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Running a Business in Ukraine

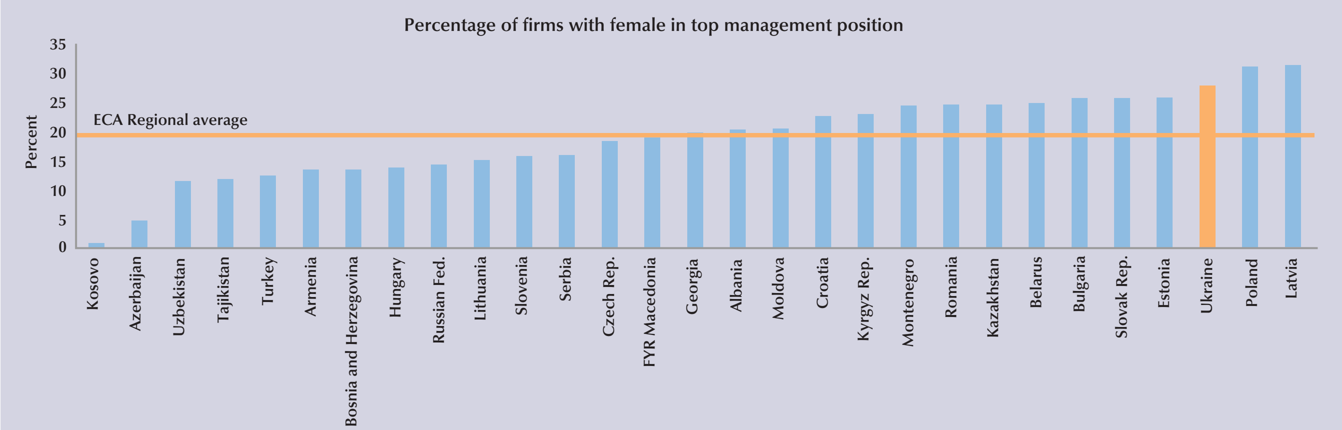
New data from Enterprise Surveys indicate that firms in Ukraine are among the largest in the Eastern Europe and Central Asia (ECA) region, as measured by the number of permanent, full-time workers. Moreover, Ukraine ranks among the top three countries in the region in the prevalence of firms managed by women (figure 1) and Ukrainian firms have a relatively large proportion of female workers, the fourth largest in the ECA region. Large firms and firms located in Kiev are more likely to engage in international trade and to have better access to technology. However, on average, the percentage of firms exporting and accessing different technologies, such as e-mail, Web sites or technology licensed by foreign companies, is lower in Ukraine than in the rest of the region. Data on the firms with repeated interviews suggest a slight reduction in corruption, particularly for exporting firms: between 2005 and 2008, the percentage of exporting firms that expected to give gifts in meetings with tax inspectors fell. However, the incidence of bribery and corruption is still quite high for Ukrainian businesses compared to firms in other ECA countries (table 1).

The Enterprise Surveys[1] use standard survey instruments to collect firm-level data on the business environment from business owners and top managers. The surveys cover a broad range of topics, including access to finance, corruption, infrastructure, crime, competition, labor, obstacles to growth, and performance measures. The survey is designed to be representative of a country's private nonagricultural economy, and firms sampled are stratified by size, location, and sector (figure 2)[2] to ensure that most major types of firms are covered. Only firms with five employees or more are included in the sample. In Ukraine, 851 firms were surveyed between June 2008 and August 2008. The information collected refers to the characteristics of the firm at the moment of the survey, or to fiscal year 2007.

What is the average firm in Ukraine?

