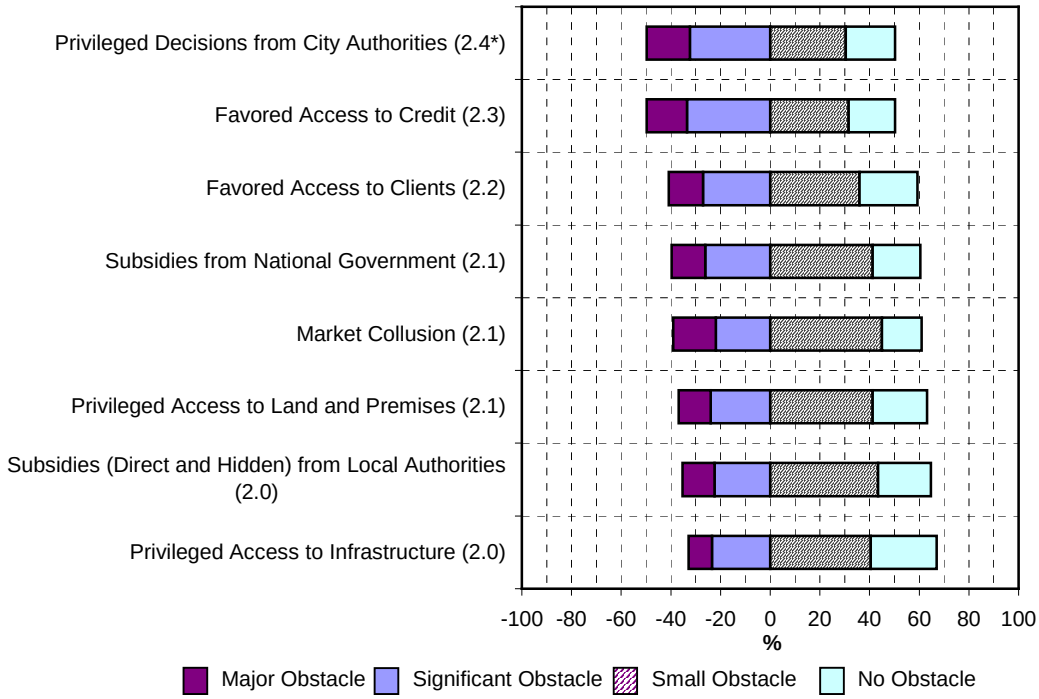


*Figure in brackets gives the average score of the answers on a scale on 1 – no obstacle to 4 – major obstacle for each obstacle listed.

The survey revealed that the main anti-competitive practices is local authorities issuing permits/permissions to rivals on favorable terms. The table below shows, that small businesses are hit hardest when their competitors receive privileged decisions from city authorities. For larger firms the biggest perceived problem is related to favored access to credit resources by competitors (see Table 82, Annex 4 for more detail.)

Table 30
Rating of Unfair Competitive Practices in Ukraine by Firm Size and Origin
(for all firms)

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More than 250	
	Score	rank	score	rank	Score	rank	Score	rank	score	rank	score	rank	score	rank
	7													
Privileged Decisions from City Authorities	**2.4**	**1**	2.0	1	2.4	2	2.5	1	2.5	1	2.3	2	2.1	3
Favored Access to Credit	**2.3**	**2**	2.0	2	2.4	1	2.4	2	2.4	2	2.4	1	2.2	1
Favored Access to Clients	**2.2**	**3**	2.0	4	2.2	3	2.3	3	2.2	3	2.2	3	2.0	5
Subsidies from National Government	**2.1**	**4**	2.0	3	2.2	4	2.1	6	2.1	7	2.2	4	2.1	2
Market Collusion	**2.1**	**5**	1.8	6	2.1	6	2.2	4	2.2	5	2.0	7	2.0	4
Privileged Access to Land and Premises	**2.1**	**6**	1.8	8	2.1	7	2.2	5	2.2	4	2.1	6	1.8	8
Subsidies (Direct and Hidden) from Local Authorities	**2.0**	**7**	1.9	5	2.1	5	2.0	8	2.1	8	2.1	5	2.0	6
Privileged Access to Infrastructure	**2.0**	**8**	1.8	7	2.0	8	2.1	7	2.1	6	2.0	8	1.9	7

Regulatory and Administrative Environment

As the regulatory climate and the role of the state in 'regulating' private business in Ukraine is often acknowledged as one the main areas of concern to Ukraine businesses, this survey sought to examine this issue in more detail for issues related to instability of business legislation, customs procedures, licensing, certification, procedures for receiving permits and permissions and business registration procedures. We asked business to rate on a 4 point scale the extent to which various regulatory issues presented obstacles to their operations.

Figure 18
Main Regulatory and Administrative Barriers to Business Development
(for firms that particular barrier was relevant)

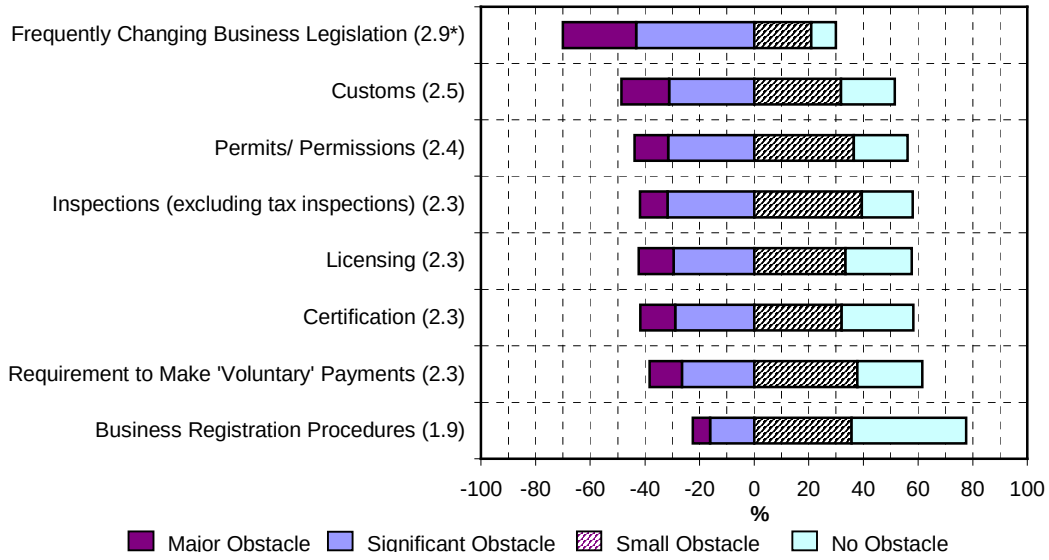


*Figure in brackets gives the average score of the applicable answers on a scale on 1 – no obstacle to 4 – major obstacle for each obstacle listed

Table 31
Main Regulatory and Administrative Barriers to Business Development in Ukraine by Firm Size and Origin

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More than 250	
	Score*	%**	score	%	Score	%	score	%	score	%	Score	%	score	%
Frequently Changing Business Legislation	**2.9**	**94**	2.9	92	2.9	94	2.8	96	2.8	95	2.9	94	3.0	94
Customs	**2.5**	**44**	2.5	40	2.5	46	2.4	43	2.4	42	2.6	45	2.4	50
Permits/ Permissions	**2.4**	**86**	2.3	87	2.4	85	2.4	87	2.4	86	2.4	86	2.3	86
Inspections (excluding tax inspections)	**2.3**	**94**	2.3	95	2.4	95	2.3	93	2.3	94	2.4	94	2.4	95
Licensing	**2.3**	**72**	2.3	70	2.3	71	2.3	73	2.3	73	2.4	70	2.3	72
Certification	**2.3**	**70**	2.3	67	2.3	73	2.2	68	2.2	69	2.4	73	2.3	71
Requirement to Make 'Voluntary' Payments	**2.3**	**77**	2.3	76	2.3	76	2.3	79	2.3	78	2.3	76	2.2	78
Business Registration Procedures	**1.9**	**70**	1.9	70	1.9	68	1.9	71	1.9	71	1.9	67	1.8	71

*average score for the respondents to whom certain regulation is applicable
**% of respondents to whom certain type of regulation is applicable

Unofficial Payments

Respondents were asked whether or not they had to make unofficial payments in dealing with some of the major regulatory issues (*i.e.* bribes and other payments not stipulated by

law) over the course of 2000. The table below gives information given not only on those firms who stated that they had made unofficial payments, but also for those who abstained from answering, claiming that this information was confidential.

Table 32
Proportion of Companies Who Made Unofficial Payments by Company Size
(% of firms to whom certain type of regulation is applicable)

	Firm Size							
	Up to 50		51-250		More than 250		Average	
	Made Unofficial Payments	Information Confidential	Made Unofficial Payments	Information Confidential	Made Unofficial Payments	Information Confidential	Made Unofficial Payments	Information Confidential
Permits/ Permissions	28.4	22.1	18.5	19.4	14.9	15.7	23.3	20.2
Licensing	17.8	20.2	10.5	14.2	11.1	12.1	14.8	17.2
Business Registration	17.6	18.6	11.7	16.8	4.9	12.7	13.7	17.0
Certification	18.0	19.3	12.2	15.8	10.7	11.0	15.0	16.7
Customs	14.5	17.9	11.0	18.1	13.4	12.4	13.4	16.7

The biggest proportion of firms (23%) stated that they needed to make unofficial payments in receiving permits and permissions. For all firms for whom a certain regulation was applicable a larger proportion of small firms had make unofficial payments than either medium sized or large firms.

Instability of Business Legislation

As can be seen the biggest regulatory and administrative challenge that the majority of businesses face are rapidly changing rules of the game. Regulatory, and to a lesser extent legislative changes, in Ukraine tend to be arbitrary and non-consultative in nature. The concept of consultation and public awareness in amending regulations is not widely practiced in Ukraine, simply because there are no requirements to do so and there are no well defined feedback mechanisms in any case. Though there have been some attempts by the government in pushing administrative reform and more attempts to make public key policy decisions, a general lack of predictability of the business environment still prevails. This problem is further compounded by three factors; firstly that central state bodies do not face the requirements to make public a lot their decisions below Cabinet of Ministers level (*see Box*); secondly that new regulations are often taken in isolation and with no consultation with other state bodies – often leading contradicting business legislation. Finally, little control exists over implementation of such decisions at the local level, further increasing the perceived arbitrariness of decisions.

Hierarchy of Laws and Regulations
The hierarchy of laws and regulations that affect business are ranked as follows:
Constitution
Codes of Ukraine
Laws of Ukraine
Presidential Decrees
Verkhovna Rada Resolutions
Cabinet of Ministers Resolutions
National Bank of Ukraine Normative Legal Acts
Ministries and Central Executive Bodies' Normative Acts and Regulations
Local Authorities' Normative Acts

In accordance with the constitution all normative acts and laws that impinge on the rights and interests of citizens have to be made public by law. However, no such law currently exists.

Currently, according to a Presidential Decree, only Laws, Decrees, Verkhovna Rada Laws and Resolutions and Cabinet of Ministers Resolutions, are obliged to be published. For the remainder (representing the bulk of regulations) there are no well-defined procedures of making regulatory changes public.

As the problems with legislative instability are so acute the survey asked managers whether it was easy to obtain information on laws and regulations that impact on their enterprises and whether they thought legislative and regulatory environment was more or less predictable in 2000 compared with 1999. On the whole, two thirds of Ukrainian firms feel that it is relatively easy to obtain necessary information on the legislative and regulatory environment for their firms. The bigger problem appears to be not so much with obtaining information (although one third of Ukrainian firms find it difficult to find this information), rather it is the fact that business legislation changes often, creating operational problems for companies and making the planning process more difficult.

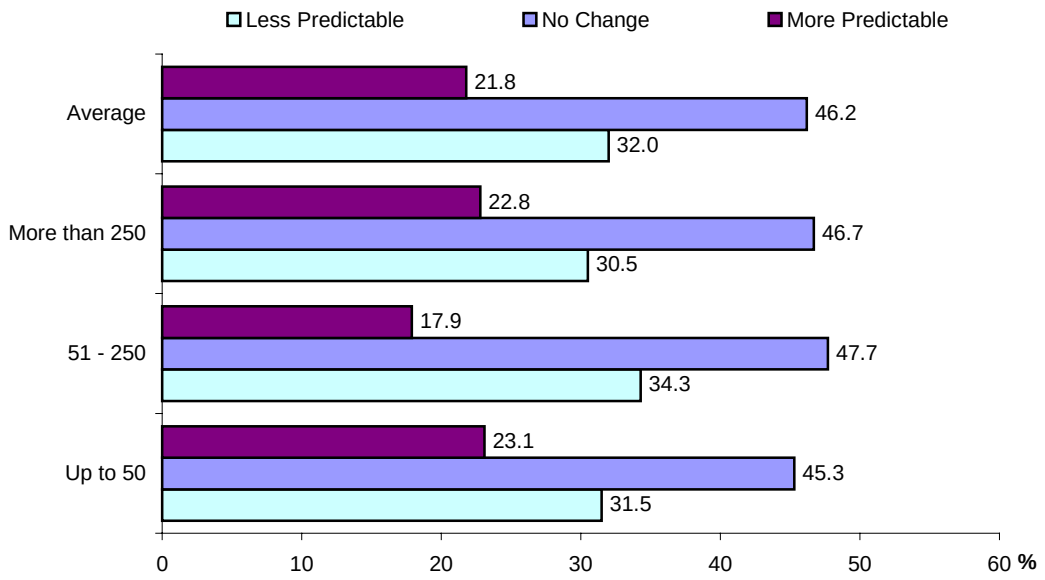
Table 33
"It is Easy to Obtain Information on Laws and Regulations that Influence my Firm"
(% respondents who agreed with the statement)

	Firm Size			
	Up to 50	51-250	More than 250	Average
Sector				
Manufacturing	62.0	70.6	73.9	**68.4**
Construction	60.0	74.5	72.2	**66.1**
Transport	64.1	80.0	84.6	**76.1**
Telecoms	83.3	100.0	100.0	**85.4**
Trade	60.7	62.2	81.8	**61.4**
Public Catering	59.7	81.8	-	**61.4**
Other Services	66.5	78.9	87.8	**72.7**
Average	**62.6**	**72.2**	**76.7**	**67.7**

More companies felt (see Figure 19) that there was less legislative predictability in 2000 compared with 1999 (32% vs. 22%). Further, there were very few optimists, only around one company in 30 felt that the legislative and regulatory environment had gotten much more stable and predictable in 2000 compared with 1999. [25]

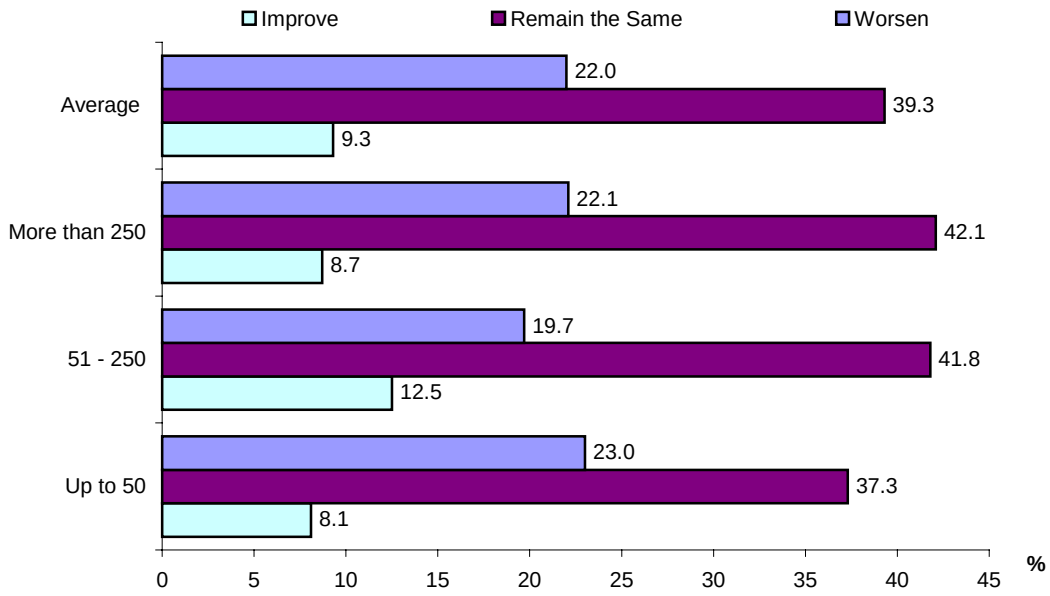
[25] Firms were given the choice of 'much less predictable', 'less predictable', 'no change', 'a little more predictable', and 'much more predictable'. For the purposes of Figure 19 the responses were aggregated into 'less predictable', 'no change' and 'more predictable.'

Figure 19
Predictability of Legislative and Regulatory Environment in 2000 Compared with 1999
(% of all firms)



Following on from this twice as many companies felt that the legislative and regulatory environment would deteriorate in 2001 compared with 2000 (see Figure 20.)

Figure 20
Assessment of Projected Legislative and Regulatory Environment in 2001
(% of all firms in each size class)



Import/ Export Operations

Among regulatory obstacles, customs procedures were rated second only to legislative instability. Around 44% of all surveyed companies were involved in foreign trade to some extent. Border customs checks and certification of imported goods were cited as the most significant barriers, and accreditation procedures were cited as the least important barrier to foreign trade transactions (see table below.) In dealing with customs procedures in general, 13% of respondents who were involved in export and import, stated they had to make unofficial payments, while 17% refused to answer claiming that this information was confidential (see Table 32.)

Table 34
Main Barriers in Import/ Export Operations
(for all importers/ exporters)

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More than 250	
	Score*	%**	Score	%	Score	%	Score	%	score	%	score	%	score	%
Border Customs Checks	2.1	26	2.2	20	2.1	25	2.1	23	2.1	21	2.2	27	2.0	26
Import Certification	2.0	19	2.2	14	1.9	18	2.1	18	2.0	16	2.0	20	2.1	19
Customs Declarations	2.0	29	2.0	21	2.0	26	2.0	24	2.1	22	2.0	27	2.0	29
Firm Accreditation by Government	1.5	18	1.5	15	1.5	18	1.6	17	1.5	16	1.6	19	1.5	18

* average score for the respondents to whom certain regulation is applicable
** % of respondents to whom certain type of regulation is applicable

Permits and Permissions

The problem cited in third place by severity in the rating of regulatory and administrative problems, that of obtaining permits and permissions is very acute in Ukraine. This covers both official permits from local bodies and formal and informal 'permissions' from local officials. The importance of this issue correlates well with the importance attached to corruption in general by companies in Ukraine. This issue is even more important than that of government inspections of business and business licensing which are ranked fourth and fifth respectively. This shows that with the exception of the legislative climate (which is mostly influenced by central bodies) most regulatory problems for businesses occur at the local level rather than at the national level.

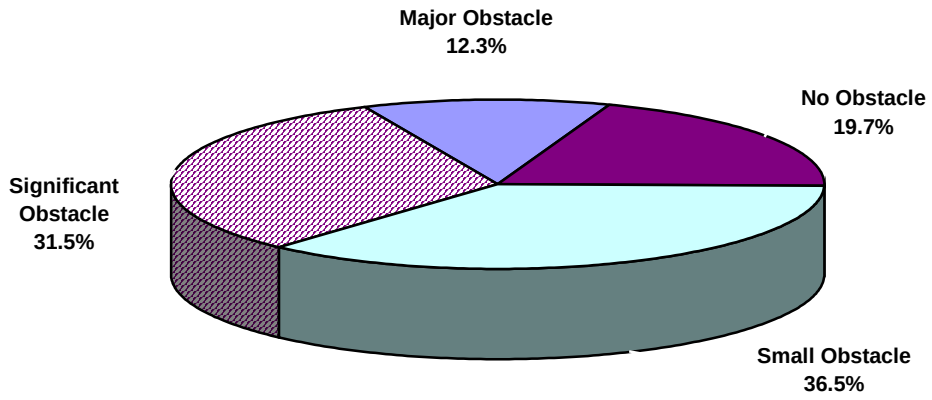
After registering a company needs to obtain not just the necessary licenses but various permits and formal and informal 'permissions' as well. The procedure for obtaining the necessary permits is not defined in national legislation (neither national laws or government resolutions), as for example company registration or licensing, but regulated through the internal rules and procedures of the relevant local authorities (city and oblast.) In addition to the necessary permits, enterprises often need to get unofficial permission and agreement from various local authorities. The whole procedure of receiving necessary permits and agreements, represents one of the most opaque, problematic and least predictable aspects of business activity in Ukraine, and as such can be associated with a monetary cost to the enterprise.

Permits and permissions include permits for advertising, location of shops and other outlets, construction, permit from road police, local health and safety agency, *etc*. However, almost

all activities have to be agreed with various local bodies as well, which typically entails just informing these bodies of proposed activities. There is no national legislation governing the issue of such permits and typically there are determined by city councils. Further, the bureaucratic nature of the issue of such permits and permissions as well as a lack of effective oversight, greatly adds to arbitrariness and possibilities for corruption.

The survey asked respondents to identify which of the main local permits that they are required to obtain as being a barrier to market entry. 86% of the entire sample faced the need to obtain permits/ permissions over 2000 (itself a powerful result indicating that over four fifths of all business are constantly engaged in these activities.) Further, the survey asked respondent whether they thought that permits and permissions were an obstacle to the development of their firms. The figure below gives the breakdown of responses only for those companies that did face the need to obtain permits and permissions and shows whether they felt that permits and permissions represented a barrier to business development. *Note that the survey did not seek to obtain specific information on unofficial 'permissions.'*

Figure 21
Barriers Presented by Local Permits and Permissions
(% of firms that had to obtain permits and permissions)



Of these companies 20% felt that obtaining permits did not present a problem. 44% reckoned that these permits and permissions constitute a significant to major barrier to market entry. The table below shows the breakdown of responses for the ten most important local state bodies that are obliged to provide permits to most firms. The percentages quoted refer to those companies that faced the need to obtain particular permits and permissions in 2000 listed in the table below, and shows the opinions of firms on the procedures for obtaining permits.

Table 35
Barriers to Market Entry Presented by Various Local Permits and Permissions
(% of all firms who needed to obtain particular permits and permissions)

Type of Permit/ Permission	Firms Who Needed to Obtain Particular Permit/ Permission (% of all firms)	Easy to Obtain	Satisfactory	Difficult to Obtain	Very Difficult to Obtain	Demand for Unofficial Payments
Permit from State Sanitary Epidemiological Service	52.3	19.0	55.8	19.1	6.1	5.0
Permit from Fire Department	63.4	18.9	52.3	20.7	8.1	5.9
Permit from Health, Safety and Environment Department	48.5	20.8	55.8	16.7	6.8	2.9
Permission for Trade and Customer Service Outlet	41.2	22.5	49.2	19.3	9.0	4.7
Permission to Occupy Premises (close agreement for hire of communal property)	38.3	33.8	44.4	13.9	8.0	3.3
Permission to Refurbish Premises	26.8	28.2	40.0	19.3	12.5	4.2
Permission for Construction	23.5	18.4	38.7	26.7	16.1	5.8
Permit for Land Plot Allocation	20.9	11.4	30.1	31.5	26.9	7.5
Approval from Housing and Communal Property Department	26.2	25.0	45.6	20.4	8.9	3.9
Approval from Road Police	37.6	20.1	53.7	17.8	8.4	5.8

As can be seen, the more difficult it is to get a permit the greater the number of companies that stated they faced the demand for making unofficial payments (*note: this data does not refer to whether firms made unofficial payments or not.*) It is then interesting to observe the breakdown by cities for those same respondents who had to obtain permits and permissions over 2000. The table below shows the proportion of these companies who felt that permits and permissions as a whole presented either a significant or major obstacle.

