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SPECIFICS OF FARM PRODUCE PROCESSING AND MARKETING IN UKRAINE (2002)



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INTRODUCTION

Continuing IFC's well-established traditions of conducting comprehensive social and economic surveys, the Ukraine Agribusiness Development Project would like to present an analytical report of the sociological study "*Specifics of Agricultural Produce Processing and Marketing in Ukraine*". This study builds upon an earlier study entitled "*State of Farm Production and Agribusiness in Ukraine*" undertaken by the Project in 2002. The present Project's work represents the next step in scrutinizing the national agrarian sector, and in particular, its food supply chain embracing "production-processing-marketing".

Processing of food products is one of a few economy sectors in Ukraine demonstrating a robust growth over the last years. This has effected an increase of output, expanded product mix and better quality of locally produced goods. Growing domestic demand and consumption have strengthened domestic processing industry and urged new market players to enter and increase competition, generated qualitatively new relationship between processors and raw material suppliers, and gave birth to new marketing strategies.

The stabilizing of large-scale production and growing domestic consumer demand positively influenced the development of wholesale and retail trade, particularly, of agricultural fresh produce and processed food. Consequently, new supermarket chains and wholesale markers have appeared in Ukrainian market. The rapid development of such retail outlets, especially in large cities, has changed the character of food consumption and brought forward new requirements both to the product quality and to its appearance, such as packaging, grading etc.

In view of the said above, the Project working on improving the food supply chain thought it was productive to conduct a comprehensive survey, which enabled to make a snapshot of the need and demand of food processing and retail industries, and understand the on-going qualitative processes. This analytical report, prepared on the basis of findings of the survey, presents the primary information received from respondents and analyzes the general situation while offering explanation to the outstanding issues.

The report is structured in the following way. It begins with a discussion of main findings of the survey and then explains its goals, objectives and methodological particulars. Section "Specifics of Agriculture Processing and Marketing" focuses on the issues of competition in the processing sector, between Ukrainian businesses on the one hand and on the other hand, competition between imported and domestic produce. Special attention is paid to contractual relations with primary producers as main raw material suppliers, quality requirements to the raw material and specifics of supplies delivered to processors. Issues of produce distribution through various channels and via different markets, as well as the implementation of trade marks and their value for businesses, is also a part of this section.

The second section of the survey focuses on how agricultural produce is marketed through the retail and wholesale network: supermarkets, greengroceries and grocer's stores and wholesale markets. The section covers product mix on offer, including imported goods, major factors of produce quality, distribution channels and markets. Special attention is paid to marketing of fresh fruit and vegetables.

Development of an enabling regulatory environment was not included into this survey as a separate study area. However, in order to have a better understanding of internal and external barriers to operations of processing and trading food businesses, and rate graveness of these hindrances, the report looks at general features of the government's regulatory policy and its effectiveness, as perceived by respondents of the survey.

1. EXECUTIVE SUMMARY

Profile of the surveyed enterprises

Most surveyed businesses in the processing industry were established as open joint-stock companies. Retail outlets were represented by three prevalent legal forms of operations: limited liability companies, closed joint-stock companies, and private firms.

A significant portion of processing businesses (43% of the sample) have extensive experience of operations in the market as they have been working in the processing industry from 1991. However, one fourth of fruit and vegetables processors and canneries began operating at some moment during the last three years.

While one third of groceries and greengrocers' were founded before 1991, a half of the surveyed supermarkets came into being after 1999. The prevailing majority of the latter indicated they were part of supermarket chains.

Raw material and ready food products supply to processing businesses and retail outlets

Processing enterprises interact with various categories of raw material suppliers, however, bigger portion of raw material comes from primary producers. Trading enterprises have rather diverse channels of produce supply. Nevertheless, over half of goods stocked in the retail network is supplied by wholesale companies and food processing businesses.

Price and quality are two key factors considered first hand while choosing a supplier of raw material and/or ready product. However, while quality is the decisive factor for processing enterprises choosing their raw material suppliers, retail outlets seem to be more preoccupied with price of supply contracts.

Processing businesses likewise retail outlets use various forms of payment for the raw material supplied. Meanwhile, the prevailing form of payment is full billing, i.e. where payment is not made until goods are delivered. Stores are more likely to accept supplies on consignment.

Output of ready produce and sale

Nowadays, processing businesses are not working at their full capacity. On average, production facilities are only half loaded, as was clearly reported by all respondents.

Although the end quality of produce is a derivative of many factors, quality of inputs and state of equipment seem to be two major factors that in most instances influence quality of processing industry's output.

Ukrainian products represents major part of the surveyed stores' product range, although the surveyed businesses also stock imported goods. Lack of Ukrainian-made substitutes is the major explanation of why stores include imported goods into their product mix.

Processing businesses have diverse distribution channels: average enterprise employs at least 12 distribution channels. 90% of the produced goods are marketed locally to domestic consumers.

End consumers/population are a major category of buyers shopping in supermarkets, green groceries and food stores. Wholesale markets are oriented, first of all, at small stores and small wholesale companies as the main buyers of their products.

Development of a competitive environment

Ukrainian producers are main competitors for the surveyed businesses in the food market: 83% of respondents experience strong competition on the part of local products. Wholesale farmer markets and supermarkets represent the principal competitors in the industry of whole and retail trade.

Almost a half of processing businesses believe that their product quality is no worse than that of their main competitors. Additional 26% of respondents noted that goods produced by their enterprises is significantly better than those produced by the industry peers.

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A key factor of large processors' output competitiveness is the establishment of trade marks and brands. Output of processing SMEs appeals to consumers thanks to more affordable prices.

In the sector of whole and retail sale, supermarkets pursue most aggressive marketing policy: 80% of the surveyed supermarkets have special divisions or personnel in charge of marketing.

Internal and external barriers for development

According to processors, obtaining external financing is the most serious barrier for the development of their businesses. High interest rates on commercial loans and limited access to long-term credit ranked highest in the list of finance-related concerns. The surveyed stores largely share this opinion.

For businesses from processing industry, instability of regulatory environment is one of the worst outstanding issues connected with the regulation of business activity: 42% of respondents in the sample recognized this a large or very large barrier.

Of internal barriers, the biggest concern for processing businesses is obsolete and worn-out fixed assets: 53% of respondents said that this problem represents a large or a very large barrier for their operations.

Specifics of investment activity

In the course of the last three years, majority of the surveyed businesses in processing industry have invested in new equipment, renovation of premises and capital repair of machinery, and purchased new motor vehicles for business purposes. 80% of the surveyed businesses rely on internal funds as the major source of such investments.

In the last five years, 88% of the surveyed supermarkets undertook new construction projects and purchased new equipment. Most of trading enterprises (69%) tap internal sources of financing for the upgrade and/or expansion of production.

68% of the surveyed processing businesses noted they would like to attract external investment, while only one third of the surveyed stores said they needed such investment.

The volume of investment funds required by processing businesses ranges between 50,000 USD and 5,000,000 USD. An average size of desired investment for a grocery store is approximately 1.8 mln. USD, while for supermarkets the respective value is 2.6 mln. USD.

Upgrade and expansion of production are two top priority areas where businesses would like to use their external investment.

2. GOAL, OBJECTIVES AND METHODOLOGY OF THE SURVEY

Primary goal of this study was to identify specific features of agriculture produce processing and marketing in Ukraine. In order to conduct field works and perform primary data processing Agribusiness Development Project used expertise of an independent marketing company *Ukrainian Marketing Group (UMG)*.

Objectives of the survey included gathering and analyzing first hand data in the number of areas:

- General characteristics of processing enterprises and members of retail network.
- Progress in the development of competitive environment in the surveyed sectors.
- Specifics of work with businesses supplying raw material to processors, and ready goods to the retail network.
- Quality of raw material and ready goods, and range of products on offer.
- Marketing of produce, including distribution channels and markets, new promotion strategies and establishment of trade marks and brands.
- Specifics of investment activity and need for external investment.
- External and internal barriers to operations of the surveyed businesses.