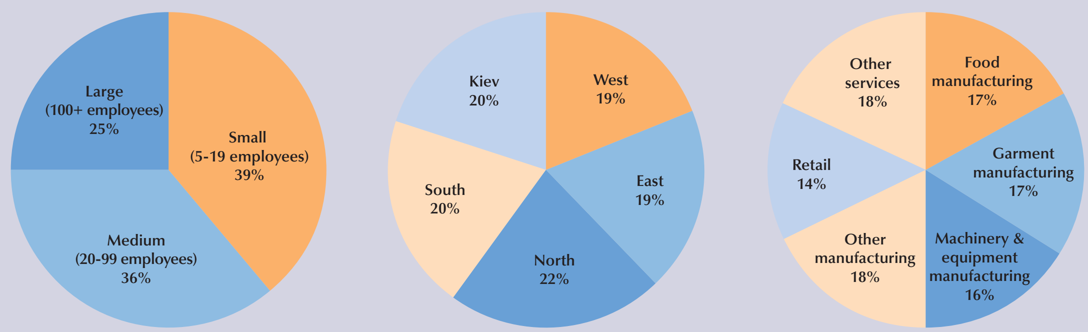
Firms in Ukraine have a large permanent workforce, the sixth largest in the ECA region.[3] Looking at differences in the size of the permanent workforce across different types of Ukrainian enterprises, those in manufacturing are more than twice as large as those in retail and other services (figure 3). Similarly, firms managed by a male manager are three times as big as firms managed by women. Ukrainian firms also vary in the gender composition of their workforce. They have a relatively large proportion of female workers, the fourth largest in the ECA region. In a typical Ukrainian firm 47 percent of full-time workers are female, as opposed to 39 percent in the average ECA country (table 2). Firms with foreign participation in

Figure 1 Women-run firms are more common in Ukraine than in most of the ECA region



Source: Enterprise Surveys.

Figure 2 Characteristics of the firms interviewed



Source: Enterprise Surveys.

ownership have a lower proportion of full-time female employees than do domestically owned firms.

Ukraine stands out in the ECA region because of its high rates of female participation in ownership (table 1) and top management. Twenty-eight percent of firms in Ukraine are managed by women. This is the third highest percentage of firms with female top managers in the region; only Latvia and Poland have higher percentages (figure 1). In retail firms, female participation in ownership and in top management is more common. Not surprisingly, firms with female participation in ownership are more likely to be managed by women: 55 percent of firms where at least one of the owners is female are run by women, while only 4 percent of firms with no female owner are managed by women. Female management is much more common in small firms, with 38 percent of small firms being run by women versus 17 percent of medium firms and 12 percent of large firms.

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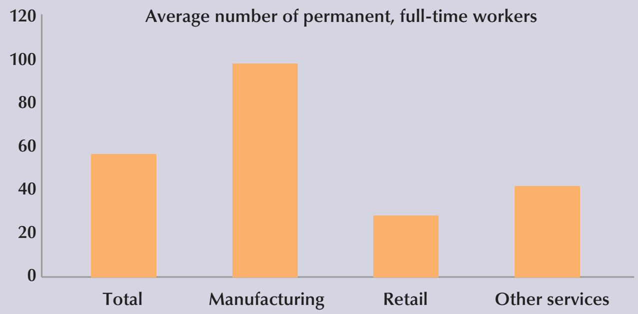
Another notable fact about the ownership structure of Ukrainian enterprises is the predominance of private, domestic ownership among smaller firms. Among

Table 1 How does Ukraine 2008 compare within Eastern Europe and Central Asia?

Ranking 1 assigned to the largest value	Descending ranking (out of 29 countries)
Percent of firms formally registered when started operations in the country	21
Private domestic ownership (%)*	9
Private foreign ownership (%)*	21
Government/state ownership (%)*	9
Percent of firms with female participation in ownership	6
Bank finance for investment (%)	21
Percent of exporter firms	20
Domestic sales (% of sales)	8
Percent of firms with internationally recognized quality certification	23
Percent of firms with annual financial statement reviewed by external auditor	19
Capacity utilization (%)	12
Percent of firms using their own Web site	20
Percent of firms using e-mail to communicate with clients/suppliers	21
Ranking 1 assigned to the smallest value	**Ascending ranking (out of 29 countries)**
Value of collateral needed for a loan (% of the loan amount)	18
Number of power outages in a typical month	11
Senior management time spent in dealing with requirements of government regulation (%)	19
Average number of visits or required meetings with tax officials	22
Incidence of graft index **	27
Losses due to theft, robbery, vandalism, and arson against the firm (% of sales)	22

Source: Enterprise Surveys.
Note: This table presents a ranking out of 29 economies for each of the listed indicators. The numbers are ranks as opposed to the actual value of the indicator.

