



CITY OF ALCHEVSK
BUSINESS ATTITUDE SURVEY

Conducted by

Strategic Development Expert Committee

in cooperation with

Local Economic Development Project

supported by



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BUSINESS ATTITUDE SURVEY

I. INTRODUCTION

In December, 2007, a selective business attitude survey was conducted among employers of the city of Alchevsk by the Strategic Plan Development and Implementation Expert Committee. The survey is a part of the city economic development strategic planning efforts. The goals of the survey were to provide useful and credible information to the members of the Committee concerning the attitudes of those who invest and create jobs in the city. Survey items included the history, status and the current condition of businesses, the nature of their 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 54 surveys was completed before December 17, 2007. The list of companies to be interviewed included the largest employers in the city, as well as the selection of small and medium-sized (SME) enterprises. The total employment of the companies surveyed constitutes 28,765 persons. Ten companies employ more than 250 employees (including 2 companies with more than 3,000 employees) and twenty-six companies employ from 50 to 249 employees. The survey contains responses also from 18 small enterprises offering employment opportunities to less than 50 workers. The survey was conducted by the Expert Committee members as part of their efforts to develop the city Strategic Plan.

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. This report contains the aggregate responses of all companies.

Differences were found among responses of companies from different sectors of economy, such as: industry (heavy and light industries and processing industry), construction and repairs, service sector, and trade. The heavy industry dominates in the city economy and, consequently, the information presented by the Alchevsk Metallurgical Open Joint-Stock Company (OJSC) had a considerable influence on the overall result of the survey.

Although surveying 54 companies can not completely reflect the attitudes of the entire business community in Alchevsk, 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.

III. MAIN FINDINGS

1. Local economy reports features of consolidation after the recent process of privatisation combined with establishment and growth of a dynamic sector of small and medium-sized enterprises. The Alchevsk Metallurgical Company OJSC and the AlchevskKoks [*Alchevsk coke*], which are the major employers and exporters of products, play the leading role in the city economy.
2. The local businessmen are not satisfied with the overall economic situation in the city, high costs for materials and units, and prices for energy and supplies. Their business activities are hampered by high internal competition and obsolete manufacturing equipment.
3. Presently, the total employment of all firms interviewed constitutes 28,765 (as compared with 30,174 in the previous year), with more than 500 new jobs being planned to be created during the coming two years. Newly-created small and medium-sized metallurgical companies, construction companies, and companies from the trade and services sector, whereas big employers are gradually decreasing the number of their employees.
4. The local economy, for its most part, is oriented at exports. Four companies indicated that they export more than half of their products and services beyond the borders of Ukraine (three companies export to European countries and one company exports to other countries), while the other two companies export at least 10% of their products. In general, 38% of locally manufactured products are sold within the Luhansk oblast and in other oblasts of Ukraine, whereas more than 60% of total sales go beyond the borders of Ukraine.
5. Lack of highly skilled work force is a problem. However, employers evaluated the quality of labour resources high. A “bad” rating was given to 1% of employees, the share of “fair” employees constitutes 14%, the majority of employees (70%) were rated as “good”, and 15% of employees were rated as “excellent”. Average salaries in 2007 reached 1,633 UAH per month, whereas in 2006 it constituted 1,304 UAH. Forty companies are either experiencing lack of workers and employees with the necessary skills and proper qualifications mainly in the technical and administrative areas, or are expecting problems with the qualified work force in the coming years.
6. Thirty-eight companies are planning to modernise or improve their current manufacturing facilities and/or technologies in the course of the nearest couple of years. About 100 million UAH are planned to be invested and more than 500 new jobs will be created in 2007-2009. Twenty companies are considering opportunities to expand outside Alchevsk. One Company is planning to relocate its business from the city trying to find a better environment for its business and more clients, with seven companies considering such an opportunity in the future.
7. The overall level of satisfaction with the quality of services rendered by the local government bodies was rated not very high (the average score was 2.43 according to the 4-grade scale with “1” being the highest score). Law enforcement, road maintenance, housing construction, infrastructure development (gas, water and electricity supply and sewage), and allocation of land plots and premises for businesses were the problems requiring immediate solution in the opinion of businesses.
8. Eleven out of 54 companies evaluated the quality of services rendered by the local government as ‘excellent’, with twenty-six rating them as “good” and fourteen rating them as “fair”. Three companies could not give their evaluation of the quality of local government services.

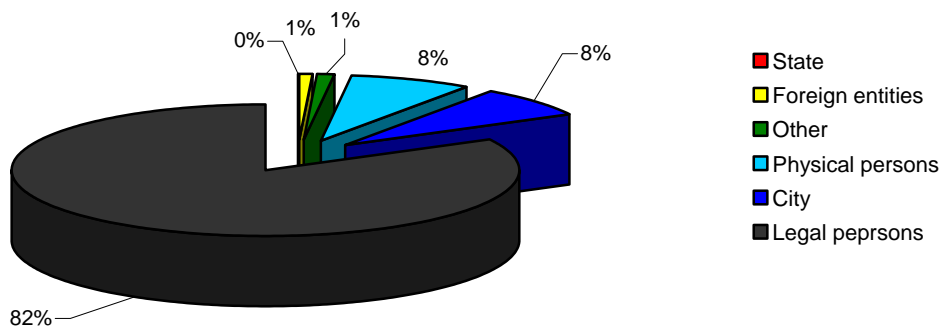
9. The opinion of the Alchevsk businessmen about the business climate in their city was not so positive. Only four companies rated the local business climate as “excellent”, thirty-three companies find Alchevsk as a “good” place to do business in, and 16 companies consider it as “fair”. One company rated the business climate in the city as “bad”.
10. Companies support the idea that local economy would improve through improvements in the environmental condition, capital investments (utility infrastructure developments), more effective cooperation between the local government and businesses (SME development), housing construction, and attraction of external resources.

