

# Impact of the economic crisis on Ukrainian companies

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Throughout the crisis Ernst & Young together with the European Business Association (EBA) has been conducting a survey entitled *Impact of the economic crisis on Ukrainian companies*. In total, we received 444 responses from domestic and international companies in the four surveys we have already conducted. The first survey was carried out in late October 2008 and each quarter thereafter.

Participants in the 4th survey are key executives of 77 domestic and international companies representing different industries. One-quarter of the participants are Ukrainian companies; foreign companies account for 73% of total respondents – 46% are global, 22% are European enterprises and 5% respondents are from other countries in the CIS.

By size, 42% respondents are small enterprises with less than 200 employees. 35% of participants are big companies with over 1000 employees and 23% are medium-sized companies with personnel between 200 to 1000 people.

The fourth survey elucidates companies' opinions on business performance and anti-crisis activities implemented in the second quarter of 2009. The survey identifies and describes in detail the top issues companies continue to face nearly a year since the beginning of the downturn as well as the results of cost reduction measures implemented since the start of the economic crisis.

The survey also discusses to what extent the current economy impacted the profits of companies in comparison to 2008; it also looks at changes in sales, production capacity and market strategy in comparison to the pre-crisis period and previous quarters.

The upcoming presidential elections are becoming an important factor for business planning. With this important event ahead, we have analyzed opinions of the participants on the endpoint of the Ukrainian economic downturn and expectations for a future recovery.

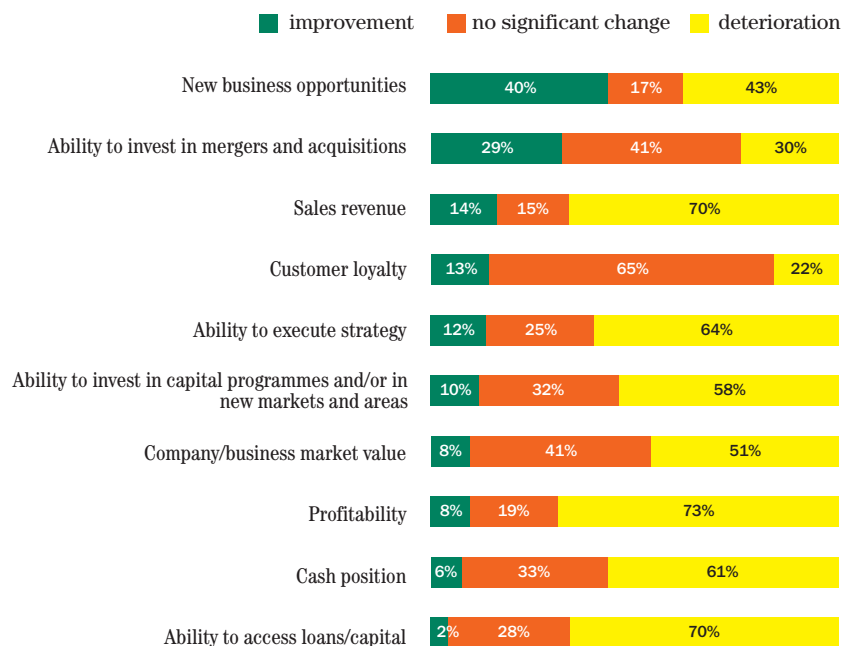
## Impact of the crisis on companies activities

Even though the Ukrainian economy continues to meander through the ongoing economic downturn, most businesses in Ukraine have adapted to the ups and downs of the economy.

Not surprisingly, the economic downturn restricted the execution of intended strategies (64% respondents), as well as limited access to external financing (70% respondents). Even though, survey results indicated that profitability and sales revenues continued to be weak as in previous periods (affected 73% and 70% participants respectively), sales revenues slightly improved over Q1, 2009, indicated by a 5% increase in positive responses (14% overall) in Q2, 2009.

More on the positive side, 40% of the respondents recognized a slight improvement in business opportunities in second quarter reported results compared to the first (7% increase in Q2 vs. Q1 2009) and an uptick in mergers and acquisitions activities (29% respondents, a 9% increase in responses).