Figure 3 **Manufacturing firms have three times more permanent workers than retail firms**



Source: Enterprise Surveys.

small firms, the average proportion of private domestic ownership is 98 percent, in contrast to 81 percent for large firms. As expected, ownership differences across exporters and nonexporters are notable as well: among exporters the average share of foreign ownership is 20 percent, in contrast to just 3 percent of nonexporters. Finally, firms in Kiev are more likely to be registered as privately held limited liability companies, with 62 percent of medium firms falling under this category.

The age of the firm and the top manager's years of experience are strongly related to size. The average large firm is nearly three times as old as the average small firm, and its manager has four additional years of experience. Compared to nonexporters, the manager of an exporting firm is likely to have six additional years of experience. A firm's legal form is also strongly related to its size: 52 percent of small firms are sole proprietorships, compared to 24 percent of medium firms and 14 percent of large firms.

How do businesses operate in Ukraine?

Relative to the ECA average, Ukrainian firms use less bank financing and face more stringent collateral requirements. In fact, nearly 68 percent of these firms did not use bank financing at all in investment. Collateral requirements vary across firm types. Exporters as well as firms with foreign participation in ownership are required to present higher values of collateral as a percentage of the loan. Firms with government participation of 5 percent or more in ownership are less likely to need to provide collateral when obtaining a loan (16 percent versus 88 percent for purely privately owned firms).

Additionally, there are marked differences across firms in participation in the formal financial sector. For example, nearly all exporters and all large firms have a checking or savings account in a bank, in contrast to 89 percent of nonexporters and 87 percent of small firms. Similarly, 50 percent of large firms have a bank loan or a line of credit, as opposed to only 26 percent of small firms.

The data also suggest that the use of external financing for firms in Ukraine relates to the gender of the top manager, as the share of banks in investment financing is only 9 percent for firms with a female top manager, as opposed to 20 percent for other firms (although these differences could be driven by other factors, such as firm size). However, there are no significant differences in external financing between firms owned partly by women and those owned solely by men.

There are, however, some regional and sectoral differences in financing. Firms in the West region of the country report selling 56 percent of output on credit, which is almost double the percentage among firms located in other regions. The percentage of sales that are prepaid is lower in the retail sector (22 percent for retail versus over 41 percent for both manufacturing and other services). Firms located in the West region are also more likely to have a checking or savings account than firms in other regions (98 percent in the West region versus below 90 percent in other regions, except Kiev).

Only 12 percent of Ukrainian firms export, in contrast to

Table 2 **The average firm in Ukraine 2008**

	Ukraine	ECA-29 †	EU-10 ‡
Age (years)	14.3	13.9	13.9
Percent of firms formally registered when started operations in the country	95.8	96.8	98.7
Most common legal form	Closed Shareholding Co.	Closed Shareholding Co.	Closed Shareholding Co.
Private domestic ownership (%)*	93.5	91.3	90.3
Private foreign ownership (%)*	4.5	6.2	7.4
Government/state ownership (%)*	1.1	1.1	0.5
Percent of firms with female participation in ownership	47.1	36.7	39.0
Percent of firms with female in top management position	27.9	18.9	22.2
Experience of the top manager (years)	13.4	16.1	17.2
Average number of temporary workers	1.6	3.2	2.5
Average number of permanent, full-time workers	56.8	43.4	36.4
Percent of full-time female workers	47.0	38.5	40.1

Source: Enterprise Surveys.