Table 36
Proportion of Firms Who Felt That Obtaining Permits and Permissions Presented a Significant or Major Barrier
(% of all firms who needed to obtain permits and permissions)

	Up to 50	51-250	More than 250	Average
City				
Vinnytsia	34.1	45.5	18.2	**33.3**
Dnipropetrovsk	56.9	48.4	40.0	**50.0**
Donetsk	50.0	32.1	41.7	**42.9**
Zhytomyr	25.8	50.0	54.5	**35.4**
Zaporizhya	18.4	36.4	38.9	**26.9**
Ivano-Frankivsk	45.2	88.2	38.5	**55.7**
Kyiv	48.3	39.3	35.6	**42.6**
Kirovograd	42.1	16.7	54.5	**39.3**
Lugansk	57.8	30.0	54.5	**53.0**
Lutsk	37.5	27.3	16.7	**32.7**
Lviv	50.9	46.7	40.0	**48.2**
Mykolayiv	36.6	40.0	42.9	**38.2**
Odesa	46.2	43.8	33.3	**42.4**
Poltava	43.2	36.8	53.8	**43.5**
Rivne	40.0	53.8	37.5	**45.8**
Simferopol	62.0	52.4	50.0	**58.2**
Sumy	43.6	62.5	62.5	**50.8**
Ternopil	32.0	50.0	44.4	**38.6**
Uzhgorod	38.0	33.3	25.0	**35.8**
Kharkiv	45.5	54.2	40.0	**46.2**
Kherson	44.1	52.9	38.5	**45.3**
Khmelnitsky	46.9	53.8	55.6	**49.3**
Cherkasy	29.6	28.6	42.9	**31.7**
Chernigiv	47.2	57.1	33.3	**46.2**
Chernivtsi	45.7	35.7	58.3	**45.9**
Average	**44.1**	**45.3**	**41.1**	**43.8**

Business Licensing

Licensing, in the opinions of entrepreneurs, takes fifth place in the overall ranking of regulatory and administrative barriers, though second place amongst just regulatory barriers behind permits/ permissions. Currently there are 58 different types of business activity subject to licensing. A genuine effort has been made over the last several years to ensure that business licensing does indeed only apply to activity that could be detrimental to public health, environment on national security. In June 2000 a new Law "On Licensing of Some Types of Economic Activity" was introduced which aims to further streamline and simplify the process of obtaining licenses. However, to date the government has still not introduced new licensing procedures in accordance with the law. Consequently the current situation regarding licensing is unclear.

Due to the fact that different types of business activity require different licenses, each with different procedures, this survey sought to examine the perceptions of company management as to whether they thought business licensing represented a barrier to business development. Overall only 28% of surveyed firms did not need to go through licensing procedures in 2000. Of those who did, 76% felt that it presented a barrier to business development in Ukraine (33% - small obstacle, 30% - significant obstacle and 13% - major obstacle). The table below shows the breakdown of responses by city for those respondents who stated that licensing was a significant or major obstacle.

Table 37
Proportion of Firms Stating that Licensing Presented a Significant or Major Barrier
(% of all firms who needed to obtain licenses)

	Up to 50	51-250	More than 250	Average
City				
Vinnytsia	51.4	25.0	11.1	**40.4**
Dnipropetrovsk	61.2	37.5	51.7	**52.9**
Donetsk	46.3	52.0	52.2	**49.4**
Zhytomyr	32.0	62.5	30.0	**37.2**
Zaporizhya	25.7	30.0	44.4	**29.6**
Ivano-Frankivsk	34.5	64.7	45.5	**45.6**
Kyiv	38.6	40.4	38.9	**39.2**
Kirovograd	48.3	0.0	66.7	**44.0**
Lugansk	52.8	33.3	30.0	**45.5**
Lutsk	22.2	44.4	25.0	**27.5**
Lviv	42.6	61.5	36.4	**45.1**
Mykolayiv	43.8	42.1	20.0	**41.1**
Odesa	40.0	46.2	61.1	**46.8**
Poltava	56.3	33.3	54.5	**50.9**
Rivne	45.8	40.0	42.9	**42.9**
Simferopol	51.4	62.5	50.0	**54.4**
Sumy	41.2	81.8	28.6	**48.1**
Ternopil	35.0	71.4	25.0	**40.0**
Uzhgorod	27.0	33.3	28.6	**27.7**
Kharkiv	44.2	55.6	40.0	**45.6**
Kherson	40.7	33.3	0.0	**30.4**
Khmelnitsky	39.5	36.4	75.0	**43.9**
Cherkasy	33.3	20.0	33.3	**31.4**
Chernigiv	21.2	36.4	28.6	**25.9**
Chernivtsi	53.6	41.7	28.6	**46.8**
Average	**41.8**	**44.7**	**40.9**	**42.3**

Overall the proportions of firms in different firm size classes who stated that licensing presented a serious was roughly the same, however this masks a significant variation among cities. Cities like Chernigiv, Lutsk, Uzhgorod only had a quarter of firms

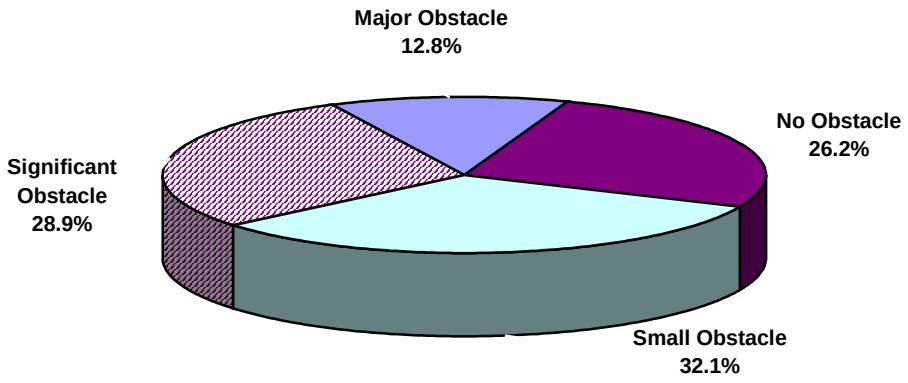
complaining about the licensing environment, whereas around half of firms in cities like Dnipropetrovsk, Dontesk, and Poltava stated that licensing presented a serious obstacle.

Licensing procedures are given in national legislation, however the issue of licenses is done by local bodies or local governments who have delegated authority from the relevant central authority. Some central bodies have their own local branches who handle licensing. Others delegate this process to oblast governments. Local authorities therefore have a large influence in establishing the environment for licensing locally.

Product Certification

Certification ranked sixth out of the nine main regulatory and administrative barriers to market entry and growth surveyed in this report. 70% of all respondents had to undergo product or service certification and their responses on whether they felt certification proved to be an obstacle in their business operation are given in the figure below.

Figure 22
Barriers Presented by Certification Procedures
(% of firms who underwent certification)



74% of all firms who underwent certification felt that certification procedures were problematic. Of these firms, 19% (or 15% of all firms who underwent certification) had to make unofficial payments during the certification process. The table below shows the breakdown of firms who stated that product certification presented either a significant or major obstacle to their business operations.

Table 38
Proportion of Firms Who Felt That Product Certification Presented a Significant or Major Barrier
(% of all firms who needed to certify products)

	Up to 50	51-250	More than 250	Average
City				
Vinnytsia	48.3	22.2	20.0	**37.5**
Dnipropetrovsk	55.8	52.0	59.3	**55.8**
Donetsk	44.4	53.6	33.3	**44.0**
Zhytomyr	32.3	87.5	27.3	**40.0**
Zaporizhya	24.3	33.3	54.5	**31.7**
Ivano-Frankivsk	22.2	47.1	54.5	**36.4**
Kyiv	49.4	47.4	50.0	**48.9**
Kirovograd	46.2	10.0	50.0	**38.1**
Lugansk	48.4	44.4	30.0	**44.0**
Lutsk	20.0	44.4	25.0	**26.3**
Lviv	35.6	42.9	44.4	**38.2**
Mykolayiv	46.7	61.5	14.3	**46.0**
Odesa	43.8	46.4	68.8	**50.0**
Poltava	56.7	23.1	10.0	**39.6**
Rivne	54.5	45.8	25.0	**48.0**
Simferopol	40.0	53.3	40.0	**44.0**
Sumy	41.9	80.0	20.0	**47.8**
Ternopil	17.6	30.0	25.0	**22.9**
Uzhgorod	32.4	33.3	14.3	**29.5**
Kharkiv	37.3	73.7	42.1	**46.1**
Kherson	28.0	14.3	25.0	**23.4**
Khmelnitsky	32.4	37.5	71.4	**38.8**
Cherkasy	36.4	60.0	33.3	**39.4**
Chernigiv	24.2	50.0	46.2	**35.0**
Chernivtsi	42.3	38.5	33.3	**39.6**
Average	**39.5**	**46.5**	**41.0**	**41.6**

11.3% of all firms surveyed had to undergo certification of imported goods. Around half (49%) stated that certification of imported goods is problematic for them. Out of all firms who had to certify imported goods 14 % had to make unofficial payments, 11% stating that information on unofficial payments is 'confidential' and the rest stating that they did not need to make any unofficial payments.

There is a relatively large number of classes of goods subject to mandatory certification – 37, which, according to the survey, creates additional obstacles to the business operations of Ukrainian firms. At present certification is considered to be another mechanism of state interference in businesses operations, a barrier to innovation and occasionally used for punitive purposes. The government should consider a further reduction in the number of goods subject to mandatory certification, adopting international and European certification standards, and simultaneously encouraging systems of voluntary certification of products.

In order to check how Ukrainian enterprises meet requirements of quality control, respondents were asked if they used any quality management systems that correspond to ISO 9000 or similar. The data below show the breakdown of responses across the whole sample and across sectors.

Figure 23
Use of Quality Management Systems
(% of all firms)

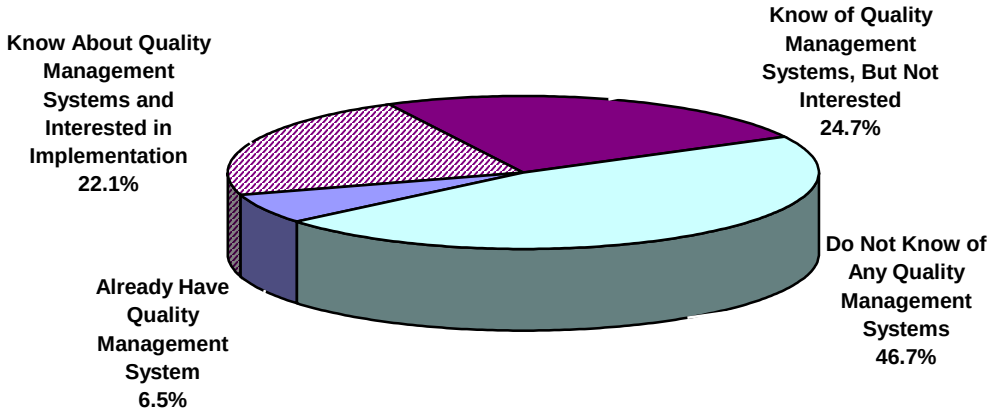


Table 39
Use of Quality Management Systems
(% of all firms in each group)

	Already Have Quality Management System	Know About Quality Management Systems and Interested in Implementation	Know of Quality Management Systems, But Not Interested	Do Not Know of Any Quality Management Systems
Sector				
Manufacturing	8.5	33.5	22.2	35.7
Construction	10.1	24.1	22.8	43.0
Transport	3.7	5.6	36.1	54.6
Telecoms	4.5	11.4	54.5	29.5
Trade	3.8	10.6	25.9	59.7
Public Catering	1.5	4.4	23.0	71.1
Other Services	5.0	14.7	23.9	56.3
Average	**6.5**	**22.1**	**24.7**	**46.7**

What is surprising from the data is the number of firms who are ignorant of such systems, particularly in manufacturing. This could be as a result of such firms simply not needing to introduce such systems or genuinely not having enough information. For exporters (17.8% of the entire sample) the picture with introducing quality system was a little more optimistic than for the overall sample.

Figure 24
Use of Quality Management Systems by Exporters
(% of all exporters)

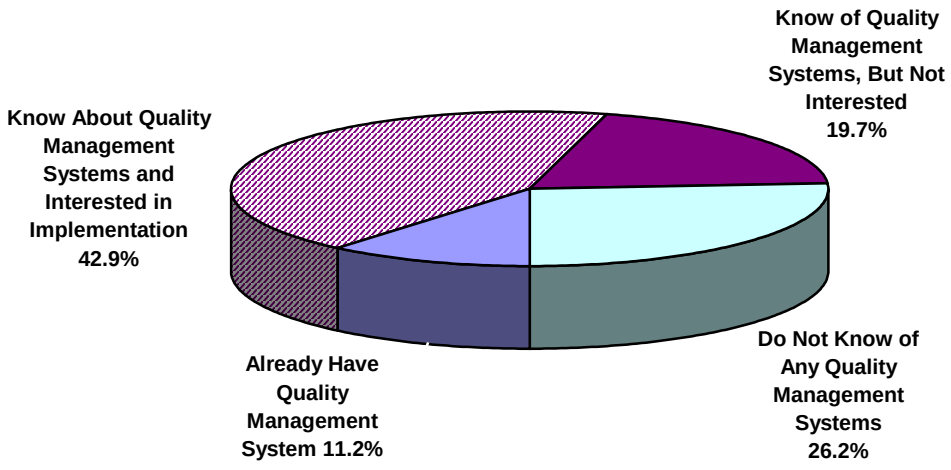


Table 40
Use of Quality Management Systems by Exporters
(% of all exporters)

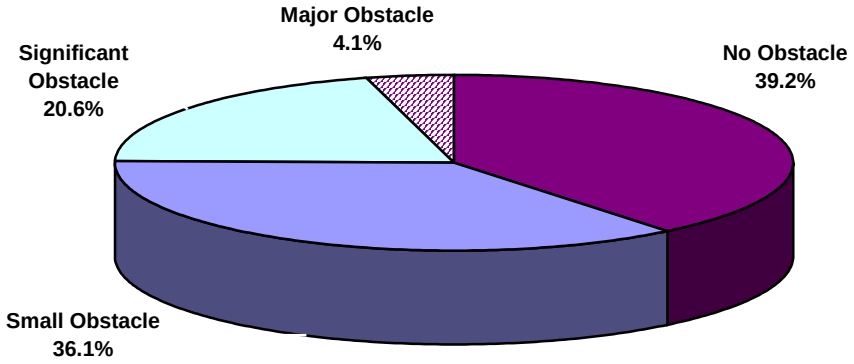
	Already Have Quality Management System	Know About Quality Management Systems and Interested in Implementation	Know of Quality Management Systems, But Not Interested	Do Not Know of Any Quality Management Systems
Sector				
Manufacturing	12.1	47.0	17.8	23.1
Construction	0.0	30.0	30.0	40.0
Transport	11.1	5.6	38.9	44.4
Telecoms	0.0	0.0	66.7	33.3
Trade	11.1	38.9	16.7	33.3
Public Catering	0.0	0.0	0.0	100.0
Other Services	0.0	27.3	18.2	54.5
Average	**11.2**	**42.9**	**19.7**	**26.2**

Registration

Company registration in Ukraine is neither straight forward nor entirely predictable at the local level (though all of the procedures are set out in law). As previous IFC surveys have shown, the registration process was a considerable obstacle faced by entrepreneurs. However, the government has scored a notable success in its attempts to simplify the registration process.

Business registration procedures were rated last out of the regulatory and administrative barriers presented in this survey (see Figure 18.) Comparing with the previous IFC survey the proportion of entrepreneurs listing registration as a major obstacle has fallen from 6.7% in 1999 to 4.1% in 2000. These figures only refer to the proportion of enterprises registered in each year.

Figure 25
Barriers Presented by Registration Procedures
(% of firms that registered/ re-registered in 2000)



Only 4.5% (97 firms) of the entire sample underwent registration/ re-registration in 2000. Of these, 25% (24 firms) felt that registration was an significant obstacle to market entry and business start up in Ukraine. 17 of these 24 enterprises were start ups with up to 50 employees.

State Business Inspections

State regulation of the private sector is excessive in Ukraine, as indeed is official state harassment of private businesses. One of the many forms of harassment is that of official state inspections of business. There are numerous state agencies who have the authority to inspect companies (*see Box below*)

Table 41
Average Number and Duration of Inspections[26]
(all firms)

	Firm Size			Firm Origin			Average Number of All Inspections over 2000	Average duration of All Inspections
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups		
Sector								
Manufacturing	10.4	17.3	20.6	17.9	17.4	11.3	**15.5**	**30.3**
Construction	7.2	14.2	15.6	14.9	11.9	7.9	**10.3**	**27.0**
Transport	10.5	18.1	24.9	21.3	19.6	12.1	**17.8**	**32.0**
Telecoms	7.2	14.5	10.0	9.4	24.7	6.2	**7.7**	**15.6**
Trade	13.2	19.0	21.6	18.1	18.4	11.7	**14.0**	**20.5**
Public Catering	16.9	23.8	-	12.0	21.3	15.8	**17.4**	**27.2**
Other Services	9.8	12.8	16.8	14.9	13.1	8.4	**11.4**	**23.1**
Firm Size								
Up to 50				11.1	14.7	10.1	**11.5**	**19.3**
51-250				16.7	17.1	16.0	**16.8**	**34.1**
More than 250				21.7	20.6	11.6	**20.4**	**43.8**
Average Number of Inspections	**11.5**	**16.8**	**20.4**	**16.9**	**17.1**	**10.9**	***14.4***	
Average Durations of all Inspections	**19.3**	**34.1**	**43.8**	**32.6**	**32.9**	**19.3**		***26.6***

The average number of inspections across all surveyed companies amounted to 14.4[27] over the course of 2000, consuming in total 26.6 days. However there was significant variation

[26] Results of 5% of the sample that quoted very high figures were excluded.
[27] A small number of firms reported the number of inspections running as a high 200 over the course of 2000.

throughout the sample. In general the more state ties a firm has the more it is likely to be inspected. Both state-owned and privatized firms experienced more inspections than start-up firms.

SME Inspections

The issue of inspections has lately become very topical in Ukraine. Whilst the average number of inspections by all inspecting bodies has decreased over the last several years, it is still very high. In order to provide a direct comparison with IFC's 1999 SME report (which surveyed only SMEs and only in 12 cities), an analysis of inspections for the same cites and same firm size is provided in the table below. The six cities that are included in both this and the 1999 report are Lugansk, Lutsk, Mykolayiv, Cherkasy, Chernigiv, Simferopol. Further for this analysis we also compared the same number of inspecting bodies. *Note: The averages below differ from the overall averages given in 1999 and 2000 due to a limited number of inspecting bodies being considered (who do however comprise the bulk of inspections), and limited number of cities.*

Table 42
Average Number and Average Duration of SME Inspections*
(for all firms, 2000 vs. 1999)

	2000		1999	
	Small Firms	Medium Firms	Small Firms	Medium Firms
Number of Inspections	10.2	14.9	9.6	12.0
Duration of Inspections	11.0	22.2	13.5	19.3

*Several firms with an extreme number of inpsections were excluded from the analysis.

As can be seen, in a direct comparison of the same cities there has been a slight increase in the number of inspections, for both small and medium sized firms (the 1999 report did not survey large enterprises). However, the average total duration of inspections for small businesses decreased over 2000.

There are over 30 state bodies and their regional branches that have the power to inspect business activities of SMEs.
There are more than 30 Laws, imposed different type of inspections, and administrative responsibility for violation of inspecting regulation.
There is no one law clearly defines what an inspection is, its forms or procedures. Presidential Decree No.817 "On Several Measures on Deregulating Entrepreneurial Activity," - July 23, 1998, attempts to regulate inspection procedures for several state bodies, notably, State Tax Administration, Customs, State Control and Revision Service, State Treasury and defined two types of state inspections for these bodies:

Planned Inspection: *This is an on-site inspection of the financial and business activities of Subjects of Entrepreneurial Activity – SEA (i.e. any business) which is envisaged in the internal work plan of the inspecting body, and is conducted once per annum. The inspecting body is obliged to inform the SEA at least 10 days in advance of the inspection.*

Unplanned Inspection: *This is an on-site inspection of the financial and business activities of an SEA, which is not envisaged in the internal work plan of the inspecting body and can occur at any time based on the following:*

- *Inspection of SEA has uncovered violations at another SEA*
- *SEA has not submitted compulsory reports on time*
- *Compulsory reports contain false information*
- *SEA claims violations of inspections procedure by inspecting body*

- *If SEA within three days has not provided a response to a written query from tax authorities that are checking information from another enterprise that had a legal relationship with the SEA*
- *SEA is being liquidated or restructured*

3rd Party Inspection: *This is an on-site inspection of an SEA conducted at the request of another inspecting body (or regional branch) that is inspecting another SEA and has uncovered potential violations in the relationship between the two SEAs. A 3rd party inspection must be conducted within 10 days of receipt of a written query.*

Operational Inspection: *This is an on-site inspection of an SEA to check that correct procedures are followed during cash and non-cash transactions with customers, check on the use of cash registers and invoices; financial and accounting documents; cash limits are observed (enterprises are severely limited in their cash transactions); registration documents; licenses; trade patents; excise duty stamps; any and all premises; and other aspects of business activity that current legislation allows inspecting bodies to check on.*

The duration of an operational inspection must not exceed 30 days. For SEAs that have sales in excess of UAH20 million there are no limits on the duration of operational inspections.

In addition to the above, all bodies having the authority to inspect businesses have their own separate inspection definitions and procedures. For example, the State Control and Revision Service, in addition to inspections has the power to undertake a 'revision' of an enterprise which is regulated only by its internal procedures.

Table 43
Average Number and Average Duration of Inspections

	Up to 50	51 – 250	More than 250	State - Owned	Privatized	Start-Ups	Average Number of Inspections	Average Duration of Inspections
City								
Vinnytsia	16.0	17.4	20.2	23.0	17.7	12.1	**16.9**	**27.6**
Dnipropetrovsk	13.7	17.5	23.0	15.2	21.3	13.5	**17.0**	**32.9**
Donetsk	7.8	16.9	21.3	21.8	15.6	9.3	**14.0**	**28.2**
Zhytomyr	18.4	28.3	26.3	25.7	21.7	19.6	**21.4**	**32.5**
Zaporizhya	14.5	18.7	18.9	21.6	20.4	11.2	**16.1**	**27.8**
Ivano-Frankivsk	8.6	12.6	10.5	8.1	12.1	7.2	**10.1**	**23.7**
Kyiv	8.9	13.7	20.5	16.8	15.4	8.8	**12.9**	**26.7**
Kirovograd	11.6	21.1	27.2	16.1	21.9	10.3	**16.0**	**26.1**
Lugansk	11.3	15.5	23.5	23.5	17.4	7.7	**14.0**	**24.3**
Lutsk	7.9	13.5	14.1	12.3	10.3	8.5	**9.7**	**19.6**
Lviv	8.1	13.6	21.3	19.9	14.5	6.7	**11.3**	**23.4**
Mykolayiv	8.1	14.7	15.5	13.5	12.8	8.1	**10.7**	**20.2**
Odesa	12.4	18.8	19.8	20.4	17.1	12.8	**16.0**	**33.2**
Poltava	16.5	22.0	33.8	18.1	26.2	14.0	**21.1**	**36.3**
Rivne	13.5	18.0	24.5	22.6	17.1	13.9	**16.3**	**31.3**
Simferopol	11.6	18.8	24.2	17.1	21.5	10.5	**14.8**	**27.3**
Sumy	9.8	7.8	5.1	4.8	5.8	11.2	**8.8**	**18.5**
Ternopil	9.6	13.2	16.0	15.2	11.3	11.5	**12.1**	**21.4**
Uzhgorod	8.7	10.0	15.1	13.6	8.7	9.1	**9.7**	**17.0**
Kharkiv	12.7	21.7	17.6	12.6	22.0	12.8	**15.7**	**27.7**
Kherson	12.2	21.7	21.0	21.5	19.7	10.0	**16.0**	**26.9**
Khmelnitsky	10.9	23.5	21.4	8.2	19.8	12.7	**14.3**	**29.9**
Cherkasy	12.8	16.5	11.4	10.6	13.6	13.8	**13.2**	**22.2**
Chernigiv	12.0	17.9	22.3	20.3	21.9	10.2	**15.6**	**28.0**
Chernivtsi	17.4	13.2	22.8	10.8	19.2	16.0	**17.3**	**26.4**
Average Number of Inspections	**11.5**	**16.8**	**20.4**	**16.9**	**17.1**	**10.9**	***14.4***	
Average Duration of Inspections	**19.3**	**34.1**	**43.8**	**32.6**	**32.9**	**19.3**		***26.6***

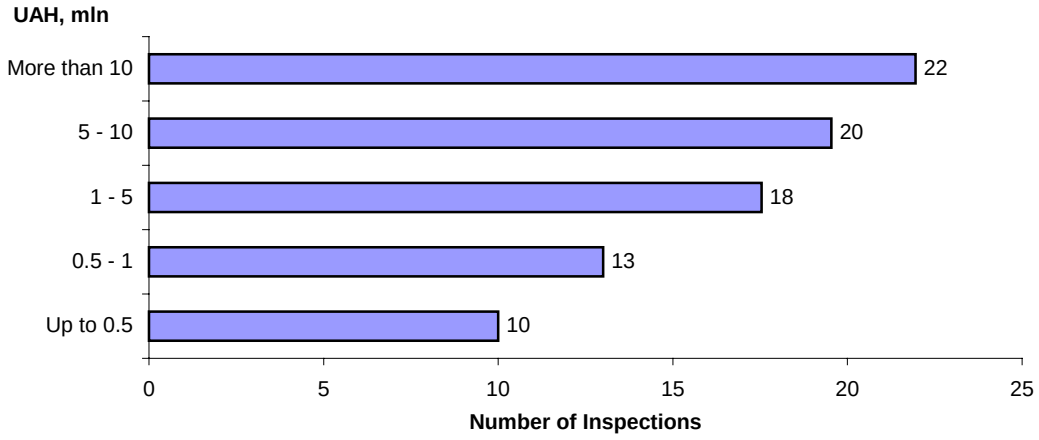
The regional picture regarding inspections is more complex, reflecting local priorities, and shows a wide regional variation, ranging from an average of 8.8 inspections in Sumy to over twice as much in Zhytomyr (21.4 inspections per year). This range in responses is an important result as it shows that local and oblast governments do indeed influence the inspection climates locally. As there are more than 30 national agencies that account for the bulk of inspections, it is unrealistic to expect them to coordinate their overall activities that closely, which implies that there is some other factor responsible for the overall level of inspections in a particular city. There are two hypothesis for the observed variation in the number of inspections. The first is that businesses tend to be city specific and share similar characteristics and regulatory infringements. The second is that local government has a larger influence on the level of inspections in a particular city than regulations governing the conduct of inspecting bodies would suggest. The authors of this survey favor the latter.