IV. RESULTS OF THE SURVEY

1. Status of Businesses

Thirty-four out of 54 companies surveyed were founded after 1990. A considerable part of these newly-created companies are predominantly small and medium-sized companies from the trade and services sector, housing and utility companies, and construction enterprises. The traditional enterprises are represented by heavy industry enterprises and other big employers, some of them having been founded in the middle of the 20th century or even at the beginning of the 20th century. Very little number of companies is owned by the state, some of them representing, for the most part, the processing industry (see Chart 1). 82.6% of the companies surveyed are owned by legal persons, with 7.6% and 7.7% owned by physical persons represented by residents of Ukraine and the city accordingly. International capital is represented in 0.7% of companies in the city.

Chart 1. Structure of ownership



2. Business in General

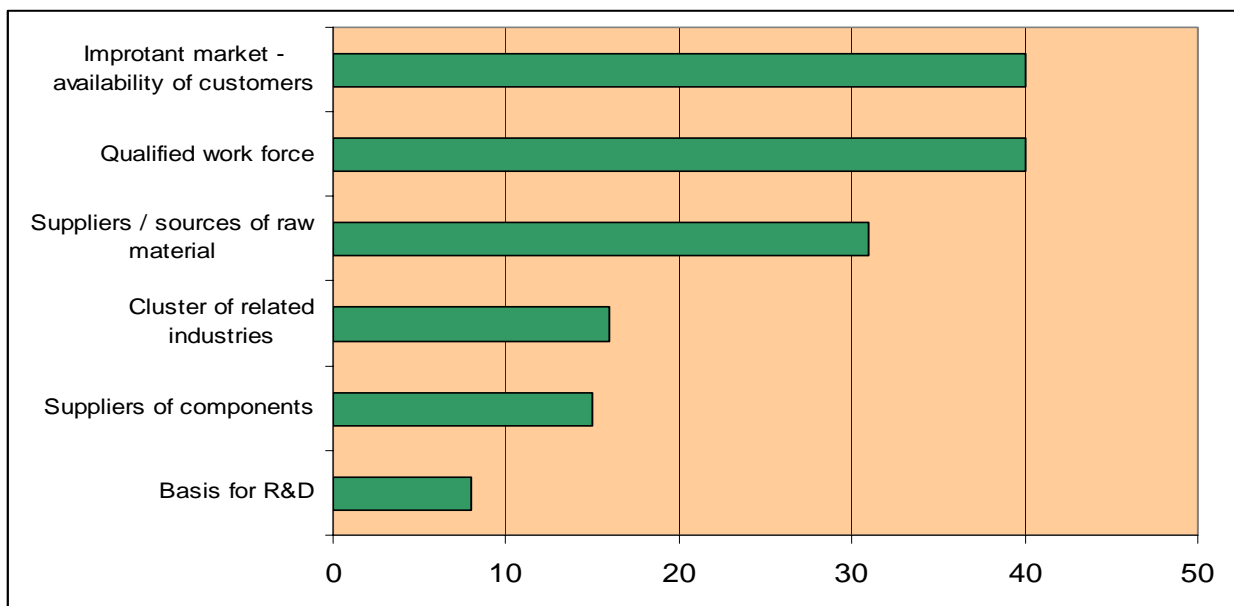
Metallurgical industry, coke production, chemical industry, and machine building represent a major portion of the local economy. These sectors employ the major part of the local labour force.

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The survey has revealed good future prospects for such sectors as industrial production and construction industry. Products and services of the companies operating in the construction sector are consumed at the local market and in the region, whereas industrial companies export a considerable part of their products. A group of small and medium-sized enterprises represents a new phenomenon in the local economy. Created by local entrepreneurs after 1990, they, for the most part, serve the various needs of companies, households and residents of Alchevsk, cities from the Luhansk oblast, and other oblasts of Ukraine.

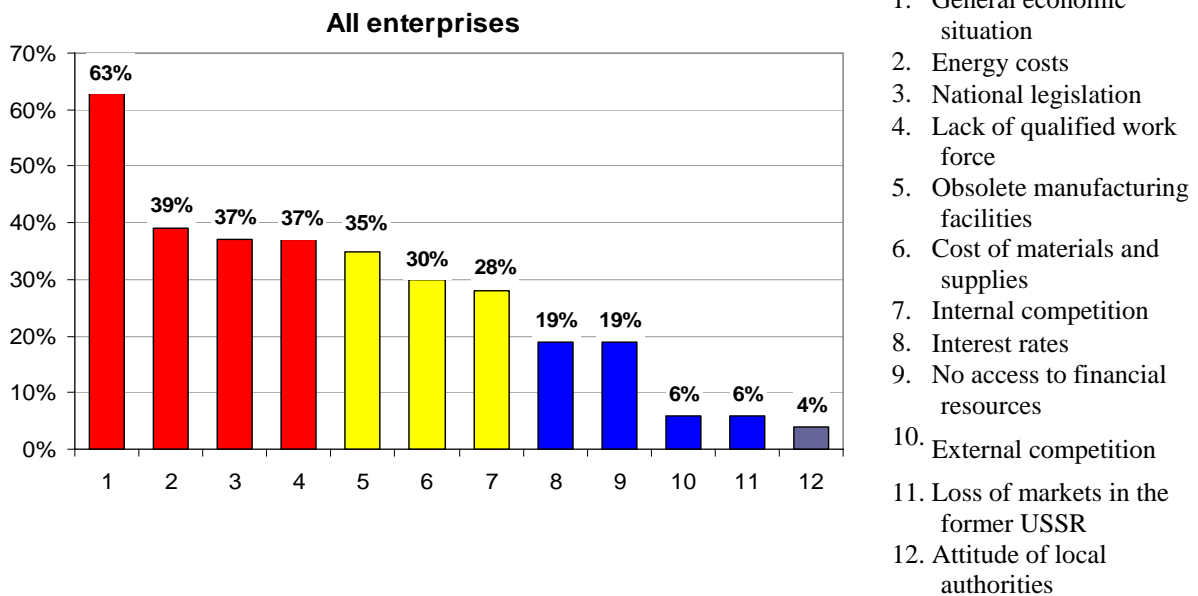
Availability of qualified work force is one of the main reasons for 40% of companies to do business in Alchevsk. In the opinion of 31% of companies, the next important reason to local companies in the city is availability of suppliers and/or sources of critical raw materials which are located in this region (see Chart 2).