Field works of the survey lasted from November 2002 through February 2003. Methodologically the survey consisted of two major parts: agricultural produce processing by processors and distribution of processed and fresh agricultural produce (fruit and vegetables) via retail and wholesale network. In view of that, the survey focused on two main groups. First group included 100 large and medium-sized (by volumes of output and employment level) enterprises processing agriculture produce. They included businesses with the following specializations:

- 23 fruit and vegetable canneries;
- 39 businesses from dairy sector (whole milk, dairy produce, animal fat butter and cheese);
- 26 enterprises producing pasta and/or baking bread;
- 13 flourmills and mixed fodder producers.

This selection of processing businesses may be explained both by the general objective of the study and by practical goals of the Project.

The other group of the sample was represented by retail and wholesale businesses, which included:

- 16 supermarkets;
- 18 greengroceries and groceries;
- 6 wholesale farmer markets.

The limited number of retail and wholesale businesses in the overall sample may be justified by the following objective factors. The majority of the surveyed supermarkets (Billa, Velyka Kyshenya, Silpo, Furchet, Euromart, Megamarket and other) belong to supermarket networks. Therefore, data received with regard to one business may to a large extent be extrapolated to the entire retail network. Speaking about wholesale farmer markets, their overall nationwide number does not exceed 12 entities. The survey covered six markets, including such well-known markets as Fermer (Kyiv), Velyki Kopani (Kherson oblast), and wholesale markets in Kharkiv and Mariupol.

Although this survey did not pursue the goal of observing geographical representation of the received data, it is important to note that spatially, the surveyed processing enterprises covered all main regions of Ukraine (Central part, South, North, West and East). However, while offering industry-based analysis, the report does not address regional variations. The surveyed retail and wholesale enterprises were represented by companies located in cities-millionaires (Kyiv, Kharkiv, Dnipropetrovsk, Odessa and Donetsk), and in Lviv and Kherson. However, proportionally, over one third of such enterprises fall on Kyiv as a city where the retail and wholesale sector is evolving most dynamically.

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Data were primarily collected via face-to-face interviews with directors, deputy directors and marketing managers of the surveyed businesses, using semi-structured questionnaires, consisting of over 80 open-ended and closed questions.

This survey was not aimed at obtaining impeccably accurate and exhaustive statistical information on the surveyed objects. As was mentioned earlier, our goal was to present a general picture of the surveyed sectors, while providing a detailed analysis of some aspects of processing and marketing of agricultural produce and processed food. However, if the primary goal of this assignment was to study general features of agricultural produce processing and marketing by the selected businesses, the received findings may be recognized representative of the overall population. By our estimates, the general sample error is 9% with the level of significance of 95%. This is completely sufficient for goals of this survey.

3. SPECIFICS OF AGRICULTURAL PROCESSING AND MARKETING

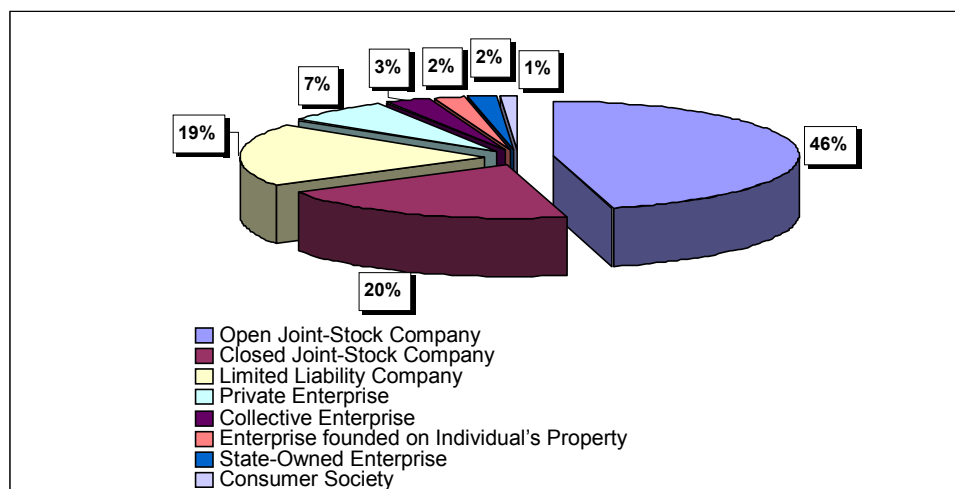
3.1 Profile of the surveyed processing enterprises

- Organizational forms of enterprises in food sector vary, however, over half of the respondents were established as open joint-stock companies.
- Open joint-stock company is the prevailing form of organization among businesses in dairy and baking sectors; closed JSCs dominate amidst flour mills and mixed fodder producers, while limited liability companies are most frequently encountered in the fruit and vegetable processing sector.
- A big portion of businesses have significant experience in agribusiness, having worked in the processing sector since 1991. However, a quarter of the surveyed fruit and vegetable processors began their operations during the last three years.

Processing of agriculture produce is one of the most dynamically developing sectors of Ukraine economy. Major drivers behind this recent rapid growth of the processing sector include: strengthening of the raw material supply base, increased domestic consumer demand for food produce and emerging new possibilities for export of Ukrainian-made food stuff. The processes of privatization and re-organization, which have taken place in the last years, have also contributed to stabilization and growth of the processing sector.

According to findings of the survey, the surveyed businesses have a variety of organizational forms (Figure 1). Open joint-stock company tends to be the most common form of business, with 46% of respondents established as such entities. Almost half of enterprises in dairy and baking sectors (including production of pasta), are established as open joint-stock companies: 53% and 46% respectively. The portions of closed joint stock companies and limited liability companies in the sample are almost equal: 20% and 19% respectively. Closed joint-stock companies more frequently may be found among dairy plants and flour milling and mixed fodder producers (24% and 23% respectively), while limited liability companies prevail among fruit and vegetable processors and canneries (26% of the surveyed sector).

Figure. 1. Structure of the Industry by Organization and legal forms of enterprises, percentage of the sample.



It is important to note that the portion of businesses of other forms of ownership, i.e. private enterprise based on an individual's property, enterprise founded on the workers' collective property and government-owned businesses – is insignificant. The share of private enterprises founded on individual's property is 7% of the sample.

Businesses of alternative forms of ownership more frequently may be found among fruit and vegetables processors and bakeries: 13% and 12% respectively. It is worth noting that most surveyed flour-mills and mixed fodder producers are established as government-owned businesses. Typically, they are large processing companies.

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Regarding the respondents' experience of work in the food processing market, a considerable portion of businesses (43% of the sample) began their operations before 1991. Flour-milling and dry fodder industries have the biggest shares of businesses with substantial working experience. This equals 54% and 50% respectively. Many surveyed companies started up in the second half of 1990's – 42% of the total number, while in the sector of fruit and vegetable processing, over one quarter of respondents entered the market no earlier than three years ago.

