KREMENETS

BUSINESS ATTITUDE SURVEY

Conducted by

Strategic Planning Expert Committee

in cooperation with

Local Economic Development Project

supported by

September 2007

BUSINESS ATTITUDE SURVEY

I. INTRODUCTION

In August 2007 a business attitude survey was conducted among employers of Kremenets. This survey is part of a community based, economic development strategic planning efforts, which is supposed to shape out the economic future of the city. The goals of the survey were to provide useful and credible information for the members of the Expert Strategic Planning Committee (SPC) concerning the attitudes of those who invest and create jobs in Kremenets. Survey items included the history and status of the business, the nature of its business activity, labour and employee matters, business facility information, government services and relations, as well as the overall impressions of a city as a place to do business.

II. METHODOLOGY

The total number of 19 surveys were completed before August 30, 2007. The list of companies to be interviewed included the largest employers in the city, small and medium-sized (SME) enterprises. This report contains the aggregate responses of all companies.

To encourage complete and frank responses from employees, those interviewed were assured that this report would not include references to specific business, and that the survey forms would remain confidential.

Differences were found among responses of companies in different sectors of economy and between bigger employees and small and medium-sized enterprises. Therefore, part of the data was analysed making this distinction.

Although surveying 20 companies cannot completely reflect the attitudes of the entire business community in Kremenets, these firms represent a significant part of the local economy - traditional employers, as well as dynamic and growing sector of small and medium sized companies, and, by doing so, give a chance to compare this survey results with the results of similar surveys conducted in other Ukrainian cities.

The surveyed companies provide job opportunities for 479 persons (including 62 residents of the city suburbs).

III. MAIN FINDINGS

1. Local economy reports features of consolidation after recent process of privatisation combined with establishment and growth of dynamic sector of small and medium-sized enterprises. Local entrepreneurs are not satisfied with the general economic situation in Ukraine, national legislation, and bureaucracy (especially in the area of granting licenses and permits, and allocation of land plots).
2. The total employment of all firms interviewed is about 500, with the 5% reduction in work force planned for the next year. This testifies to the fact that presently employees feel negative about the development of their businesses during the coming years.
3. The labour market can be characterised by the following important parameters:
   36.1% of employees are women;

17.9 % of employees have higher education;
suburban residents constitute 12.7%.

These numbers have been stable and have not changed over the last two years.

4. The local economy has virtually no export orientation. Only 2% of products manufactured by only one company are exported. It is natural that small and medium-sized enterprises working in the services sector serve predominantly local and regional markets (i.e. national market). The level of sales per employee (17 thousand UAH per year) in business (labour productivity) is lower than the average Ukrainian indicator, however, it is comparable with the cities having similar structure of their industries and similar number of their residents. Only one company is expecting the decrease of its sales (by 25%) next year.
5. There is no lack of skilled workers in the city and the quality of labour resources is high. In general, according to the management opinion, companies have a relatively small share of fair (28 %) and poor (3 %) workers. One should mention a high level of satisfaction of local employees by the quality of labour resources. The number of "excellent" workers constitutes 21 %, and the number of "good" employees is 48%. Therefore, the 3 % share of "bad" workers does not indicate a problem. The average salary in 2006 has reached the level of 639 UAH per month. In 2005, it was 540 UAH per month. In 2005, the average salary in Ukraine constituted 806 UAH per month. A relatively big number of companies (13) are either missing employees with necessary skills or are expecting problem with skilled workforce in the nearest future (3). Only 3 companies out of all companies surveyed do not experience such problems. For the most part, the lack of qualified workforce is observed in technical areas. Three small business companies are experiencing the lack of qualified managers.
6. Only one company has a structural department engaged in scientific research. However, 5 companies are planning to create such departments in the nearest future.
7. Premises and manufacturing equipment are in a relatively good condition, however, there is a considerable lack of premises for the development of small enterprises. 63% of companies informed about their willingness to expand their business and difficulties they face while trying to get land or premises. At the same time 37% of companies do not experience such a problem. About 90% of companies are planning to develop or modernise their current facilities in order to expand their activities in Kremenets, with 5 companies considering such a possibility in the nearest future. The total amount of expected investments (more than 420 thousand UAH) is not very high for a city of almost 21.5 thousand. None of the companies are planning to expand outside the city of Kremenets in the nearest future and only two companies are considering such a possibility. The possibility of relocating their business to another city mostly in search of new premises for expansion and more favourable market opportunities is considered by only three companies.
8. Availability of sales markets for their products and services (for the most part characteristic for small companies), cheap and qualified work force, suppliers of raw materials have become decisive factors for companies to locate their businesses in Kremenets.
9. The overall level of satisfaction with the quality of services rendered by the local government bodies in the city of Kremenets is somewhat better than the average indicators for other cities surveyed in Ukraine. On average this is 2.51 according to the 4-grade scale where 1 is the highest grade and 4 is the lowest. Road maintenance (3.28), solid waste collection and removal (2.06), housing construction (2.71), public transportation (2.28), law enforcement (2.41), infrastructure development (2.76), SME

development (2.33), and simplification of licensing and permit procedures (1.94) – these are the areas where businesses would like to see improvements in as soon as possible. It is obvious that the local businesses (especially small enterprises) are expecting the local government to keep a continuous information exchange and to demonstrate a live interest in the city business climate. High level of red tape especially in the area of land plot allocation (3.06) is another factor small and medium enterprises feel negative about.

10. Nine companies rated the local government as “excellent”, with eight companies considering it as “good”. The local government also received two “bad” ratings. The average rating is 1.63 according to the 4-grade scale. Despite the good rating, these data demonstrate “patient expectations of changes for the better”.
11. Responses about the general business climate in Kremenets were a bit worse (average rating of 2.31). One company rated the city as an “excellent” place to do business, eleven rated it as “good”, and seven as “fair”. None of the companies chose the “do not have an opinion” answer about the business environment in the city.
12. Companies support the idea that local economy would improve mainly through the development of the tourism sector in the city and region, through the positive changes at the local level (utility infrastructure development), and better cooperation between businesses and the local government (small and medium-sized enterprise development).