Chart 2. Reasons for locating businesses in Alchevsk



Companies were asked to name the negative factors influencing their current development or may impair their future development (see Chart 3). The group of major factors include (in the priority order): (1) general economic situation is the most important factor and was mentioned by 63% of companies; (2) energy costs were mentioned by 39% of companies; (3) conflicting national legislation, and (4) lack of qualified labour force were mentioned by 37% each, (5) obsolete means of production and costs of materials and supplies were mentioned by 35% of companies. These factors represent a major problem for most of local companies. At the same time, limitations associated with the environmental protection and remoteness of markets were mentioned by none of the companies surveyed. Obsolete means of products represent a problem primarily for the majority of heavy industry enterprises (60%), as well as for 46% of construction companies. Fifty percent of companies from the light and food industry sectors find high costs for materials and supplies to be a problem. Internal competition is a barrier for 40% of service and trade companies.

Chart 3. Barriers for further development



The prospects of a closer cooperation with the European Union / joining the EU are perceived rather sceptical by the Alchevsk businessmen. Better legal protection of entrepreneurs (44%) and more stable business climate (39%) are considered by companies to be the main advantages of the new integration process (see Chart 4).

On the other hand, 74% of companies believe that this will lead to increased prices for components, services and goods, whereas 52% share the opinion that this will entail additional costs to adjust to the new environment. Strong competition on the part of foreign companies (this factor was mentioned by 50% of businesses) and the necessity of making additional investments associated with stricter environmental protection legislation were mentioned as factors which may have a negative influence on the development of local businesses and their productivity (see Chart 5).

Chart 4. Benefits from joining the EU

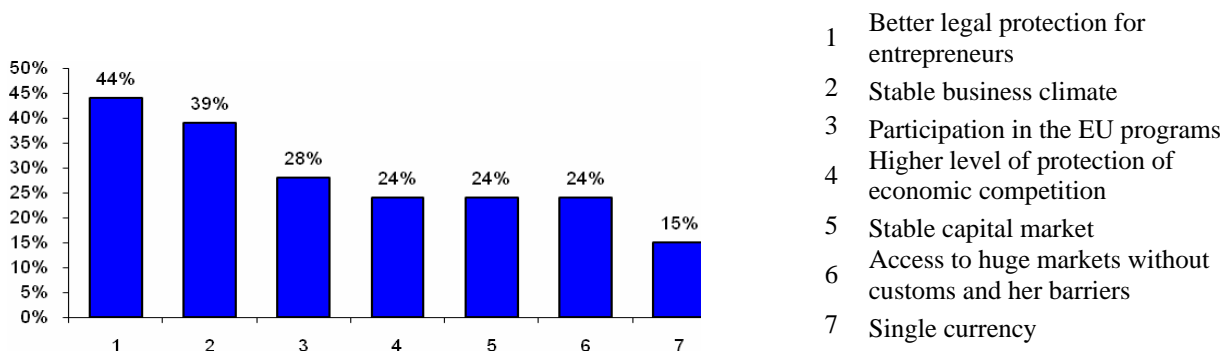
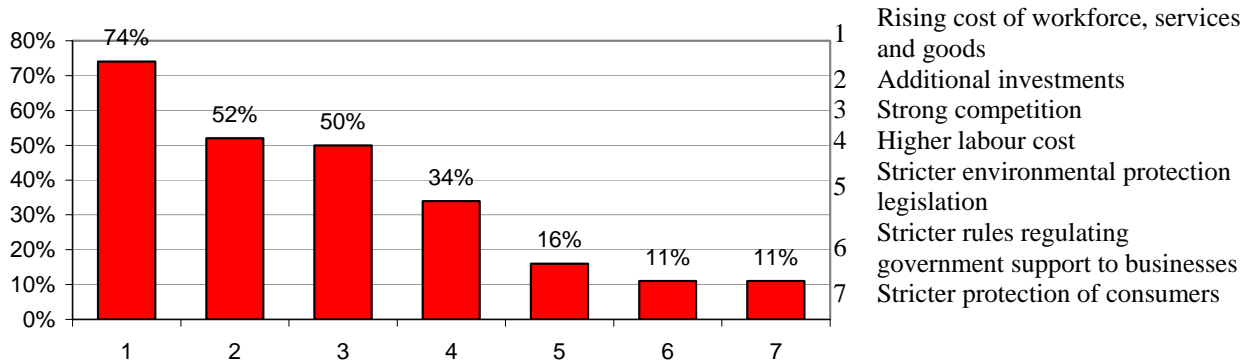
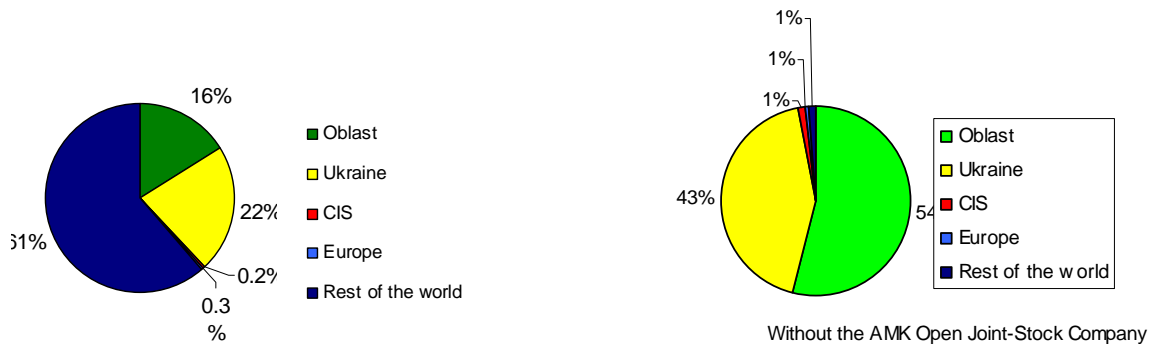


Chart 5. Disadvantages from joining the EU



3. Customers

Chart 6. Export orientation of the local economy



All companies were willing to provide information about the geographic distribution of their customers (see Chart 6). Four companies indicated that they export more than half of their products and services outside Ukraine (three export to the European countries and one – to other countries in the world), with the other two companies exporting at least 10% of their products. All in all, 38% of the overall sales go to the markets within the Luhansk oblast and other oblasts in Ukraine, whereas more than 60% of the total sales go beyond Ukraine.