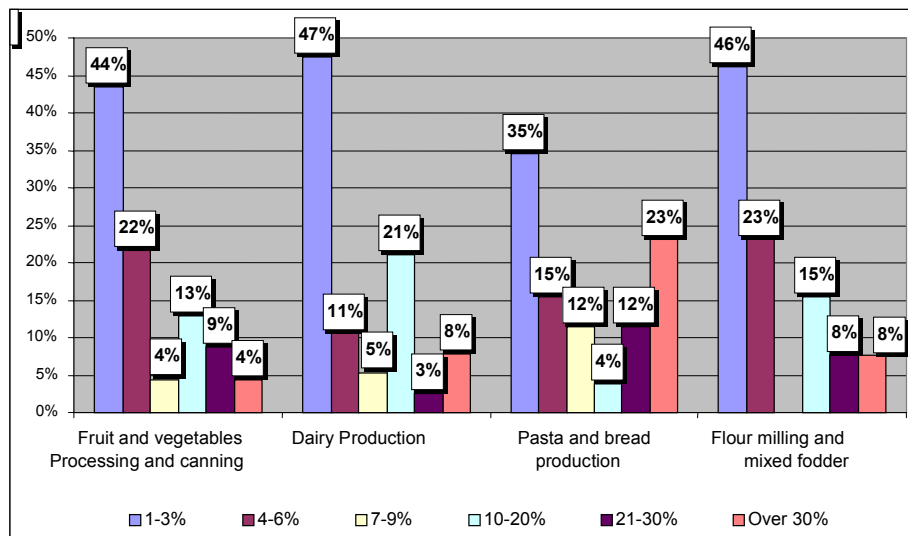
3.2 Development of a Competitive Environment

- Ukrainian producers present the major competition in the food market for the survey respondents. The domestic competition is particularly strong in the dairy sector.
- The competition in food industry is increasing steadily. The majority of the surveyed businesses admit that the competition among Ukrainian producers has recently become stronger.
- Larger producers hold strong positions in their respective product markets due to two major factors: a higher reputation among consumers and well-established trade marks and brands.
- Lower prices for produce rank highest among major advantages helping small and medium sized producers beat the competition. Pricing factor plays a particularly important role for businesses in fruit and vegetables and in bread baking sectors.
- Although agriculture food produce market is not monopolized, it does reveal dominance of a few leading food processors. These include, first of all, dairy plants and vegetable canneries selling their goods under recognizable brands and trade marks.

One of the objectives of this survey was to gauge the level and define specifics of competition in the sectors of agriculture produce processing. The appearance of new food processing businesses on the Ukrainian market in the last years has positively impacted the development of this sector. It has boosted competition, essentially broadened the range of products on offer and advanced the development of product quality. Today, the quality of most Ukrainian food products is no worse than that of imported food, which abounded on Ukrainian store shelves not so long ago, in mid-90's.

Of all industries in Ukraine's economy, competitive environment in the agriculture produce processing sector is one of the most developed. This statement is supported by findings of the survey. According to 43% of respondents, their shares in the respective produce markets range from 1 to 3 percent, while only 14% of respondents noted that their output represents from 10% to 20% share of the respective market. If we look at the distribution of market shares in the sectoral context, we will notice that most of respondents in fruit and vegetable sector (65%) believe their goods do not take more than 6% of the Ukrainian fruit and vegetable processing market (Figure 2).

Figure. 2. Portion of processed goods in the market of the respective industry, % of the total responses.

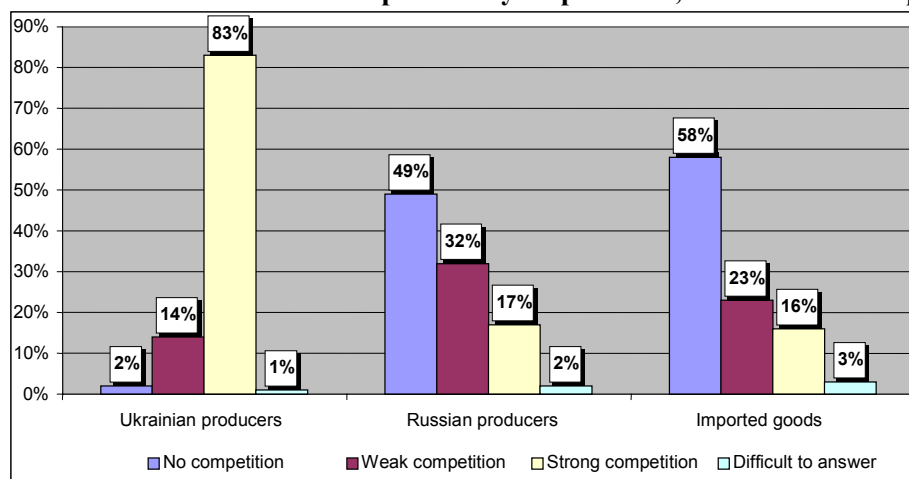


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Preciseness with which most of respondents gave estimates of their respective market shares, and the negligible quantity of instances where respondents had difficulty in describing sizes of their niches in the domestic consumer market (3% of such responses), suggest that most businesses are very well aware of the situation in their market segment. These data also indicate that the food processing market offers aggressive competitive environment.

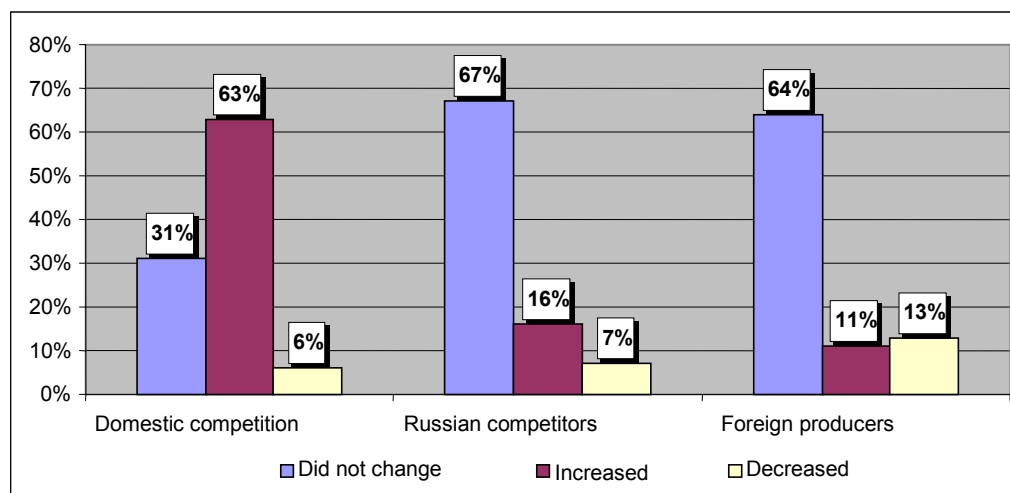
Enterprises-respondents were also requested to evaluate the level of their industry competition on the part of Ukrainian and Russian producers, as well as on the part of goods imported from other countries (Figure 3). According to the survey findings, Ukrainian producers represent the strongest competition for local food producers: 83% of the surveyed businesses feel hard competition on the part of locally made goods. Domestic competition is particularly strong in the dairy sector, reported by as many as 90% respondents in the surveyed industry. Only 2% of the sample think that there is no such a thing as domestic competition. These comments were given by businesses from flour milling and dry fodder sector, where the competition is the weakest compared to the other industries.

Figure 3. Evaluation of the level of competition by respondents, % of the total responses.



It is obvious that competition in the food sector is growing steadily. 63% of the surveyed admit that the competition among Ukrainian producers has grown over 2002 (figure 4). The competition in the dairy sector is perceived by 76% of respondents as evolving particularly fast. Approximately one third of respondents (31% of the sample) think that the competition on the part of Ukrainian producers has not changed in the last year. Those were predominantly businesses of the flour-milling and dry fodder sector. The meaningfulness of competition on the part of Ukrainian producers was further backed up by the fact that nobody from respondents had difficulty with the estimation of the level of competition and its recent change.

Figure 4. Changes in the level of competition over 2002, % of the number of responses.