Such trends suggest that expectations of the economic downturn is reaching the bottom prior to a slow improvement. This is recognized by changes in reported 'crisis' business practices and a continued commitment to doing business in Ukraine.



## Current performance in comparison to pre-crisis benchmarks

Not surprisingly, sales volumes, one of the key business indicators, are continuing to fall well below pre-crisis levels for the majority of respondents (71%). Of those companies who are experiencing this decrease, over 34% of them reported decreases of over 40%.

One revealing trend shown in our analysis is that during the second quarter of 2009, a larger number of companies (21%) recognized increases in their sales volumes compared to the beginning of the year (Figure 1). 75% of those companies recognizing increased sales volumes report increases of 10% or more. If there will be no major economic turbulence, more likely, sales will continue to slowly grow.

Changes to production or service capacity closely track the changes in market demand for products or services. The majority of respondents (60%) lowered their production or service capacity levels in Q2 and in Q1, 2009 in order to meet the lower demands in the market (figure 2). Companies reduced their production activity mainly by 21%-40%.

Figure 1.

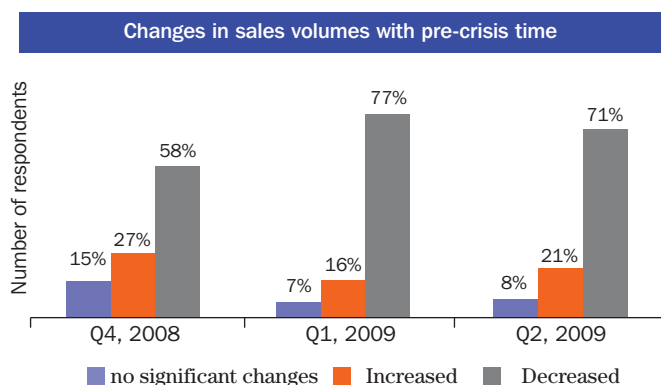
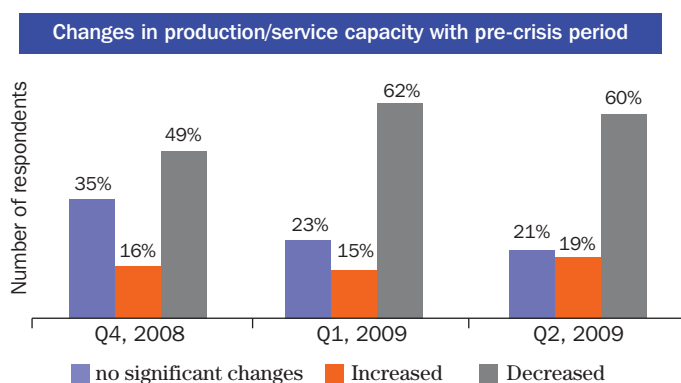


Figure 2.



### Current performance against previous quarter (2Q, 2009 vs. 1Q, 2009)

By comparing the dynamic changes of sales volumes and production capacity with the previous quarter, we observed the following trends.

Reported second quarter 2009 results indicated the first and very significant growth of sales volumes since the beginning of our survey in third quarter of 2008. Decreases in sales volumes have consistently worsened since the end of 2008 to Q1, 2009. For the first time this survey now reports an improvement in sales volumes in Q2, 2009 (figure 3).

In this survey over 50% of our respondents admitted the sales growth in the Q2, 2009. On average, companies recognize sales growth on the level from less than 5% to 10%.

Decisions to lower production or service capacity still prevail in the current economic conditions were reported by 35% of the respondents. Again, the percentage of companies choosing to do so is reducing. Compare this current trend with the beginning of the year, there are 20% fewer respondents that lowered production / service capacity in Q2, 2009 (figure 4). Most companies lowered production from 5% to 10% percent.

At the same time, a rise in production capacity was reported by 27% of companies. Although not a large increase, the majority of companies increased the production capacity from 5% to 10% percent.

These trends may indicate early signs of a slow recovery by companies that are either "getting used" to doing business in the new economic conditions or are finding a more permanent improvement in their business.

Figure 3.