However, average figures for any particular city disguise a very large variation in responses. For smaller business there is a more than a two-fold difference between Zhytomyr (18.4 inspections) and Donetsk (7.8). A larger variance is observed with large firms, ranging from 33.8 inspections in Poltava to 5.1 in Sumy. Those cities that tend to have less inspections for smaller business also tend to have less inspections for larger business. This result does indeed demonstrate that local authorities wield a large degree of influence on the local inspections climate. A very small difference does exist between the number of inspections between state owned firms and privatized firms, though on average across the country they experience the same number of inspections. There is larger discrepancy between state owned firms and start ups, with state-owned firms experiencing one and a half times more inspections than start ups. Only in five cities did state owned firms experience less inspections than start ups.

State owned firms, rather than experiencing fewer state inspections, actually tend to have more than firms in the private sector, with the exception of Ivano Fraknkivsk, Sumy, Khmelnitsky, Cherkasy, and Chernivtsi where they had fewer inspections than private firms. The big anomaly is Sumy which bucked the trend across all parameters. Small businesses were inspected twice as much as large businesses and state owned firms experienced twice as few inspections as start ups.

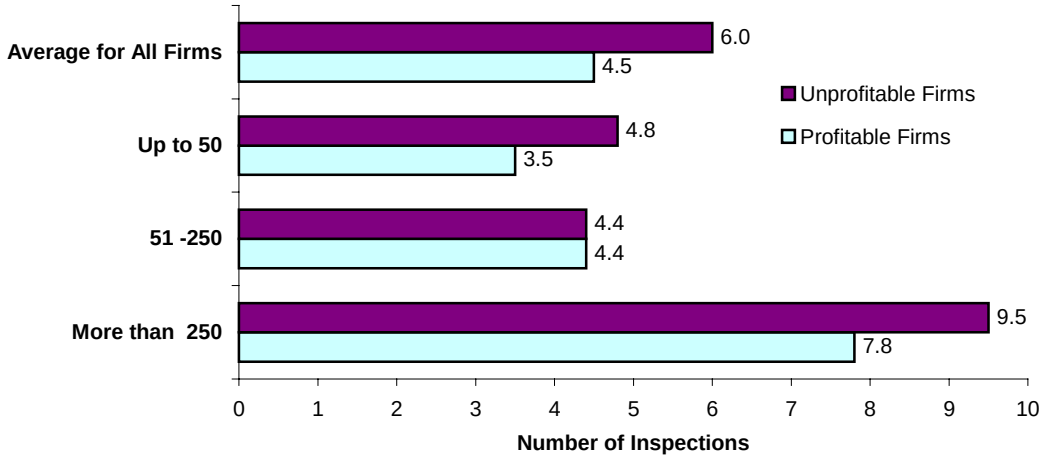
There is a positive correlation between company size and the number of inspections (*see Figure 26*). The larger the company the more the number of inspections. On average across the whole sample, a 10% increase in the number of employees leads to a 2% increase in the number of inspections. Figure 26 below shows the number of inspections by firm size (expressed in sales) and Figure 28 by number of employees.

Figure 26
Average Number of Inspections per Firm by Sales
(all firms)



As can be seen there is a positive correlation between firm size, expressed in terms of sales o number of employees, and the number of inspections. This should also logically imply that the more profitable a company the more inspections it should experience. In fact the data shows the exact opposite. Loss making enterprises experienced more inspections than profitable enterprises (though there is no link between different levels of profitability and number of inspections.) This result presumably reflects greater suspicion on the part of state officials of concealed sales and profits at poorer performing enterprises.

Figure 27
Average Number of Tax Inspections by Profitability
(all firms)



Notwithstanding the fact that the larger the enterprise the more inspections, smaller enterprises tend to experience disproportionally more inspections per employee than larger ones. The inspections burden per employee is higher with smaller companies than with larger companies – by more than 20 times.

Figure 28
Average Number of Inspections
(by firm size)

Inspections Perceptions

In addition to determining the number and duration of inspections experienced by companies in Ukraine it is also important to assess their perceptions of whether the inspections burden has changed or not as this provides a good indication of whether changes in inspection procedures are having an effect or not. In this context, what is probably more important is not whether there has been any reduction in the level of inspections, but whether company managers reckon that there has been a change or not.

Confirming the data that shows that there has not been a fall in the number of inspections, at least not for smaller businesses, the majority of businesses felt that number of tax inspections has not changed (57 % of respondents) in 2000. 17 % of all respondents thought that the number of tax inspections have increased during 2000. A similar picture is observed with respect to non-tax related inspections with the same proportion (57%) thinking that the level of inspections had not changed in comparison to 1999, and 21% stating that it had increased.

Table 44
Perceptions of Changes in the Number of Inspections for All Firms
(% of all firms)

	Have the Number of Tax Inspections Changed? (2000 vs.1999)				Have the Number of Non-Tax Inspections Changed? (2000 vs. 1999)			
	Increased	Decreased	No Change	Don't Know	Increased	Decreased	No Change	Don't Know
City								
Vinnytsia	22.5	12.7	53.5	11.3	21.1	14.1	54.9	9.9
Dnipropetrovsk	18.6	15.5	61.2	4.7	23.3	11.6	58.9	6.2
Donetsk	20.8	13.1	59.2	6.9	25.4	6.2	60.8	7.7
Zhytomyr	16.7	25.8	53.0	4.5	22.7	16.7	51.5	9.1
Zaporizhya	17.7	20.3	53.2	8.9	21.5	15.2	55.7	7.6
Ivano-Frankivsk	15.6	20.3	51.6	12.5	23.4	15.6	53.1	7.8
Kyiv	14.6	16.8	58.4	10.2	17.3	10.6	62.4	9.7
Kirovograd	14.3	20.0	57.1	8.6	18.6	15.7	60.0	5.7
Lugansk	12.5	16.3	60.0	11.3	35.0	11.3	47.5	6.3
Lutsk	23.3	16.7	50.0	10.0	25.0	10.0	60.0	5.0
Lviv	22.0	18.0	48.0	12.0	16.0	16.0	52.0	16.0
Mykolayiv	12.0	14.7	60.0	13.3	20.0	6.7	64.0	9.3
Odesa	21.2	13.5	51.9	13.5	24.0	9.6	58.7	7.7
Poltava	13.2	5.3	75.0	6.6	17.1	6.6	67.1	9.2
Rivne	15.9	8.7	58.0	17.4	14.5	2.9	69.6	13.0
Simferopol	30.0	15.0	48.0	7.0	33.0	14.0	43.0	10.0
Sumy	7.1	18.6	55.7	18.6	18.6	15.7	51.4	14.3
Ternopil	6.0	34.3	50.7	9.0	11.9	37.3	46.3	4.5
Uzhgorod	16.9	21.1	57.7	4.2	19.7	11.3	62.0	7.0
Kharkiv	22.9	12.7	58.5	5.9	23.7	8.5	61.9	5.9
Kherson	11.4	12.9	64.3	11.4	17.1	12.9	61.4	8.6
Khmelnitsky	18.2	15.6	54.5	11.7	27.3	9.1	53.2	10.4
Cherkasy	17.4	17.4	54.3	10.9	17.4	13.0	56.5	13.0
Chernigiv	12.9	11.4	60.0	15.7	15.7	7.1	54.3	22.9
Chernivtsi	17.1	20.0	54.3	8.6	21.4	11.4	57.1	10.0
Average	**17.2**	**16.3**	**56.6**	**9.9**	**21.4**	**11.9**	**57.4**	**9.3**

Roughly the same number of companies thought that tax inspections had increased (17.2%) as decreased (16.3%). The survey asked those respondents who felt that inspections had increased to identify what they felt to be the main reasons for this increase. Table 45 below lists some of the more frequently encountered reasons for increase in the number of tax inspections. A quarter (26.3%) did not know why inspections had increased. The two biggest perceived reasons for increases in inspections (according to entrepreneurs themselves) were being caught unawares by changes in tax legislation and regulations and pressure from local government on inspecting bodies.

Table 45
Firm Perceptions for Increase in the Number of Tax Inspections
(% firms that reported an increase in tax inspections)

	Up to 50	51 - 250	More than 250	State - Owned	Privatized	Start-Up	Average
Changes to Legislation and Regulations	22.2	16.1	27.5	22.9	23.4	20.7	**22.3**
Increased Pressure from Local Government	17.6	19.5	22.9	27.1	16.8	19.3	**19.6**
Enterprise Lodged Complaints Against Inspection Bodies	6.8	3.4	10.1	11.4	4.2	8.1	**7.0**
Worsened Relationship with Inspecting Bodies	4.0	5.7	3.7	1.4	4.2	5.9	**4.3**
Enterprise Switched to Simplified Taxation (only applicable for small firms)	6.8	0.0	0.0	1.4	1.2	6.7	**3.2**
Don't Know	30.1	25.3	21.1	15.7	27.5	30.4	**26.3**

Out of the 16.3 % of the entire sample who felt that the number of tax inspections decreased over 2000, 40% were at a loss to explain why. Table 46 below shows the breakdown of the most frequently encountered answers.

Table 46
Firm Perceptions for Decrease in the Number of Tax Inspections
(% of firms that reported a decrease in tax inspections)

	Up to 50	51 - 250	More than 250	State - Owned	Privatized	Start-Ups	Average
Changes to Legislation and Regulations	21.1	13.4	26.3	24.2	19.4	20.1	**20.2**
Enterprise Use of Inspections Journal	7.5	14.6	24.6	21.2	13.7	7.6	**11.9**
Enterprise Transferred to Simplified Taxation (only applicable for small firms)	18.3	0.0	0.0	3.0	7.4	17.4	**11.1**
Improved Relationship with Inspecting Bodies	8.0	11.0	8.8	3.0	8.6	10.4	**8.8**
Decreased Pressure from Local Government	7.0	7.3	5.3	6.1	6.3	7.6	**6.8**
Don't Know	40.4	42.7	36.8	30.3	44.0	38.2	**40.3**

As can be observed, the most significant factor influencing the level of tax inspections, in the opinion of company managers, is the instability of tax legislation and regulations. Simplified taxation offers some measure of relief from this instability, as it is intended to simplify tax reporting requirements. In this context it is interesting to observe that 3% of companies who experienced an increase in the number of tax inspections felt that this was as a direct result of the switch to simplified taxation.

The picture for non tax related inspections is the following. 9% more respondents felt that non-tax inspections have increased as those that felt they had decreased over 2000 (21% vs. 12%.) Employing the same analysis as with tax-related inspections, respondents were asked to name the main reasons for the change. Overall the same number of firms felt that there was no change in the level of both tax and non-tax related inspections in 2000 (57%.) The tables below list some of the more frequently encountered reasons in our survey for the reasons in the changes to the number of non-tax related inspections.

Table 47
Firm Perceptions for Increase in Non-Tax Related Inspections
(% of firms that reported an increase in non-tax inspections)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Changes to Legislation and Regulations	31.8	20.2	35.3	29.1	29.1	31.6	**30.1**
Increased Pressure from Local Government	22.3	28.4	24.1	27.9	21.6	25.4	**24.2**
Enterprise Lodged Complaints Against Inspection Bodies	5.9	7.3	12.0	11.6	7.0	7.3	**8.0**
Worsened Relationship with Inspecting Bodies	5.0	4.6	3.8	2.3	5.0	5.1	**4.5**
Don't Know	3.2	0.0	2.3	2.3	1.5	2.8	**2.2**

Table 48
Firm Perceptions for Decrease in Non-Tax Related Inspections
(% of firms that reported a decrease in non-tax inspections)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Changes to Legislation and Regulations	28.6	24.2	29.3	27.6	27.6	27.6	**27.6**
Enterprise Use of Inspections Journal	13.6	27.4	43.9	41.4	25.2	12.4	**21.8**
Improved Relationship with Inspecting Bodies	13.6	21.0	22.0	10.3	19.5	15.2	**16.7**
Decreased Pressure from Local Government	11.0	12.9	12.2	10.3	12.2	11.4	**11.7**
Don't Know	3.2	3.2	0.0	0.0	2.4	3.8	**2.7**

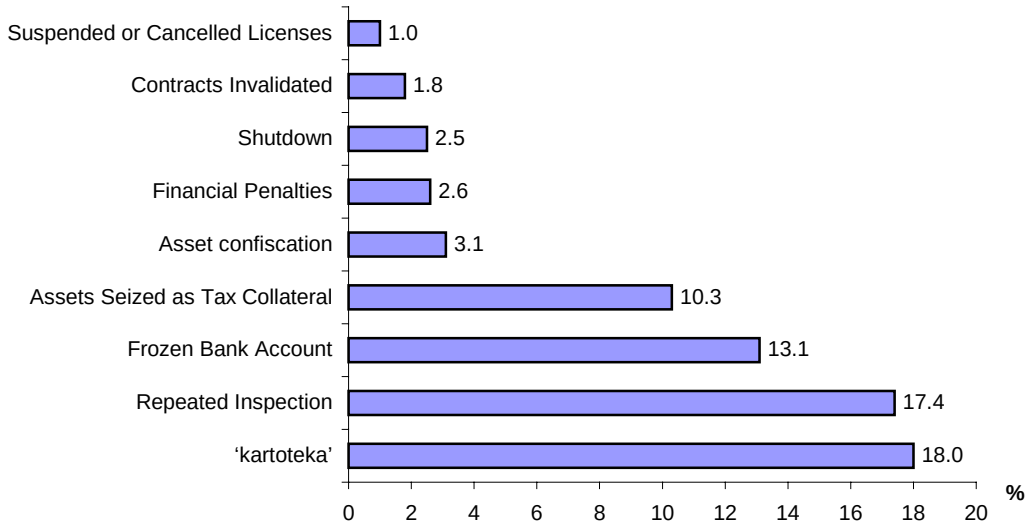
As far as firms are concerned the reasons behind changes in both tax and non-tax related inspections is the same. The major reasons for increases were changes in legislation and pressure from local governments and for decreases use of inspections journals and improved 'relationships' with inspectors. What is interesting though is that company managers feel a lot less confident about the reasons behind changes in the number tax inspections compared with other forms of inspections. The proportion of firms answering 'Don't Know' is much higher for tax inspections than for non-tax inspections, implying that the workings of the tax authorities are much more opaque.

Inspection Consequences

Sate inspections of business in Ukraine are designed to uncover violations, occasionally for other reasons such as pressure from local governments or as a form of unfair competition. Consequently it is not surprising that 44% of all surveyed firms faced some form of negative consequences imposed by inspecting bodies. These can range from being just a

serious distraction from running a company to the 'kartoteka' system[28] to outright closure. Up until 2001, these measures were taken unilaterally by inspecting agencies without any court orders. Figure 29 below shows the breakdown of possible negative consequences for surveyed companies. *For full city breakdown of consequences please refer to Annex 6.*

Figure 29
Inspection Consequences
(% of firms that had negative consequences)



However the true scale of the problem with this form of state harassment of business becomes apparent in looking at the time that enterprises experience various sanctions. The average enterprise experienced more than a year's worth of sanctions over 2000 (some sanctions are concurrent.) Table 49 below shows the average duration of negative consequences for those respondents who experienced the four most popular forms of sanctions.

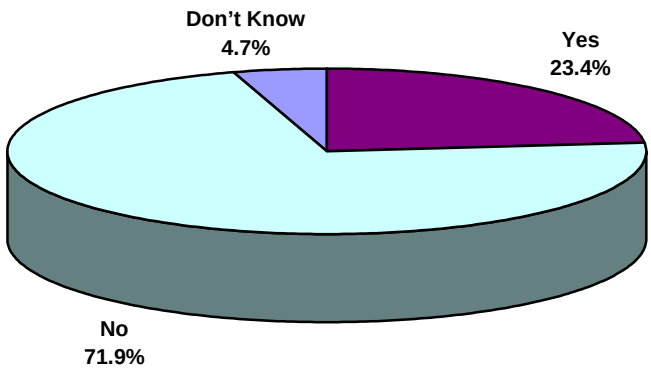
Table 49
Average Duration of Inspection Consequences
(% of all firms who experienced inspection consequences, days)

	Repeated Inspection	Assets Seized as Tax Collateral	Frozen Bank Account	'kartoteka'
Firm Size				
Up to 50	15.5	119.5	52.9	105.6
51 – 250	15.6	202.9	132.1	207.0
More than 250	11.7	171.6	99.6	198.3
Sector				
Manufacturing	18.6	181.6	113.6	178.4
Construction	22.5	156.9	63.5	285.8
Transport	5.2	269.2	62.4	255.3
Telecoms	33.0		120.0	49.0
Trade	4.3	14.0	26.3	40.0
Public Catering	5.8	38.0	58.4	61.0
Other Services	11.8	53.0	60.7	60.9
Firm Origin				
State –Owned	14.0	147.4	118.1	235.9
Privatized	14.2	196.0	121.2	195.6
Start-Ups	15.2	100.8	29.3	77.7
Average	**14.5**	**173.7**	**94.8**	**170.8**

[28] The kartoteka 2 system, disbanded in 2001, allows inspecting bodies (in particular the State Tax Administration) to directly debit arrears to the state from a company's bank account, effectively stopping a firm's cash flow.

The widespread nature of confiscatory practices such as asset seizure, frozen bank accounts and kartoteka goes a long way towards explaining the size of 'shadow' activities and the reluctance to initiate bankruptcy or restructuring. If most of the perceived benefit of such activities will accrue to the state then enterprises are understandably going to be reluctant to initiate restructuring.

Figure 30
"Have you ever contested the claims of inspectors, size of penalties, or other inspections consequences?"
(% of firms who experienced inspection consequences)



The majority of respondents did not contest the claims of inspecting bodies, either because the claims were indeed justified, or because they felt they would not receive satisfaction. Less than one enterprise in four expressed any faith in the Ukrainian court system as given in the table below.

The firms surveyed were asked how often were the following statements justified in relation to the Ukrainian court system (*i.e.* how often they agreed or disagreed.) They were given options of 'always', 'almost always', 'often', 'sometimes', 'rarely', and 'never'. For the purposes of the table below those firms who said "always', 'almost always' and 'often' were aggregated.

Table 50
Assessment of Ukrainian Court System
(% of all firms that agree with statements)

	Firm Size			
	Up to 50	51-250	More than 250	Average
Fair and Impartial	16.9	23.4	29.3	**20.9**
Honest and Uncorrupt	14.3	17.1	23.0	**16.6**
Quick	12.1	15.7	19.5	**14.4**
Affordable	18.1	24.0	28.6	**21.5**
Consistent and Reliable	10.8	14.1	19.6	**13.3**
Able to Enforce Decisions	23.0	24.1	30.7	**24.7**
Court system Can Defend My Rights Now	15.4	20.6	25.4	**18.6**
Court system Could Defend My Rights Two Years Ago	13.5	18.6	23.2	**16.6**

There is a tendency for larger firms to have more trust in the court system than smaller firms. On a more optimistic note, more Ukrainian firms (though still very few) felt that the

court system could defend their rights and interests (18.6% expressed faith in the courts in 2000 vs. 16.6% in 1998.)

Unofficial Payments During Inspections

Respondents were asked if they had to make additional 'unofficial' payments in connection with inspections by various bodies. Not surprisingly, as this is a very sensitive issue, more companies chose not to answer this question (replying that this was confidential information) than those that admitted to making these payments. *It must be stressed that this data was supplied by companies themselves in an anonymous questionnaire and represent their opinions only.*

The majority of companies replied that they had not made any unofficial payments over 2000. Table 51 below gives the breakdown of responses by particular inspecting bodies only for those companies who experienced inspections by those same bodies. As this is sensitive information, large proportion of companies stated that this information was confidential. The largest numbers of firms who made unofficial payments made them to the most active inspecting agencies.

Table 51
Unofficial Payments During Inspections
(% of all firms who experienced a particular form of inspection)

	Made Unofficial Payments	Confidential Information	Did Not Make Unofficial Payments
Fire Department	11.6	25.4	63.0
Sanitary-Epidemiological Department	10.7	23.7	65.6
Tax Inspection Service or Police	9.5	24.8	65.7
Internal Affairs	8.0	26.6	65.4
Consumer Rights Protection Committee	7.9	22.2	69.9
Licensing Bodies	6.6	24.6	68.8
City Department of Industry and Consumer Market Development	6.3	27.0	66.7
Architecture Department	6.2	22.2	71.6
City Department on Issues of Business Development, Registration and Licensing	5.6	26.4	68.0
Prosecutors Office	5.1	19.9	75.0
Environmental Protection Ministry	4.9	19.5	75.6
Anti-Monopoly Committee	4.6	18.1	77.3
Health and Safety Committee	4.5	19.1	76.4
Price Control Inspection	4.5	20.0	75.5
Customs Service	4.0	32.3	63.7
Standardization, Certification and Metrology Committee	3.9	19.6	76.5
State Commission of Ukraine on Securities and Securities Market	3.5	18.4	78.1
Pension Fund	3.2	17.0	79.8
Employment Fund	2.9	17.6	79.5
Control Revision Service	2.9	19.6	77.5
City Financial Department	2.3	20.4	77.3
Social Security Fund	2.2	16.6	81.2

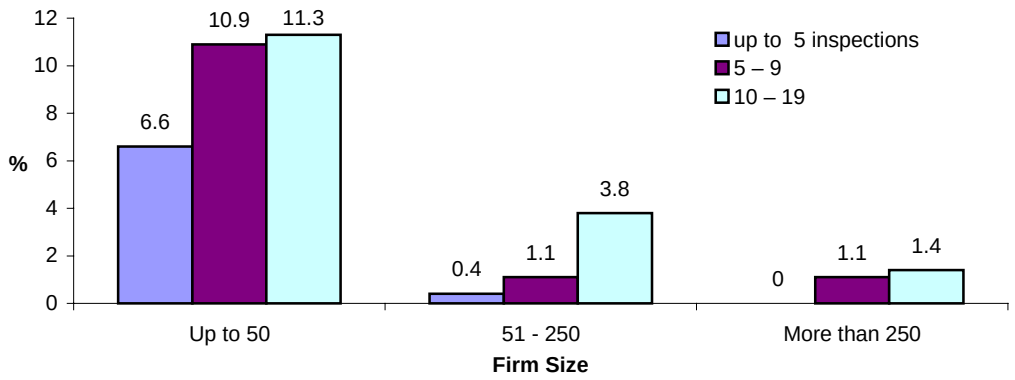
Examining this issue further, the data allowed for an analysis showing on whom the burden of unofficial payments fell the most. The figure below shows the firm size breakdown of all

of those firms that made unofficial payments (*i.e.* answered 'yes' in the table above) in 2000.

Whilst larger firms generally experience more inspections, smaller firms tend to make more unofficial payments. This coupled with the fact that smaller firms have more inspections per employee means that they are at a much larger disadvantage compared with larger, more established firms.

Figure 31 shows the relationship between the incidence of inspections and firms who make unofficial payments. For example, 6.6% of small firms who had up to 5 inspections made unofficial payments in relation the inspections, whereas 11.3% of small firms who experienced up to 19 inspections made unofficial payments. Overall, the picture is clear, a greater proportion of inspected small firms make unofficial payments compared with larger firms, and incidences of unofficial payments increase with the number of inspections.

Figure 31
Unofficial Payments by Number of Inspections
(% of firms that made unofficial payments)



Time Tax

An often overlooked consequence of frequently changing legislation, unstable business environments and a complicated regulatory and administrative environment is the amount of time that the management of a company needs to spend on coping with various changes and in dealing with the state in its many forms. This survey attempted to establish what percentage of senior management work time was spent on dealing with state officials on interpretation of laws and regulations (this covers almost all forms of interaction with the state and local government.) However, this is not just time spent, it is time spent away from managing an enterprise, and therefore has a monetary impact as well (lost contracts, worse management, etc.). In that sense it can be considered to be a tax on enterprises, whose value is calculated by considering the opportunity cost of management work time.