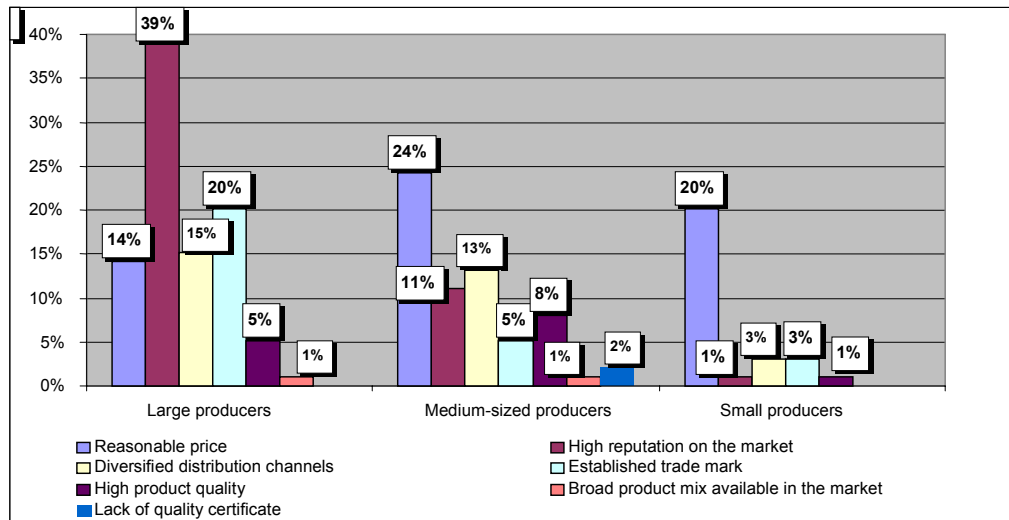
SPECIFICS OF FARM PRODUCE PROCESSING AND MARKETING IN UKRAINE

As regards the competition from Russian companies, (Figure 3), respondents are prone to think it is either non-existent (49%) or weak (32%). Russian competitors are perceived as particularly strong by fruit and vegetable producers: almost one third of businesses (30%) face a strong pressure competitive on the part of Russia's vegetable canneries. However, pasta producers and bakeries feel no pressure from Russian competitors. According to the participants of the survey, in the last year the level of Russian competition did not change (Figure 4) (noted by 16% of respondents). However, approximately equal portion of businesses, prevalently dairy producers and fruit and vegetable canneries, admit growth of such competition.

Speaking about foreign competition (other than Russian) on the Ukrainian processed food market, the majority of respondents (58% of the sample) believe that there is no such competition (Figure 3), while additional 23% recognized this competition weak. In the bread and pasta sector, foreign competition is practically unavailable. Sectoral analysis allows to see the strongest competition in the sector of canned vegetables. 26% of respondents admitted strong competition on the part of foreign producers. Evaluating changes in the competitive environment, 18% of dairy producers and 15% of flour-mills believe that the competition on the part of imported produce is subsiding. This is an indication of stronger positions of Ukrainian producers in the market of processed food. However, we have to note most respondents (64%) think that in 2002, the level of competition on the part of foreign producers remained unchanged.

In this survey, in addition to quantitative measurement of the competition in the studied sectors, we also tried to determine qualitative characteristics of this process. In order to do this, we asked respondents what were the strengths of Ukrainian producers depending on their sizes: large, medium-sized and small (Figure 5). According to respondents, large processors may successfully compete in the respective market due to two major factors: a higher reputation among consumers (39%) and well-established trade marks and brands (20%). 15% of respondents recognize well-developed markets and distribution channels as an important driver behind stronger businesses' competitiveness, while even fewer respondents (5%) give preference to the product quality.

Figure 5. Factors behind competitiveness of various processors, % of responses.



So, in the opinion of respondents, a food processor' profile in the consumer market, i.e. a recognizable trademark, is the path to reach high competitiveness for larger producers. Well-known market reputation and availability of trademark are specifically important for processors in dairy and vegetables sectors, in the perceptions of, respectively, 87% and 61% of respondents. The role of diversified distribution channels and sale markets for the vegetable sector participants is negligible. These factors were recognized only by 4% of respondents as important preconditions to enjoy high product competitiveness on the Ukrainian market.. In our opinion, this fact may be an indication of large renowned businesses marketing their produce through a few stable distribution channels (supermarket chains in larger cities of Ukraine and trade companies), which may ensure large volumes of sale.

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Lower prices for small and medium-sized businesses' produce rank highest among the factors behind their competitiveness: this factor gathered 24% and 20% of responses respectively. In a segmented market, where smaller businesses have no established brands, lower prices may ensure competitiveness of their goods. Price plays particularly big role for businesses of vegetable and baked produce sectors. Diversified distribution channels and sales market were rated second most important factor for medium-sized businesses' competitiveness. It was reported by 13% of respondents. Diversified distribution channels help produce penetrate consumer markets with different purchasing power.

Market reputation is perceived by SMEs as having the secondary importance for their produce competitiveness. However, the received responses give grounds to state that market reputation of smaller businesses is associated to smaller extent with their trademarks and established brands than with the high quality of their produce. As we saw earlier, trade marks were important for larger companies. In the opinion of respondents, high quality of goods is more essential for competitiveness of smaller businesses, than for large companies. The issue of high quality produce stands particularly acute for flour mills and dry fodder plants. This was indicated by one fourth of such respondents.

Although the processed food market is not monopolized, business-leaders in food production clearly stand out. These include, primarily, dairy and processed vegetable products with well-known brands and trade marks. Table 1 below presents a list of businesses which were recognized by respondents as top leaders in their respective sectors. As may be seen from the table, such trade marks as Veres (Kaniv), Chumak (Kakhovka, Kherson oblast), Galakton (3rd Kyiv Dairy Plant) and Wimm-Bill-Dann are recognized top competitors in the dairy and vegetable sectors. No obvious leaders may be distinguished among bakeries and mixed fodder producers. The alternate explanations here may be either a large number of processing businesses, or a lack of famous and well-established trademarks for baked bread products.

Table 1. List of major competing trade marks recognized by processors in dairy and vegetable sectors (% of responses).

Fruit and vegetables processing and canning		Dairy production	
Enterprise	%	Enterprise	%
"Veres" TM	39,1	"Galakton" TM	36,8
"Chumak" TM	34,8	"Wimm-Bill-Dann" TM	23,7
"Torchin Produkt" TM	17,4	"Fanni" TM	18,4
"Vinni-Fruit" TM	13,4	"President" TM	18,4
"Sandora" TM	13,0	"Zlagoda" TM	13,2
Odessa Cannery	13,0	Kharkiv Dairy Plant	13,2
"Wimm-Bill-Dann" TM	8,7	"Bilotsvit" TM	7,9
"Olkom" TM	8,7	"Komo" TM	7,9
"Smak" TM	8,7	"Na Zdorovye" TM	7,9
Gaisyn Cannery	8,7	Dnipropetrovsk Dairy Plant (Rainford)	7,9
Kherson Cannery	8,7	Romny Dairy Plant	5,3