The indicator of the export orientation of the industrial sector of the city is higher than the average for Ukraine. At the same time, companies operating in such sectors as construction, utility services, food processing, and services serve exclusively the domestic market.

The majority of the Alchevsk companies (86%) are expecting a steady increase of their sales in 2007 as compared with 2006, at 23% on average, whereas with three of them expecting a 100% increase of their sales. Only three companies are expecting the decrease of their sales as compared with the previous year. One should mention that the average sales per employee at city companies is considerably higher than the average indicator for Ukraine and constitutes approximately 304,253 UAH a year. Fourteen companies have their annual sales per employee indicator at more than 100,000 UAH. This group of companies includes the biggest employers in the city, one construction

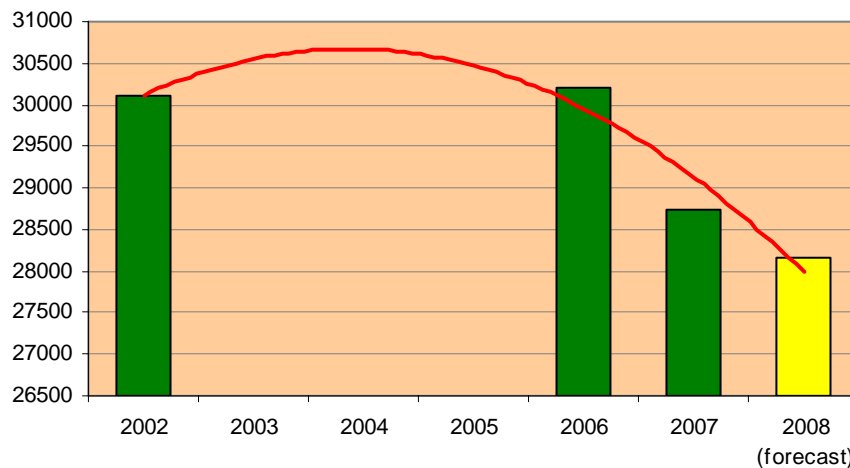
company, and couple of companies from the trade sector.

The lowest indicators of labour productivity are demonstrated by some city utility companies and one transportation company providing passenger transportation services in the city. This is most likely caused not only by low labour productivity at these companies, but also by the social orientation of their services, unbalanced prices, and absence of subsidies.

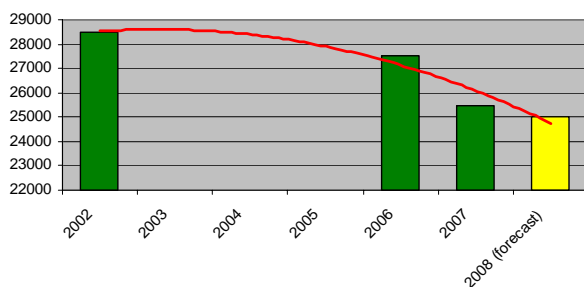
4. Labour and Employment Matters

The total number of payroll workers employed at the 54 companies surveyed constitutes 28,765. The following employment dynamics tendency can be observed: five years ago, this indicator constituted 30,114 employees, with 30,174 employees in the previous year. The decrease in the number of company employees is mostly observed at enterprises operating in the traditional sectors. At the same time, new jobs were created at machine building companies, construction materials enterprises, construction companies, and at newly created small and medium-sized enterprises operating in the trade and catering sectors.

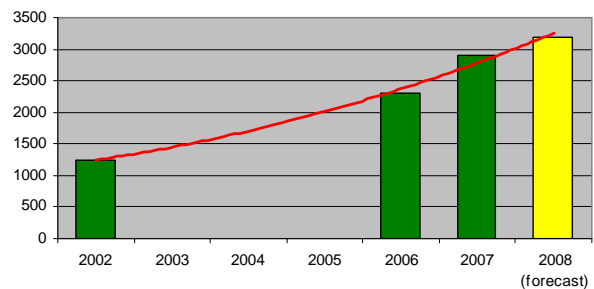
Chart 7. Employment tendencies



Number of employees - big companies



Number of employees - medium-sized companies



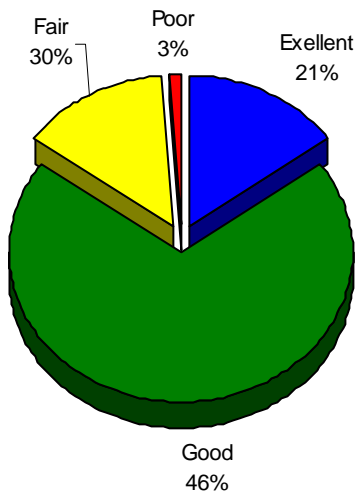
The employment tendencies observed over the last five years remain the same. Companies indicate that they are planning to create more than 500 new jobs when asked about new investments, however, this increase in employment does not make up for the lay-offs at big companies.

Poor diversification of the local economy tells on the problems associated with employment of females, who constitute less than 40% of employees working at the surveyed companies, and

whose employment level has been gradually decreasing over the last five years. The share of employees with higher education in the Alchevsk economy constitutes 20%, which is somewhat lower than the average indicator for Ukraine, but higher than in Central and Eastern European countries.