Table 52
Time Tax
(% of management work time, all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	14.5	16.0	19.4	18.2	17.8	13.3	**16.5**
Construction	18.8	19.9	19.8	21.9	19.1	18.8	**19.3**
Transport	20.0	15.5	20.3	19.9	18.9	17.1	**18.7**
Telecoms	12.3	4.3	19.3	15.5	38.7	10.1	**12.6**
Trade	14.1	15.5	8.8	21.5	13.0	14.2	**14.1**
Public Catering	19.2	20.0	-	16.1	17.1	22.0	**19.2**
Other Services	11.6	10.9	23.7	19.3	14.1	9.6	**13.4**
Average	**15.0**	**15.8**	**19.7**				
Firm Size							
Up to 50				14.3	16.7	14.3	**15.0**
51-250				16.0	16.4	14.0	**15.8**
More than 250				24.0	18.1	13.0	**19.7**
Average				**18.8**	**17.0**	**14.2**	***16.1***

The measure that this survey used to assess time tax was very crude and offers respondents' subjective opinions on the amount of time spent dealing with state officials, without detailing particular areas of state involvement in companies or providing information on whether the state or firms initiate contact. A previous analysis[29] shows Ukraine to have the highest level of time tax on management in the CIS and Central and Eastern Europe.

Management of state owned enterprises faced the highest level of time tax with start ups the least. Large enterprise faced the highest level, and small enterprises the least, though there is no significant difference between small and medium enterprises. This means that, taking into account the difference in the amount of human resources available, and the opportunity cost of management time, small enterprises are hit hardest of all. This is a disappointing result as it is precisely the small business sector that should be the most dynamic and innovative. This level of state involvement, inspections and unfair competition all contribute to a poor public perception of private business and helps explain the low level of entrepreneurship in Ukraine. The table below shows the average proportion of work time that senior management needs to spend dealing with state officials for all firms in a given city.

[29] 'EBRD Transition Report 1999,' pp.124-126.

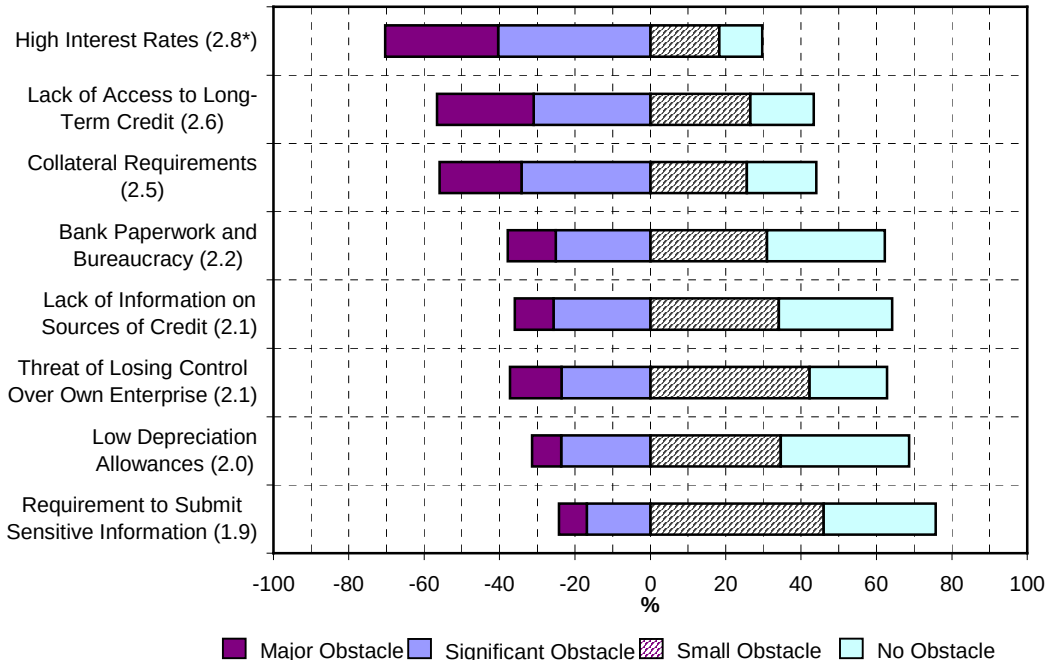
Table 53
Time Tax
(% of management work time)

	Firm Size			
	Up to 50	51-250	More than 250	Average
City				
Vinnytsia	16.7	14.4	12.5	**15.5**
Dnipropetrovsk	17.9	14.2	24.2	**18.5**
Donetsk	14.6	15.6	14.6	**14.9**
Zhytomyr	13.4	6.1	11.8	**12.2**
Zaporizhya	22.7	11.0	15.7	**18.8**
Ivano-Frankivsk	14.2	23.0	30.0	**19.7**
Kyiv	14.6	15.3	17.5	**15.5**
Kirovograd	13.6	23.1	32.6	**18.8**
Lugansk	22.9	15.9	20.4	**21.4**
Lutsk	11.8	8.8	4.8	**10.4**
Lviv	12.9	22.3	27.0	**16.9**
Mykolayiv	14.7	17.1	23.3	**16.2**
Odesa	13.3	20.9	24.7	**18.4**
Poltava	16.7	23.0	22.4	**19.7**
Rivne	11.3	16.5	14.4	**13.9**
Simferopol	18.9	17.8	10.8	**17.9**
Sumy	10.9	13.8	18.7	**12.4**
Ternopil	11.7	9.4	13.0	**11.2**
Uzhgorod	7.3	4.7	22.0	**9.0**
Kharkiv	16.4	14.8	24.1	**18.0**
Kherson	19.0	13.4	30.6	**19.7**
Khmelnitsky	13.2	13.5	14.5	**13.4**
Cherkasy	13.8	11.9	3.0	**11.8**
Chernigiv	13.7	12.8	16.2	**14.1**
Chernivtsi	13.4	16.5	27.7	**16.8**
Average	**15.0**	**15.8**	**19.7**	**16.1**

Barriers to Receiving Financing and Credit

The survey asked respondents to rate their main problems with obtaining financing, particularly credit. The figure below lists some of the more commonly encountered issues with obtaining financing in Ukraine and to what extent all surveyed firms felt they presented obstacles to their development.

Figure 32
Barriers to Receiving Financing and Credit
(distribution of responses for all firms)



*Figures in brackets refer to the overall average score for a given obstacle on a scale of 1 – no obstacle to 4 - major obstacle.

Table 54
Barriers to Receiving Financing and Credit

	Average		Firm Origin						Firm Size					
			State-Owned		Privatized		Start-Ups		Up to 50		51 - 250		More 250	
	Score*	rank	Score	rank	Score	rank	score	rank	score	rank	score	rank	score	rank
High Interest Rates	**2.8**	**1**	2.6	1	3.0	1	2.7	1	2.7	1	2.9	1	3.0	1
Lack of Access to Long-Term Credit (more than 1 year)	**2.6**	**2**	2.4	2	2.6	2	2.5	2	2.5	2	2.6	2	2.7	3
Collateral Requirements	**2.5**	**3**	2.3	3	2.6	3	2.5	3	2.5	3	2.5	3	2.7	2
Bank Paperwork and Bureaucracy	**2.2**	**4**	2.0	4	2.2	4	2.2	4	2.2	4	2.2	4	2.2	4
Lack of Information on Sources of Credit	**2.1**	**5**	2.0	7	2.1	6	2.2	5	2.2	5	2.1	7	2.0	7
Threat of Losing Control Over Own Enterprise	**2.1**	**6**	2.0	5	2.1	5	2.1	6	2.1	6	2.1	6	2.1	5
Low Depreciation Allowances	**2.0**	**7**	2.0	6	2.1	7	2.0	7	2.0	7	2.1	5	2.1	6
Requirement to Submit Sensitive Information	**1.9**	**8**	1.6	8	1.9	8	1.9	8	1.9	8	1.8	8	1.8	8

*on a scale of 1 – no obstacle to 4 –major obstacle

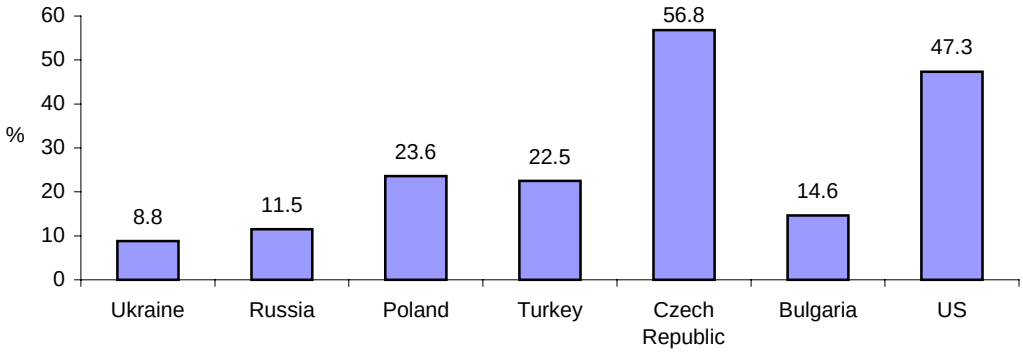
The biggest barrier to obtaining commercial financing and credit, in keeping with most with transition economies, are high interest rates. Over and beyond this problem, SMEs are

particularly hard hit by the lack of availability of longer term credit. Collateral requirements are in third place for all companies (except large companies which ranked this problem second.) Companies on the whole reckon that they are fairly knowledgeable on potential sources of credit and financing as this was rated as only the fifth biggest problem.

During 2000 the government and the National Bank of Ukraine (NBU) managed to reduce interest rates. The NBU discount rate was reduced from 45% in January to 27% in October 2000. Increasing money supply (M2 and M3 grew by 45% over the year) together with the relatively low NBU discount rates decreased commercial bank lending interest rates in nominal terms from 56.2% in January to 37.3%[30] in December (source: NBU statistics). In effect, real annual interest rates on bank credits in 2000 fell sharply – on average by 19% to around 18%. However, the cost of long term capital still remains restrictively high for long term business financing with the main reasons cited for high interest rates being high credit risks and an underdeveloped banking sector. The average spreads between annual interest rates on deposits and credits were 32.7% and 26.8% respectively in 1999 and 2000.

The upturn in bank crediting (as proportion of GDP) did not enhance investment activities, calculated as long-term loans. While in early 2000 8.9% of bank credit was used for investment, in early 2001 this had fallen to 5.6%. (Source: NBU Bulletin). In 1999 credit to the private sector was 8.8% of GDP growing by the end of 2000 to only 10.3% of GDP. For comparison, in 1999 this indicator for Poland was at 23.6% and for Czech Republic – at 56.8% of GDP.

Figure 33
Bank Credit to Private Sector in 1999
(% of GDP)



Source: IMF International Monetary Statistics, December 2000

Perceptions of the Effectiveness of Local Authorities and Infrastructure

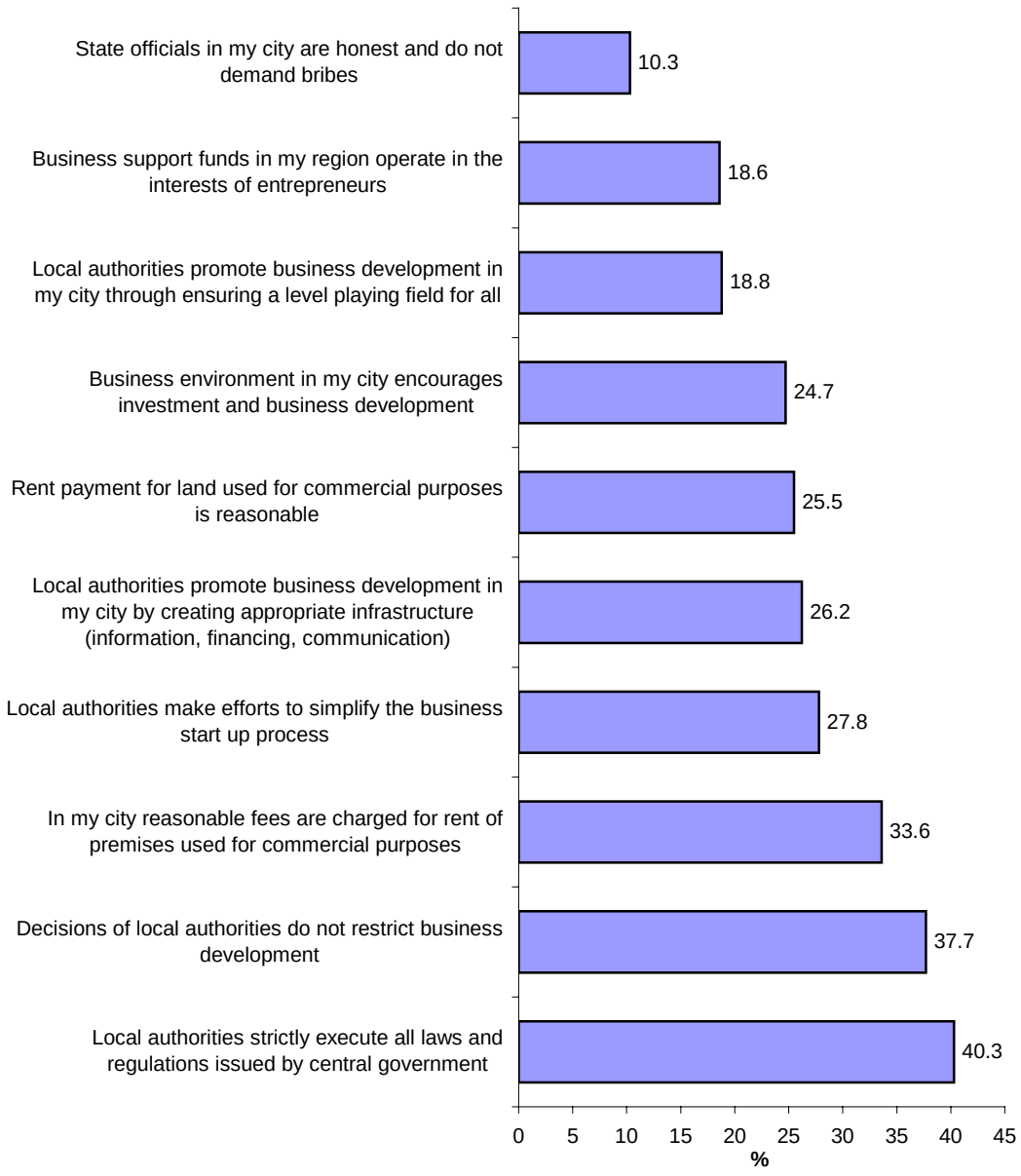
Surveyed firms were asked about their perceptions of the local authorities and local infrastructure. It must be stressed that that these questions were asked in an anonymous survey of a sample of firms in every oblast capital and represents their opinions only.

The survey asked firms to assess the business climate in their cities by posing several specific statements. Respondents were asked to indicate whether they agreed or disagreed

[30] National Bank of Ukraine Bulletin

with the statements. Figure 34 below shows the proportion of all respondents who agreed with various statements. For a full breakdown of responses by city please refer to Annex 5.

Figure 34
Assessment of Local Business Environments
(% of all firms who agree with statements)



Analysing all of the statements across cities we looked at those cities where there were more responses of "agree with the statement" than with "disagree with the statement.", without taking into account the other three possible answers. In other words for what statements and in what cities were the opinions of respondents positive (*i.e.* more agreed than disagreed.)

- 'Local authorities strictly execute all laws and regulations issued by central government.' Cities that were positive: Donetsk, Ivano-Frankivsk, Ternopil, Khmelnitsky.

- ‘Decisions of local authorities do not restrict business development.’ Cities that were positive: Ternopil, Chernivtsi.
- ‘Business environment in my city is better than in the majority of other Ukrainian regions.’ (*not given in* figure) Cities that were positive: Dnipropetrovsk, Donetsk, Kyiv and Odessa.

The rest of the statements produced more negative responses than positive responses (*i.e.* more firms disagreed with the statement than agreed).

Finally, respondents were asked to assess the quality and effectiveness of local infrastructure. The figure below shows the breakdown of responses for providers of essential services. Please refer to Annex 5 for more details.

Table 55
Assessment of Quality and Effectiveness of Local Infrastructure

	Very Bad	Bad	Probably Bad Than Good	Probably Good Than Bad	Good	Very good
Roads Department	25.1	34.3	25.7	10.4	4.4	0.2
Architecture department	5.2	15.3	33.3	31.7	14.0	0.4
Land department	5.6	15.6	35.6	31.0	11.7	0.4
Telephone service	6.8	18.0	25.7	29.7	18.5	1.2
Electricity enterprise	7.3	14.9	25.3	28.8	22.6	1.2
Water Service	7.8	14.1	22.0	30.7	24.2	1.1
Oblgas	6.1	13.3	23.8	29.7	25.6	1.5
Teploenergo	15.2	22.3	26.0	21.0	14.9	0.6
Public Health Care	13.4	25.7	30.7	18.4	11.2	0.7
Education Institutions	7.0	16.8	32.5	28.7	14.0	1.0

Barriers to Market Entry and Expansion - Conclusions

Whilst general macroeconomic stability is very important in determining the business environment in Ukraine, it is still the role of the state in business (regulatory environment including taxation, formal and informal influence, ensuring a level playing field, *etc.*) that is most important for Ukrainian businesses. Business in Ukraine is unanimous that taxation is still the biggest problem in Ukraine with almost all firms ranking taxation as their biggest business problem. This degree of unanimity on one issue is a very strong message to policy makers that the biggest help they could provide to business is to tackle taxation problems, lower rates and make tax compliance easier.

According to surveyed firms, the most important taxation problem is the instability of tax legislation. The tax burden, as measured by the number of taxes paid and tax rates was rated as second. In 2000 surveyed firms paid on average 11 taxes and other compulsory payments to the budget and non-budget funds of all levels, whilst the average tax burden was very high at 53% of the value added generated by firms.

It is not so much high tax rates, but the overall tax environment comprising changing tax regulations, many different taxes and tax-like payments, accounting and reporting, and of course the power that tax bodies have to severely disrupt a business that poses problems. Further, the effects of the taxation environment are wider than just on a company’s financial position. Taxation is also an important component of administrative corruption in Ukraine, and is also a large cause of shadow or unofficial activities which in turn contribute to unfair competitive practices, by effectively penalizing firms who are compliant as

compared to those who evade tax. The issue of tax privileges, exemptions, special economic zones, soft budget constraints, also contribute to unfair competitive practices by in effect providing hidden subsidies to firms who benefit from such favorable treatment.

All firms experienced some form of unfair competition in 2000. Only one fifth of all surveyed firms did not feel that the unfair competition that they experienced was a barrier for the further development of their business. The issue of unfair competition is even more important for surveyed companies than obtaining financing. The most problematic form of unfair competition is local governments granting preferential terms to competitors in issuing permits amd permissions, access to credit, subsidies, *etc.* This demonstrates the large degree of influence that local government and state bodies have on local business environments.

One topic that has been at the center of attention over the last several years, is the issue of business inspections. The survey shows that, at least for surveyed companies, the number of inspections has not fallen over 2000 compared with 1999. For smaller business, comparing with IFC's 1999 survey of small business, the average number of inspections has not decreased and has remained at around the same level. Further, smaller businesses bear a larger inspections burden than large enterprises and have fewer resources to deal with the consequences of inspections. Whilst the level of inspections has fallen compared with 3-4 years ago, it is still far too high. This issue, together with taxation, and frequently changing legislation helps to explain why Ukrainian firms have some of the highest time tax levels in the CIS (16% of management time is spent on dealing with the state in clarifying and interpreting laws and regulations) and a very significant shadow economy.[31]

Whilst there are those who consider a certain amount of shadow activities to be beneficial inasmuch as they provide a useful safety net (particularly for households), overall they are very much to the detriment private sector development. Shadow activities deprive the economy of much needed investment funds, are a major component of unfair business practices, reduce the incentives for enterprise restructuring (as compliance raises the cost of restructuring), provides a fertile environment for corruption, lowers budgetary revenues and deprives the government of economic feedback on policy matters.

Oblast and city governments have a large influence on businesses in Ukraine. Local governments are responsible for registering businesses, issuing permits, issuing licenses (at least those delegated to local governments), giving permissions for business, establishing local infrastructure. Perhaps their biggest role is indirectly influencing the behavior of local officials and state bodies, even if these bodies do not report locally. Overall, those cities that tend to have better administrative environments also tend to do better with unfair competition and have a better regulatory environment as well. National policy makers need to pay more attention to local business environments in Ukraine and how local governments interpret national laws and regulations. It is not that central government has no role to play, rather it is that most Ukrainian business is local in nature and are therefore most influenced by local business climates. In this regard, most survey respondents overall had a negative opinion of the effectiveness and quality of local governments.

Greater oversight and scrutiny is required over the work of local authorities (both city and oblast.) The central government should make more resources available to ensure deregulation at the local level, streamlining local regulatory and administrative procedures and ensure compliance by local officials with national laws and regulations. At the same time effective safeguards need to be introduced to ensure that firms have adequate redress in cases of rent-seeking or abuse of authority by local officials. This goes hand in hand with

[31] World Bank estimates that the size of the shadow economy in 1997 was more than 40% of the real economy. "Economic Growth With Equity", discussion paper 407, pp. 128-129.

improving the judicial system in Ukraine. The incidence of firms of using the courts to challenge unjust administrative decisions is still too low in Ukraine. However, until the judiciary achieves full independence from local governments, the court system will remain under-utilized in issues of conflict between the state and private business.

Use of Information Technologies

Computer Use

As a representative sample of Ukrainian enterprises were surveyed in all oblasts it was also interesting to establish a base line for computer and internet use in Ukraine. The survey shows that overall 76% of firms have at least one computer.

Table 56
Proportion of Enterprises Having at Least One Computer
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	72.0	88.4	97.4	90.1	87.0	79.0	**85.0**
Construction	69.8	81.8	94.4	64.7	76.7	78.5	**76.3**
Transport	57.5	82.9	95.0	85.3	87.8	56.3	**78.3**
Telecoms	95.5	100.0	100.0	100.0	100.0	95.0	**96.0**
Trade	63.8	93.3	90.9	41.2	54.3	75.7	**67.7**
Public Catering	34.3	90.9	-	38.1	26.8	48.5	**38.6**
Other Services	59.9	79.3	100.0	81.0	58.3	74.3	**70.7**
Average	**64.0**	**86.9**	**97.1**				
Firm Size							
Up to 50				57.7	48.4	71.6	**64.0**
51-250				79.5	85.6	95.7	**86.9**
More than 250				97.7	97.7	87.5	**97.1**
Average				**80.3**	**75.6**	**75.1**	***76.0***

Of more interest is the number of computers per 100 people at various enterprises. This allows for a more refined measure of uptake of computers at the firm level rather than just measuring the number of companies that had one computer or more. The data shows that enterprises had on average one computer per for 20 employees. The following table shows the average number of computers for different groups of firms.

Table 57
Average Number of Computers, per 100 employees
(weighted by number of employees)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	17.8	5.0	4.0	2.5	5.2	7.8	**4.3**
Construction	7.2	3.1	1.7	0.7	2.4	4.0	**2.4**
Transport	13.5	3.3	0.9	1.0	1.6	3.8	**1.3**
Telecoms	134.7	82.4	28.3	160.1	10.8	54.4	**70.4**
Trade	12.4	9.8	4.2	9.1	4.8	14.2	**8.8**
Public Catering	3.9	3.9	-	3.0	3.0	5.6	**3.9**
Other Services	18.0	21.3	5.9	3.7	12.7	32.0	**8.4**
Average	**17.9**	**7.1**	**3.9**				
Firm Size							
Up to 50				47.3	7.2	19.6	**17.9**
51-250				5.7	5.7	13.6	**7.1**
More than 250				2.2	5.2	5.9	**3.9**
Average				**2.7**	**5.3**	**12.3**	***4.7***

The probability of the presence of at least one computer increases with firm size, with almost all of large enterprises having at least one computer. However, in terms of computer penetration the reverse is true, the smaller the company the greater the ratio of computers to

employees. Not surprisingly telecom companies have the highest level of computer penetration with 24.1 computers per 100 employees, the least intensive users are transport enterprises with 1.3 per 100 employees.

The survey further sought to determine what computers were used for at the firm level. Respondents were given a choice of 10 management uses for computers and asked to select which they used most actively. Table 58 below shows the breakdown of responses. With the exception of the telecoms sector, there were no large sectoral or firm size variations observed. Uptake of information technology does not seem to be a function of company size or sector of the economy.