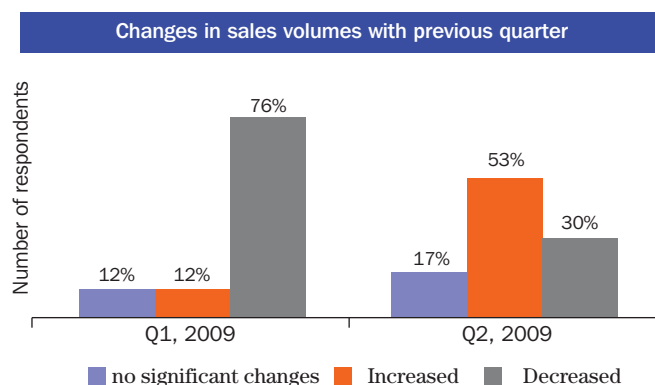
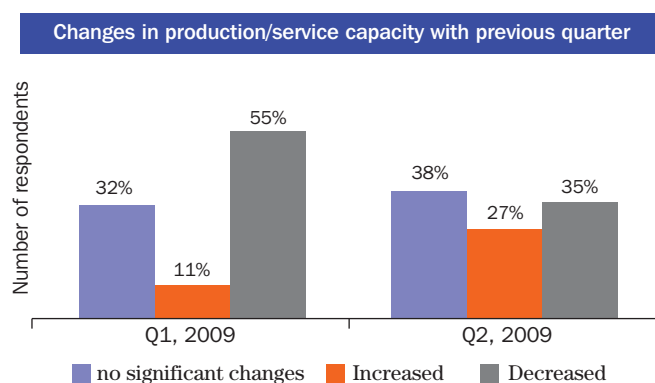


Figure 4.



### Top issues that companies are facing now

The five major problems, which companies have faced since the beginning of the crisis, remain the same. They are Hryvnia devaluation, reduction in sales, delayed payments by partners/clients, lower (sometime much lower) demand for products/services, and ways to reduce expenses.

The order of problem priorities has shifted though. During this survey, respondents ranked the devaluation of Hryvnia (82% of respondents) as their most pressing problem followed by reduction of sales. Last quarter, devaluation was second behind sales reductions.

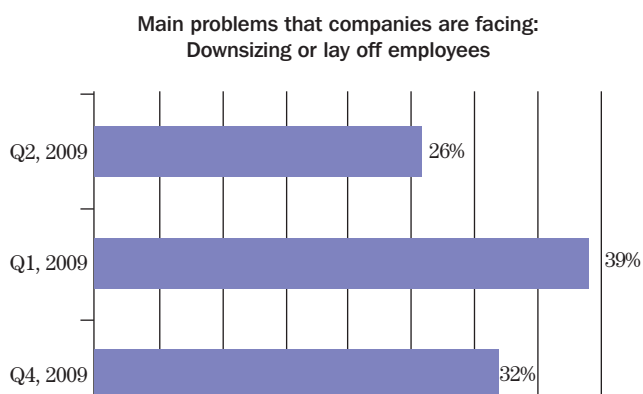
Current results most likely reflect the recent volatility of the Hryvnia caused by the current economic situation, concerns about inflation, and the economic instability of the country. On a year to date basis however, Ukrainian Hryvnia has been significantly less stable than 2008.

The other important issues like reduction in sales and delayed payments by partners continue to worry 57% and 49% of respondents respectively. However, these concerns were reported by fewer respondents since the last survey where 65% reported sales concerns and 59% indicated delayed payments.

Importance of company's downsizing and laying off employees fell by 13% since the beginning of the year and is the lowest level since the end of 2008. Again, this suggests that the negative effects of the crisis aren't as harsh as they have been in the past (figure 5).

Main problems that companies are facing at the moment: Crisis Survey 2 Quarter 2009	% of companies
Devaluation of the Hryvnia / inflation	82%
Reduction in our sales	57%
Delayed payments by our partners or clients	49%
Decline of demand for our services	45%
Reducing our overall operating expenses	45%
Competitive pricing pressures	43%
Increased costs of financing	35%
Unavailability of capital	27%
Downsizing or laying off employees	26%
Market fluctuations and, as a result, the reduced market capitalization of our company	18%
Our company has not yet experienced the economic crisis	1%

Figure 5.