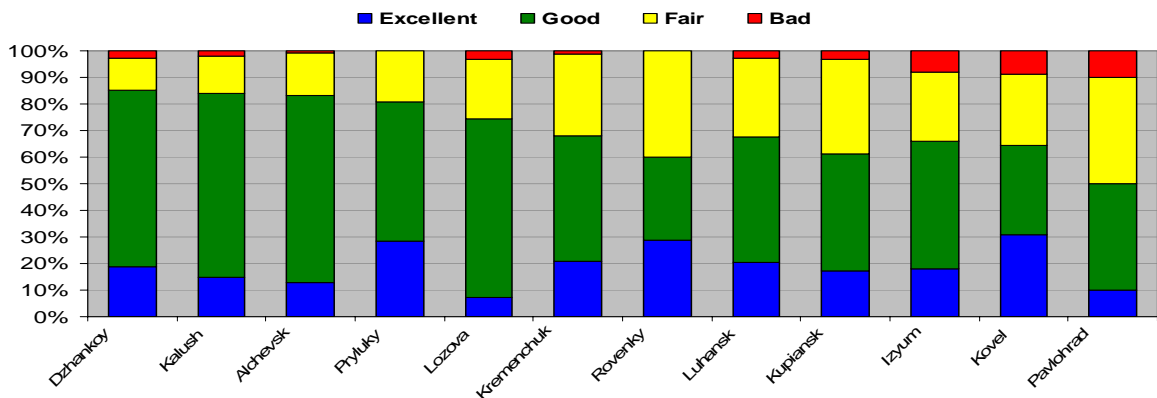
In 2007, the average number of employees per enterprise for the companies surveyed constituted 533 persons, whereas in 2002 this indicator was 558 persons. If the tendency remains, this number will decrease to 530 in the next year. These data testify to the fact that the average size of business entities in Alchevsk has been decreasing over the last five years. The average size of a heavy industry enterprise constitutes 254 employees, with the average size of a food or processing company being 224 persons, 68 persons for a construction or construction materials company, and 215 persons for a transportation company.

Chart 8. Satisfaction level of employers with the quality of work force



The level of satisfaction of employers with the quality of their workforce is high (see Charts 8 and 9). In general, 15% employees were rated as “excellent”, 70% were rated as “good”, 14% - as “fair”, and only 1% was rated as “bad” (see Chart 8). It is important for the city to retain this level of labour force quality rating, because the availability of qualified work force belongs to the main reasons for companies to locate their businesses in Alchevsk.

Chart 9. Satisfaction level of employers with the quality of work force (as compared with 11 Ukrainian cities)



In 2007, the average salaries actually paid at the surveyed enterprises constituted 1,633 UAH, whereas in 2006 is constituted 1,304 UAH. Salaries paid at enterprises representing the local economy vary from 460 to 7,735 UAH per month. The lowest salaries are paid in the trade sector. Twenty-four companies pay the average salaries of more than 1,000 UAH.

Despite the low level of satisfaction with the quality of labour force, forty companies are presently experiencing lack of qualified labour force or are expecting such problems in the future. Lack of blue-collar workers (welders, turners, and drivers), as well as lack of white-collar workers with higher education (engineers, processing engineers, and mid-level managers) were mentioned most often.

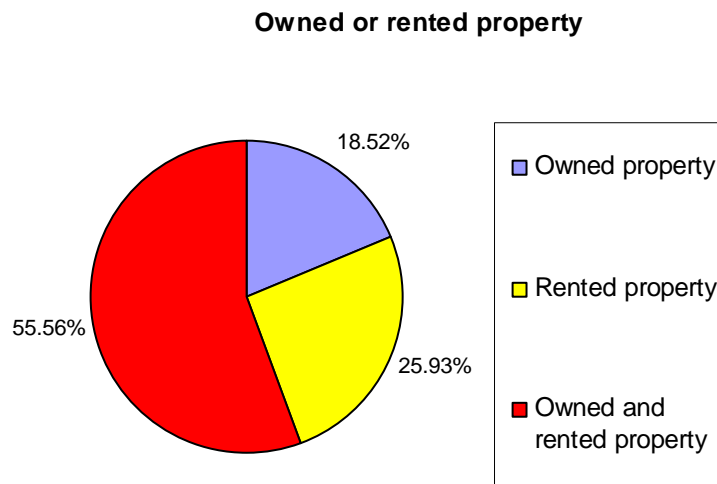
Representatives of 13 companies informed about the availability of research and development departments (R&D) engaged predominantly in designing new products, all of them offering employment opportunities to 114 persons. Such level of innovative organisational units at the surveyed companies is very low.

5. Information about Available Manufacturing Facilities for Businesses

The situation with property for businesses has its positive and negative sides (see Chart 10). The majority of companies own their premises and have the title to their land plots. However, 54% of companies are already experiencing lack of land plots and/or premises to expand their businesses. At the same time, only five companies are willing to lease or sell their excessive facilities. Twenty companies are considering the opportunity to expand beyond Alchevsk. One company is planning to relocate its business to a different city in search of a better business environment and more clients and seven additional companies are considering such an opportunity in the future.

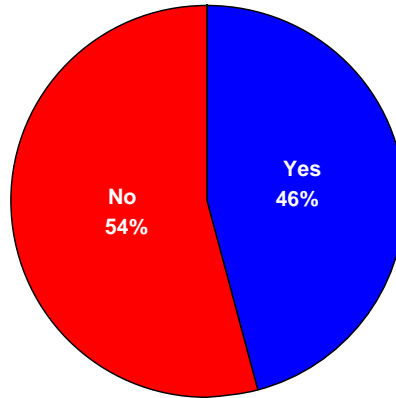
Thus, the lack of resource may represent a problem (see Chart 11).

Chart 10. Information about available property



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Property for expansion purposes