IV. RESULTS OF THE SURVEY

1. Status of Businesses

The majority of the companies interviewed were founded after 1990. The biggest share of newly established companies is among small enterprises engaged in trade and services. There is no foreign capital in the structure of shareholders. At the same time the relative share of state-owned property reaches 43 percent. As a rule, these are utility companies owned by the city community.

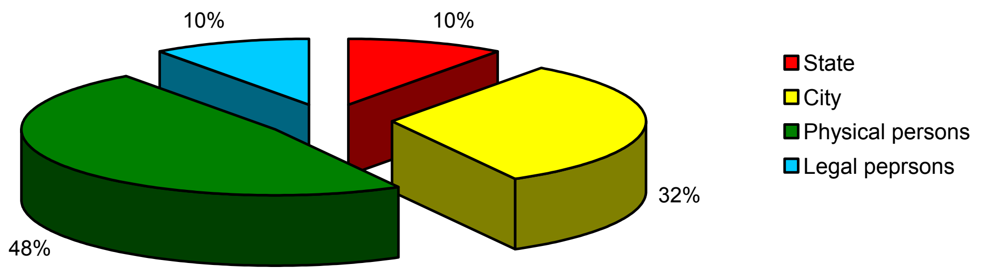
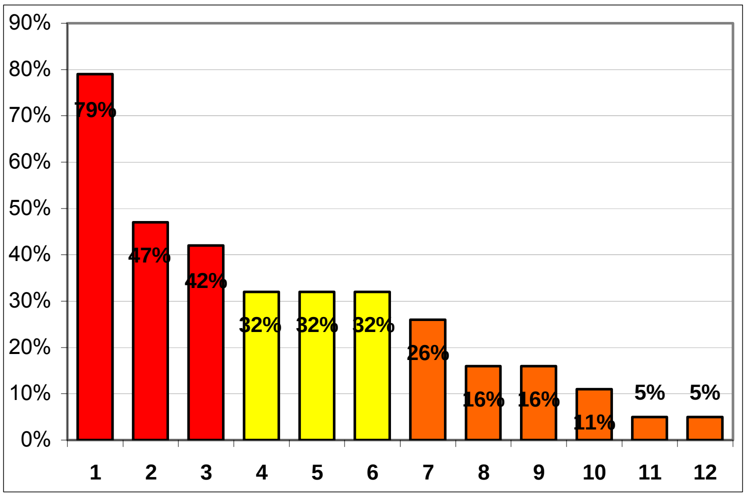


Chart 1. Structure of shareholders (owners)

2. Business in General

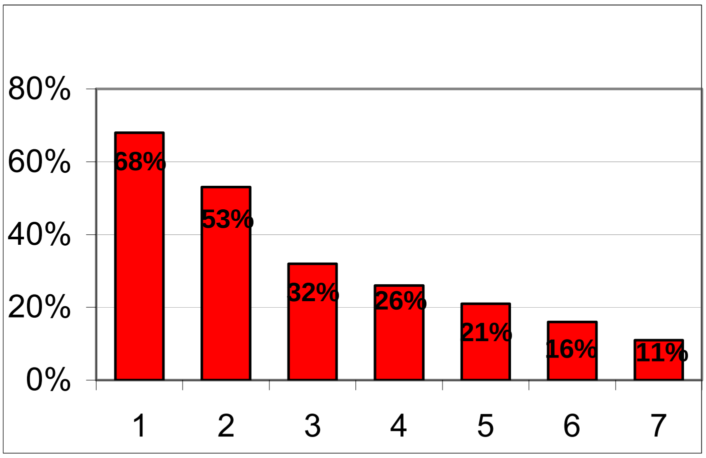
The Kremenets economy is well diversified, however trade and services remains its key sector. This sector continues to be the major employer. These companies predominantly satisfy various needs of regional sectors, households and population. Kremenets, unlike the majority of one-company cities in Ukraine, did not experience a lot of fluctuation on the labour market during the transition period. The important employers continue their successful operations demonstrating high effectiveness.



1 National legislation
2 General economic situation
3 Energy costs
4 Internal competition
5 Costs for materials and supplies
6 Interest rates
7 Obsolete manufacturing facilities
8 External competition
9 Lack of financial resources
10 Lack of qualified workforce
11 Attitude of the local government
12 Loss of markets in the former USSR

Chart 2. Barriers for further development

Companies were asked to name the factors of the negative impact on the current and future development of their products or services (see Chart 2). The top group of factors included: (1) national legislation – mentioned by 79% of all interviewees; (2) general economic situation – 47 %; and (3) energy costs – 42 %. Internal competition, costs for materials and supplies, and high interest rates represent a barrier for further development of one third of predominantly small and medium-sized companies. Obsolete manufacturing facilities with the 26% rating was yet another factor. Other issues, such as: external competition, lack of financial resources, lack of qualified work force, and attitude of the local government present a concern to three or four companies each.



1 Stable business climate
2 Better legal protection for entrepreneurs
3 Participation in the EU programs
4 Higher level of protection of economic competition
5 Access to huge markets without customs
6 Single currency
7 Better supply of labour force

Chart 3. Benefit s from joining the EU

Expectations associated with more close cooperation of Ukraine with the EU or joining this organisation are rather positive, although companies are expecting negative consequences as well. More stable business climate (68 %), better legal protection for entrepreneurs (53 %), participation in the EU programs – 32%, and higher level of protection of economic competition - 26% are, in the opinion of companies surveyed, the main benefits from the initiation of the EU integration process and demonstrate what these companies need most in the present-day Ukraine.

On the other hand, 84 percent of companies have negative expectations about the loss of advantages of having cheap labour, services and goods. 53 percent are concerned with the increased competition and 42 percent are concerned with increased protection of consumer rights. Additional 32 percent are concerned with the necessity to incur additional costs to adjust to the new environment.