### Companies' reaction to the downturn

Companies continue to respond to the economic downturn through cost reduction efforts. All have reported that they are undertaking or have already undertaken some form of cost reduction activities.

Most business reported that they opted for traditional ways to reduce costs – reduction of administrative expenses (77%), reduction of marketing and selling costs (63%), better terms on real estate (62%), personnel layoffs (54%), and better financial term with vendors / suppliers (51%). The percentage of respondents undertaking these activities has remained quite constant since the last survey.

One significant shift in terms of company reaction reported in this survey is the dramatic increase of respondents who are focusing on becoming more efficient – 70% reported they are focusing on operational efficiencies and 55% are reevaluating profitability of products / services.

Operational and efficiency improvements, while more difficult to achieve over typical cost reduction activities, are certain to help companies remain more competitive and profitable in the longer-term.

### Types of cost reduction activities undertaken



The top seven cost reduction activities listed above have been implemented by over 50% of the respondents. The results and percent of the cost reduction activities undertaken are considered in detail below:

Priority:	Most popular cost reduction activities:	Average reduction or improvement by:
1	Reduction of administration expenses	23%
2	Better use of financial terms with vendors and suppliers	20%
3	Negotiation better terms with landlords and property owners	27%
4	Reduction of marketing and selling costs	39%
5	Personnel lay-off	19%
6	Becoming more operationally efficient	17%

### Activities whose importance to business will change in the future

When asked to rank what business activities will become more important in the future, managing risk was listed as number one (78% respondents), followed by managing working capital and cash (74%).

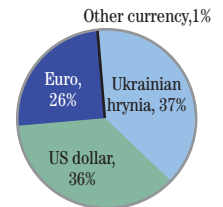
The top billing for risk and working capital management indicates a potentially important shift in how businesses will use risk and controls over cash to better manage their business in the future. In addition to these with cost reduction programs and managing customer relationship they remain the top importance.

Planning in a turbulent environment

Most business in Ukraine reported the use one of three currencies for planning and budgeting purposes: Ukrainian Hryvnia, US Dollar or Euro.

Although Ukrainian Hryvnia remains the leading currency for planning and budgeting purposes (37%) in 2009, the US dollar also becomes major planning currency (36%). Since the last survey there has been a significant shift towards the US Dollar (18% responses increase) from both the Euro and the Hryvnia.

The usage of the Euro for planning and budgeting dropped by 10% since Q1, 2009 and it is used by 26% of participant companies.



Companies –respondents used following exchange rate for the currencies:

**US dollar** rate used by companies in second quarter 2009 was from 8 UAH per 1 US dollar to 10 UAH, with an average of 8.8 UAH per 1US dollar.

**Euro rate** used by companies in second quarter 2009 was from 11 UAH per 1 Euro to 13 UAH, with an average of 12.1 UAH per 1 Euro.

External financing

The majority of the respondents (38%) stated that they did not require external financing to support their business in 2009.

Those that did, 30% applied for a bank loan or other financial institution and received financing while another 22% of the respondents did not apply for financing because of the current market situation. These concerned borrowers would consider and perhaps used financing if the economic situation was different.

Surprisingly only 10% of respondents indicated that they needed external financing in 2009, but were unable to attain it.

External financing in 2009	% of companies
We do not need bank loans or other external financing for our operations	38%
Yes, we applied and received financing	30%
In 2009 our company has not applied for financing with a view to a change in the market situation	22%
We applied but were not able to receive bank loans (or other financing) in 2009	10%

Anticipated impact of crisis on 2009 profits compared to 2008

More companies continue to expect that their profits would be dramatically lower than in pre-crisis 2008. In this survey, a larger number of respondents (51%) indicated their profits would be lower in the second quarter of 2009 compared to pre-crisis 2008 levels. In percentage terms, 17% more respondents reported a dramatic fall in profits than in the previous survey (Q1, 2009). Perhaps this reported shift of dramatically lower profits is a result of a better understanding of 2009 annual performance.