Companies planning to sell or lease part of their land, buildings and premises

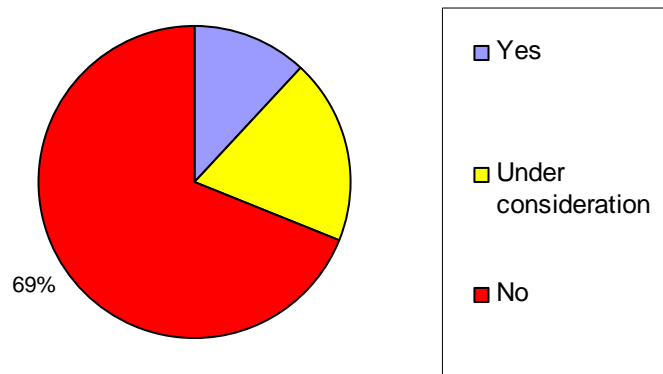
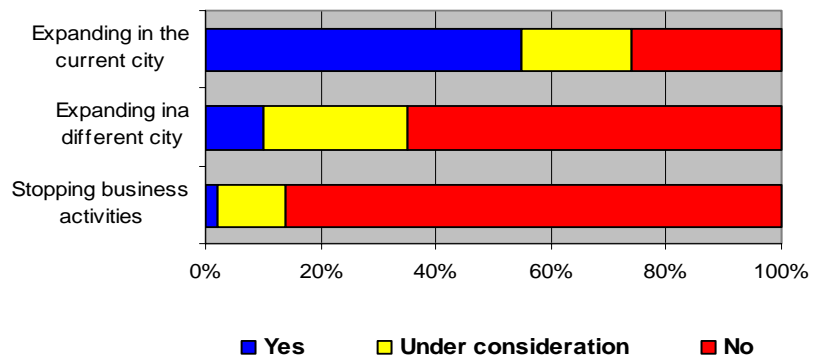


Chart 11. Information about investments

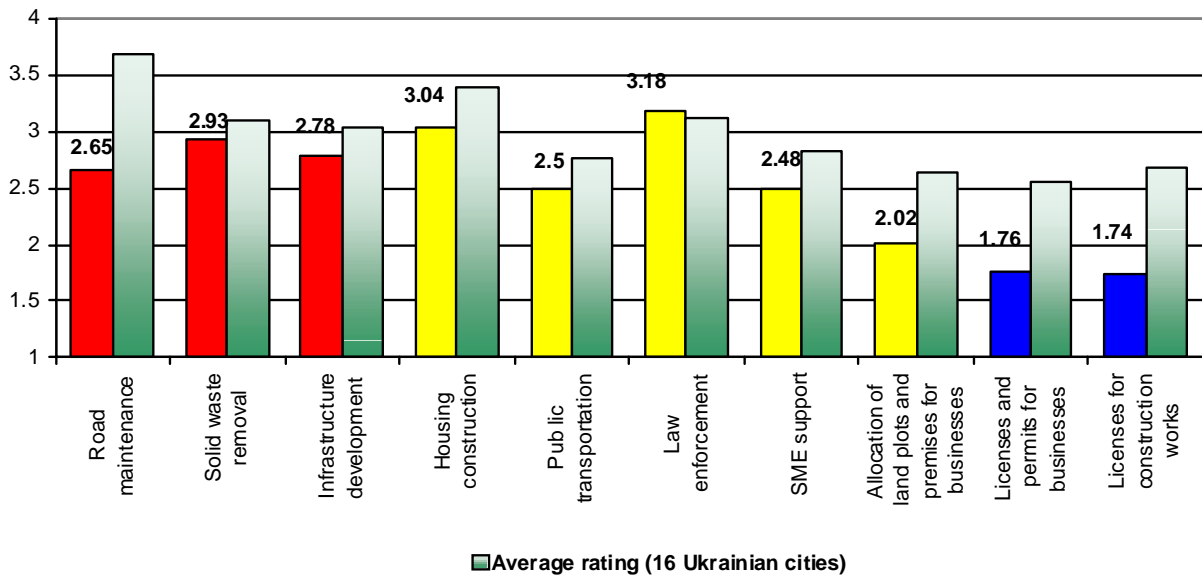


The current quality of equipment and technologies is not very high, therefore companies are planning to make investments in the development of their manufacturing facilities. Thirty-eight companies are planning to modernise or improve their current manufacturing premises and/or technologies in the nearest couple of years. About 100 million UAH are planned to be invested and more than 500 new jobs are planned to be created.

6. Services rendered by the Local Government and Relations

Companies were offered an opportunity to rate nine kinds of services rendered by the local government bodies according to the 4-grade scale (with 1 being "excellent" and 4 - "bad"). On average, these services have been rated not very high: 2.43 (see Chart 12). Companies were most satisfied with such services as licensing of construction works and licensing and permits for launching businesses (1.74 and 1.76 accordingly) followed by a service associated with allocation of land plots and premises for businesses (2.02).

Chart 12. Local government services



Entrepreneurs are not satisfied with the level of law enforcement (3.18), housing construction (3.04), solid waste collection and removal (2.93), infrastructure development (gas, water, sewage, and electricity) (2.78), and road maintenance (2.65). The rating results were rather even and balanced, whereas deviations of rating given by companies to these services were insignificant.

At the same time, when asked about the kinds of services where they would like to see improvements, companies informed that first of all they would like to see the implementation of initiatives in such areas as law enforcement, road maintenance and infrastructure development, housing construction, and allocation of land plots and premises for business purposes. In addition to that, many companies mention the necessity of SME support.