3.3 Supply of Raw material to processors

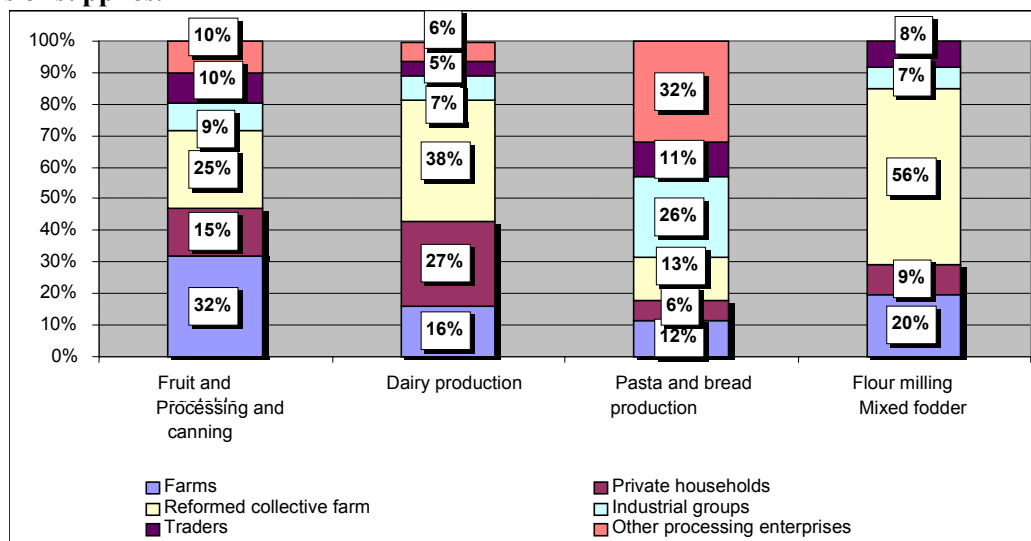
- Processing businesses work with different categories of input suppliers, however, primary agricultural producers represent the main category of raw material suppliers.
- Quality of raw material supplied for processing is the decisive factor influencing choice of supplier.
- Dealing with different categories of suppliers, processing businesses use various forms of payment for deliveries. Full billing tends to be today the prevailing arrangement.
- The purchasing price in most cases is a result of combination of two main factors: market prices for raw material at the time of purchase and cost of production of raw material.

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The quality of raw material delivered to processors, on-time delivery and established delivery channels are the factors having most direct influence on the competitiveness of food processing industry. Today, processing businesses work with a variety of suppliers. These include: primary producers, traders and industrial groups. Primary producers (agriculture enterprises, private family farms and private households) remain the major category of raw material suppliers for processing industry. Overall in the sample, 60% of enterprises purchase raw material from agriculture enterprises, 58% - from farms and 45% from private households.

If we speak about the portions of separate suppliers in the overall sizes of supplies, agriculture enterprises are major suppliers of raw material for businesses in mixed fodder and dairy industries: 56% and 38% respectively (Figure 6). 71% of the surveyed dairy plants purchase milk from private households, and the share of this category of suppliers is equaling 27% of the total volume of purchased raw material. Private family farms are primary suppliers of raw material for canning industry (32%), while bakeries tend to purchase most raw material not from primary producers, but rather through industrial groups (26%) and from processors (32% of the purchased supplies). Among all studies enterprises, bakeries have most diversified channels of supplies.

Figure 6. Shares of major raw material suppliers in the overall volumes of supplies, % of overall volumes of supplies.

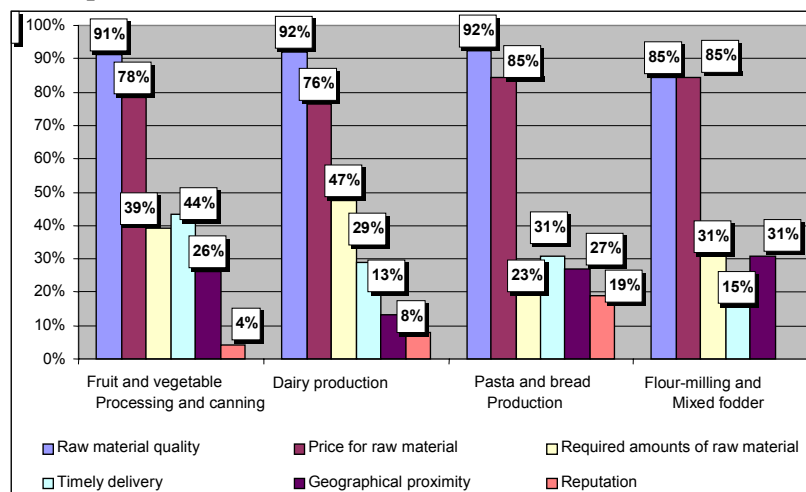


Raw material may be delivered to a processing enterprise by either the enterprise or the producers. Fruit and vegetable processing businesses, likewise dairy plants, in the majority of cases use their own transportation vehicles to deliver raw material for processing: It was reported by 91% and 95% of such businesses respectively. An explanation here is that vegetables, fruit and milk are perishable goods, and untimely delivery affects the quality of end-product. As regards bakeries and mixed fodder industries, such businesses tend to rely more on the suppliers' transportation vehicles for the delivery.

The quality of raw material supplied for processing, is the decisive factor influencing the choice of supplier. As may be seen from Figure 7, in 90% of all cases, the quality of raw material is the key for signing a contract with a particular supplier. Second most important factor is price for raw material, which reported by 80% of respondents in the sample. Among other important factors, influencing the choice of supplier, is the availability of needed amounts of raw material and timely deliveries. The significance of these two factors was underscored by 37% and 31% of respondents.

The availability of the needed amounts of raw material is particularly important for businesses in dairy sector: 47% of responses. Individual households tend to remain the major raw material suppliers for many dairy processors. Limited capabilities of this category of suppliers with regard to shipping required batches of milk causes additional costs for dairy plants transporting the produce to the plant.

Figure 7. Significant factors influencing the choice of raw material supplier by processing businesses, % of responses.

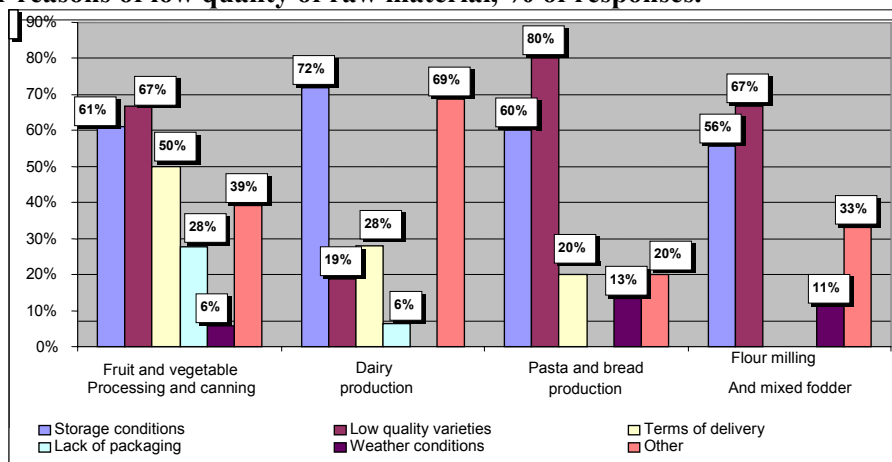


Among the factors mentioned above, timely delivery seems to be more important for processors of fruit and vegetables: 44% of such businesses consider this factor important. Geographic proximity of a supplier, even though it is ranked sixth by importance (22% of the sample), has nevertheless a great importance for mixed fodder producers. For closing raw material supply contracts, the role of such factors as supplier's market reputation, personal connections and references of colleagues are not regarded important.

In the course of this survey, we also tried to clarify how the quality of raw material has changed recently. Most of the surveyed businesses irrespective of their specialization, tend to believe that no tangible change in raw material quality has happened lately. At the same time, 30% to 40% of respondents in the sample admit that the quality of raw material has improved. This is particularly true for such suppliers as industrial groups and companies-traders. Better quality of raw material was recognized, specifically by businesses in fruit and vegetables processors and in the dairy sectors. One third of the surveyed fruit and vegetable processors and 41% of dairy plants appreciate better quality of raw milk collected from private family farms; and respectively 46% and 48% notice improvements in the quality of supplies shipped by agriculture enterprises.

Despite the positive trend to better quality of raw material, nevertheless, 74% of the surveyed processing plants still encounter the problem of its low quality. As proved by the obtained data, the problem of low quality stands more acute for the businesses in vegetable and dairy sectors, which is pointed by 84% and 78% of the surveyed enterprises. As may be seen from Figure 8, the following three factors affect the quality of raw material supplied for processing: storage conditions, bad crop varieties/unproductive breeds of cattle, and conditions of raw material delivery.

