

# **BUSINESS PERFORMANCE**

## **INVESTMENT BEHAVIOR OF ENTERPRISES IN 2002-2003**

### **S. P. Aukutsionek**

In 2002, as the REB surveys are showing, investment activity of industrial enterprises did not change much from 2001. Stability of the SHARE OF NON-INVESTING ENTERPRISES is the first sign of this trend. While in 1999, about 58% of enterprises did not buy any equipment for two or more months in succession, and in 2000 their share was 50%, in 2001 this indicator declined to 45% and remained the same in 2002. Consequently, the remaining 55% were buying equipment regularly. Let us remind that this is a record high level of investment activity over the whole period of our measurement (since 1993).

Similar results were also obtained for total volume of capital investment by 12-month time spans. The share of enterprises that neither made nor expected to make any capital investment in six preceding and six following months (relative to the moment of survey) was 23% on average of four surveys in 2002. This is one percentage point less than in 2001, and 24 points less than in 1998 when the investment activity had hit the lowest level for the period of current crisis. In terms of this indicator, the last year was next only to 1993 and 1992 when the share of non-investing (for twelve months) enterprises had been still smaller- 15% and 12%, respectively.

THE DEGREE OF FULFILLMENT OF INVESTMENT PLANS is another indirect measure of investment activity in the REB investigation. In 2002, the degree of fulfillment of the plans increased by 3 percentage points and appeared to be record high over the whole period of market-oriented reforms: 64% (total volume of planned investment at an enterprise is taken as 100%).

"Shortage of financial resources" is the first decisive FACTOR TO RESTRAIN CAPITAL INVESTMENT at enterprises, a constant for

several years. In 2002, 84% of the respondents on average pointed at this reason. This is 2-3 points higher than in 1998-2001 and much higher than the level of fund shortage, which was typical of the pre-default period of 1992-1997 (63-74%).

"High prices of equipment and construction works" - 55% - is the next and already a routine factor. The decline from the level of 2001 is only 3 percentage points. The lowest level of this indicator was observed

in 1998 when high prices limited capital investment at 46% of the enterprises.

The third and fourth main limiting factors are "high borrowing rate" - 28%, and "high indebtedness" - 22%. For the borrowing rate, this is a record high level since 1996. The indebtedness, on the contrary, is at a record low point in the whole period of our observation (excluding 1993 and 2001 when the figure was the same).

The above-mentioned limitations can be neutralized to some extent with reliance on barter.

However, in recent time the role of exchange in kind has been declining in the Russian economy in general, and in capital investment in particular. In 2002, the share of INVESTMENT BASED ON BARTER was 12% of total capital investment, down by 23 percentage points from

1999. As seen from Table 1, the decline in investment based on barter continued in the first quarter of 2003 as well.

**Table 1**  
**Share of Capital Investment Based on Barter in Last Six Months**  
**(Industry, %)**

	1st quarter	2nd quarter	3rd quarter	4th quarter	Average annual
1998			46	43	—
1999	40	36	30	35	35
2000	27	25	19	18	22
2001	15	14	16	13	14
2002	10	16	10	11	12
2003	8				

Speaking about the most plausible SOURCES OF FUNDS FOR CAPITAL INVESTMENT in the next two or three years, 42% of the respondents point out accumulated earnings of their enterprises. This is 2 percentage points lower than in 2001. The number of enterprises hoping to get investment loans from banks continued to grow. While in 1998, only 10% of them hoped for borrowing, in 1999, their share rose to 18%, in 2000, to 24%, in 2001, to 26%, and in 2002, to 30% of all enterprises. Finally, in 2002 the share of pessimists who do not believe that they will be able to get any funds at all for capital investment in next two or three years, has become a little higher. While in 2001, the share of such respondents had been 28%, it was 32% in 2002 (see Table 2).

**Table 2**

**Sources of Investment Funds in the Next Two or Three Years  
(Share of respondents having pointed out each source as the most plausible one, average data of two surveys, %)\*)**

	1996**)	1997	1998	1999	2000	2001	2002
1. The enterprise will make savings	18	22	27	42	41	44	42
2. Borrowings from commercial banks	13	15	10	18	24	26	30
3. From a domestic partner	7	9	8	8	12	10	9
4. From a foreign partner	7	8	7	4	4	4	2
5. From selling shares	5	5	4	3	5	3	4
6. From the government	9	7	8	8	8	6	3
7 Other sources	2	10	5	2	4	4	5
8. Funds will come from nowhere	49	41	44	37	30	28	32
9. Hard to answer	19	19	18	12	10	10	9

\*) Respondents were offered to choose no more than two versions of answer.

\*\*\*) Second half-year.

The role of BANK BORROWINGS IN FINANCING OF CAPITAL INVESTMENT has increased quite recently, but it is still clearly insignificant. The vast majority of enterprises did not make any attempt to find investment loans within a year. Moreover, their share has not

declined since 1998 but has even increased from 58% to 67% of enterprises in the REB sample (see Table 3).

On the other hand, chances of success in talks with the banks are also much higher. In 1998, only one or two out of ten applicants could obtain investment credit, but in 2000, the share of successful seekers was three, in 2001, four, and in 2002, five out of ten.