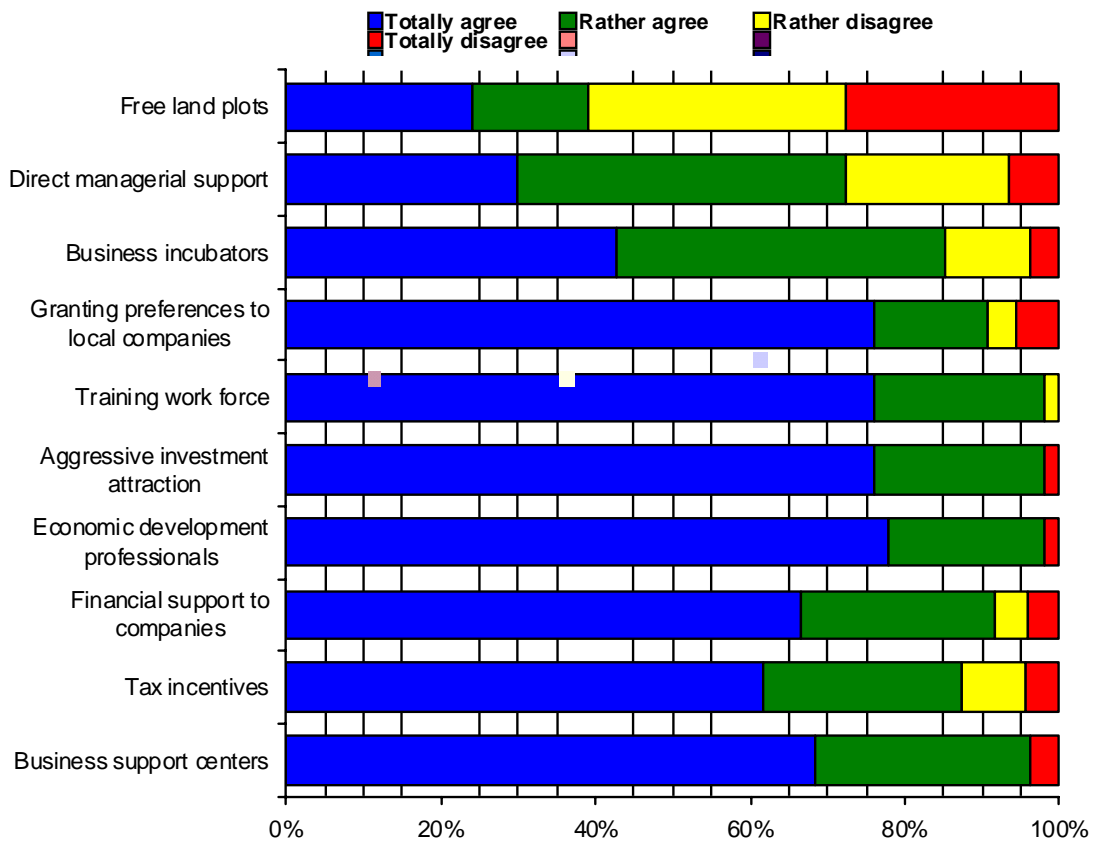
Companies were also asked about the services to be rendered by the local government (including the department for Economic Development) to business entities operating in Alchevsk.

As shown in Chart 13, companies welcome almost all the services proposed. Entrepreneurs support the idea of setting up the Business Support Center, training and on-the-job training of

work force, financial support to companies (loan guarantees) and aggressive investment attraction.

Unlike companies in some East European countries, the local companies do not support the idea of having the local government prepare and provide vacant land plots with infrastructure to private businesses for free. It looks like they are not sure whether those companies, which will get such land plots, will realistically start creating new jobs and whether the process itself will be transparent. The idea of having City Hall employees providing direct support to companies through searching for sales markets and important clients received a low level of support.

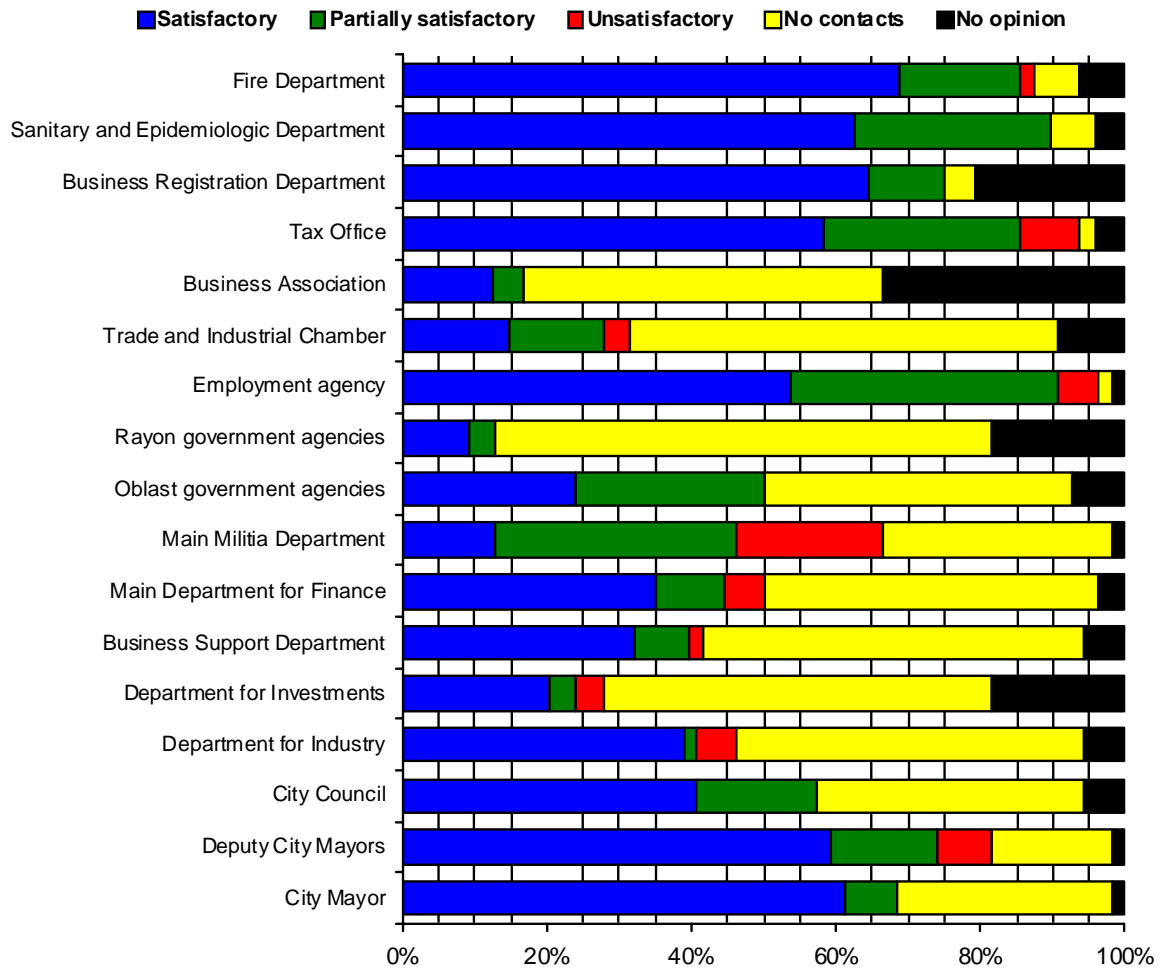
Chart 13. Services provided by the Municipal Office for Economic Development



The surveyed companies also assessed their contacts with government authorities and officials. The data shown on Chart 14 demonstrate that they were rated positively. Business registration offices and even Tax Offices, Fire Department and Sanitary and Epidemiologic Department received positive rating. The survey testifies to limited contacts of businessmen with the Trade and Industrial Chamber, departments on investment activities and business support and development, rayon government authorities, and business associations.