Table 3 Choices by the average firm in Ukraine 2008	Ukraine	ECU-29†	EU-10‡
Internal finance for investment (%)	59.4	59.7	58.8
Bank finance for investment (%)	17.7	22.9	25.7
Value of collateral needed for a loan (percent of the loan amount)	137.5	132.2	123.4
Loans requiring collateral (%)	86.8	81.0	74.2
Percent of firms with a checking or savings account	90.1	88.9	85.2
Percent of exporter firms	12.2	22.1	29.1
Domestic sales (percent of sales)	94.1	90.8	88.3
Sales exported directly (% sales)	4.2	7.1	9.5
Sales exported indirectly (% sales)	1.6	2.0	2.2
Sales that are pre-paid (%)	37.9	23.0	11.2
Sales sold on credit (%)	34.6	49.4	66.3
Percent of firms with internationally recognized quality certification	13.0	20.0	25.8
Percent of firms with annual financial statement reviewed by external auditor	27.3	37.9	38.6
Capacity utilization (%)	77.1	73.7	81.3
Percent of firms using their own Web site	35.7	48.5	63.6
Percent of firms using e-mail to communicate with clients/suppliers	64.0	73.1	88.3

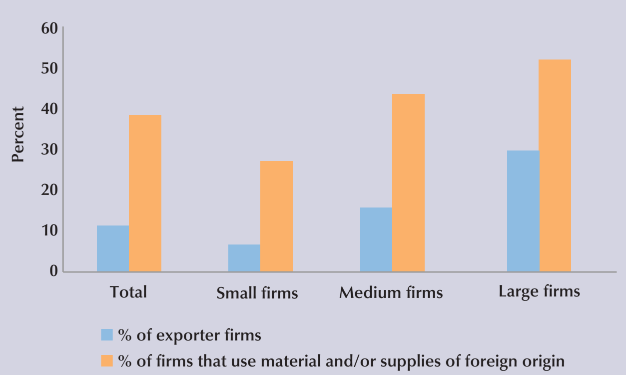
Source: Enterprise Surveys.

the ECA average of 22 percent (table 3). Moreover, small firms are less likely to be exporting: 7 percent of small firms and 30 percent of large firms export. Similarly, large firms use twice as many imported inputs (as a percentage of all inputs) as small firms (figure 4). Furthermore, firms in Ukraine use the lowest percentage of inputs of foreign origin in the region, and the proportion of firms that use imported inputs or supplies is the second lowest after Uzbekistan. Firms located in Kiev are more likely to be exporters than firms in other regions of the country except for firms in the West region.

Larger Ukrainian firms appear more likely to utilize technology than their smaller counterparts. For instance, 60 percent of large firms use their own Web site to communicate with clients and suppliers, as opposed to only 28 percent of small firms. Additionally, large firms are more than twice as likely to be using technology licensed from foreign companies (45 percent versus 18 percent). Moreover, 54 percent of large firms use external auditors, as compared to only 18 percent of small firms, implying a higher degree of quality control among large firms. There are some regional differences in communications technology usage as well. For instance, nearly 84 percent of firms in Kiev use e-mail to communicate with clients, and 60 percent of firms have their own Web site, proportions that are significantly higher than those in other regions.

Similar differences are found across exporters and nonexporters: 66 percent of exporters have their own Web site, in contrast to only 32 percent of nonexporters. Not surprisingly, the prevalence of foreign technology licensing is also markedly higher among exporters, at 50 percent versus 20 percent for nonexporters. Compared to domestically owned firms, firms with foreign participation in ownership are more likely to have an international quality certification, and to have their own Web site.

Figure 4 **Larger firms engage more in international trade**



Source: Enterprise Surveys.

What constrains firms in Ukraine?

In Ukraine, informal payments are an extra cost of doing business for at least one-third of firms in the private sector. Thirty-two percent of firms report that informal payments to government officials are expected in order to get things done (table 4), and 28 percent report that these types of payments are expected when dealing with tax officials in particular. Only four countries in ECA have a higher percentage of firms expected to make informal payments to tax officials: Uzbekistan, Azerbaijan, Kyrgyzstan, and Tajikistan. These results are in line with data collected by others. For instance, Ukraine was ranked 118 out of 179 countries worldwide in Transparency International's Corruption Perceptions Index, in 2007.