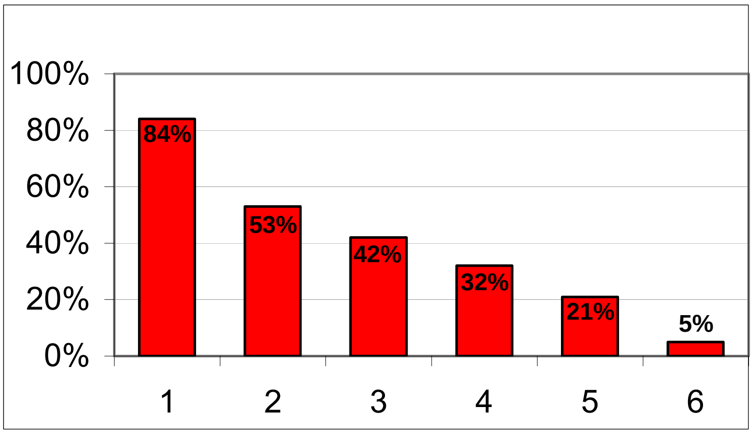


Chart 4. Disadvantages from joining the EU

3. CUSTOMERS

All companies were willing to provide information about the geographic distribution of their customers.

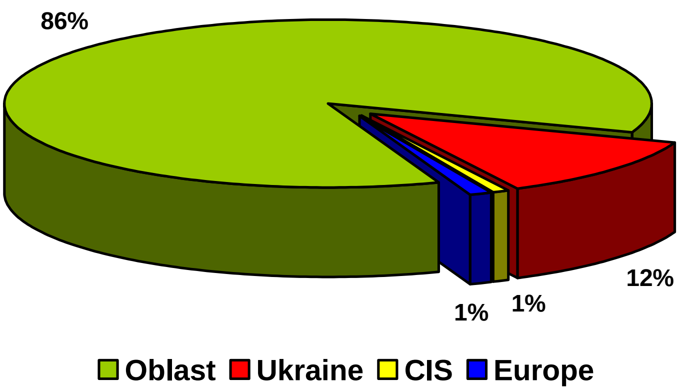


Chart 5. Regional distribution of sales of companies in the city of Kremenets

As one can see from Chart 3, the Kremenets industry has a very low level of export orientation – 2%. The Ukrainian market (including local and regional markets) is served by mostly small and medium-sized companies and constitutes 98 percent in the overall structure.

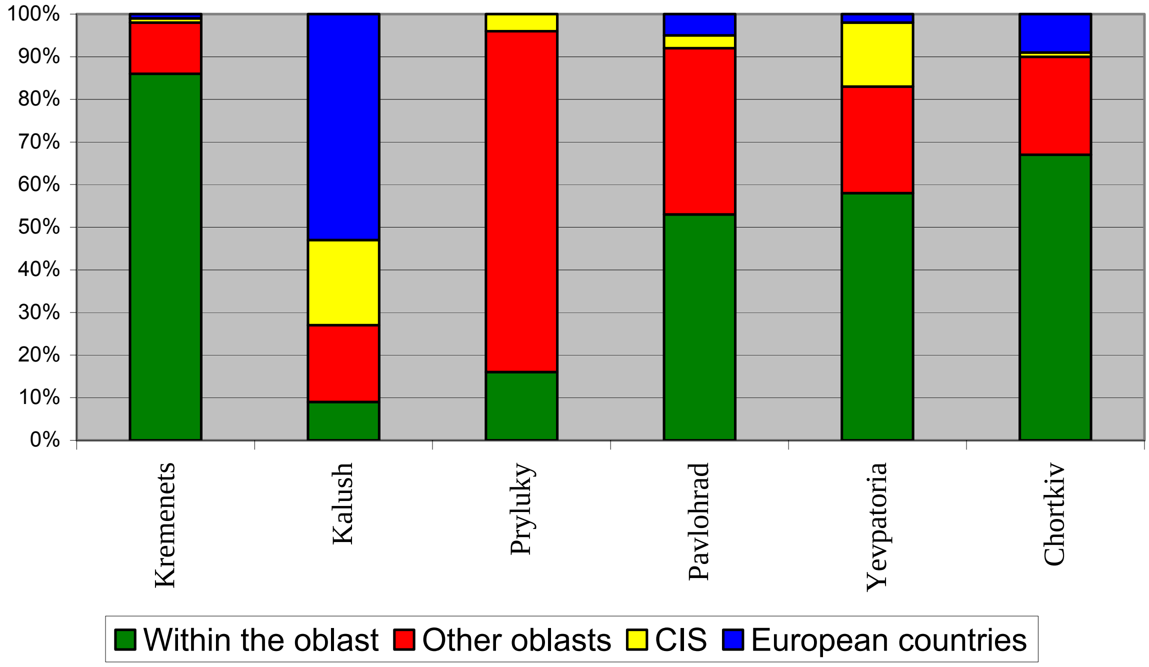


Chart 6. Sales markets and level of export orientation of the local economy

All companies are expecting a steady increase of their sales in 2008 as compared with the previous year (by more than 25% on average). Only one company has negative expectations and is expecting a 25% decrease of its sales.

The average sales per employee of all companies surveyed in the city is at the 17 thousand UAH per year level.

The highest productivity has been demonstrated by one of the biggest employer in the city, a number of trade companies, and one construction company.

Availability of raw material suppliers is one of the main reasons for 84% of companies to locate their business in Kremenets. Availability of suppliers of components is important for 63% of companies. Availability of qualified work force was such a reason for 58% of companies.

It is important to note that 21% of companies named the availability of a cluster of similar companies as the reason to locate in Kremenets (mainly in construction and trade sectors).

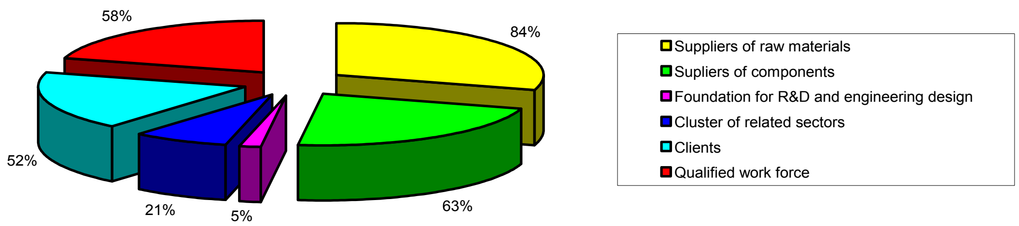


Chart 7. Reasons for locating businesses in Kremenets

4. Labour and Employment Matters

In general, companies consider 21 percent of employees as “excellent”, 48 percent as “good”, 28 percent as “fair”, and only 3 percent as “bad”.