The comments made by companies regarding their contacts with government authorities can be generalised in one sentence: “red tape, officials are totally indifferent to problems of businesses, time consuming bureaucratic procedures, etc.”

Chart 14. Contacts with government authorities

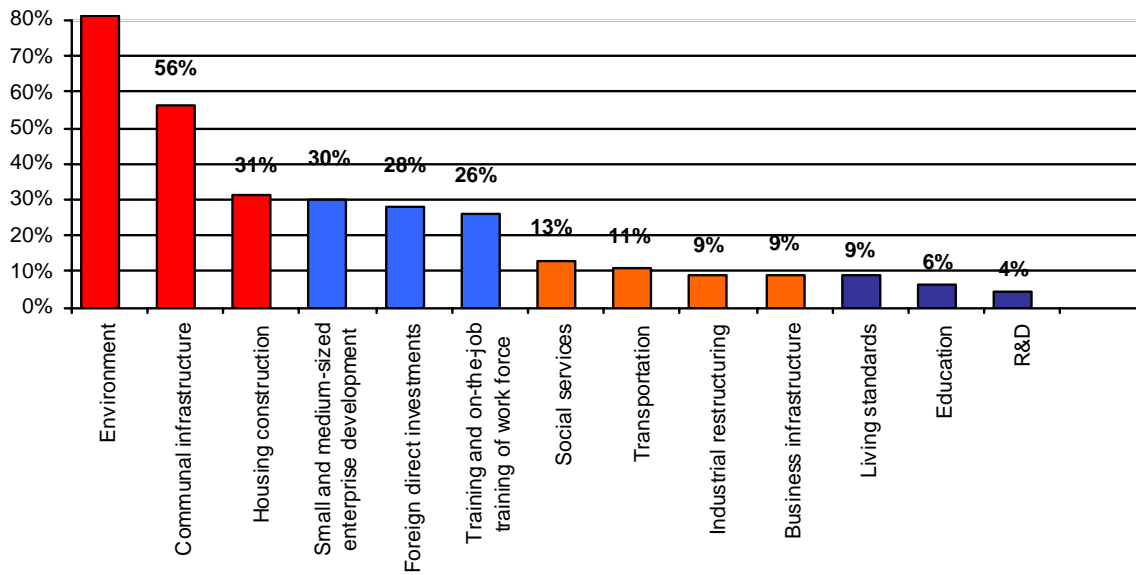


7. Critical Issues

Companies gave the following answers when asked what the three most critical and top priority issues the city strategic development strategic plan should focus on (see Chart 15):

- Environment - this issue received the biggest support from businessmen – 81%;
- Communal infrastructure (roads and electricity, gas and water supply) – 56%;
- Housing construction is considered as a priority issue by 31% of surveyed companies;
- SME development received 30% of votes;
- Foreign direct investment attraction was recommended by 28% of interviewees;
- Training and on-the-job training – (26%);
- Social services in Alchevsk are considered to be the priority by 13% of companies.

Chart 15. Critical issues



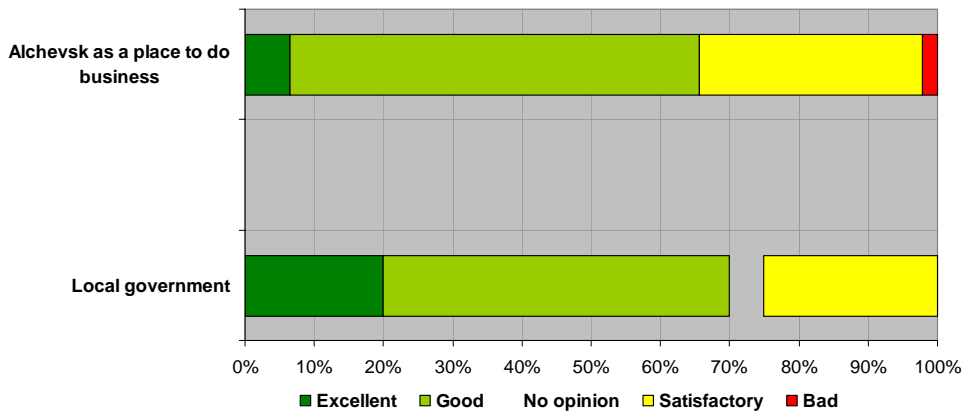
Issues related to development of education and R&D received the smallest number of votes.

8. Overall Impressions

Companies were asked to give their overall impressions about the Alchevsk government authorities (see Chart 16).

Eleven companies out of 54 rated the performance of the local government authorities as “excellent”, twenty-six rated them as “good”, and fourteen rated them as “fair”. Companies also expressed their opinion about the city as a place to do business. Answers to this question were not so positive. Four companies rated the business climate in the city as “excellent”, with thirty-three considering Alchevsk as a “good” place to do business, and sixteen companies considering it to be “fair”. One businessman rated the business climate in the city as “bad”.

Chart 16. Overall impressions



The following positive aspects of the business climate in Alchevsk were most often mentioned by companies:

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- Advantageous geographic location;
- Compact city;
- High purchasing capacity of local population;
- Positive dynamics of the City Executive Committee performance; the City Mayor is very active and interested in developing the city.

The following problems associated with the city as a place to do business were mentioned by companies:

- Environmental pollution;
- No protection from raider attacks on companies;
- Unfair competition;
- Complicated procedures to connect to the city engineering infrastructure.

V. SUMMARY

The Business Attitude Survey reflects the accumulated opinion of the business community in the city of Alchevsk. 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 Alchevsk Economic Development Strategic Plan Development and Implementation Expert 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.

Experts of the Local Economic Development Project would like to extend their acknowledgements to all employers who shared their opinions and provided useful information, as well as to the members of the Expert Committee who dedicated their time to organise and conduct the interviews.