Table 4	Constraints on the average firm in Ukraine 2008		
	Ukraine	ECA-29 †	EU-10‡
Number of power outages in a typical month	2.1	5.2	2.1
Senior management time spent in dealing with requirements of government regulation (%)	11.3	10.6	9.5
Average number of visits or required meetings with tax officials	2.1	1.6	1.1
Percent of firms expected to pay informal payment to public officials (to get things done)	31.8	23.1	12.7
Incidence of graft index**	29.8	13.5	6.8
Losses due to theft, robbery, vandalism, and arson against the firm (% of sales)	0.6	0.5	0.4
Percent of firms paying for security	55.2	57.7	62.2

Source: Enterprise Surveys.

The burden of regulation or corruption does not fall equally on different types of firms. As many as 87 percent of firms with foreign participation in ownership are expected to give gifts to get construction permits, as opposed to only 57 percent of domestically owned firms. Finally, the evidence on subnational differences in the burden of regulation is mixed. The proportion of firms that are expected to give gifts to get an operating license or a construction permit is significantly lower in the West region as compared to the rest of the country.

Although the number of power outages per month is lower in Ukraine than the ECA average, their average duration is significantly higher at five hours as opposed to four hours average in the ECA region. Perhaps as a result of this, the average firm in Ukraine loses over 4 percent of sales value to power outages. Only seven countries in the region report higher losses due to power outages. Firms in the North and South regions experience higher losses due to power outages (at 10 to 12 percent of sales value), while in the rest of the country only 2 percent of sales value is lost due to power outages.

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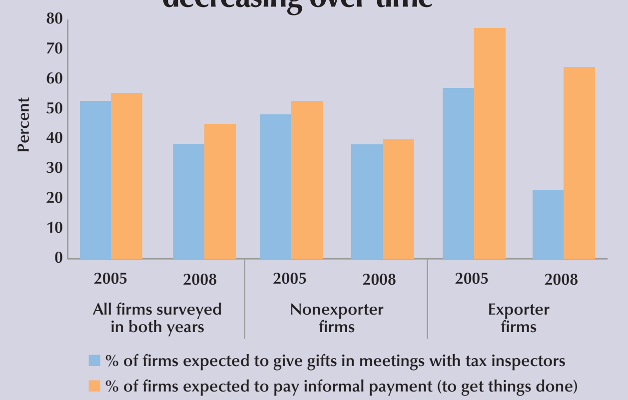
How has the business environment changed over the past three years?

The Enterprise Surveys data provide the tools to monitor changes in the business environment across different rounds of surveys. In Ukraine, of the 851 firms surveyed in 2008, 120 were also previously surveyed in 2005.[4] Since the same firms are interviewed over time, this subset of data is more appropriate to evaluate the evolution of the business environment, and the impact of business environment reforms, than are the full datasets for both years. Considering the full datasets would introduce effects that are the result of variations in the sample composition over the two years.[5] Therefore, the following analysis refers only to these firms that were interviewed in both rounds of surveys.

The data show improvement in the business environment in a few areas. First, the data suggest that corruption has declined over time. Specifically, among firms interviewed in both 2005 and 2008, the percentage of firms that expected to pay informal payments to public officials (to get things done) fell from 54 percent to 44 percent (figure 5). In addition, the percentage of firms expected to give gifts in meetings with tax officials declined from 51 percent to 37 percent. This is consistent with the Paying Taxes indicator of the *Doing Business 2009* report, which measured a decrease in tax compliance time of 1,237 hours over the same period. These improvements in the indicators could in part be the result of reforms in tax administration, such as the improvement in electronic filing as documented by the *Doing Business 2009* report.

Second, the survey data show that the average value of collateral required (as a percent of loan amount) declined from 203 percent in 2005 to 136 percent in 2008 among the firms surveyed in both years (figure 6). This is consistent with the expected effect of reforms strengthening creditor

Figure 5 The percentage of firms expected to make informal payments is decreasing over time



Source: Enterprise Surveys.