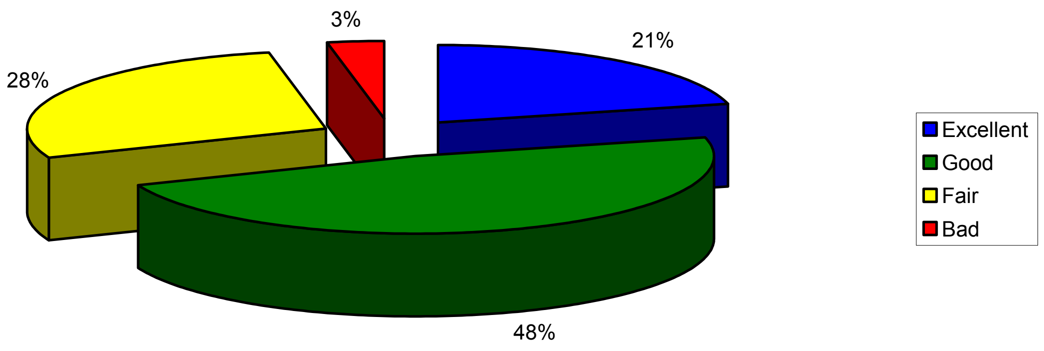


Chart 8. Satisfaction level of employers with work force quality in Kremenets

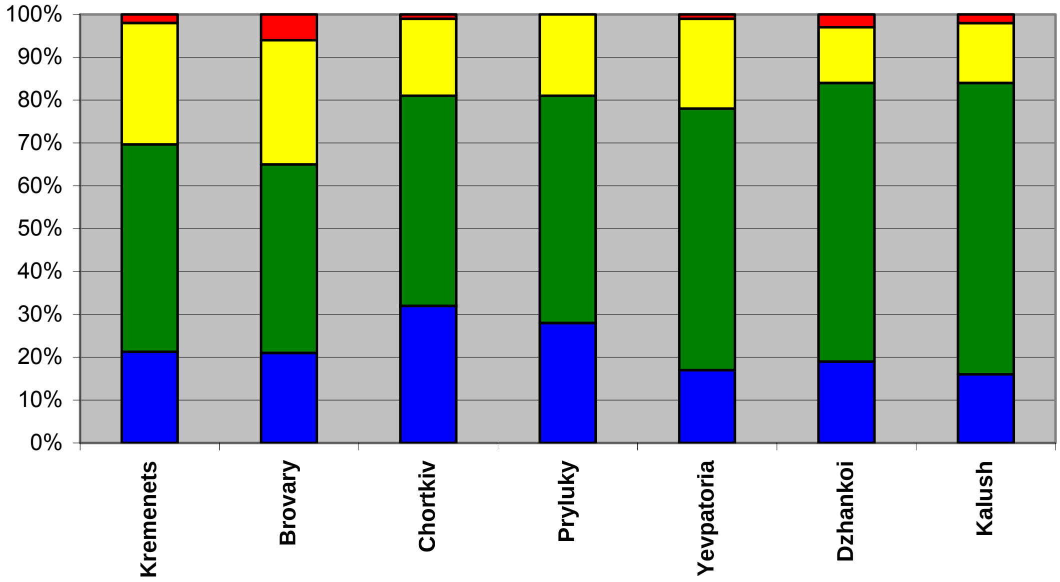
The total number of full-time employees at all companies surveyed constitutes 479. Five years ago these companies employed the total of 591 workers, with 471 employees last year. During the last five years, it was the biggest employers who started to reduce the number of their employees. It should be mentioned that the increase of employees at small enterprises during the last five years was also slow. The number of employees practically stays the same.

Unfortunately, companies are not planning to increase the number of jobs next year. On the contrary, they are likely to decrease them by 4.5%.

Females constitute only 39.5 percent in the selection. At the same time the selection does not include two important sectors providing employment opportunities for women: education and health care.

The share of employees with higher education constitutes only 18.4%. It is interesting to note that such a low percentage of employees with higher education, as compared to other cities surveyed, correlates with a rather insignificant number of company employees engaged in scientific research and investigations. There are only 2 such persons, which constitutes 0.41% of employees working at the companies surveyed. Research and Development structural departments have been set up by only one company. Yet, it is noteworthy that five companies are planning to create then in the nearest future.

The local employers are satisfied with the quality of their employees. The employers’ level of satisfaction with the quality of work force stays at the same level as in other Ukrainian cities (Cart 8). It should be mentioned that managers of small and medium-sized companies from the trade sector are most critical about the quality of their work force.



Note: the colours of the legend of the diagram coincide with Chart 8.

Chart 9. Satisfaction level of employers with workforce quality in selected Ukrainian cities

The actual monthly salary paid by the surveyed companies constitutes on average 639 UAH (540 UAH in 2006). The lowest average monthly salaries are paid at small and medium-sized companies from the services sector.