Table 58
Proportion of Enterprises Actively Using Computers* to Perform Major Management Functions
(% of all firms who have at least one computer)

	Sector							Firm Size			
	Manufacturing	Construction	Transport	Telecoms	Trade	Public Catering	Other Services	Up to 50	51-250	More than 250	Average
Financial Accounting	77.4	72.4	71.1	85.4	83.4	66.1	73.6	74.6	77.1	82.0	**77.1**
Managerial Accounting	32.9	34.4	38.6	60.4	28.3	42.9	35.0	31.8	32.2	40.1	**34.0**
Budgeting	29.9	20.8	31.0	48.9	20.2	12.5	31.1	22.1	27.6	38.5	**27.7**
Sales and Marketing	51.1	28.8	22.1	53.2	56.8	30.4	34.1	45.2	41.2	54.1	**46.3**
Servicing Clients	55.0	45.6	43.7	91.7	59.1	39.3	72.9	57.2	50.1	64.2	**56.9**
Production Management	32.4	31.2	43.2	56.3	20.9	33.9	32.8	29.9	25.9	42.0	**31.7**
Quality Manage-ment and Control	15.1	8.8	9.3	43.8	8.7	5.4	12.8	13.0	11.0	17.3	**13.5**
Inventory Management	41.7	30.4	25.3	43.8	55.4	42.9	22.2	41.1	35.4	44.2	**40.2**
Project Management	14.0	17.7	8.1	33.3	7.6	3.6	14.4	13.0	10.3	16.8	**13.2**
HR Management	16.8	13.6	25.9	31.3	10.5	14.5	17.8	12.7	15.8	24.2	**16.4**

*Respondents were given a choice of ‘do not use’, ‘to a small degree’, and ‘actively use’.

Internet Use

Around a third of all enterprises had access to the internet in 2000. More larger firms had internet access (52%) than smaller firms (27%), probably reflecting poor understanding of internet possibilities and smaller ability to pay for connections. Public catering is easily the most indifferent sector to internet possibilities. Excluding telecoms and public catering, between quarter and just over a third of all enterprises who had a computer were connected to the internet.

Table 59
Proportion of Enterprises Connected to the Internet
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Sector							
Manufacturing	29.6	29.9	55.3	37.7	36.4	39.0	**37.4**
Construction	24.0	21.8	27.8	5.9	13.7	36.7	**23.7**
Transport	17.5	11.4	22.5	20.6	12.2	21.9	**17.4**
Telecoms	84.1	50.0	75.0	71.4	33.3	87.5	**82.0**
Trade	24.9	53.3	72.7	5.9	18.6	35.7	**29.2**
Public Catering	5.2	27.3	-	0.0	5.4	10.3	**6.9**
Other Services	31.2	41.4	56.1	30.2	29.8	47.7	**37.5**
Average	**26.8**	**31.1**	**51.7**				
Firm Size							
Up to 50				14.4	12.2	34.8	**26.8**
51-250				15.7	26.3	55.6	**31.1**
More than 250				48.5	51.9	66.7	**51.7**
Average				**29.0**	**28.4**	**38.3**	***32.7***

Figure 35 below shows the frequency of internet use for those who do have access to the internet (*i.e.* a third of all firms.) Just over half of all firms (56%) use the internet on a daily basis, whilst another third (31%) several times per week. These firms can be considered to be regular internet users.

Figure 35
Frequency of Internet Access
(% of all firms that have internet access)

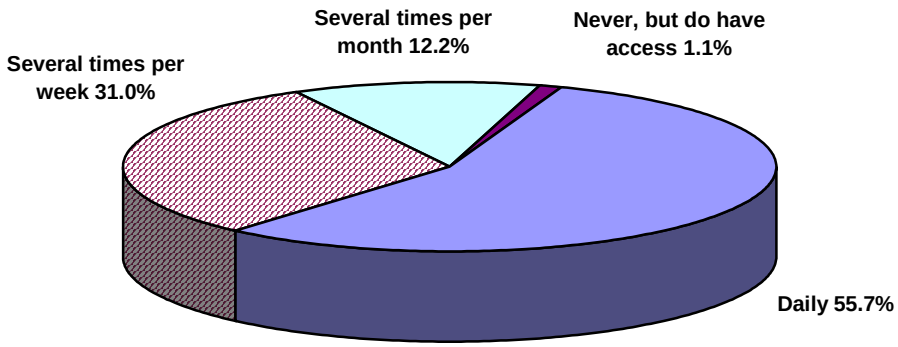
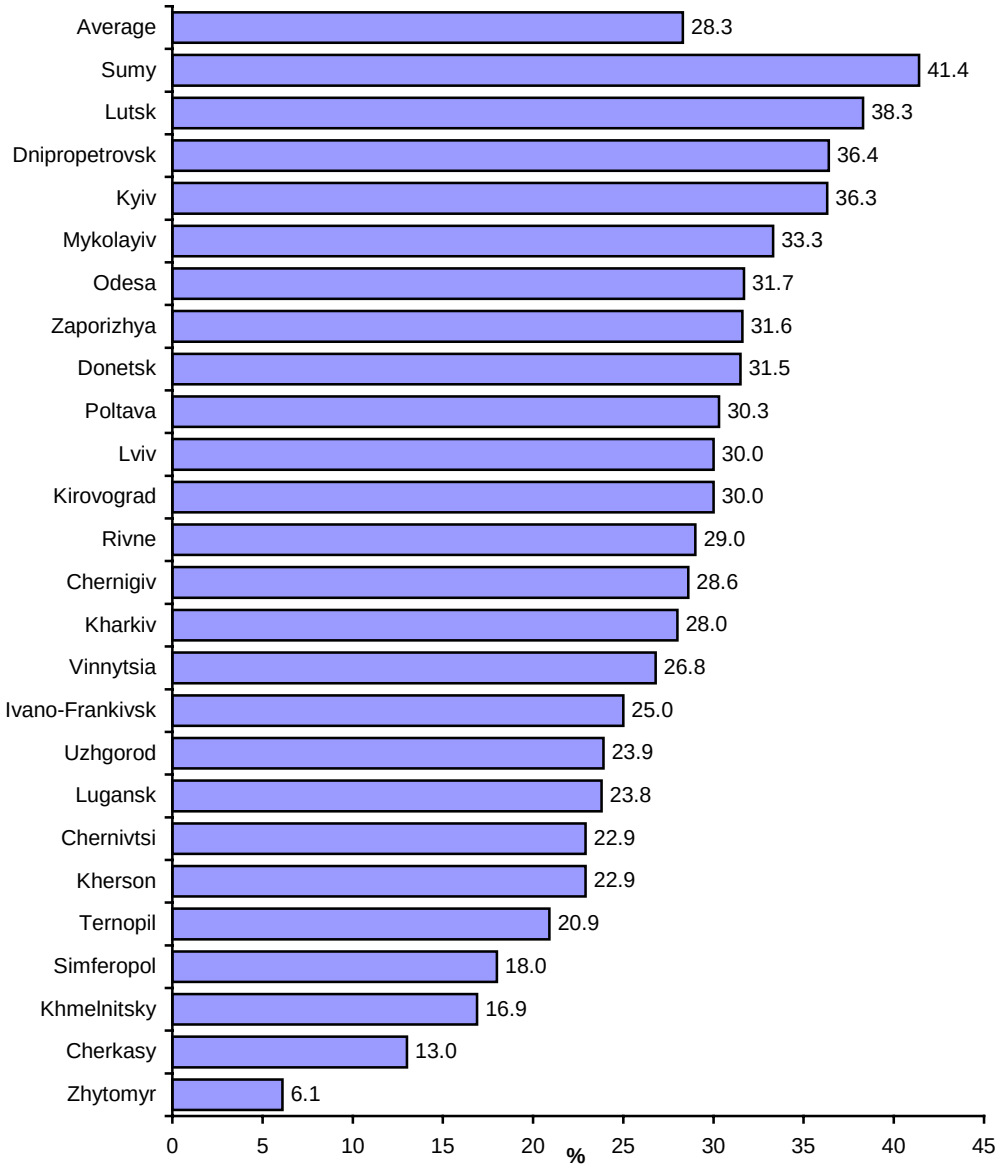


Figure 36
Active Internet Users by City*
(% of all firms)



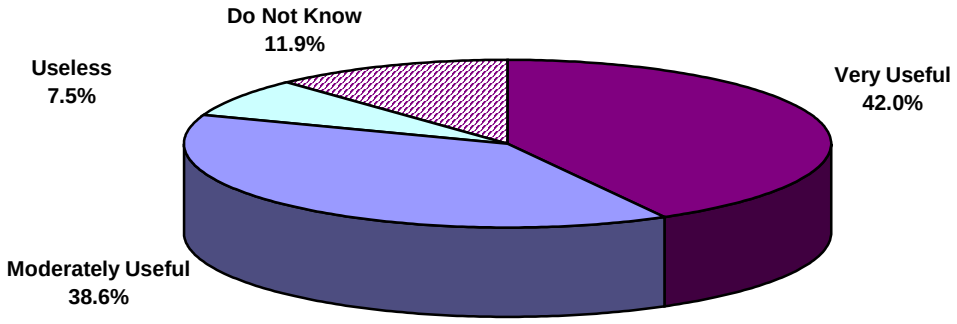
*Firms who stated that they used the internet daily or several times per week.

There is a large variation in the proportion of active internet users between various cities in Ukraine, ranging from 6% and 13% of all firms in Zhytomyr and Cherkasy to 38% and 41% in Lutsk and Sumy respectively. The very low figure in Zhytomyr is anomalous, possibly due to a sampling error. It should be treated with caution as representative of firms in Zhytomyr as a whole.

Connection to the internet was mostly through dial-up (70% of those with access to the internet), leased lines made up a quarter (27%) and a satellite connection was enjoyed by only 3% of enterprises. Dial up connections cost an average of UAH349 (median of UAH185) per month, leased lines – UAH1, 405 (median of UAH330) and satellite internet access – UAH1055 (median of UAH1000.)

Figure 37 below shows, for those companies that have at least one computer, perception of usefulness of the internet to their business. On the whole, over 80% of businesses who had at least one computer (*i.e.* 61% of the entire sample) find the internet useful to some extent. With the exceptions of the telecoms sector there is no strong variance observed between sectors, firm size or origin. However only a third of enterprises had access to the internet. In other words, twice as many company managers feel that the internet is useful for their business as those that actually have access to the internet. This shows that the internet access gap in Ukraine is very high and demonstrates the latent demand for internet services.

Figure 37
Perception of Benefit of the Internet
(% of firms who have at least one computer)



The figure below shows barriers to internet use expressed by all firms who have at least one computer. The biggest perceived barriers to internet use in Ukraine are those related to access - low quality of phone lines and high prices for internet connections.

Figure 38
Barriers to Internet Use
(distribution of responses for all firms who have at least one computer)

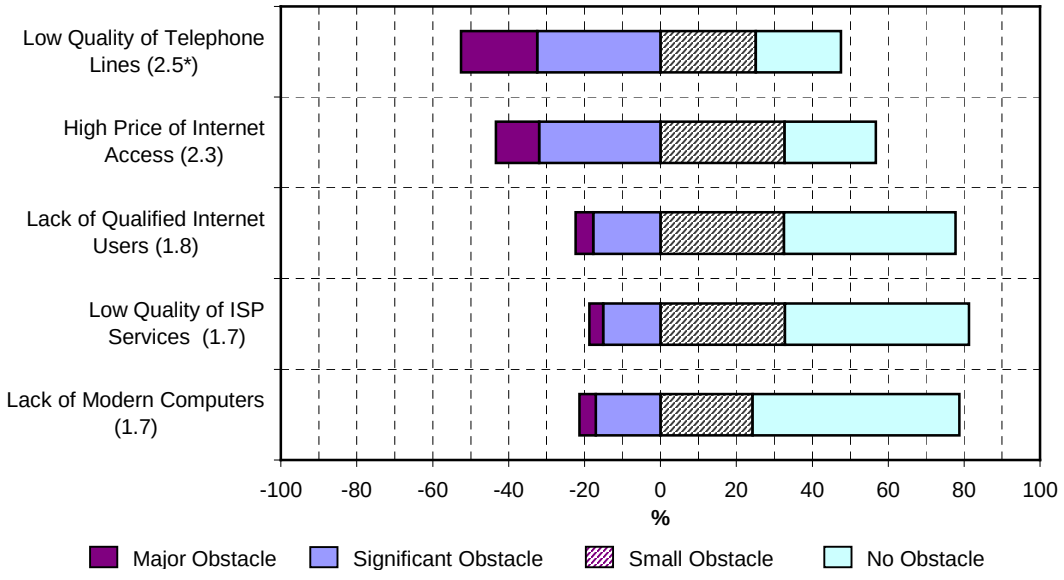


*Figure in brackets gives the average score across all firms on a scale on 1 – no obstacle to 4 – major obstacle for each obstacle listed

Ukraine does not have high telephone penetration. The latest comparative figures released in EBRD's Transition Report 2000 shows Ukraine to have 19.1 main telephone lines per 100 inhabitants (figure unchanged over two years.) In comparison the Slovak Republic has 31 lines, Poland - 26 lines, and Lithuania 31.

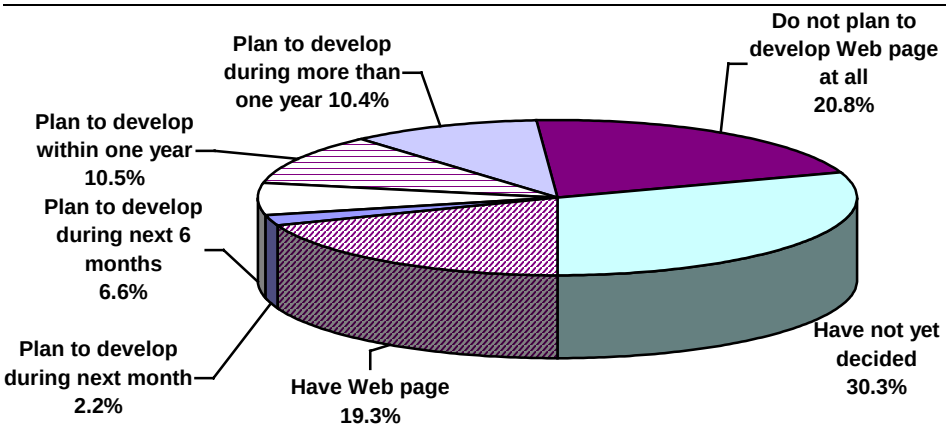
At this early stage of development of internet services in Ukraine the most common use for the internet is email (80% of firms that have access) and receiving general news and information. Search for good/ services and market/ industry specific information are ranked third and fourth. However, they could be a subset of 'obtaining news and other information' category. Similarly, establishing and maintaining relations with clients is most probably a subset of email use.

On the whole there is little difference in usage patterns among small, medium and large enterprises and between different sectors.

Table 60
What Internet Access is Used For
(% of firms that have internet access)

	Sector							Firm Size			
	Manufacturing	Construction	Transport	Telecoms	Trade	Public Catering	Other Services	Up to 50	51-250	More than 250	Average
Send/ Receive Email	81.4	85.0	65.0	80.5	76.2	50.0	80.2	81.5	73.5	81.4	**79.6**
Obtain News and Other info	77.7	90.0	80.0	75.6	69.7	80.0	79.2	75.6	75.3	80.9	**77.2**
Look for Goods/ Services	57.2	75.0	55.0	53.7	67.2	40.0	43.8	60.5	56.6	54.0	**57.6**
Market Research	46.8	42.5	25.0	53.7	36.1	10.0	30.2	40.1	41.0	44.7	**41.7**
Purchase Goods/ Services	23.9	35.0	25.0	36.6	27.0	20.0	14.6	24.7	25.3	23.7	**24.5**
Advertise Goods/ Services	53.7	52.5	20.0	56.1	34.4	30.0	39.6	45.4	52.4	46.0	**47.2**
Establish/ Maintain Relations with Clients	42.6	62.5	35.0	73.2	39.3	40.0	43.8	48.5	38.6	44.2	**44.8**
Publish Corporate Info	19.1	20.0	15.0	53.7	8.2	10.0	20.8	17.0	20.5	21.9	**19.3**
Sell Goods/ Services	30.6	32.5	20.0	46.3	21.3	10.0	20.8	29.0	24.7	29.3	**28.1**
Hire Employees	4.0	2.5	5.0	26.8	7.4	10.0	4.2	7.1	6.0	4.2	**6.0**

Figure 39
Proportion of Enterprises that Have a Web Page
(% of all firms that have at least one computer)



About 15% of surveyed firms claimed to have a web page (or just less than half of all those who access to the internet.) The probability of having a web page increases with firm size from 11% of small firms to about 26% of large firms. A larger proportion of start-ups have web pages than either their privatized or state-owned counterparts. The figure of one firm in seven that has a web page is very high and possibly misleading. Firms are possibly referring to free web site space that ISPs provide customers.

Table 61
Enterprises Having Web Page
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Sector							
Manufacturing	12.0	13.7	27.8	15.9	17.6	17.5	**17.3**
Construction	3.1	10.9	16.7	0.0	5.5	10.1	**7.1**
Transport	10.0	5.7	5.0	5.9	6.1	9.4	**7.0**
Telecoms	72.7	100.0	75.0	71.4	66.7	75.0	**74.0**
Trade	7.2	11.1	36.4	0.0	3.1	11.4	**8.4**
Public Catering	0.7	0.0	-	0.0	1.8	0.0	**0.7**
Other Services	15.9	20.7	26.8	14.3	16.7	22.9	**18.8**
Average	**11.3**	**13.5**	**25.7**				
Firm Size							
Up to 50				8.2	3.9	14.9	**11.3**
51-250				9.6	10.8	23.9	**13.5**
More than 250				18.5	28.2	37.5	**25.7**
Average				**12.9**	**13.2**	**16.6**	***14.6***

External Business Assistance

Business Planning

It is interesting to observe whether enterprises reckoned they had a business plan or not, though it has to be noted that the survey did not attempt to capture the quality of business plans (well thought out and reasoned organizational strategy versus a vague idea of firm development.) On the whole, with the question phrased in general terms, a surprisingly[32] large number of firms (44%) felt that they did indeed have a business plan. The larger the enterprise the greater the chance that they possess a business plan. The same proportion (49%) of state owned enterprises and privatized enterprises also had a business pan.

Table 62
Have Business Plan
(% of all firms)

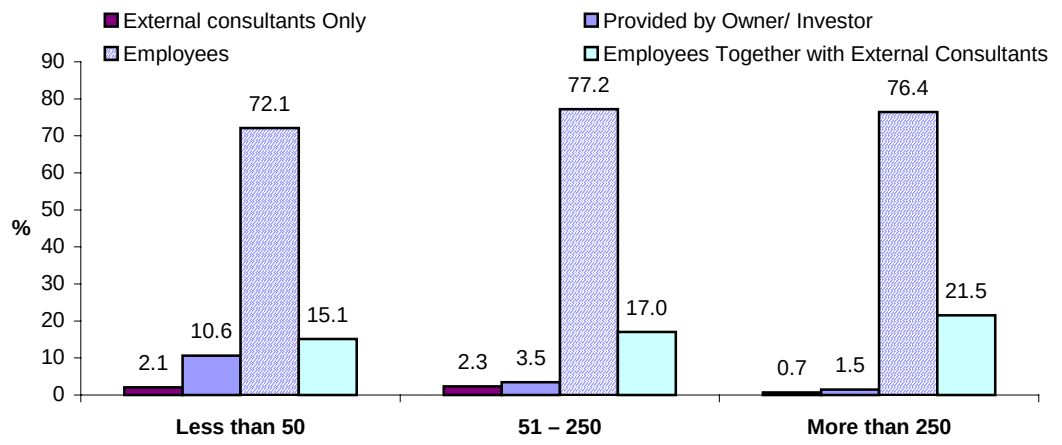
	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Sector							
Manufacturing	43.5	53.7	72.6	58.4	60.2	46.0	**55.5**
Construction	27.1	38.2	55.6	35.3	34.2	32.9	**33.7**
Transport	45.0	37.1	45.0	44.1	44.9	37.5	**42.6**
Telecoms	45.5	50.0	75.0	57.1	66.7	45.0	**48.0**
Trade	27.3	33.3	36.4	29.4	30.2	27.2	**28.2**
Public Catering	30.6	54.5	-	38.1	26.8	35.3	**32.4**
Other Services	35.7	46.6	56.1	41.3	36.9	45.0	**41.4**
Average	**35.0**	**48.5**	**66.6**				
Firm Size							
Up to 50				35.1	34.1	35.4	**35.0**
51-250				45.8	48.8	49.6	**48.5**
More than 250				61.7	69.0	66.7	**66.6**
Average				**49.0**	**49.1**	**38.0**	***44.4***

The data presented above is not conclusive and demonstrates that the majority of firms do not have a clear understanding of the business planning process (*e.g.* almost a third of all cafes and restaurants reckon they have a proper business plan.) Experience suggests that company managers are confusing 'industrial-financial' plans (in the case of manufacturing enterprises,) or vague ideas which substitute for the planning process. In a lot of cases bank credit applications are considered to be business plans as well.

The vast majority of 'business plans' are compiled by enterprise employees with little recourse to outside assistance. Figure 40 below shows the breakdown among small, medium and large enterprises.

[32] IFC's own anecdotal evidence (based on 11 consulting centers and 7 years of business and investment planning experience in Ukraine) suggests that less than 2% of companies in Ukraine have anything approximating a proper business plan in the western sense.

Figure 40
Who Prepared the Business Plan?
(% of firms that have a business plan)



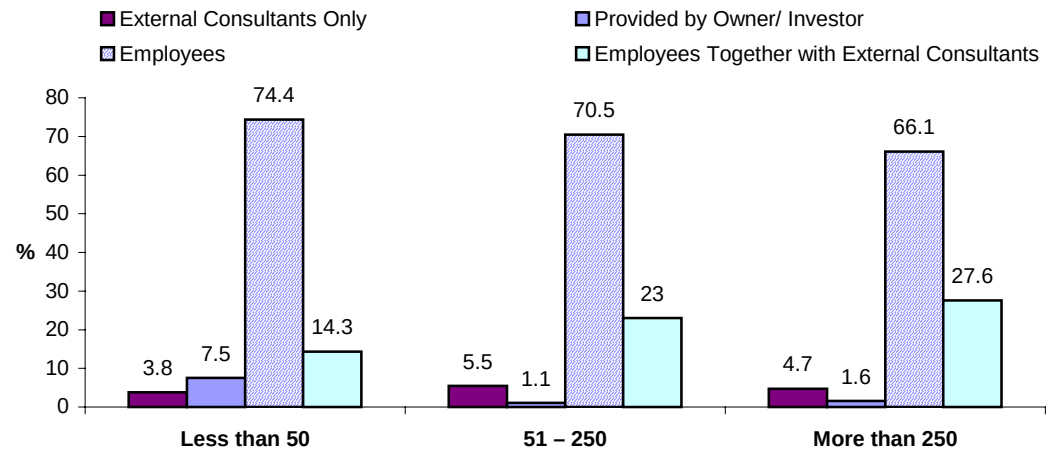
The incidence of the use of outside experts is very low, with most firms relying on internally generated plans. The breakdown is fairly similar among enterprises, implying little dependence on ability to pay or on company size, though three times as many small companies were willing to retain an outside consultant than large companies.

The survey also sought to establish whether companies had performed market research for their enterprises and their products prior to, or as part of the business planning process. 70% of surveyed firms who have a business plan stated that they had undertaken market research for their companies and for their products as part of the business planning.

Table 63
Proportion of Enterprises Having Conducted Market Research as Part of Business Plan
(% of enterprises that have a business plan)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Sector							
Manufacturing	74.7	75.0	71.6	67.4	73.3	77.9	**73.6**
Construction	53.8	61.9	70.0	50.0	56.0	65.4	**59.6**
Transport	61.1	53.8	66.7	46.7	59.1	83.3	**61.2**
Telecoms	85.0	100.0	100.0	75.0	100.0	88.9	**87.5**
Trade	73.5	66.7	75.0	20.0	74.4	75.3	**72.6**
Public Catering	60.0	33.3	-	50.0	53.3	60.9	**56.5**
Other Services	57.1	66.7	40.9	36.0	71.0	57.1	**56.2**
Average	**69.3**	**70.7**	**69.1**				
Firm Size							
Up to 50				52.9	70.2	71.0	**69.3**
51-250				57.9	69.9	81.0	**70.7**
More than 250				58.4	72.6	81.3	**69.1**
Average				**57.0**	**71.1**	**73.1**	***69.6***

Figure 41
Who Undertook the Market Research?
(% of firms who undertook market research)



All in all a very similar picture with market research emerges as with business planning. The majority of Ukrainian enterprises think that they have a business plan and have undertaken market research. The majority of companies performed these duties in-house and this is confirmed by the very under developed nature of the Ukrainian commercial consulting industry in general.

Outsourcing

Outsourcing is an acknowledgement by companies that certain business functions can be performed better and cheaper by outside specialists leaving the company to concentrate on key areas and running the business. Globally, more and more firms are outsourcing more activities that hitherto they would have performed in-house. Certain functions of course have to be outsourced, for example financial audits, advertising, etc.

As some of the more important tasks that are generally performed by outside specialists (business planning and market research) are generally performed in-house it is interesting to see what business functions Ukrainian firms typically outsource. The table below lists some of the more widespread outsourced functions and the percentage of all Ukrainian enterprises that outsource a particular business function.