Figure 8. Major reasons of low quality of raw material, % of responses.

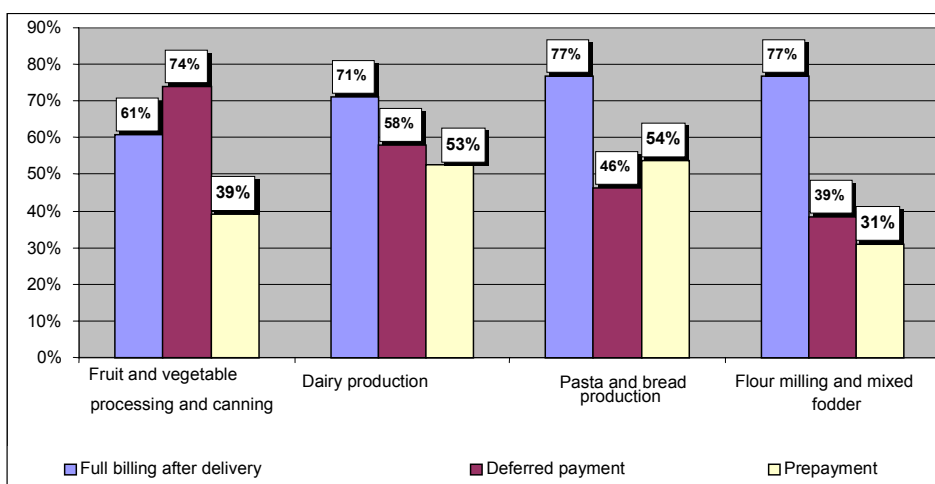


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Two thirds of respondents note that improper storage conditions are the major reason for low quality of raw material, while the percentage of respondents among dairy sector players who support this statement, is 72%. In the opinion of 80% of the surveyed sector, poor quality crop variety (for example, low content of protein) is the major explanation of unsatisfactory quality of raw material supplied to bakeries. In addition to listed reasons, 28% of fruit and vegetable processors recognize lack of special packaging one of the factors behind the problem of raw material's low quality of.

Dealing with various categories of suppliers, processing businesses use different payment arrangements for the supplied raw material (Figure 9). Full billing after delivery seems to be the predominant form of payment. On average in the sample, 71% of the surveyed businesses use this form of payment. Deferred payments were used by 56% of respondents on average. This form of payment is most common for businesses in fruit and vegetables industry (74% of companies), and least common for flour mills and mixed fodder producers – 39% of the surveyed businesses. The length of deferral for the majority of businesses (80% in the sample) is 30 days (Figure 10). Only 18% of the surveyed businesses noted that the term of deferral may exceed one month.

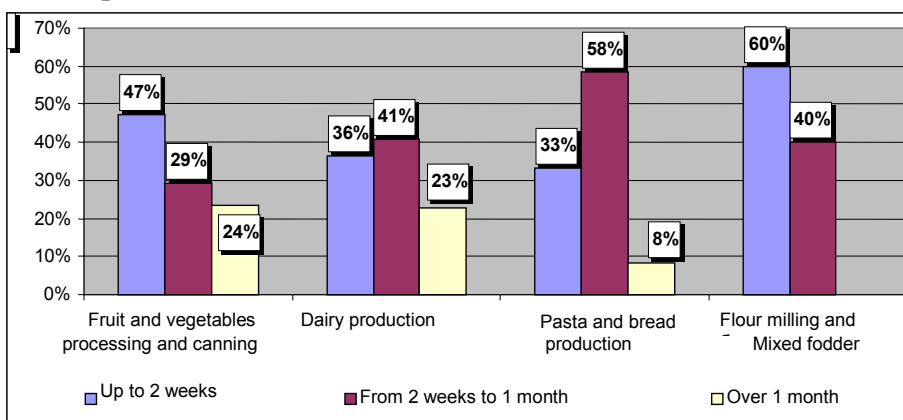
Figure 9. Predominant forms of payment arrangements for the supplied raw material, % of responses.



A new form of payment is the prepayment as a sort of trade credit of agriculture producers. The prepayment allows to minimize risks of low supply of raw material to processor. 47% of the overall sample use prepayment, with dairy plants, pasta producers and bakeries being incontestable leaders in using it. 53% and 54% of such businesses use this form of payment.

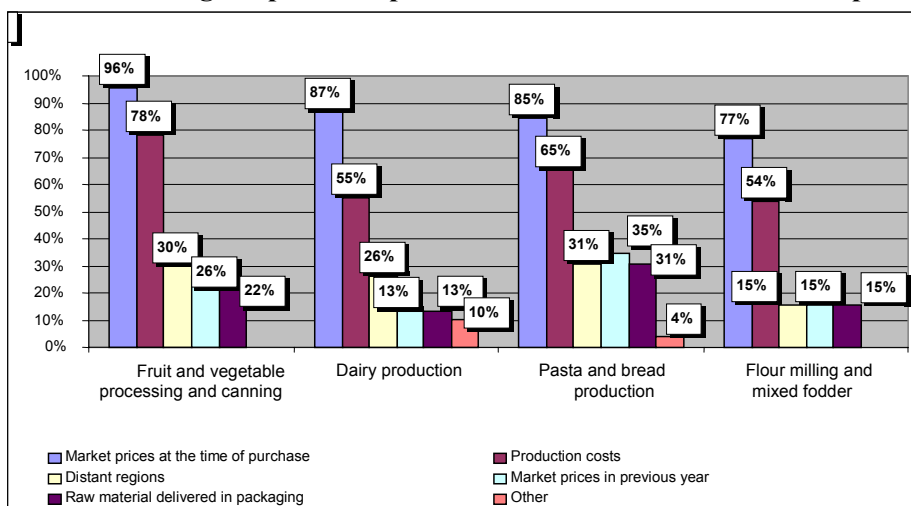
The average size of prepayment depends on the category of supplier and industry. However, we should note that in all surveyed industries the size of prepayment rarely exceeds 50% of the total contract value.

Figure 10. Time period for which the deferral of payment is possible, percentage share of the overall number of respondents.



The pricing for the delivered supplies was another question in focus of this survey.. As was demonstrated by the survey findings, the purchase price in most cases is the derivative of two major factors: market prices for raw material at the time of purchase and the cost of raw material production (Figure 11). Moreover, the first factor was decisive in 87% instances, while 63% of the surveyed businesses also take into consideration the production cost of raw material. The latter factor is particularly important for fruit and vegetable industry: 78% of companies in the sector base themselves on the cost of production while establishing the purchase price.

Figure 11. Major factors driving the purchase price for raw material, % of total responses.



Among other factors impacting pricing strategy, respondents noted the distance to the market, market prices for raw material in the previous year and whether or not material is delivered in packaging. It is important to say that market prices for raw material in the previous year appear particularly significant for bakeries and fruit and vegetable processors.

As was demonstrated by the survey, today the prevailing majority of businesses use locally produced raw material, while only third of respondents purchase imported material. Among major explanations of why businesses purchase imported raw material, respondents cited either unavailable locally produced stuff or better quality of imported raw material.

3.4 Production process and the quality of end product

- At present, processing businesses do not work at their full capacity. On average, production facilities are working only on half their capacity, and this is observed across all surveyed industries.
- Almost half of businesses indicate that by the quality their produce is no worse than the major competitors' goods. Another quarter of respondents noted that quality of their output by far outdoes the quality of competitors' goods in the industry.
- In sectors of agriculture food processing, the quality of end produce is the derivative of many factors, meanwhile, the quality of raw material and equipment are those factors that in the majority of cases determine the quality of end-product.
- Availability of packaging is one of the drivers behind growing competition between domestically made products. In the opinion of respondents, in addition to merely practical value (preservation of quality, easier handling of produce), packaging should be attractive for buyers and provide additional information about the product.