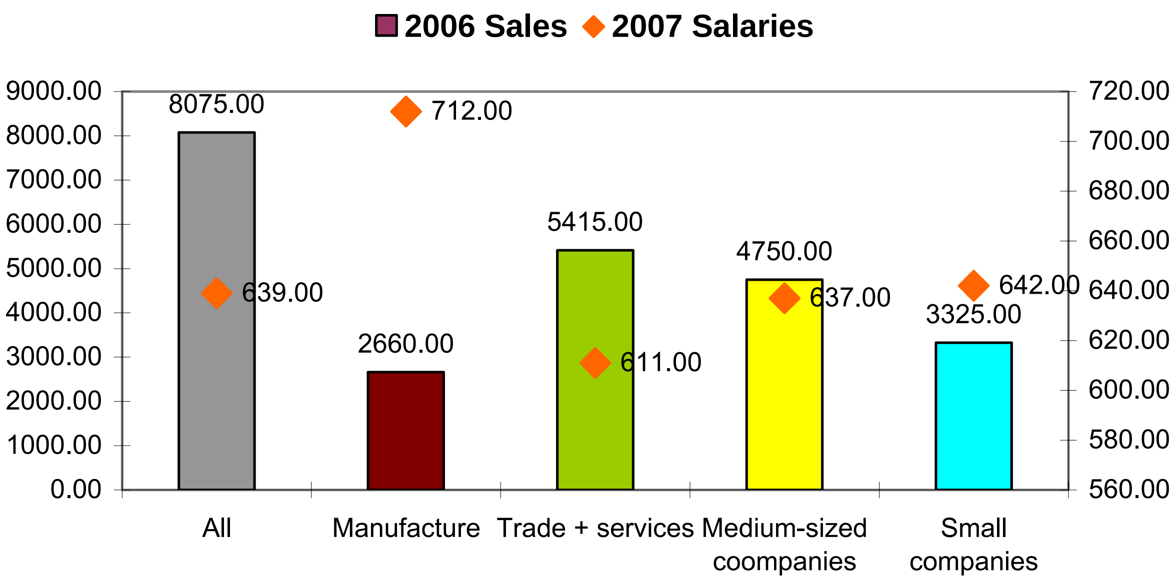


Chart 10. Salaries and sales

Lack of qualified work force is a growing problem. It is experienced by 68% of surveyed companies now, with 16% of companies expecting problems with employees in the future. 16% of companies do not have such a problem.

A considerable number of companies either already lack employees with proper qualifications or are expecting it in the nearest future. Only 3 companies of all surveyed do not have such problems. The lack of qualified specialists is mostly observed in technical areas. Three small companies lack qualified managers.

Welders, cooks, technologists, designers, and carpenters are the most needed professional skills.

5. Real Estate

The situation with the real estate in Kremenets has its positive and negative sides (see Chart 11).

Of all companies surveyed, only 21% are owners of premises or land. Besides, 26% of companies have property to do their business while renting some part of it, with 53% of companies only have only rented property. A little bit more than 32% of companies have the opportunity to expand their businesses in the current location, with about 60% of companies considering such a possibility. At the same time only 16% of companies are ready to rent or sell some part of their premises, which testifies to small potential of the private sector regarding improvements in availability of lands or premises for business purposes. The overwhelming majority of quite successful companies are not ready to sell or rent their excessive property. 36% of companies indicated that they have enough land and premises to expand their businesses. Only three companies are considering relocation to another city. Lack of property for economic activities is the most likely reason for this.

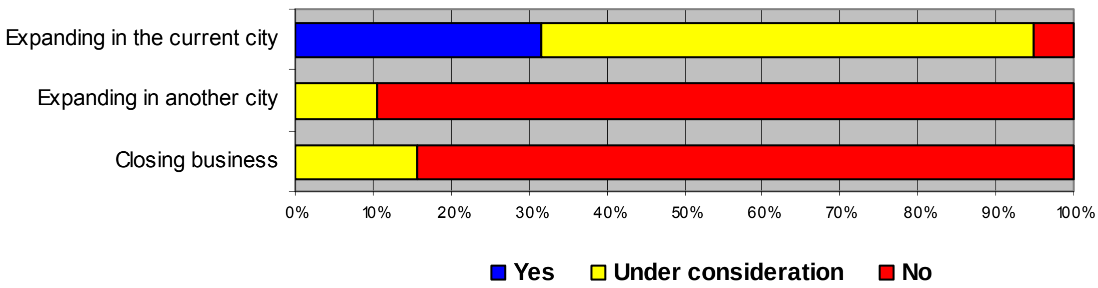


Chart 11. Information about the real estate and expansion opportunities

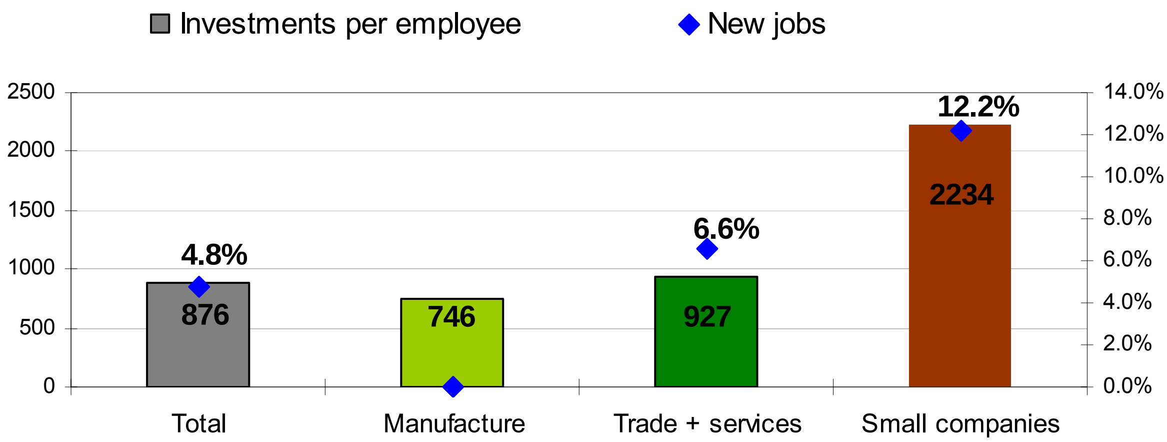


Chart 12. Investments per employee and new jobs created

The current condition of premises and technologies leaves much to be desired, therefore many companies are planning significant investments to improve their manufacturing facilities (see Chart 12). About 90% of companies are planning to develop or modernise their existing facilities in order to expand their businesses in Kremenets. 5 companies are considering such a possibility in the nearest future. The total of 420 thousand UAH of expected investments is not very high for a city of almost 21.5 thousand. The fact that investments in company expansion or modernisation are not coupled with creation of additional jobs remains a big problem for the city economy.

6. SERVICES AND RELATIONS WITH THE LOCAL GOVERNMENT

Companies were offered an opportunity to rate nine kinds of municipal services according to the 4-ponit scale (with 1 being "excellent" and 4 - "bad"). On average these services have received the rating of 2.51, which is somewhat better than the average Ukrainian data and is comparable with other cities. Business licensing and permit procedures, waste collection and removal, licensing and permits for construction works, public transportation, and SME support received rather high scores (as compared with other cities).