Table 64
Outsourced Services
(% of all firms)

	Manufacturing	Construction	Transport	Telecoms	Trade	Public Catering	Other services	Average
Advertising	57.6	53.3	40.0	72.0	59.6	41.4	53.5	**55.5**
Audit	52.4	41.4	41.7	32.0	29.2	20.0	37.1	**42.0**
Transport services	35.0	40.8	9.6	22.0	37.8	17.9	19.9	**31.4**
Recruitment	9.8	14.2	10.4	14.0	9.3	12.4	9.0	**10.2**
Accounting	9.4	7.7	10.4	20.0	13.4	11.0	6.6	**10.1**
Marketing/Market Research	9.9	7.7	4.3	14.0	7.4	2.1	8.2	**8.3**
Executing foreign trade contracts	6.8	6.5	1.7	0.0	2.2	0.0	3.9	**4.6**
Payroll	1.4	1.2	1.7	2.0	1.9	2.1	2.7	**1.7**
Logistics	1.1	0.0	1.7	4.0	2.6	0.7	0.8	**1.3**
Other Business Services	7.0	9.5	7.0	12.0	5.3	1.4	5.9	**6.4**
Do Not Outsource Anything	15.8	18.3	27.8	10.0	22.2	33.8	25.8	**20.2**

It is very important to note that the survey did not capture whether firms engaged in all of these business functions or not. The data above simply refers to the proportion of companies that paid outside specialists for particular services. As the survey did not produce data on what proportion of firms used these services at all it is difficult to comment on those firms that outsourced services.

The most popular outsourced business functions are advertising (56% of all firms), auditing (42%), and transportation services (31%.) In the case of auditing it is safe to assume that the remainder of firms (58%) just did not face the need to have audits of their finances. One fifth of all Ukrainian enterprises simply did not see the need to use outside specialists at all.

Training

Just under half of all enterprises (45%) did not see any need to have their employees trained in any business area. For those who did express demand for training the topics most in demand are accounting and business planning, presumably explained by Ukraine's transition to new accounting standards and the need for investment. Telecoms firms, the most dynamic in our survey and with the best financial performance, have the greatest demand for training services They also had the highest proportion of business plans and completed market research.

Table 65
Demand for Business Training
(% of all firms)

	Manufacturing	Construction	Transport	Telecoms	Trade	Public Catering	Other services	Average
Accounting	29.4	26.0	20.9	22.0	25.6	33.1	26.2	**27.6**
Marketing	30.0	20.1	13.0	42.0	23.4	19.3	16.8	**25.0**
Business Planning	22.9	20.7	18.3	28.0	16.5	17.9	21.9	**20.9**
Financial Management	22.5	16.0	13.0	28.0	16.5	11.0	18.8	**19.2**
Sales	19.5	13.0	4.3	24.0	23.7	13.1	8.6	**17.4**
Information Technology	18.7	20.1	10.4	36.0	10.3	12.4	17.6	**16.6**
Human Resource Management	14.6	19.5	7.8	28.0	13.9	15.2	16.4	**15.1**
General Management	14.0	12.4	9.6	24.0	11.2	13.1	11.3	**13.0**
No Need	41.3	43.2	54.8	38.0	46.7	54.5	47.7	**44.8**

Consulting

Echoing the picture with training, the biggest demand for professional help is with accounting, business planning and marketing, though the overall proportion of Ukrainian companies willing to pay for these services is much lower than with training, at around one in ten. Manufacturing companies were the most willing to pay for outside professional help and cafes and restaurants the least.

Table 66
Demand for Business Consulting
(% of all firms)

	Manufacturing	Construction	Transport	Telecoms	Trade	Public Catering	Other services	Average
Accounting	11.9	15.4	11.3	8.0	12.4	8.3	10.5	11.8
Business Planning	12.6	11.8	7.0	14.0	6.9	4.1	7.4	10.0
Marketing	10.0	11.8	8.7	14.0	8.4	6.2	6.6	9.2
Information Technology	8.8	12.4	5.2	10.0	5.7	2.8	4.7	7.4
Financial Management	8.5	7.7	5.2	4.0	7.7	4.8	5.5	7.4
Sales	8.2	7.1	1.7	6.0	8.4	3.4	6.3	7.2
General Management	6.1	5.3	4.3	12.0	5.7	3.4	3.9	5.6
Human Resource Management	5.6	4.1	7.0	8.0	5.3	2.8	5.1	5.3
No Need	59.2	61.5	71.3	62.0	62.9	72.4	67.2	62.7

Business Advocacy

As is traditional in IFC surveys respondents were asked to comment on business advocacy in Ukraine. Specifically whether they belonged to any business associations that could advance their interests and what they felt were the most effective mechanisms for lobbying their interests.

Table 67
"Are you a member of a business association"?
(% of all firms)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-Owned	Privatized	Start-Ups	Average
Yes, and satisfied with results	6.3	10.1	18.5	9.5	12.4	6.6	**9.5**
Yes, but not satisfied with results	6.7	16.3	29.1	15.3	19.2	6.7	**13.3**
No, because see no reason to join	26.7	23.4	18.5	22.4	21.9	27.4	**24.3**
No, because there are no adequate associations for my needs	31.0	28.1	22.1	28.9	25.7	31.5	**28.6**
No, because do not know of any associations	29.4	22.1	11.8	23.8	20.7	27.9	**24.3**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

As can be seen there is generally a low level of participation in business associations and other groups that could collectively represent the interests of their members. Only 23% of Ukrainian firms actually belong to a business association, however less than one in ten firms actually feels that they receive any benefit. There is a very marked trend in membership in an association from small to large firms. Smaller firms are very under represented and only 6% of all small firms feel that they receive any benefit from business associations, whilst at the same time almost one in three small firms feel that there are no suitable associations that they could belong to.

Given that there is weak collective advocacy in Ukraine, it is interesting to find out what company directors feel is the best method that they employ to try and influence legislation and policy in their favor.

Table 68
Preferred Method for Influencing the Results of Legislative and Policy Changes that Impact on Own Enterprise
(% of all respondents)

	Firm Size			Firm Origin			
	Up to 50	51-250	More than 250	State-owned	Privatized	Start-ups	Average
Business Association	7.3	10.7	16.1	10.3	12.4	7.0	9.8
Direct Ties with State Bodies and State Officials	11.6	22.7	33.4	33.5	20.0	11.9	18.5
Mass Media	9.3	11.4	12.5	11.0	11.5	9.2	10.4
Parliamentary Deputies/Political Parties	5.6	9.2	14.2	9.4	10.3	5.6	8.2
Other Methods	7.7	6.7	8.9	7.7	7.5	7.9	7.7
I have No Influence	65.3	50.4	38.0	42.9	51.9	65.5	56.3

As can be observed the majority of Ukrainian firms feel that they have no influence on government policies that impact on them. This is particularly true for smaller firms and less so for larger firms. Larger firms (especially larger state owned firms) do indeed feel that they have some influence, particularly through direct ties with state bodies and key officials.

Annex 1

Survey Methodology

IFC's annual surveys have traditionally covered the SME sector. The 2000 survey has been expanded to include large and state owned enterprises as well in order to gain a better insight into the comparisons between different parts of the Ukrainian economy. In particular to give policy makers a better understanding of the differences between small and large enterprises.

Firm Origin

State Owned Firms

To make the survey even more representative state owned enterprises have been included as well. These have been split into two groups, nationally owned enterprises and local municipal enterprises to provide more detail. State-owned enterprises are defined as those enterprises in which the stake of central government or municipal government is not less than 50%.

Privatized Firms

This survey also separated out of the sample privatized enterprises to gain a better understanding of their performance in relation to state owned enterprises and start ups. Privatized enterprises are those formerly state-owned entities in which the state transferred into private ownership more than 50% of shares. Privatized enterprises have been split into two groups, early privatized firms (privatized prior to January 1, 1996) and late privatized firms (privatized after January 1, 1996.) This division allows for observation of privatized enterprise performance over time. So called mass privatization started in 1994 and this first wave of enterprises should have already experienced major change, compared with later privatizations. 54.7% of all privatized firms in our sample were early privatizations.

Start-Up Firms

For comparison purposes the survey also included private firms that were newly created. Again, similar to privatized firms start-ups have been divided into two groups, early and late start-ups with January 1, 1996 as the cut off date. Start-up companies include all companies established from scratch since legislation permitted this and not just in 2000. 38.7% of all start-ups in our sample were early start-ups.

Sectors

The sectors were selected to best reflect the make-up of business in Ukraine. Pure state financed sectors (health care, education, etc.) were not selected as they have practically no private sector competition. Further, firms engaged in primary agriculture were not selected as they are highly specific and are generally researched separately. The sectors were chosen to reflect the methodology used by the State Statistics Committee of Ukraine in their macroeconomic reports and is widely used in Ukraine in economic research. This allows the data in this survey to be compared with other research results. The sectors selected for this survey were:

- Manufacturing: This includes heavy and light industry, food processing and food industry, energy, construction materials.
- Construction: This refers to construction services companies. Producers of constructions materials are accounted for in Manufacturing.

- Transport: Freight services, passenger transportation, public transportation.
- Telecoms: Paging services, internet providers, mobile telephony.
- Trade: Wholesale and retail.
- Public Catering: Restaurants and cafes.
- Services: General non-manufacturing services. This includes, hotels, tourism, financial services, domestic services, public utilities.

The telecoms sector was selected as a separate sector (generally state statistics combine telecoms with transport) to see how a new sector of the economy fares in comparison to more traditional sectors.

Firm Size

Enterprise selection included small firms (up to 50 employees), medium sized firms (from 51 to 250 employees) and large firms (more than 250 employees.) Sole traders and micro enterprises (less than 5 employees) were not surveyed as this would have made comparative analysis difficult with medium and large enterprises.

Sample Selection

A non-proportional stratified random sample of 2,200 enterprises was constructed. Enterprises were sampled in 25 oblast centers. Sample parameters for each city are stated below.

Manufacturing: 1,005 manufacturing enterprises were selected, distributed proportionately among oblast centers based on each city's share of manufacturing enterprises in Ukraine (but in any case not less than 20 firms in each city.) The distribution of firms surveyed within each city reflects the overall oblast composition of manufacturing sectors (using a stratified random sample.) The only exception to this was for Donetsk and Zaporizhzhya where the oblast centers' industry structure differed significantly from that of the whole oblast.

For non-manufacturing sectors, fixed quotas were used for each city, but also ensuring that the number of enterprises in each sector were representative of the sector as a whole. The fixed quotas were as follows:

- Construction: 6 enterprises;
- Trade:16 enterprises including 4 wholesale and 12 retail firms;
- Public catering: 6 enterprises including 4 cafes and 2 restaurants;
- Transport: 1 freight and 4 passenger transportation enterprises;
- Telecommunications: 2 enterprises including an internet provider and a paging company. For Kyiv, two vehicular communication companies were added;
- Other services: 12 enterprises including hotel, travel agency, commercial bank, insurance company, domestic service firms and public utilities.

Due to the reluctance of some selected enterprises to be interviewed, not all sector quotas were completely filled. The following tables display the distribution of surveyed firms by sector, size, ownership status and region.

Table 69
Sample Distribution by Sector, Firm-Size and Firm Origin

	Firm Size			Firm Origin						Total
	Up to 50	51-250	More than 250	State-Owned		Privatized		Start-Ups		
				National	Municipal	Early	Late	Early	Late	
Sector										
Manufacturing	375	328	302	128	23	290	248	142	174	**1005**
Construction	96	55	18	14	3	45	28	40	39	**169**
Transport	40	35	40	12	22	22	27	7	25	**115**
Telecoms	44	2	4	7	0	1	2	14	26	**50**
Trade	362	45	11	10	7	72	57	76	196	**418**
Public Catering	134	11	0	18	3	26	30	26	42	**145**
Other Services	157	58	41	26	36	53	31	51	59	**256**
Total	**1208**	**534**	**416**							
Firm Size										
Up to 50				69	28	167	170	285	489	**1208**
51-250				63	20	187	146	59	59	**534**
More than 250				83	46	155	107	12	13	**416**
Total				**215**	**94**	**509**	**423**	**356**	**561**	**2158**

Table 70
Sample Distribution by City and Sector

	Sector							Total
	Manufac-turing	Construction	Transport	Telecoms	Trade	Public Catering	Other Services	
City								
Vinitsya	23	6	5	2	20	5	10	**71**
Dnipropetrovsk	80	10	5	3	15	6	10	**129**
Donetsk	79	11	6	1	17	6	10	**130**
Zhytomur	22	6	4	0	19	4	11	**66**
Zaporizhzhya	33	7	5	2	17	6	9	**79**
Ivano-Frankivsk	20	5	5	2	14	6	12	**64**
Kyiv	168	15	4	3	16	7	13	**226**
Kyrovograd	25	4	5	2	16	6	12	**70**
Lugansk	32	9	2	2	16	7	12	**80**
Lutsk	25	1	3	3	14	6	8	**60**
Lviv	47	7	6	2	24	4	10	**100**
Mykolayiv	31	5	6	2	14	7	10	**75**
Odessa	56	8	5	2	16	6	11	**104**
Poltava	31	6	5	2	17	7	8	**76**
Rivne	23	5	5	2	18	5	11	**69**
Symferopol	47	11	3	3	18	6	12	**100**
Sumy	26	8	5	2	14	6	9	**70**
Ternopil	26	4	6	1	16	6	8	**67**
Uzhgorod	17	10	5	2	19	7	11	**71**
Kharkiv	68	9	5	5	15	6	10	**118**
Kherson	26	5	4	3	16	5	11	**70**
Khmelnytsky	35	5	3	0	19	6	9	**77**
Cherkassy	13	4	2	0	14	4	9	**46**
Chernigiv	25	4	6	2	18	5	10	**70**
Chernivtsi	27	4	5	2	16	6	10	**70**
Total	**1005**	**169**	**115**	**50**	**418**	**145**	**256**	**2158**

Table 71
Legal Forms of Ownership

	%
Private Enterprise	20.0
Closed Joint Stock Company	13.3
Open Joint Stock Company	24.0
Limited Liability Company	24.1
Mixed Partnership	0.4
Full Liability Company	0.9
Enterprise Owned by Public Organization	0.9
Municipal Enterprise	2.9
State Enterprise	6.7
Joint Venture	1.6
Branch	3.2
Cooperative	0.7
Leased Enterprise	0.9
Collective Enterprise	0.6
Total	**100.0**

Table 72
Survey Respondents

	%
Owner/ Entrepreneur	9.2
Director/ General Director	39.0
Deputy Director	22.6
Financial Director	3.2
Executive Director	3.6
Commercial Director	4.1
Chief Accountant	18.3
Total	**100.0**

Table 73
Firm Origin

	%
State-owned	10.0
Municipal	4.4
Privatized	43.2
Start-up	42.4
Total	**100.0**

The proportion of exporters in the sample totals 19.5%, while only 11% of all surveyed enterprises sell more than 10% of their output outside of the country.

The figures below show distribution of sales, value added and employment of surveyed companies.

Figure 42
Sale Structure, by Firm Origin

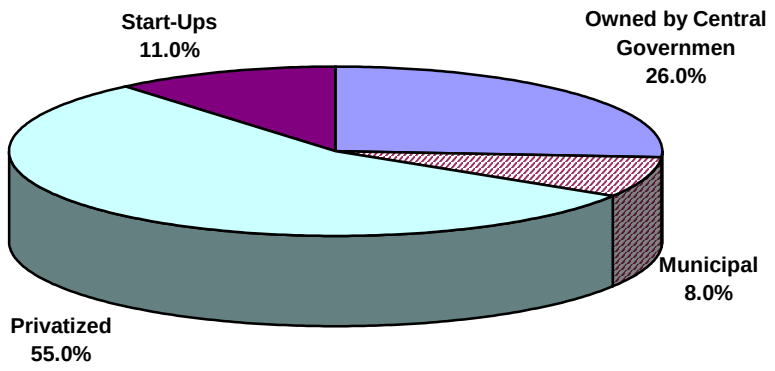


Figure 43
Value Added Structure, by Firm Origin

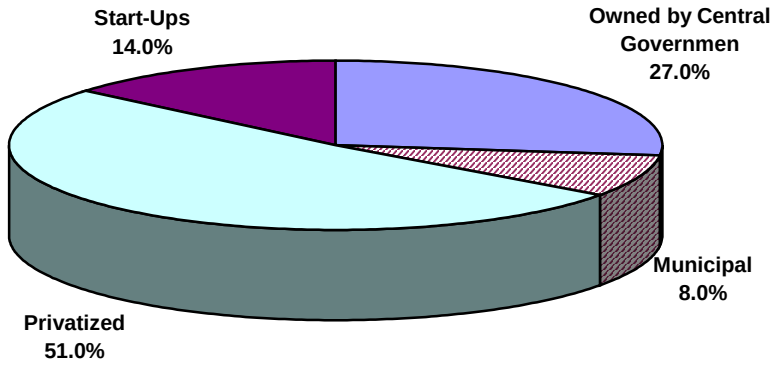
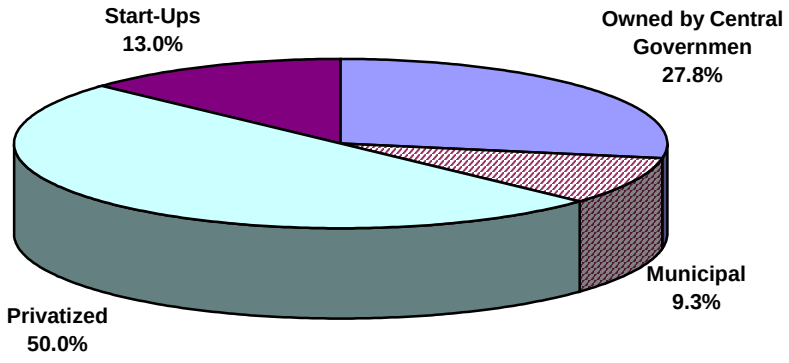


Figure 44
Employment Structure, by Firm Origin



Structure of the Questionnaire

The survey instruments were prepared in both Ukrainian and Russian and piloted at 12 Kyiv based enterprises to ensure that respondents correctly understood the questions. As a further quality control measure around half of all respondents were telephoned after interviews to check the consistency of responses on key questions.

Due to the complex nature of the questionnaire it was divided into three smaller questionnaires. The first questionnaire was used for the interview with the top manager of the company and filled in by an interviewer. It contained 50 questions related to legal status of enterprise, ownership status, sectors of major activity, markets at which enterprise operates, restructuring measures, investment and sources of its financing, business planning, use of computers and internet, barriers to market entry and expansion in particular related to taxation, regulations and financing.

The second questionnaire containing 31 questions was filled in by the company's top manager. The questions related to inspections, permits and permissions by different state agencies (number, duration, unofficial payments), quality and efficiency of government agencies, business association membership, local business climate, presence of tax and energy arrears, management turnover and demand for consulting services and business training.

The third questionnaire with 18 questions was devoted to enterprise performance (sales, shares of material inputs in sales, profitability, employment, exports, use of non-monetary instruments), tax system used, number of taxes and their volume as share of sales. The questionnaire was completed together with the firm's chief accountant.

Annex 2

Factors That Influence Enterprise Performance and Restructuring

The research presented in this report looked at short term measures of financial performance – one year changes in sales and value added. Real sales growth rations were obtained directly from the questionnaire presented to enterprises, while value added growth ratios were derived from the real sale ratios and the cost of inputs for 1999 and 2000. Other indicators such as productivity and profitability are also very important, however this survey did not measure them directly. For this reason the regression analysis did not look at either of these two indicators.

In selecting the possible variables that influence enterprise performance the same variables were used as in EBRD's 1999 Business Environment and Enterprise Performance Survey, namely: ownership status (state-owned, privatized, start-ups), market structure (number of foreign and domestic competitors), degree of softness of budget constraints (tax and energy arrears), and different kinds of restructuring activity. The influence of privatization on enterprise performance was not explored as no real data exists on pre-privatization performance. Further two regression analyses were run with the same variables, with the exception that the first looked at origin of strong competition (foreign or domestic) and the second analyses looked at intensity of competition (number of competitors).

In all of the tables below, the first figure refers to the estimated variable coefficient, whilst the second figure in brackets gives the standard error. The coefficients that are significant are marked with asterisks as follows:

*	significant at 1% confidence level
**	significant at 5% confidence level
***	significant at 10% confidence level

Regression Analysis on Enterprises Performance
(origin of competition)

Weighted Least Squares (WLS) regressions with real sales growth ratio and value added ratio as dependent variables and dummies for competition intensity, ownership and restructuring measures as explanatory variables.

Table 74

Independent Variables	Dependent Variables	
	Real Sale Ratio	Value Added Ratio
Competition		
Significant Pressure from Domestic Competitors	0.117* (0.037)	0.002 (0.038)
Significant Pressure from Foreign Competitors	-0.074*** (0.040)	0.046 (0.040)
Firm Origin		
Municipal	0.089 (0.066)	0.123*** (0.068)
Privatized	0.087*** (0.047)	-0.039 (0.048)
Start-up	0.271* (0.062)	0.154** (0.061)
Soft budget constraints (presence of significant tax and/or energy arrears)	-0.086 (0.064)	-0.044 (0.067)
Restructuring		
Developed New Products	-0.225* (0.040)	-0.241* (0.041)
Improved Existing Products	0.140* (0.039)	-0.008 (0.040)
Ceased Old Production	0.041 (0.047)	0.085*** (0.049)
Changed Sales Channels	0.228* (0.038)	0.195* (0.038)
Attracted Major New Clients	-0.019 (0.037)	0.083** (0.036)
Introduced New Technologies	0.047 (0.034)	0.002 (0.038)
Sold/ Leased Excess Assets	-0.160* (0.046)	-0.035 (0.045)
Purchased/ Rented New Assets	0.077 (0.047)	0.074 (0.045)
Changed Major Suppliers	-0.163* (0.043)	-0.186* (0.041)
Shed Excess Labor	-0.019 (0.038)	-0.115* (0.037)
Attracted New Employees	0.013 (0.036)	0.090** (0.036)
Trained Employees in New Technologies	0.055 (0.041)	0.091** (0.042)
Changed Organizational Structure of Enterprise	-0.052 (0.046)	-0.152* (0.048)
Constant	1.161* (0.042)	1.126* (0.045)
R^2 adj.	0.087	0.083
F	9.605	8.047
N	1721	1483

* significant at 1% confidence level
** significant at 5% confidence level
*** significant at 10% confidence level

Regression Analysis on Enterprises Performance
(level of competition)

Weighted Least Squares (WLS) regressions with real sales growth ratio and value added growth ratio as dependent variables and dummies for market structure, ownership and restructuring measures as explanatory variables.

Table 75

Independent Variables	Dependent Variables	
	Real Sale Ratio	Value Added Ratio
Competition		
1-3 competitors	0.066 (0.058)	-0.048 (0.060)
More than 3 competitors	0.155* (0.048)	-0.080 (0.050)
Ownership		
Municipal	0.117*** (0.065)	0.115*** (0.068)
Privatized	0.101** (0.047)	-0.023 (0.048)
Start-up	0.278* (0.063)	0.180* (0.061)
Soft budget constraints (presence of significant tax and/or energy arrears)	-0.088 (0.064)	-0.036 (0.066)
Restructuring		
Developed New Products	-0.256* (0.041)	-0.218* (0.041)
Improved Existing Products	0.106* (0.040)	0.008 (0.040)
Ceased Old Production	0.042 (0.048)	0.091*** (0.049)
Changed Sales Channels	0.218* (0.039)	0.194* (0.039)
Attracted Major New Clients	-0.020 (0.037)	0.079** (0.036)
Introduced New Technologies	0.047 (0.034)	-0.002 (0.038)
Sold/ Leased Excess Assets	-0.190* (0.045)	-0.029 (0.045)
Purchased/ Rented New Assets	0.065 (0.047)	0.083*** (0.045)
Changed Major Suppliers	-0.171* (0.043)	-0.178* (0.041)
Shed Excess Labor	-0.026 (0.038)	-0.114* (0.037)
Attracted New Employees	0.024 (0.036)	0.078** (0.037)
Trained Employees in New Technologies	0.039 (0.041)	0.099** (0.042)
Changed Organizational Structure of Enterprise	-0.011 (0.047)	-0.165* (0.048)
Constant	**1.098*** **(0.046)**	**1.171** **(0.052)**
R^2 adj.	**0.086**	**0.095**
F	**9.557**	**8.128**
N	**1721**	**1483**

* significant at 1% confidence level.
** significant at 5% confidence level.
*** significant at 10% confidence level

Factors That Influence Enterprise Restructuring

Regression Analysis on Enterprises Restructuring
(origin of competition)

Logit regressions with certain types of restructuring as dichotomy dependent variables and dummies for ownership, origin of strong competitive pressure and presence of tax and energy arrears as explanatory ones.