The rapid development of agriculture food processing sector would not have been possible without essential changes in the production process. However, dependence on the seasonality of raw material production remains one of the specific features of the production in processing industries. This is first

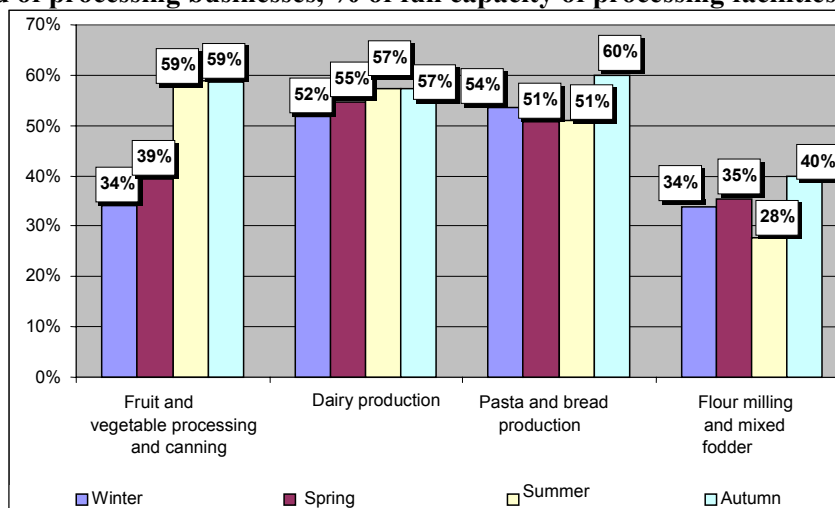
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cause true for sectors dealing with crops and vegetable produce. Seasonal nature of raw material production, in its turn, directly influences load of companies' production capacities.

According to findings of the survey, today the surveyed businesses do not work at their full capacity. On average, their production facilities are loaded only by half, and this is true for all surveyed industries. Their production facilities are loaded less in winter and in spring, when the load falls to 47%. In the fall, after the new harvest comes, the load grows to 56%.

Of all surveyed sectors, flour mills and mixed fodder producers tend to have the least loaded facilities. As may be seen from Figure 12, the highest load in the industry in autumn never goes farther than 56%. Processors of fruit and vegetables have the widest range of variation of load for production facilities. The average number varies from 34% in winter to 59% in summer and autumn, which is the direct outcome of the new harvest supply to businesses. In dairy sector, where seasonality has smaller affect on the load of production facilities, this indicator is more stable during the year and fluctuates between 52 and 57% of the production facilities use.

Figure 12. Load of processing businesses, % of full capacity of processing facilities.



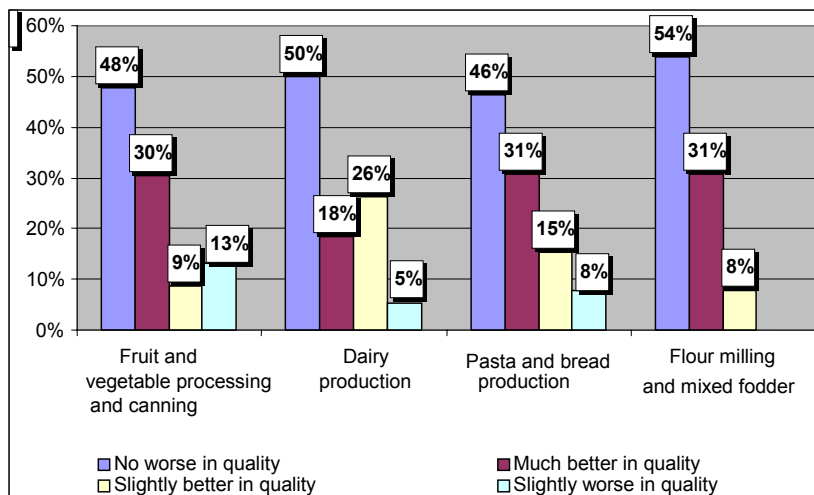
Thus, most processors today have substantial capacities to increase their outputs. The gradually strengthening raw material base, growing internal demand and broader product mix may in the nearest years may lead to greater production outputs and more efficient use of production facilities.

Speaking about potential opportunities to increase volumes of output of the processing industry, it is important to emphasize that produce quality is the major precondition for its competitiveness, especially in the foreign market. It would be fair to say that in recent years the quality of domestic products has improved significantly, due to which domestic goods have almost entirely replaced imported ones.

Admitting certain subjectivism in the respondents' answers, almost half of the surveyed enterprises (49% of the sample) admit that quality of their output is no worse than that of their main competitors'. Another 26% of respondents note that produce manufactured by their business is much better in quality than similar produce of other industry players. Worse than competitors' product quality was acknowledged by only 7% of respondents. Findings in the industrial context are presented in Figure 13.

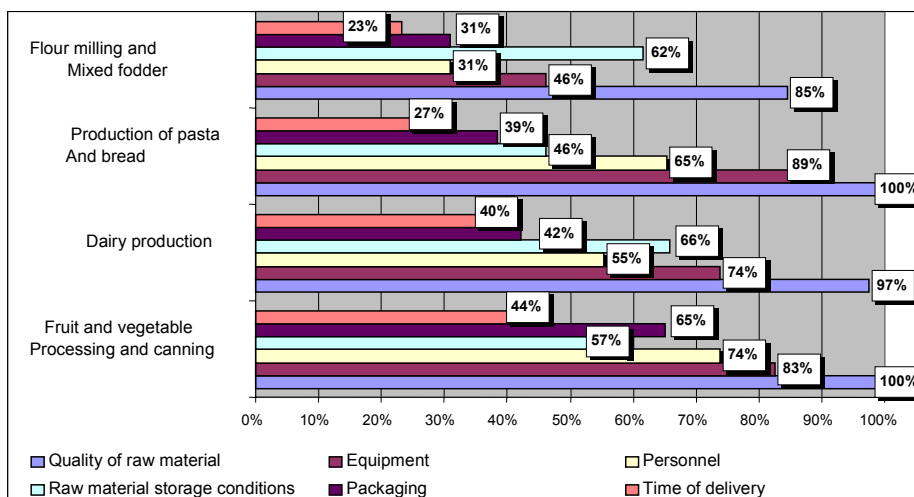
In the sector of agriculture produce processing, the quality of end-product is a derivative of many factors. Here we talk about at least six main factors directly impacting the quality of end-product in the studied industries. These include quality of raw material, modern equipment, personnel, raw material storage conditions, packaging and time of inputs delivery. However, as demonstrated by results of the survey, the significance of these factors varies.

Figure 13. Quality of commodity produce made by respondents, compared to the quality of similar products, % of responses.



The quality of raw material and equipment are the factors which, in 97% and 76% of cases respectively, appear to determine the quality of end-produce on a large scale. If the quality of raw material was reported by all, without exceptions, industries as the decisive factor for the quality of ready product, then the role of production equipment is somewhat lower at enterprises in flour-milling and mixed fodder sector. The distribution of factors impacting the end-quality of output of the surveyed businesses, is presented in Figure 14.

Figure 14. Factors impacting the quality of end-product, % of responses.



Professional staff and storage conditions of raw material are considered the second most influencing factors on the quality of end-product: 59% and 58% of businesses respectively admitted importance of these two factors. Personnel seem to be particularly important for fruit and vegetable processors: 74% of such businesses recognize personnel's professionalism as a factor influencing the quality of produce. However, less than one third of the surveyed flour-mills and mixed fodder producers believe that professional skills of their work force directly impact the quality of end-product. In our opinion, these industry variations may be explained by specifics of technologies employed by processing businesses as well as enterprises' organization form (most of the surveyed flour-mills and mixed fodder plans are in the state ownership).