At the same time local entrepreneurs are very dissatisfied with the infrastructure development and allocation of land plots and premises for business purposes. Road maintenance was the top issue businesses are not satisfied with. This rating for indicator is the same for the similar Ukrainian indicator and serves as a proof to the fact that this is a national problem, rather being an exception.

One should pay attention to improvements in small and medium-sized enterprise support and registry procedures for launching a new business. Other concerns, in general, are most likely caused by the objective reasons, such as a very limited city territory, as compared with other cities, high density of construction and population with practically no land resources for development purposes available.

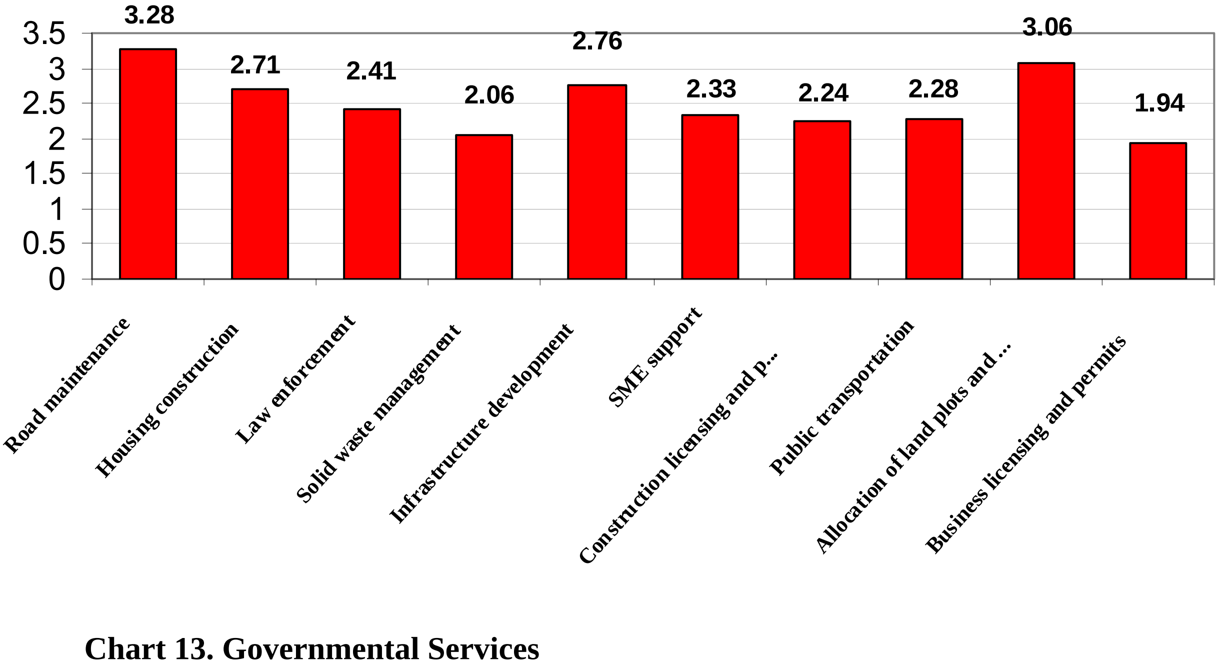


Chart 13. Governmental Services

Companies were also asked about the services rendered by the city government (in particular, by the Municipal Office for Economic Development) to the business community of Kremenets. Chart 14 shows that companies strongly welcome all services which can be offered to them, except for free allocation of land plots or for symbolic prices. Companies support the ideas of creating business centers, setting up business incubators and active investment attraction most. However, according to the rules in sociology, the aggregate result is somewhat different, because negative responses are also taken into consideration which "lowers" the positive feedback from other interviewees.

It is interesting to note that unlike companies in other Eastern European countries, companies are less supportive of the idea of the city government allocating vacant land plots with engineering infrastructure to private firms for symbolic prices. It looks like they are not sure that those who would get such a subsidy will actually start creating new jobs. Therefore, such a potential service received the lowest rating. Thus, the following are the most expected steps the government has to take to meet businesses' needs and to support them:

- setting up business support centers;
- active investment attraction;
- setting up business incubators.

The overall rating is presented on Chart 14.