Table 76

Types of Restructuring	Estimated Variable Coefficients and Standard Errors (in brackets)[33]						
	Firm Origin			Origin of Significant Competitive Pressure		Presence of Significant Tax or Energy Arrears	Intercept
	Municipal	Privatized	Start-Ups	Domestic	Foreign		
Developed New Product	-0.622** (0.291)	0.369** (0.159)	0.413* (0.161)	-0.117 (0.092)	0.885* (0.135)	-0.238 (0.191)	-0.636* (0.148)
Improved Existing Products	-0.715** (0.282)	0.219 (0.156)	0.240 (0.157)	-0.064 (0.092)	0.620* (0.133)	-0.545* (0.194)	-0.374* (0.144)
Ceased Old Production	-1.259** (0.495)	0.191 (0.200)	-0.446** (0.213)	-0.033 (0.126)	0.819** (0.151)	0.405** (0.220)	-1.729* (0.188)
Changed Sales Channels	-1.432* (0.423)	0.176 (0.171)	-0.043 (0.175)	-0.259** (0.104)	0.751* (0.135)	-0.323 (0.219)	-0.991* (0.159)
Attracted Major New Clients	-0.782** (0.320)	-0.019 (0.165)	0.328** (0.165)	-0.149 (0.096)	0.564* (0.134)	-0.801* (0.232)	-0.730* (0.152)
Introduced New Technologies	0.301 (0.276)	0.192 (0.174)	0.162 (0.176)	-0.164*** (0.101)	0.612** (0.136)	-0.103 (0.203)	-1.113* (0.162)
Sold/ Leased Excess Assets	-0.382 (0.308)	0.136 (0.174)	-1.459* (0.206)	0.187 (0.119)	0.505* (0.152)	0.590* (0.194)	-1.255* (0.164)
Purchased/ Rented New Assets	0.190 (0.482)	0.325 (0.301)	1.042* (0.294)	-0.032 (0.140)	0.209 (0.199)	-0.263 (0.344)	-2.659* (0.282)
Changed Major Suppliers	-0.985** (0.501)	0.333 (0.215)	0.356*** (0.216)	0.110 (0.115)	0.324** (0.158)	-0.733** (0.302)	-1.818* (0.202)
Shed Excess Labor	-0.593** (0.263)	0.082 (0.154)	-0.791** (0.159)	0.204** (0.095)	0.247*** (0.134)	0.528* (0.184)	-0.336* (0.142)
Attracted New Employees	-0.234 (0.288)	0.248 (0.166)	0.670* (0.167)	-0.027 (0.093)	0.307** (0.133)	-0.502** (0.208)	-0.862* (0.154)
Trained Employees in New Technologies	-0.164 (0.341)	0.453** (0.193)	0.448** (0.195)	-0.126 (0.105)	0.295 (0.145)	-0.518 (0.243)	-1.466* (0.181)
Changed Organizational Structure of Enterprise	-0.160 (0.415)	0.345 (0.242)	-0.567** (0.262)	-0.011 (0.150)	-0.477** (0.238)	-0.032 (0.282)	-2.068* (0.227)

Number of observations in each regression is 2158.
* significant at 1% level.
** significant at 5% level.
*** significant at 10% level.

[33] National state-owned firms with no significant domestic and/or foreign competitive pressure are taken as a base line for comparisons.

Regression Analysis on Enterprises Restructuring
(level of competition)

Logit regressions with certain types of restructuring as dichotomy dependent variables and dummies for ownership, intensity of competition and presence of tax and energy arrears as explanatory ones.

Table 77

Types of Restructuring	Variable Coefficients and Standard Errors (in brackets)[34]						
	Firm Origin			Level of Competition		Presence of Significant Tax and Energy Arrears	Intercept
	Municipal	Privatized	Start-ups	1-3 competitors	More than 3 competitors		
Developed New Product	-0.683** (0.293)	0.263** (0.160)	0.195 (0.163)	0.998* (0.216)	0.849* (0.193)	-0.173 (0.189)	-1.239* (0.215)
Improved Existing Products	-0.759* (0.284)	0.141 (0.157)	0.087 (0.160)	0.794* (0.205)	0.588* (0.181)	-0.501* (0.193)	-0.795* (0.201)
Ceased Old Production	-1.344* (0.495)	0.187 (0.200)	-0.543** (0.215)	0.259 (0.282)	0.334 (0.247)	0.476** (0.216)	-1.868* (0.269)
Changed Sales Channels	-1.495* (0.423)	0.111 (0.171)	-0.199 (0.177)	0.430*** (0.236)	0.433** (0.209)	-0.264 (0.216)	-1.283* (0.228)
Attracted Major New Clients	-0.819** (0.320)	-0.078 (0.166)	0.195 (0.168)	0.451** (0.221)	0.426** (0.196)	-0.756* (0.230)	-1.025* (0.215)
Introduced New Technologies	0.222 (0.275)	0.203 (0.175)	0.114 (0.179)	-0.062 (0.213)	-0.018 (0.185)	-0.065 (0.201)	-1.046* (0.211)
Sold/ Leased Excess Assets	-0.374 (0.310)	0.100 (0.176)	-1.570* (0.208)	0.505*** (0.265)	0.729* (0.232)	0.661* (0.194)	-1.699* (0.249)
Purchased/ Rented New Assets	0.189 (0.482)	0.313 (0.303)	0.997* (0.298)	-0.001 (0.342)	0.169 (0.301)	-0.244 (0.343)	-2.750* (0.365)
Changed Major Suppliers	-0.985** (0.502)	0.312 (0.217)	0.290 (0.220)	0.330 (0.285)	0.397 (0.254)	-0.690** (0.302)	-2.055* (0.286)
Shed Excess Labor	-0.554** (0.265)	0.037 (0.156)	-0.891* (0.163)	0.376*** (0.209)	0.656* (0.182)	0.583* (0.184)	-0.734* (0.200)
Attracted New Employees	-0.241 (0.288)	0.209 (0.168)	0.587* (0.169)	0.321 (0.211)	0.331** (0.186)	-0.476** (0.207)	-1.085* (0.211)
Trained Employees in New Technologies	-0.205 (0.341)	0.441** (0.195)	0.409** (0.198)	0.114 (0.230)	0.019 (0.203)	-0.505** (0.242)	-1.481* (0.236)
Changed Organizational Structure of Enterprise	-0.132 (0.416)	0.320 (0.244)	-0.546** (0.266)	0.178 (0.298)	-0.064 (0.263)	-0.079 (0.281)	-2.102* (0.299)

Number of observations in each regression is 2158.
* significant at 1% level.
** significant at 5% level.
*** significant at 10% level.

[34] National state-owned firms with no significant domestic and/or foreign competitive pressure are taken as a base line for comparisons.

Factors That Influence the Attraction of New Outside Management

Regression Analysis on Management Turnover

Logit regression with the arrival of a new top manager from outside of the enterprise over last 3 years as a dichotomy dependent variable and dummies for market structure, ownership (origin, concentration, insider owner dominance) and presence of budget constraints as explanatory variables.

Table 78

Independent Variables	Variable Coefficient estimates with standard errors in brackets
Competition	
1-3 Competitors	0.740*** (0.396)
More than 3 Competitors	0.762** (0.353)
Firm Origin	
Privatized	-0.364 (0.399)
Start-Ups	-0.946** (0.426)
Dominance of Insider Owners	-0.582* (0.189)
2-3 Major Owners	0.230 (0.431)
More than 3 Major Owners	0.020 (0.420)
Soft budget constraints (presence of significant tax and/or energy arrears)	0.528*** (0.273)
Constant	**-2.466*** **(0.346)**
N	**2101**

* significant at 1% level.
** significant at 5% level.
*** significant at 10% level.

Annex 3

Business Environment Indices

In order to provide comparative ratings for cities for several components of the business environment, various indices have been calculated. These indices just sum several parameters (all assigned equal weighting) and rate cities according to the responses of firms themselves.

The indices should in no way be interpreted as an assessment of the business environment in any particular city. There is simply not enough information for objective assessments. All they capture is how respondents in one city answered questions relative to respondents in other cities and then ranked compared to an Ukrainian average.

Index Calculation

Ratings were calculated for each parameter that is included in an index. The percentage of firms in a city that stated whether a parameter was a significant barrier and were added to the percentage of firms that stated that the same parameter was a major barrier to give a combined percentage. At the same time the percent of firms who needed to make unofficial payments in dealing with the same parameter was calculated. The combined percentage of those for whom a parameter was a problem was multiplied by the coefficient of those who needed to make unofficial payments. This provides a rating for a particular parameter. Different parameter ratings were then added together which then provided the general ratings for each index. For each particular index the ratings were compared to the average in Ukraine and arranged by difference from average (on a scale of –10 to +10).

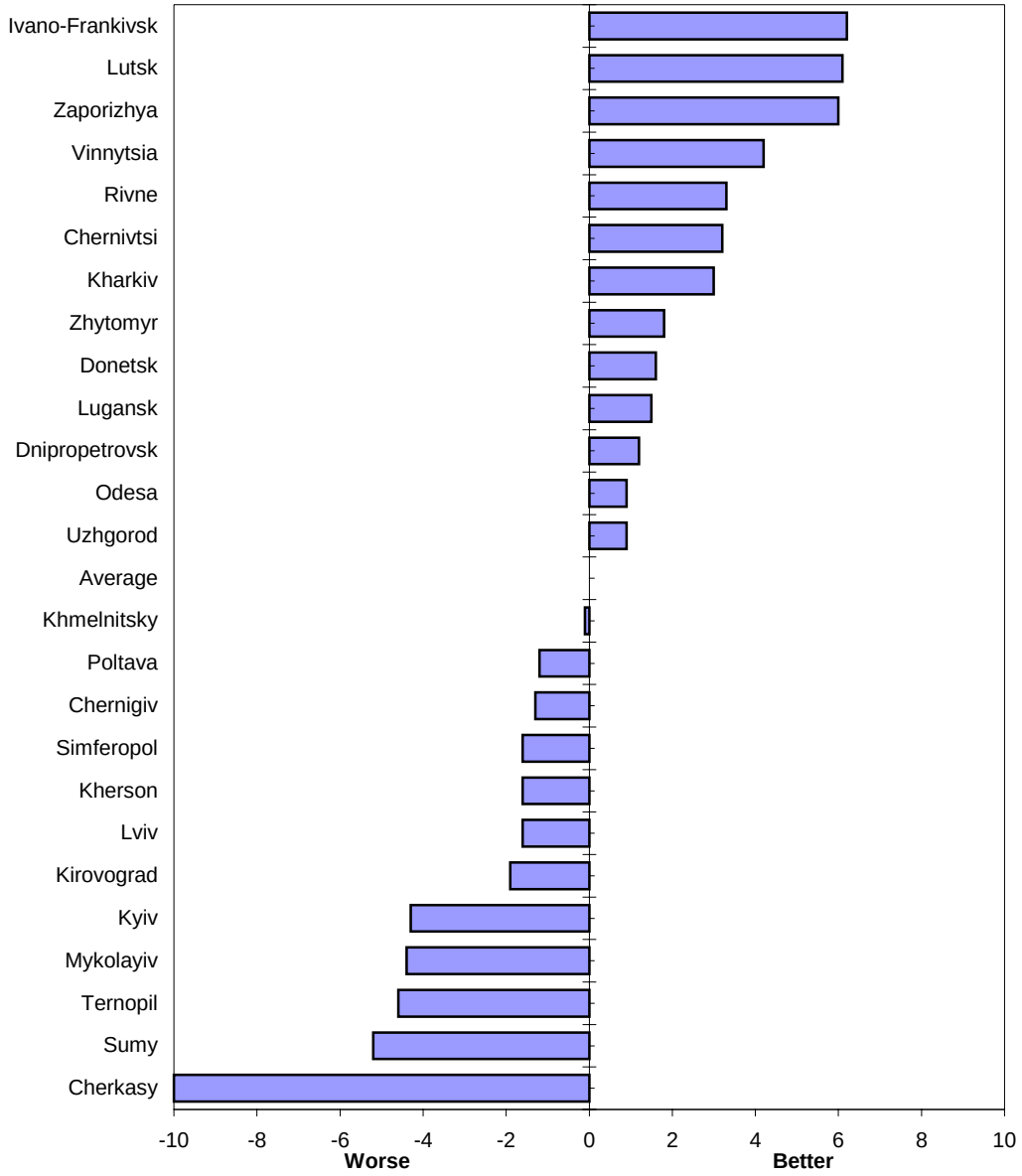
All parameters below that were multiplied by a coefficient of unofficial payment are denoted by*.

Combined City Index of Unfair Practices

The figure below shows an index of cities rated by the unfair practices that this survey captured. The parameters in this index were taken from questions in the survey, specifically:

- competitors receiving privileged decisions from municipalities,
- preferential access to infrastructure,
- preferential access to land,
- preferential access to premises,
- subsidies from municipalities.

Figure 45
Combined City Index of Unfair Practices

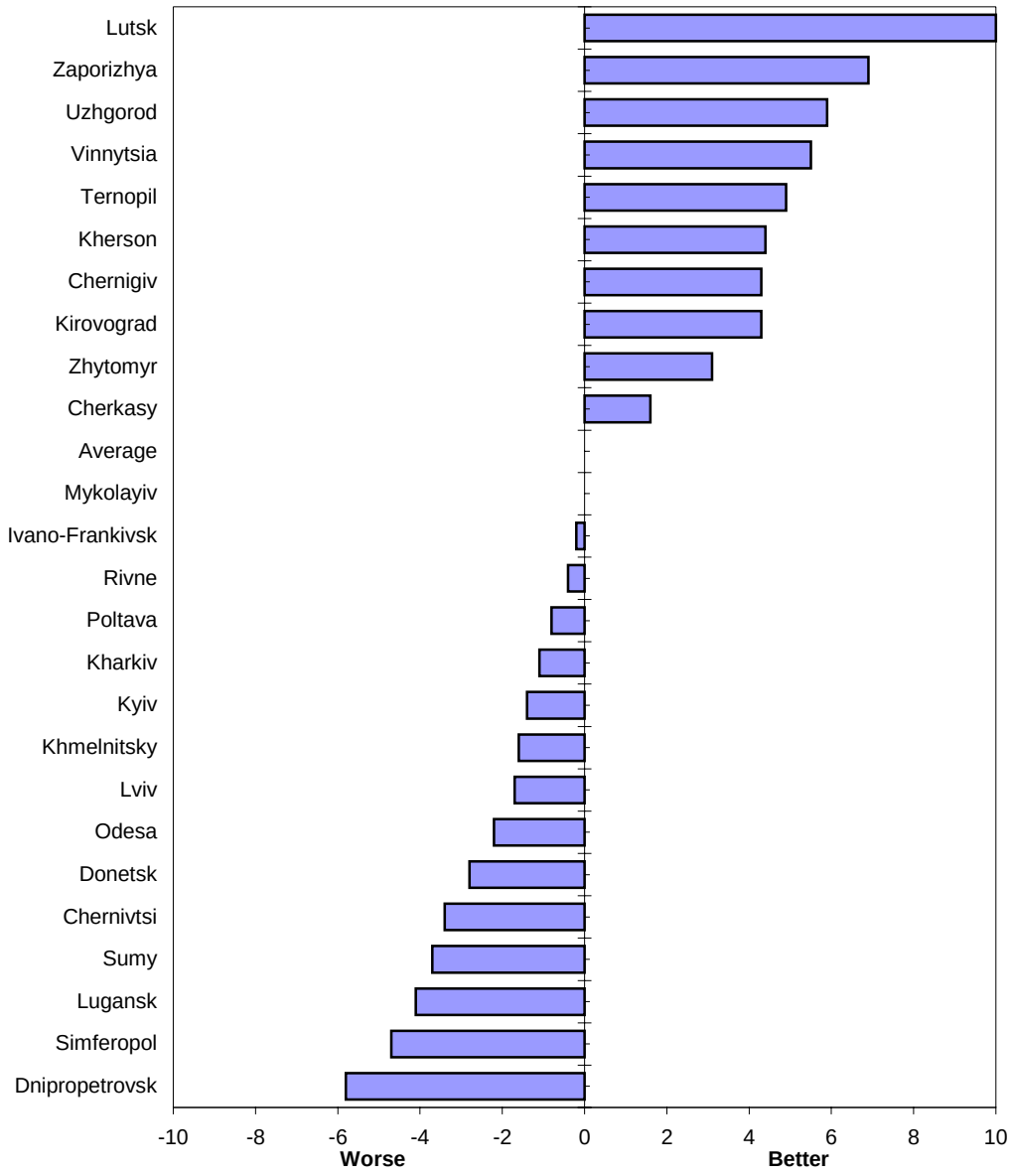


Combined City Regulatory Index

Combining the main regulatory parameters surveyed in this report allows for the construction of a combined city regulatory index. The parameters used in this index were barriers to business development presented by:

- registration/ re-registration,*
- permits and permissions,*
- business licensing,*
- product certification,*
- customs.*

Figure 46
Combined City Regulatory Index

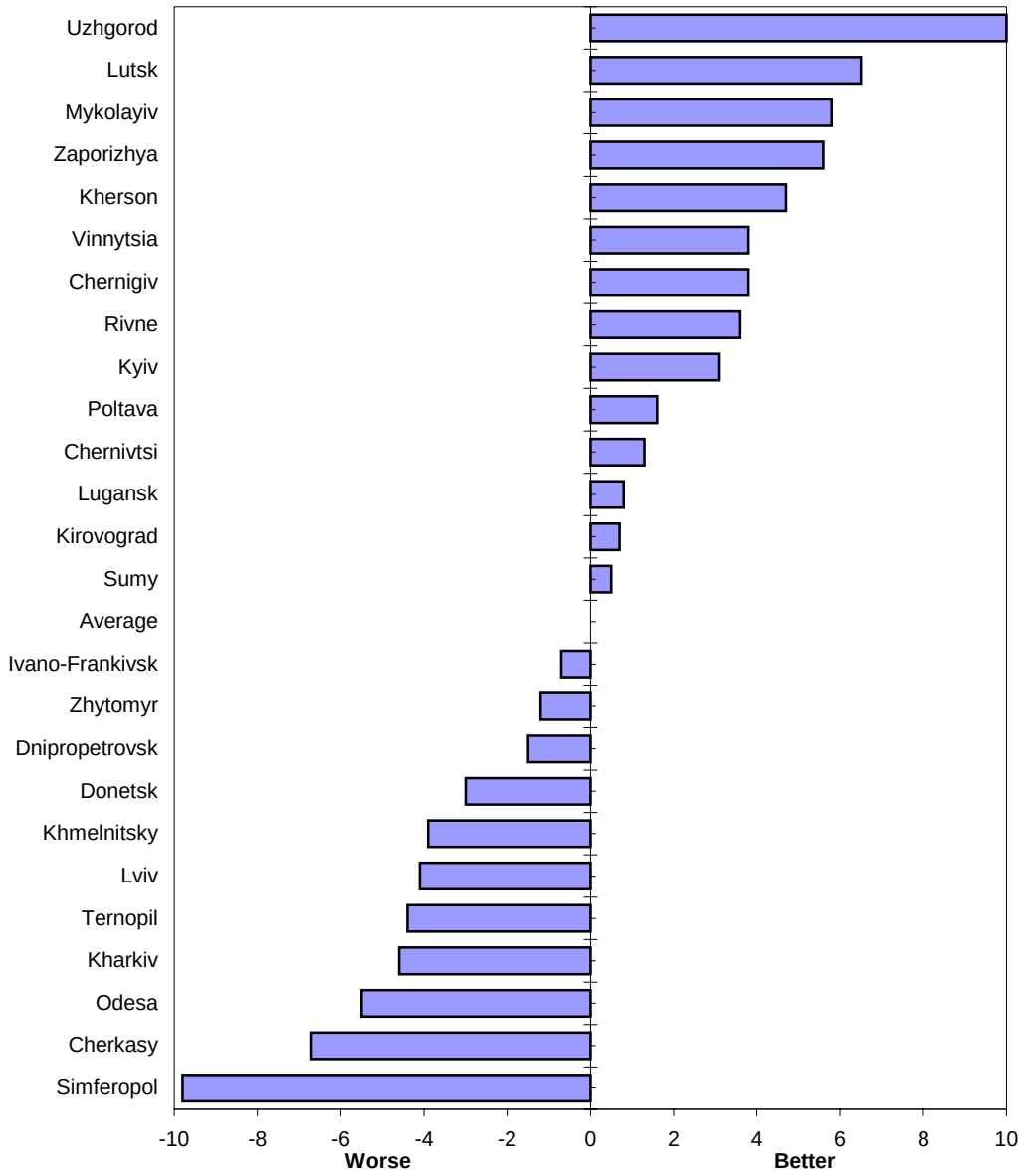


Combined City Administrative Index

Using the survey data a combined city administrative index can be calculated for all cities in our survey. The following parameters were added together to generate this index:

- tax inspections (adjusted by coefficient of firms who stated that tax inspections had increased),
- non-tax inspections (adjusted by coefficient of firms who stated that non-tax inspections had increased),
- 'voluntary' contributions to non-budget municipal funds,
- local corruption,
- pressure from local government.

Figure 47
Combined City Administrative Index



Combined City Access to Financing and Infrastructure Index

A city index was calculated that arranges cities in Ukraine according to whether firms felt that obtaining financing (*note: obtaining financing does not necessarily reflect local conditions*) and access to local infrastructure were a serious barrier. The parameters used were the following:

- undeveloped infrastructure,
- access to external financing,
- internet access.

Figure 48
Combined City Access to Financing and Infrastructure Index

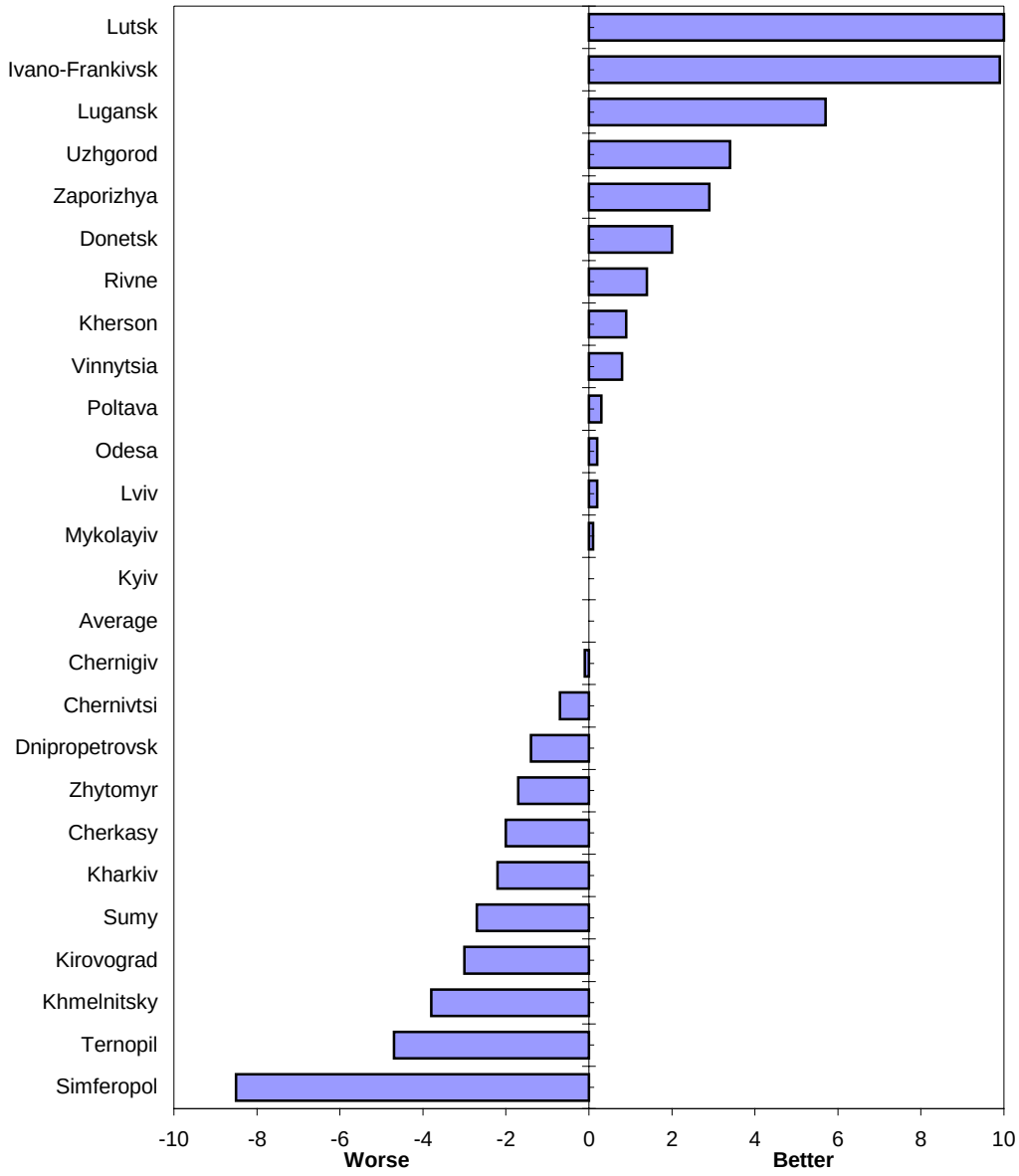


Table 79
Combined City Indices

	Access to Finance and Infrastructure	Unfair Competitive Practices	Regulatory Environment	Administrative Environment
City				
Vinnytsia	0.8	4.2	5.5	3.8
Dnipropetrovsk	-1.4	1.2	-5.8	-1.5
Donetsk	2.0	1.6	-2.8	-3.0
Zhytomyr	-1.7	1.8	3.1	-1.2
Zaporizhya	2.9	6.0	6.9	5.6
Ivano-Frankivsk	9.9	6.2	-0.2	-0.7
Kyiv	0.0	-4.3	-1.4	3.1
Kirovograd	-3.0	-1.9	4.3	0.7
Lugansk	5.7	1.5	-4.1	0.8
Lutsk	10.0	6.1	10.0	6.5
Lviv	0.2	-1.6	-1.7	-4.1
Mykolayiv	0.1	-4.4	0.0	5.8
Odesa	0.2	0.9	-2.2	-5.5
Poltava	0.3	-1.2	-0.8	1.6
Rivne	1.4	3.3	-0.4	3.6
Simferopol	-8.5	-1.6	-4.7	-9.8
Sumy	-2.7	-5.2	-3.7	0.5
Ternopil	-4.7	-4.6	4.9	-4.4
Uzhgorod	3.4	0.9	5.9	10.0
Kharkiv	-2.2	3.0	-1.1	-4.6
Kherson	0.9	-1.6	4.4	4.7
Khmelnitsky	-3.8	-0.1	-1.6	-3.9
Cherkasy	-2.0	-10.0	1.6	-6.7
Chernigiv	-0.1	-1.3	4.3	3.8
Chernivtsi	-0.7	3.2	-3.4	1.3
Average	**0.0**	**0.0**	**0.0**	**0.0**

The table above shows that for the majority of cites regulatory and administrative indices tend to converge. This implies that there is a link between the regulatory and administrative indices surveyed in this report. For those cites that perform well in regulatory index tend to perform in administrative as well, and vice versa. One of the possible hypotheses is that city governments have quite large amount of influence on different types of regulation and therefore on local business environments.