■ Becomes less important ■ More important ■ No change

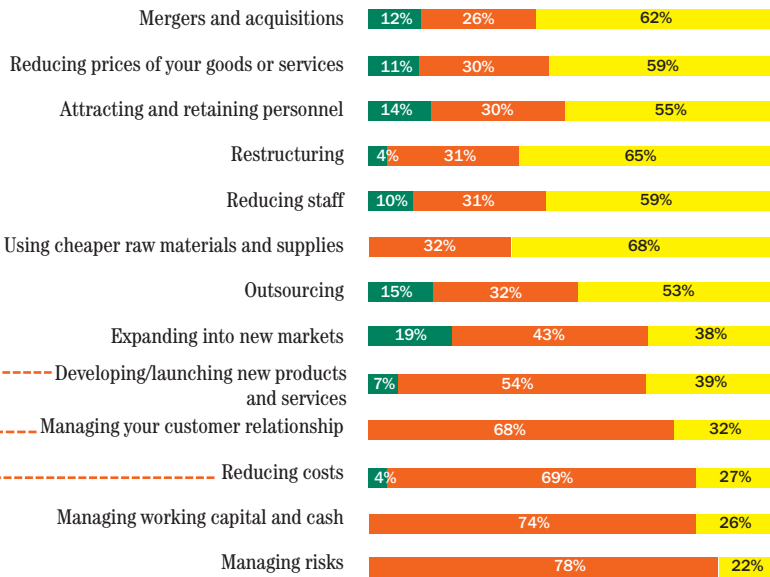
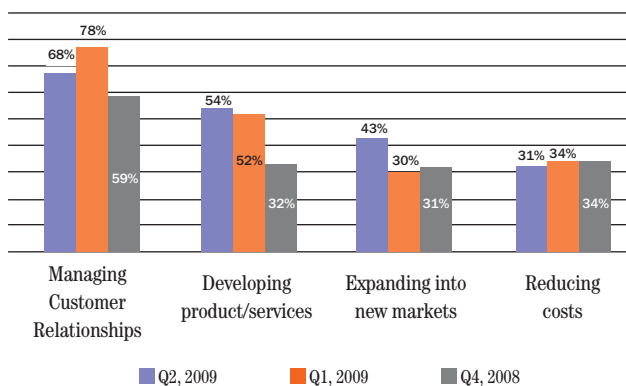


Figure 6. Activities that importance increase in the future-trend analysis from 4 Quarter 2008 to 2 Quarter 2009



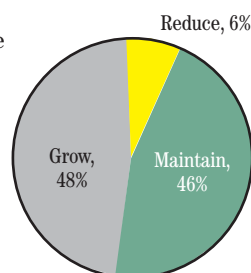
Respondents reported some increasingly responsible activities they have applied to navigate through the crisis (figure 6):

- Focus on managing customer relationships
- Developing and launching new products into the market (54% respondents). Its significance improved by 22% since Q4, 2008.
- Expanding into new markets (43%) indicate a significant increase since the beginning of the year (by 13%).

Market share strategy

Companies are positive regarding the size of their market share in the shrinking domestic economy. This indicator demonstrates companies' response to the current economic crisis in terms of market share and penetration.

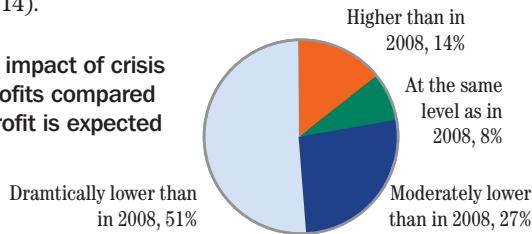
None of the survey participants indicated their plans of exiting the market. These responses were supported by 91% percent confidence on behalf of the respondents in their plans to achieve their stated strategies.



## Expectations on Ukrainian economic recovery When Ukrainian economy will stop falling?

Majority of the respondents are positive about the economic future of Ukraine, however expectations have slipped from a 2009 recovery to 2010. In this survey, a significant number of respondents (80% respondents) believe that Ukrainian economy will stop falling in 2010, as in the 1Q 2009 the response rate was 62% (figure 14).