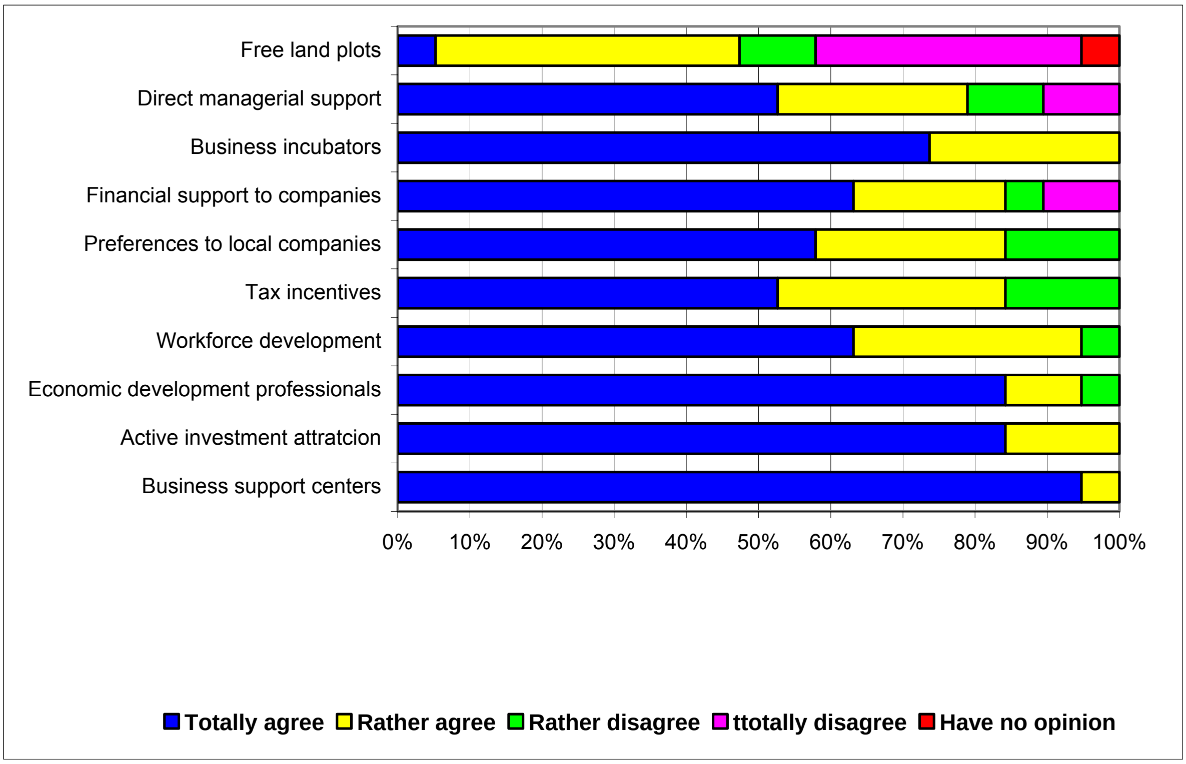


Chart 14. Services provided by Municipal Office for Economic Development

Companies surveyed were also provided an opportunity to rate their contacts with governmental agencies and officials. Results (Chart 15) demonstrate a relative medium level of contacts of businessmen with governmental and executive agencies. Most positive contacts were reported with the City Mayor, Fire prevention unit and Deputy Mayor. All of them received positive responses. Companies did not have many contacts with the rayon government, business associations, structural department of the City Council engaged in investment attraction, Trade and Industry Chamber, City Finance Department and Business Support Department. The Department for Land Resources, Department for Architecture, Water and Sewage Utility Company and tax authorities received 5 "black marbles" each. In other words, the cooperation with these entities was rated as negative by companies.

Many comments of managers can be generalised into one sentence: high level of red tape and too many bureaucratic agencies, too much of unnecessary reporting, lengthy and time-consuming procedures, lack of understanding of business issues on the part of officials, poor qualification of officials, inadequate attitude on the part of authorities to companies as to clients (and taxpayers), and improper legislation.

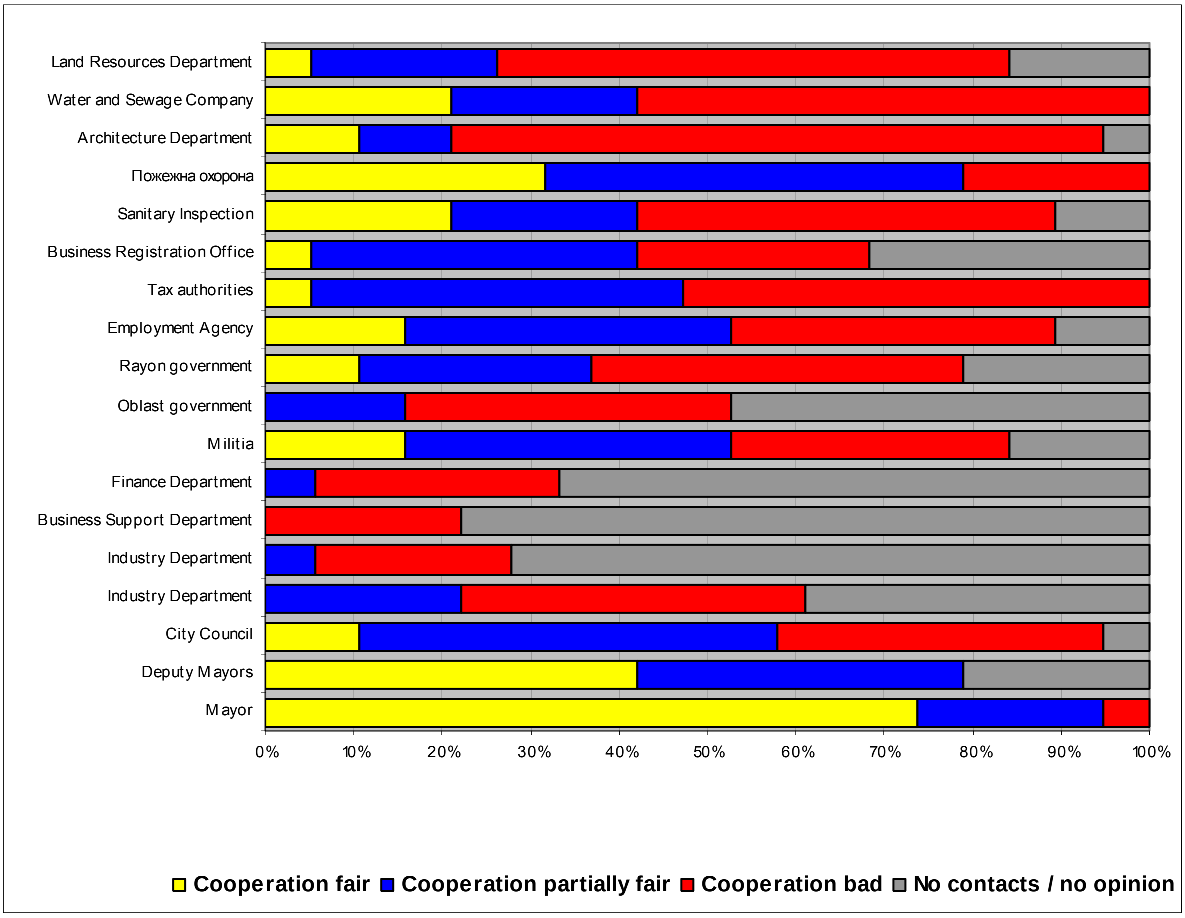


Chart 15. Contacts with authorities

7. CRITICAL ISSUES

Companies gave the following answers when asked what the three most critical issues the economic development strategic plan should focus on were (see Chart 16):