**Table 3**

**Distribution of Enterprises by Their Activity and Success in Seeking Investment Credit in Last Twelve Months  
(Share of enterprises, average data of two surveys, %)**

	Enterprises seeking no bank credit for financing investment within a year	Enterprises seeking bank credit for financing investment for a year	
		Of which:	
		Got no credit	Got credit
1998	58	35	7
1999	66	28	5
2000	69	22	9
2001	63	21	16
2002	67	16	17

The level of credit rate was named the major DIFFICULTY IN CONCLUDING CREDIT AGREEMENTS. As seen from Table 4, this is the key problem of most credit agreements. However, its rating has declined by 4 percentage points from 2001 - to 49%. This is the lowest level since 1998.

The second, third and fourth places on the list with almost the same rating of 26-27% are shared by the problem of collateral, term of borrowing, and risk of default. Bottom of the list is volume of credit - this problem was pointed out only by 13% of all enterprises that had been seeking an investment loan.

**Table 4**  
**Main Difficulties in Concluding Credit Agreements**  
**with Banks for Financing Capital Investment**  
**(Share of enterprises having singled out the point in total number**  
**of seekers of investment loans in the last 12 months, %)**

	interest rate	default on loan	Term of loan	Problem of collateral	Loan volume
1998	66	60	37	26 <sup>*)</sup>	17
1999	75	46	36	29	18
2000	91	55	36	36	18
2001	53	24	27	34	18
2002	49	27	26	27	13

<sup>\*)</sup> Second half of 1998.

In REB surveys, the respondents evaluate potential profit rates and risks of investment in an indirect way, using a MARGINAL INTEREST RATE (MIR), which is defined in the questionnaire as the highest interest rate on bank loans in rubles for a term of 2 to 3 years, affordable to an enterprise to finance its capital investment.

A sharp decline in the MIR from about 15% in 1996 to 9-10% in the following years was due to drastic slowing of inflation. Since then, the range of fluctuations in MIR changed very little. On the average of four 2002 surveys, the marginal interest rate was 8.9%. As earlier, this is a half of the average effective rate on short-term lending to enterprises in the same year (19%), and lower than the annual price increase expected at that time (14%). In other words, as well as in 1996-2001, the great majority of enterprises were ready to borrow from banks for capital investment only at a negative real interest rate.

As a year ago, the MAIN PURPOSE OF INVESTING was mastering of new products. This purpose was reported by 33% of the respondents. Improvement of product quality and cost reduction were in the second (29%) and third place (20%) by the number of references. In 2001, the respective indicators were 29%, 22% and 18%.

Expansion of productive capacities was named one of the key purposes by just 17% of the respondents (in 2001, 14%). It is not surprising, because excessive capacities are still quite sizeable in the industry in general, as well as in most large-scale industrial sectors.

Evaluating THE EXISTING CAPACITIES AGAINST THE DEMAND EXPECTED FOR THE PRODUCTS OF AN ENTERPRISE IN 12 MONTHS, enterprise managers were using the term "excessive" five times as frequently as "insufficient" (42% and 8%, respectively). In this respect, there was no improvement in 2002 from 2001. The share of enterprises having excessive capacities increased by 1 percentage point

from 2001, but at the same time, the share of those with insufficient capacities declined by 2 points. So, the general balance became even worse. Nevertheless, the situation still looks pretty well in comparison with 1998 (see Table 5).

**Table 5**

**Distribution of Enterprises by Volume of Productive Capacities against Expected Demand for their Products In 12 Months (Average of four quarterly surveys, %)**

Volume of capacities against future demand	1998	1999	2000	2001	2002	2003 1 <sup>st</sup> quarter
1. Excessive	60	50	43	42	43	35
2. Normal	35	40	45	48	49	55
3. Insufficient	5	10	12	10	8	10
4. Balance: (4)-(3)-(1)	-55	-40	-31	-32	-35	-25

In conclusion, let us give the data of the August 2002 survey of innovations. The share of respondents having answered that in the last year and a half, there were TECHNOLOGICAL INNOVATIONS AT THEIR ENTERPRISES, was 80%. This is a record high level of over the whole period of our measurement (since 1992). The level of the preceding year has been exceeded by 5 percentage points at once. As in all preceding years, product innovations surpassed process innovations (31% against 14% of all respondents). At the same time, the

share of enterprises introducing both kinds of innovations concurrently has substantially increased (35%) (see Table 6).

**Table 6****Distribution of Enterprises by Type of Innovation Activities (%)**

Time of survey <sup>1)</sup>	Share of enterprises having introduced innovations in last 1.5 years (%)			
	Total	Including prevalence of:		
		Products	Processes	Both equally
1990-1992 <sup>2)</sup>	58	31	27	4)
1993 <sup>3)</sup>	62	38	24	4)
1994	60	38	22	4)
1995	63	46	17	4)
1996	62	41	21	4)
1997	51	35	16	4)
1998	71	41	15	15
1999	76	43	33	4)
2000	75	39	10	26
2001	75	33	14	28
2002	80	31	14	35

<sup>1)</sup> The surveys are conducted once a year in August.

<sup>2)</sup> A retrospect assessment obtained in the survey of January 1993.

<sup>3)</sup> The July survey

<sup>4)</sup> This kind of response was not provided for.

The share of new products introduced not earlier than a year and a half ago in total output was 16%. This is 2-4% more than in the surveys of 1998-2001. But it is still relatively little in comparison with an earlier period. For instance, in 1994 the average share of new products was 19%, and in 1993, 27% of the volume of output at the surveyed industrial enterprises.