Annex 4

Barriers to Business Development

The following tables show the breakdown of responses by sector for various business development barriers in Ukraine. Respondents were asked to rate various issues according to a four point scale:
1 - no obstacle
2- small obstacle
3 - significant obstacle
4 - major obstacle

The overall score for a particular barrier was calculated as a simple unweighted arithmetic average of the responses of all surveyed firms. For ease of comparison these scores have been ranked from highest (more problematic) to lowest (less problematic).

Table 80
General Overview of Barriers to Market Entry and Expansion

	Average		Sectors													
			Manufacturing		Construction		Transport		Telecoms		Trade		Public Catering		Other Services	
	*score**	*rank*	*score*	*rank*	*score*	*rank*	*score*	*rank*	*score*	*rank*	*score*	*rank*	*score*	*rank*	*score*	*rank*
Taxation	**3.1**	**1**	3.2	1	3.2	1	3.2	1	2.9	2	3.1	1	3.0	1	2.9	1
Low Demand	**2.9**	**2**	2.9	2	3.0	2	2.6	4	3.1	1	3.0	2	2.8	3	2.9	2
Inflation	**2.8**	**3**	2.8	3	2.8	3	2.9	2	2.7	3	2.9	3	2.9	2	2.7	3
Non-Level Playing Field/ Anti-Competitive Practices	**2.5**	**4**	2.4	4	2.6	4	2.9	3	2.4	5	2.6	4	2.4	4	2.2	5
Corruption	**2.3**	**5**	2.3	5	2.6	5	2.5	6	2.2	7	2.5	5	2.2	6	2.2	6
Regulations	**2.3**	**6**	2.2	6	2.4	6	2.5	5	2.3	6	2.4	6	2.4	5	2.3	4
Underdeveloped Infrastructure	**2.2**	**7**	2.2	8	2.3	7	2.4	7	2.6	4	2.2	7	2.1	7	2.2	7
Problems with Sourcing Necessary Inputs	**2.0**	**8**	2.2	7	2.2	8	2.3	8	1.7	8	1.7	9	1.8	8	1.8	8
Obtaining External Financing	**1.8**	**9**	1.8	9	2.0	9	2.0	9	1.7	9	1.7	8	1.7	10	1.7	9
Pressure from Criminal Elements	**1.6**	**10**	1.5	10	1.7	10	1.7	10	1.5	10	1.6	10	1.7	9	1.5	10

Table 81
Barriers Dealing With Taxation

	Average		Sectors													
			Manufacturing		Construction		Transport		Telecoms		Trade		Public Catering		Other Services	
	score*	rank	score	rank	score	rank	score	rank	score	rank	score	rank	score	rank	score	rank
Unstable Tax Legislation	**3.3**	**1**	3.3	1	3.3	2	3.3	1	3.2	1	3.3	1	3.3	1	3.2	1
High tax rates	**3.2**	**2**	3.3	2	3.3	1	3.2	2	3.0	2	3.2	2	3.2	2	2.9	2
Large Number of Taxes	**3.1**	**3**	3.2	3	3.2	3	3.1	3	2.7	3	3.1	3	3.1	3	2.9	3
Tax Reporting & Accounting	**2.6**	**4**	2.7	4	2.6	5	2.7	6	2.5	5	2.6	6	2.7	6	2.6	4
Unfair Competition from Untaxed Shadow Activities	**2.6**	**5**	2.6	5	2.9	4	2.7	5	2.3	7	2.8	4	2.7	4	2.3	6
Tax Inspections	**2.6**	**6**	2.5	6	2.6	6	2.6	7	2.3	6	2.6	5	2.7	5	2.4	5
Different Tax Treatment of Competitors	**2.5**	**7**	2.5	7	2.5	7	2.7	4	2.5	4	2.5	7	2.6	7	2.3	7

Table 82
Barriers Dealing With Unfair Competition

	Average		Sectors													
			Manufacturing		Construction		Transport		Telecoms		Trade		Public Catering		Other Services	
	score	rank	score	rank	score	rank	score	Rank	score	rank	score	rank	score	rank	score	rank
Privileged Decisions from City Authorities	**2.4**	**1**	2.3	2	2.7	1	2.6	1	2.5	1	2.5	1	2.2	1	2.2	1
Favored Access to Credit	**2.3**	**2**	2.4	1	2.4	4	2.4	2	2.2	4	2.4	2	2.2	2	2.1	2
Favored Access to Clients	**2.2**	**3**	2.2	3	2.5	3	2.1	5	2.4	2	2.2	4	1.8	8	2.0	3
Subsidies from National Government	**2.1**	**4**	2.2	4	2.3	5	2.0	6	2.0	6	2.0	7	1.9	6	2.0	5
Market Collusion	**2.1**	**5**	2.1	6	2.6	2	2.1	3	2.0	7	2.2	5	2.0	4	1.9	7
Privileged Access to Land and Premises	**2.1**	**6**	2.0	7	2.2	6	1.9	8	2.1	5	2.3	3	2.1	3	2.0	4
Subsidies (and Hidden) from Local Authorities	**2.0**	**7**	2.1	5	2.2	7	2.1	4	2.0	7	2.0	7	1.9	7	1.9	6
Privileged Access to Infrastructure	**2.0**	**8**	2.0	8	2.1	8	2.0	7	2.3	3	2.1	6	2.0	5	1.9	8

Table 83
Barriers Dealing with Business Regulations

	Average		Sectors													
	score*	%**	Manufacturing		Construction		Transport		Telecoms		Trade		Public Catering		Other Services	
			score	%	score	%	score	%	score	%	score	%	score	%	score	%
Frequently Changing Business Legislation	**2.9**	**94**	2.9	95	2.8	95	2.8	97	2.9	98	2.8	94	2.8	93	2.8	93
Customs	**2.5**	**44**	2.5	48	2.6	39	2.5	49	2.6	48	2.4	41	2.5	34	2.3	40
Permits/ Permissions	**2.4**	**86**	2.4	86	2.5	85	2.4	85	2.3	84	2.3	85	2.3	85	2.4	91
Inspections (excluding tax inspections)	**2.3**	**94**	2.4	94	2.4	93	2.3	93	2.2	96	2.3	94	2.4	92	2.3	95
Licensing	**2.3**	**72**	2.3	72	2.4	70	2.3	68	2.2	78	2.2	73	2.3	76	2.3	73
Certification	**2.3**	**70**	2.3	74	2.4	68	2.2	70	2.1	76	2.2	66	2.3	62	2.2	69
Requirement to Make 'Voluntary' Payments	**2.3**	**77**	2.3	79	2.3	73	2.3	77	2.3	86	2.2	75	2.3	76	2.3	79
Business Registra-tion Procedures	**1.9**	**70**	1.9	69	1.8	66	2.0	71	1.9	64	1.8	70	1.9	72	1.8	75
Foreign Trade																
Border Customs Checks	**2.1**	**26**	2.0	29	2.7	15	2.1	27	2.5	24	2.1	18	2.5	13	2.2	18
Certification of Imported Goods	**2.0**	**19**	2.0	22	2.0	13	2.0	19	2.5	20	2.0	12	2.1	8	2.3	13
Customs Declaraitons	**2.0**	**29**	2.0	31	2.3	18	2.0	28	2.3	24	2.0	20	2.3	14	2.1	18
Firm Accreditation by Government	**1.5**	**18**	1.5	21	1.6	11	1.5	20	1.5	16	1.5	16	1.8	9	1.5	12

* - average score for the respondents to whom certain type of regulatory barrier is applicable
** - % of respondents to whom certain type of regulatory barrier is applicable

Table 84
Barriers to Receiving Financing and Credit

	Average		Sectors													
	Score*	*rank*	Manufacturing		Construction		Transport		Telecoms		Trade		Public Catering		Other Services	
			score	*rank*	score	*rank*	score	*rank*	score	*rank*	score	*rank*	score	*rank*	score	*rank*
High Interest Rates	**2.8**	**1**	3.0	1	2.9	1	2.8	1	2.6	1	2.7	1	2.5	1	2.5	1
Lack of Access to Long-Term Credit (more than 1 year)	**2.6**	**2**	2.7	2	2.8	2	2.6	3	2.5	2	2.5	2	2.3	3	2.3	2
Collateral Requirements	**2.5**	**3**	2.6	3	2.6	3	2.6	2	2.5	3	2.4	3	2.3	2	2.2	3
Bank Paperwork and Bureaucracy	**2.2**	**4**	2.2	4	2.3	5	2.3	4	2.0	8	2.2	4	2.1	4	2.0	4
Lack of Information About Sources of Credit	**2.1**	**5**	2.1	5	2.3	4	2.1	7	2.3	4	2.1	5	2.0	6	1.9	7
Threat of Losing Control Over Own Enterprise	**2.1**	**6**	2.1	6	2.1	6	2.1	6	2.2	5	2.0	6	2.1	5	1.9	5
Low Depreciation Allowances	**2.0**	**7**	2.1	7	2.1	7	2.2	5	2.2	6	2.0	7	1.9	7	1.9	6
Requirement to Submit Sensitive Information	**1.9**	**8**	1.8	8	1.8	8	1.8	8	2.1	7	1.9	8	1.8	8	1.8	8

Annex 5

Firm Perceptions of the State and Business Environments

Assessment of Local Business Environment

Respondents were asked whether they agreed or disagreed with 11 statements concerning their local business environment. For ease of analysis we compared the number of respondents in a given city who agreed with a particular statement with the number of respondents who disagreed. The table below indicates whether on balance respondents reacted positively to the statements or negatively. If a city has 'yes' for a particular statement then more people agreed than disagreed with that statement. *Note: The balance of the yes/ no answers was in most cases less than the number of firms who answered either one of the three options – 'yes', 'no', 'don't know'.*

Table 85

Agreed or disagreed with the statements	Local authorities are strictly compliant with laws and regulations issued by central government	Decisions of local authorities do not restrict business development	Local authorities make efforts to simplify the business start up process	Reasonable fees for rent of premises used for commercial purposes	Rental fee for land used for commercial purposes is reasonable	Local authorities promote business development in the city through ensuring equitable conditions for businesses	Local authorities promote business development in the city by creating appropriate infrastructure (information, financing, communications)	Business support foundations in my region serve the interests of local businesses	State officials in my city are honest and do not demand bribes	Business environment in my city encourage investment and invite business development	Business environment in my city is better than in most Ukrainian regions
Vinnytsia	yes	yes	yes	no	no	no	no	no	no	no	no
Dnipropetrovsk	yes	yes	no	no	no	no	yes	no	no	no	yes
Donetsk	yes	yes	no	no	no	no	yes	yes	no	yes	yes
Zhytomyr	yes	yes	yes	yes	yes	no	no	yes	no	yes	no
Zaporizhya	yes	no	no	no	yes	no	no	no	no	no	no
Ivano-Frankivsk	yes	yes	no	yes	no	no	no	no	no	no	no
Kyiv	yes	yes	no	no	no	no	no	no	no	no	yes
Kirovograd	no	no	no	no	no	no	no	no	no	no	no
Lugansk	yes	no	no	yes	yes	no	no	no	no	no	no
Lutsk	yes	yes	no	yes	yes	no	yes	no	no	yes	no
Lviv	yes	yes	no	yes	yes	no	no	no	no	no	no
Mykolayiv	yes	yes	no	yes	no	no	no	no	no	no	no
Odesa	no	no	no	no	no	no	no	no	no	no	yes
Poltava	yes	yes	yes	yes	yes	yes	yes	yes	no	yes	yes
Rivne	yes	yes	no	yes	yes	no	no	no	no	no	yes
Simferopol	no	no	no	no	no	no	no	no	no	no	no
Sumy	yes	no	no	yes	no	no	yes	no	no	no	no
Ternopil	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Uzhgorod	yes	yes	yes	yes	yes	no	no	yes	no	yes	yes
Kharkiv	no	no	no	yes	no	no	no	no	no	no	no
Kherson	no	no	no	yes	no	no	no	no	no	no	no
Khmelnitsky	yes	yes	yes	yes	yes	no	no	no	no	yes	yes
Cherkasy	yes	yes	no	yes	no	no	no	yes	no	no	yes
Chernigiv	no	no	no	yes	yes	no	no	no	no	no	no
Chernivtsi	Yes	yes	yes	yes	yes	no	no	no	no	yes	no

Assessment of Local Services

Respondents were asked to rate on a scale of 1 – 6 their assessment of various providers of local infrastructure service. The rating system used was as follows:
1 - very good
2 - good
3 - satisfactory
4 - unsatisfactory
5 - bad
6 - very bad

The following table shows the responses broken by cities and shows the average score for the city and for a particular local infrastructure service. For ease of analysis any rating of below 4 can be taken to mean a negative opinion of the listed state institutions, a rating of above 4 and above positive.

Table 86

	Roads Department	Architecture Department	Land Resources Department	Telephone Service	Electric Supply	Water Supply	Gas Supply	Teploenergo	Public Health Care	Educational Institutions
City										
Vinnytsia	4.72	3.83	3.75	3.45	3.54	3.38	3.43	4.06	4.12	3.82
Dnipropetrovsk	4.81	3.69	3.82	3.80	3.23	3.23	3.48	4.31	4.30	4.06
Donetsk	4.76	3.53	3.59	3.62	3.22	3.08	3.34	3.40	4.21	3.75
Zhytomyr	4.23	3.66	3.55	3.40	3.65	3.83	3.62	4.80	3.89	3.52
Zaporizhya	4.71	3.93	3.72	3.59	3.29	3.39	3.94	4.27	4.38	3.76
Ivano-Frankivsk	4.72	3.44	3.60	3.39	3.47	3.25	3.23	3.80	3.61	3.37
Kyiv	4.12	3.46	3.79	3.30	3.10	2.82	2.63	3.18	3.90	3.69
Kirovograd	5.49	3.88	3.77	3.68	3.24	4.02	3.13	4.74	4.56	4.14
Lugansk	4.61	3.88	3.86	3.34	3.48	3.37	3.46	4.05	4.24	4.03
Lutsk	4.53	3.17	3.08	3.20	2.75	2.83	2.60	2.97	3.22	2.95
Lviv	4.90	3.73	3.89	3.64	3.59	4.16	2.99	3.72	4.19	3.60
Mykolayiv	4.92	3.83	3.96	4.14	4.20	3.80	4.42	4.87	4.24	3.52
Odesa	4.40	3.88	3.87	3.86	4.08	3.66	3.33	4.27	4.12	3.82
Poltava	4.01	3.25	3.43	3.30	3.62	3.83	3.48	3.93	3.99	3.78
Rivne	4.86	3.68	3.79	3.96	3.54	3.56	3.36	4.33	4.18	3.84
Simferopol	5.03	4.11	4.34	4.18	4.09	4.14	4.12	4.25	4.14	3.86
Sumy	4.91	3.35	3.36	4.23	3.72	3.58	3.13	3.90	4.21	3.50
Ternopil	3.52	2.99	3.07	3.01	2.91	3.01	2.91	3.21	3.30	3.11
Uzhgorod	4.63	3.37	3.51	3.51	3.69	3.77	2.77	3.61	3.90	3.32
Kharkiv	4.95	3.70	3.88	3.59	4.11	3.81	4.18	4.60	4.51	3.94
Kherson	5.11	3.82	3.65	3.54	3.77	3.49	4.46	5.06	4.10	3.89
Khmelnitsky	4.61	3.91	3.81	3.37	3.57	3.64	3.40	3.95	4.38	4.09
Cherkasy	4.24	3.46	3.71	3.35	2.83	2.71	2.60	3.09	3.84	3.74
Chernigiv	4.73	3.77	3.58	4.01	3.35	3.11	3.04	4.30	4.17	3.54
Chernivtsi	5.02	3.68	3.52	3.60	3.81	3.86	3.85	3.97	4.23	3.51
Average	**4.65**	**3.65**	**3.71**	**3.60**	**3.51**	**3.47**	**3.40**	**4.00**	**4.10**	**3.71**

Annex 6

State Business Inspections

Table 87
The average number and duration of inspections by different state bodies

Inspecting Bodies	Number of Inspections	Duration (days)	Average number of employees engaged during inspection
Fire Department	4.9	9.2	4.2
Sanitary-Epidemiological Department	3.1	1.7	2.3
Tax Inspection Service or Police	4.3	1.7	2.8
Internal Affairs	3.5	3.1	5.6
Consumer Rights Protection Committee	2.4	1.6	2.2
Licensing Bodies	5.7	2.3	2.9
City Department of Industry and Consumer Market Development	2.5	1.8	2.3
Architecture Department	2.2	2.9	2.5
City Department on Issues of Business Development, Registration and Licensing	1.7	2.2	2.1
Prosecutors Office	1.9	1.6	1.9
Environmental Protection Ministry	1.9	1.7	2.3
Anti-Monopoly Committee	2.3	2.1	2.6
Health and Safety Committee	1.6	3.1	2.8
Price Control Inspection	1.8	2.1	2.0
Customs Service	1.5	1.5	1.8
Standardization, Certification and Metrology Committee	1.5	1.8	2.0
State Commission of Ukraine on Securities and Securities Market	2.9	3.8	4.2
Pension Fund	2.8	10.1	4.3
Employment Fund	1.9	3.0	3.3
Control Revision Service	2.0	1.5	2.1
City Financial Department	1.4	1.5	1.6
Social Security Fund	1.6	2.2	2.0

Table 88
Incidence of Various Inspection Consequence
(% of all firms)

	No Consequences	Repeated Inspection	Assets Seized As Tax Collateral	Frozen Bank Account	kartoteka	Suspended or cancelled license	Business Shutdown	Confiscation	Penalty	Contracts Deemed Invalid
City										
Vinnytsia	49.3	23.9	5.6	15.5	12.7	1.4	5.6	4.2	5.6	1.4
Dnipropetrovsk	61.2	17.8	15.5	18.6	22.5	0.8	3.1	1.6	0.8	1.6
Donetsk	56.9	14.6	18.5	19.2	21.5	0.0	1.5	5.4	2.3	3.8
Zhytomir	53.0	19.7	13.6	18.2	22.7	1.5	4.5	4.5	0.0	0.0
Zaporizhya	45.6	25.3	8.9	13.9	19.0	0.0	2.5	6.3	3.8	1.3
Ivano-Frankivsk	53.1	9.4	6.3	4.7	12.5	0.0	0.0	1.6	14.1	0.0
Kyiv	53.5	19.0	10.2	11.5	17.3	0.4	3.5	0.9	1.8	2.7
Kirovograd	64.3	8.6	2.9	8.6	12.9	4.3	1.4	2.9	5.7	0.0
Lugansk	47.5	20.0	12.5	10.0	20.0	1.3	3.8	5.0	3.8	0.0
Lutsk	61.7	18.3	5.0	5.0	13.3	1.7	1.7	1.7	0.0	8.3
Lviv	51.0	25.0	17.0	17.0	25.0	0.0	3.0	5.0	4.0	1.0
Mykolayiv	58.7	12.0	13.3	21.3	14.7	0.0	0.0	4.0	1.3	0.0
Odesa	44.2	22.1	17.3	20.2	32.7	1.0	1.0	1.9	6.7	1.0
Poltava	43.4	28.9	6.6	11.8	11.8	2.6	2.6	2.6	1.3	1.3
Rivne	53.6	18.8	11.6	15.9	23.2	0.0	0.0	4.3	1.4	0.0
Simferopol	63.0	20.0	6.0	11.0	12.0	3.0	2.0	6.0	2.0	0.0
Sumy	50.0	14.3	10.0	10.0	15.7	0.0	4.3	2.9	0.0	0.0
Ternopil	79.1	9.0	4.5	4.5	11.9	0.0	1.5	1.5	0.0	0.0
Uzhgorod	69.0	11.3	7.0	5.6	15.5	2.8	0.0	0.0	1.4	1.4
Kharkiv	59.3	15.3	10.2	14.4	19.5	0.0	6.8	0.0	0.0	5.9
Kherson	60.0	5.7	8.6	21.4	22.9	1.4	4.3	5.7	2.9	1.4
Khmelnitsky	70.1	7.8	13.0	9.1	13.0	0.0	1.3	3.9	1.3	0.0
Cherkasy	69.6	21.7	2.2	4.3	10.9	0.0	0.0	0.0	0.0	0.0
Chernigiv	60.0	12.9	11.4	10.0	11.4	1.4	1.4	4.3	4.3	2.9
Chernivtsi	44.3	25.7	0.0	10.0	18.6	2.9	2.9	2.9	2.9	5.7
Average	**56.3**	**17.4**	**10.3**	**13.1**	**18.0**	**1.0**	**2.5**	**3.1**	**2.6**	**1.8**

Other Survey Results on Inspections

In 1997 International Financial Corporation (IFC) conducted a survey aimed at studying business conditions for small business. In the same year, the Soros International Economic Advisory Group (SIEAG) carried out a survey of the regulatory climate for medium and large business. In 1998 IFC conducted a second survey of small businesses. A survey of the regulatory environment was conducted by the IRIS Regulatory Reform Project. In 1999 IFC conducted a third survey of small business. In the same year DAI NewBiznet carried out a legislative implementation survey which dealt with the actual implementation of five pieces of legislation aimed at improving the operating environment for small and medium businesses in Ukraine. In particular the implementation of Presidential Decree "On some deregulatory measures for business activities" aimed at reducing the level of state interference in the operations of private business by developing clearer and simpler rules for state business inspections. Further, MSI and the Kyiv International Institute of Sociology (KIIS) conducted a large-scale survey of business in Ukraine and one part of this survey dealt with inspections issues.

The table shows results from all of the above mentioned surveys and combines results to show the average number of inspections per one business entity in the period 1997-1999. In 1997 the total number of inspection per one enterprise was calculated by combining the data from the IFC survey of small businesses and the SIEAG survey of medium and large businesses. For 1998 the total number of inspection was calculated by combining the data from the IFC survey of small business and the IRIS Regulatory Reform survey of medium and large businesses. 1999 figures were derived from the IFC survey and the MSI/ KIIS survey.

Table 89
The Average Number of Inspections

	IFC, SIEAG, IRIS data			DAI NewBiznet data	MSI/ KIIS data[35]			
	Average	Small Firms (IFC Surveys)	Medium and Large Firms (SIEAG and IRIS surveys)	Small and Medium Firms	Small Firms	Medium Firms	Large Firms	Average
1997	**20.5**	**16.3**	**26.7**	**-**	**-**	**-**	**-**	**-**
1998	**13.8**	**9.6**	**22.4**	**-**	**-**	**-**	**-**	**-**
1999	**-**	**9.6**	**-**	**9.4**	**7.1**	**13.2**	**19.4**	**10.6**

[35] This is average number of inspections by state agencies for a six month period prior to the survey. If the six-month rate were maintained for 12 months, this would imply an annual average of 21.2 inspections per firm.