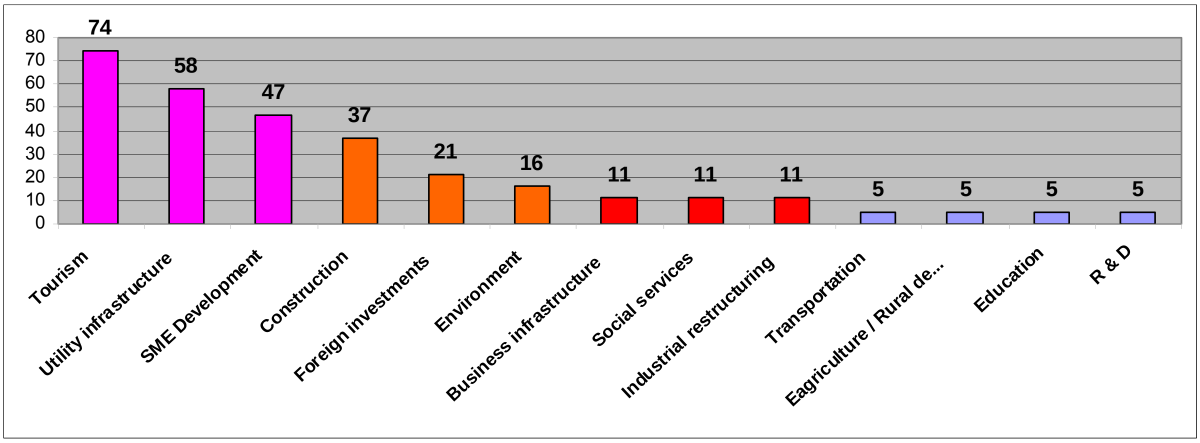


Chart 16. Critical issues

Hence, being asked to choose three most critical issues out of thirty suggested by the survey, companies have rated their responses in the following way:

- tourism development – 74 % of votes;
- utility infrastructure – 58 %;
- small and medium-sized enterprise development – 47 %;
- housing construction– 37%;
- foreign direct investment attraction – 21 %;
- environment – 16%;
- business infrastructure, social services and industrial restructuring – 11 % each;
- transportation, rural and agriculture development, education, and research and development were mentioned most rarely.

8. OVERALL IMPRESSIONS

Companies were asked to give their overall impressions about the Kremenets governmental agencies. The responses to this question reflect the general feeling that the city government is performing well. No bad responses were given to neither governmental agencies, nor business climate. The city of Kremenets as a place to do business received less optimistic scores. Only one company rated is as "excellent", with 50% rating it as "good" and 35% of companies rating it as "fair".

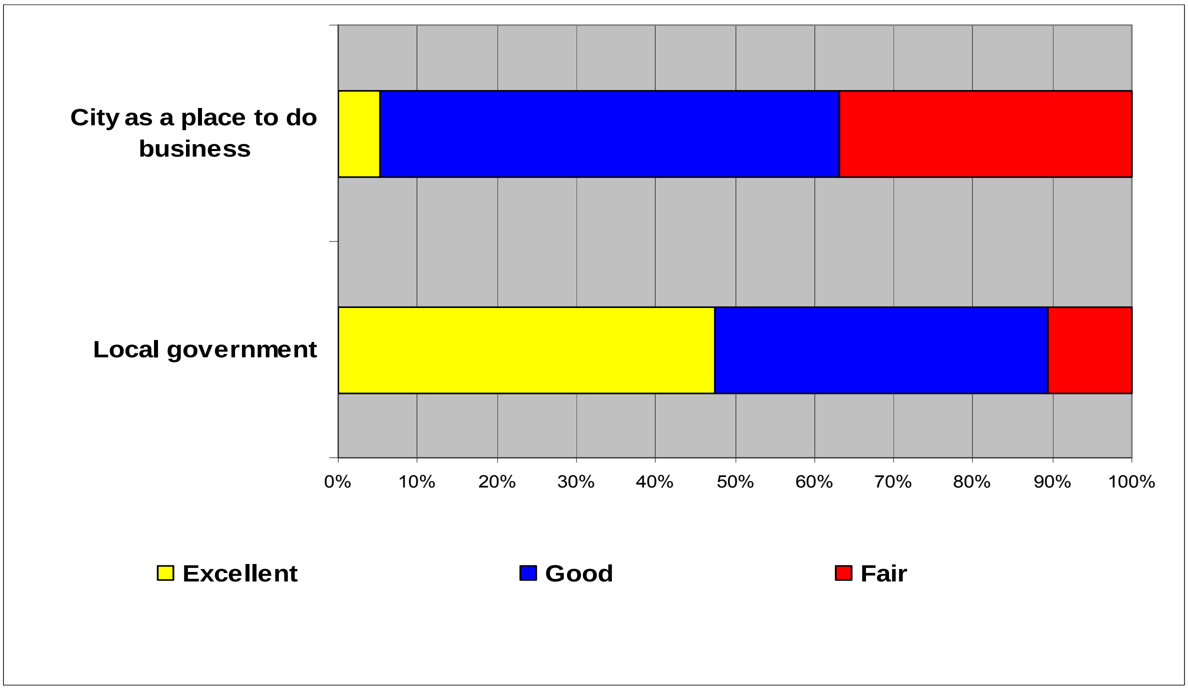


Chart 17. Overall impressions about the local government and city business climate

The most critical strengths of the local business climate which were repeatedly mentioned were: advantageous geographic location, potential for industrial development and high expectations for the newly-elected professional mayor who in cooperation with the new team can do a lot to change for the better.

The main negative factors as identified by companies are the following:

- lack of an on-going dialogue between government and businesses;
- problems with “old habits” and mentality;
- underutilised recreational and tourism opportunities;
- lack of proper attention to city development;
- high level of red tape;
- lack of territories for development purposes;
- problems with legislation framework;
- the size of the city is too small;
- poor local competitiveness;
- low citizens’ participation;
- decline of a number of companies;
- poor buying capacity of the real sector of the economy, local budget and citizens.

V. SUMMARY

This Business Attitude Survey reflects the accumulated opinions of the business community in Kremenets. Their collective attitude towards the city government will have a strong influence on the economic future of the city - whether its economy will grow; stagnate or decline. The report will assist the Expert Strategic Planning Committee in its work and will be of value to the local government in its effort to maintain and improve the business climate in the city.

The Local Economic Development Project extends its acknowledgements to all the representatives of companies which shared their opinions and provided useful information to the Strategic Planning Committee, as well as to all employees of the executive departments of the City Council and volunteers who dedicated their time to conduct the interviews.