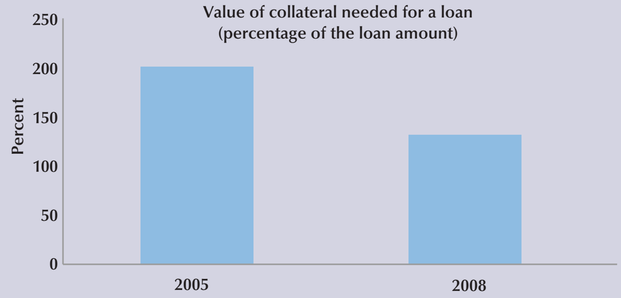
rights. In fact, over the period 2005-08, Ukraine established a new centralized registry for charges on movable asset, and introduced out- of- court enforcement remedies for secured creditors, as reported in *Doing Business 2006*.

Third, access to technology improved. Between 2005 and 2008, e-mail usage went up from 66 percent to 75 percent among the set of firms interviewed in both rounds. This increase was driven by domestically owned, by medium- size, and by nonexporting firms.

The results regarding international trade show a mixed picture. In Ukraine, exporting activity is low and has decreased over the past three years; among firms interviewed in both years, the percentage of exporters fell from 28 percent in 2005 to 20 percent in 2008. However, among the same set of firms, the share of foreign inputs in total inputs rose from 27 percent to 32 percent. This is in line with improvements in terminal handling at the port, which reduced the total import terminal handling time over this three- year period, as described in the *Doing Business 2009* report.

In summary, Ukraine implemented several reforms that are associated with a more conducive business environment, as experienced by the firms interviewed in the Enterprise Surveys. However, there is still room for improvement, in particular in the areas of corruption, access to finance and in technology.

Figure 6 **Less collateral is needed to obtain a loan than before**



Source: Enterprise Surveys.

Notes

1. The Enterprise Surveys, when implemented in Eastern Europe and Central Asia countries, are also known as Business Environment and Enterprise Performance Surveys (BEEPS) and in this region are conducted jointly by the World Bank and the European Bank for Reconstruction and Development.
2. This figure presents the unweighted distributions by size, sector, and location of the firms interviewed without any inferences to the whole economy.
3. The term "average firm" is used to convey the average firm characteristics from the Ukraine 2008 Enterprise Survey. The sample of firms interviewed is representative of the manufacturing and services sectors of the economy. For more information on the survey methodology, please consult http://www.enterprisesurveys.org/Methodology/
4. The information collected in 2005 refers to the characteristics of the firm at the moment of the survey or to fiscal year 2004.
5. The firms surveyed in both years may not be representative of the Ukraine's private nonagricultural economy since these are a subset of the full sample. Firms with fewer than five employees may be included among the firms surveyed in both years. The analysis presented is purely descriptive and does not aim at establishing causality between reforms and their intended effects.

† ECA includes Albania 2009, Armenia 2009, Azerbaijan 2009, Belarus 2008, Bosnia and Herzegovina 2009, Bulgaria 2009, Croatia 2009, Czech Republic 2009, Estonia 2009, Georgia 2008, Hungary 2009, Kazakhstan 2009, The Republic of Kosovo 2009, Kyrgyz Republic 2009, Latvia 2009, Lithuania 2009, FYR Macedonia 2009, Moldova 2009, Montenegro 2009, Poland 2009, Romania 2009, Russian Federation 2009, Serbia 2009, Slovak Republic 2009, Slovenia 2009, Tajikistan 2008, Turkey 2008, Ukraine 2008, and Uzbekistan 2008.

‡ EU-10 includes 2009 data from Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

* The ownership variables represent the average ownership composition within a firm. These variables do not represent the ownership composition across firms.

** Incidence of Graft Index is the percentage of instances in which a firm was either expected or requested to provide a gift or informal payment during solicitations for public services, licenses, or permits. This Index uses data from six survey questions for each firm. For purposes of Index computation, a refusal to answer a particular survey question is considered an affirmative answer. This Index is a modified version of the Graft Index defined in A. Gonzalez et al. 2007. World Bank Policy Research Working Paper #4394.

The Enterprise Surveys measure the business environment in over 100 countries in the world. A standardized questionnaire, universe under study, and implementation methodology is used to make sure information is comparable across countries and time. The full data and documentation explaining the methodology are available at www.enterprisesurveys.org.

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IFC International Finance Corporation World Bank Group