**Anticipated impact of crisis on 2009 profits compared to 2008. Profit is expected to be:**



80% of participants believe that economy in Ukraine will stop falling in 2010. Most of these expect that the economy will stop falling in 3rd or 4th quarter of 2010. Optimism about a 2009 recovery as nearly evaporated when comparing results with the beginning of the year (figure 7).

Perhaps more worrying is the increased number of respondents that think the economy won't bottom-out until 2011 - 6% reported they believe the economy will stop falling in 2011, an increase from 1% from the last survey (figure 7).

We asked an open-ended question to let participants reveal their views as to why and when the Ukrainian economy will stop falling. As this question is on the mind of many, we received a lot of answers. Some focused on the causes for further decline while others answered what will cause things to improve.

Participant's opinions are summarized below:

### Ukrainian economy will:

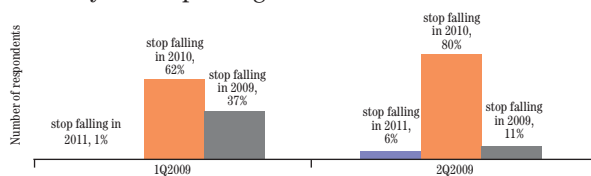
Continue falling because:

- Political turmoil and
- no political support on economic recovery
- No forecasting possible in current political situation
- When increased demands for Ukrainian exports (steel and agriculture) that will pull other segments

Improve because:

- Expect future political stability after the presidential elections as a base for further anti-crisis measures
- Banking sector improvement
- Improved world economy is expected in 1 year
- Stabilisation of production and demand
- Growth of commodity prices and increased consumer confidence
- We hit the bottom line already

Figure 7. Dynamics of company's expectations of when the economy will stop falling



## Recovery of the Ukrainian economy

Survey results show that respondents are less confident of an economic recovery in Ukraine in the near future. After Ukrainian economy stops falling, respondents (54%) believe that the economic recovery will begin the same 2010

year. Most of these expect that the recovery will only start in 3rd or 4th quarter of 2010. Although, these 2010 recovery expectations represent the majority, it represents a significantly lower percentage of responses than reported during the 1st quarter 2009 survey, when 72% of respondents believed in economic recovery in 2010 (figure 8).

Another group of the respondents (41%) believe that recovery will start in 2011 year, nearly double the percentage reported in the last survey (22%). In particular, the majority believes it will happen in 1st quarter of 2011 (figure 8). The others estimate the recovery between 2013 and 2015.



Figure 8. Dynamics of company's expectations of when the economy will start recovering

## Conclusion

Companies have a lot of hope for a 2010 recovery. They expect that, after the president elections in January 2010, the economy of Ukraine will stop falling and the recovery will begin in late 2010 or the 1st quarter of 2011 after political stabilisation and world's economic recovery. Until then, most Ukrainian companies remain concerned with their financial positions and operational results. Sales revenues and cash positions are below (or far below) 2008 results. Profitability and sales revenues continue to be low.

Perhaps more importantly than future expectations and current financial results are early indicators that the downward economic slide may be lessening; survey results report small signs business adapting to the new economic environment:

- Nearly all have undertaken necessary anti-crisis measures, such as cost reduction and downsizing.
- An increased percentage of respondents are starting to see sales / profit improvements. 50% of the respondents admitted sales growth in the second quarter 2009. Reported increases in production.
- Companies recognized slight increase in production (+4%)
- A reportedly greater focus on initiatives to maintain (or grow) market share
- Reassessment of business plans and renewed business activities
- The development and launch of new products into the market and focus customer loyalty
- Recognized new business opportunities in the market

These positive signs may indicate a slow recovery is ahead or that companies are "getting used" to doing business under new economic conditions. If no major economic turbulence happens, this trend is likely to continue.

Meanwhile, as companies wait for better times, they are now, largely focused:

- Assessing, measuring and managing risks
- Switching to the US dollar for budgeting and planning purposes
- Assessing and improving operational efficiencies

By overcoming the worst time, companies now are shaping themselves up for future growth once the economy actually turns the corner, both nationally and economically.