Finally, high quality of packaging and timely delivery of raw material to processors are also decisive factors for the quality of end-product. Packaging directly impacts both the duration of storage of raw material and shelf life of ready product. They seem to be particularly important for businesses in

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vegetable and in dairy sectors with respectively 65% and 42% of respondents admitting direct dependence between the quality of packaging and quality of end product.

The importance of packaging as a factor influencing the quality of end-product has increased both due to the Ukrainian produce entering external markets, and due to strengthened competition between domestic producers and the introduction of trade marks and brands. Table 2 below presents major functions, which according to respondents, packaging has to serve. In parallel with basically practical characteristics of packaging (preservation of product and easier handling), in the opinion of respondents, packaging must be attractive and informative for consumers, i.e. provide additional information on the product. Two latter factors are particularly important for industries with the highest level of competition.

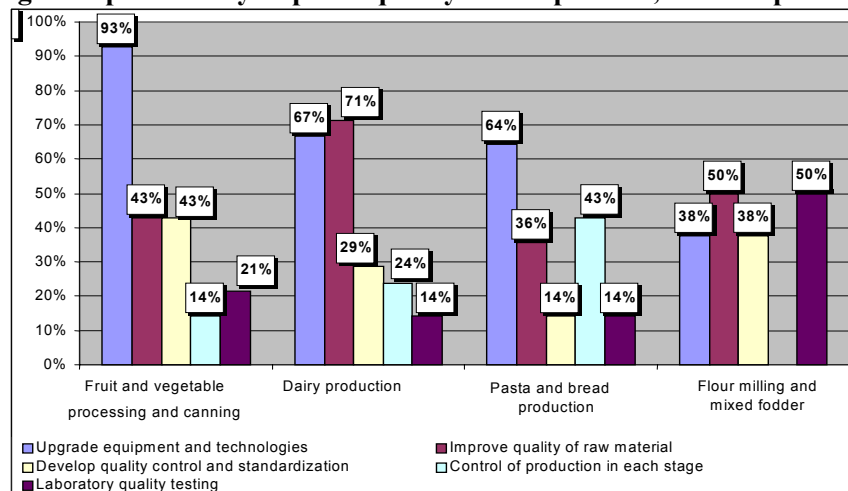
Table 2. Functions to be performed by packaging, % of responses.

	Fruit and vegetables processing and canning	Dairy production	Production and pasta and bread	Flour milling and mixed fodder
Help preserve the produce	83	90	77	54
Make handling easier	78	68	62	54
Be eye-catching and attractive for customers	70	55	58	31
Bear additional information	57	58	58	39
Label the produce	57	50	46	39

In the meantime, 70% of the surveyed responders need to modernize packaging lines, while 39% of respondents report physically outdated packaging equipment. This problem is particularly acute for businesses where packaging directly impacts consumer qualities of the goods, shelf life, easy handling, information. 81% of dairy companies and 74% of fruit and vegetable companies admit the need to upgrade their packaging equipment. As the survey findings reveal, today many processors worry that their available packaging facilities do not allow them to use new types of packaging material (71% of responses) and hold back product mix expansion (58% of responses in the sample). The last problem looks worse for fruit and vegetables processors: 77% of such businesses admit that upgraded packaging lines could facilitate expansion of their product mix. Moreover, 47% of respondents believe that modernized packaging lines could help boost volumes of output.

Almost one third of respondents noted, that in addition to higher quality of raw material and upgraded equipment, the quality of end product may be improved through the introduction of a quality control system (Figure 15). Fruit and vegetable processors seem to be more fervent supporters of a quality control and standardization system, with 43% of the surveyed businesses in favor. The introduction of international quality standards may serve for Ukrainian processors one of the preconditions for entry to more markets, particularly, those in European countries.

Figure 15. Rating of steps that may improve quality of end-product, % of responses.



3.5 Marketing of produce and introduction of trademarks

- Companies have rather diversified distribution channels, targeting various categories of customers.
- Major market where businesses sell their product, is domestic: nearly 90% of the output is sold through the domestic marketplace.
- Most surveyed businesses have specialized departments in charge of marketing, and developed special strategies to promote their produce.
- An integral part of today's marketing is the development and introduction of trademarks and brands, which help boost sales, expand distribution channels and markets, and raise producers' profile among consumers.

In addition to stronger raw material base and gradually increasing internal demand, the introduction by processing businesses of qualitatively new produce marketing strategies contributed to the dynamic development of this sector of the national economy. Therefore, another goal of this survey was to determine how businesses market their produce, particularly, what channels they employ and what markets they operate in, moreover, the survey attempted to study specifics of promotion of the product in the domestic and international markets.

Findings of the survey demonstrate that businesses have rather diversified distribution channels and target various categories of buyers. Today we may say that an average company employs at least 12 distribution channels which allows businesses to be flexible with sizes of deliveries for each specific market. Retail stores and trade outlets remain the most developed channel in distribution ready produce. Overall, 61% of the sample use this particular distribution channel. The portion of dairy businesses selling their produce via retail stores and trade outlets is even higher equaling 74%. Large and small wholesalers rank second most popular channel with processing businesses. Almost half of the surveyed businesses, or 49% of the sample, work with wholesalers.

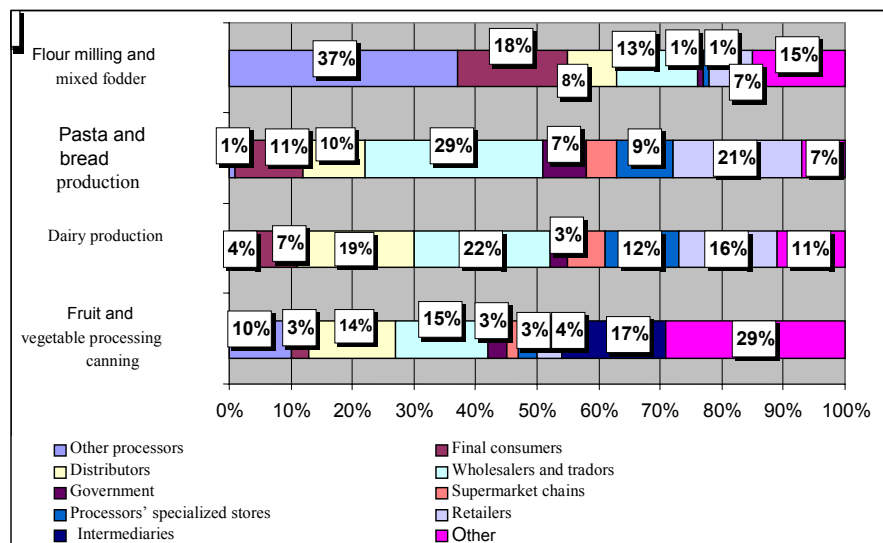
In order to ensure a better control over sales of produce, particularly in the establishment of end consumer price, a significant portion of businesses have built their own dealership networks and opened their company stores. This is specifically the case with food produce. 94% of dairy companies and 92% of businesses producing pasta and bread sell their produce via stores located on-site.

A supermarket chains network, a relatively new distribution channels that came into being only a few years ago, was mentioned by respondents as another popular distribution channels. On average, 38% of the surveyed businesses noted that they work with supermarkets. These, typically, are businesses producing goods under famous trademarks, which therefore may ensure quick circulation of such products and effective usage of supermarkets shop area.

The weight of each channel in the overall volumes of sold produce varies and depends, first of all, on specialization of business and the level of the development of a specific channel (Figure 16). Wholesale companies and distributors appear to be the major distribution channel for dairy processors. Their portions in the overall sales of such produce is respectively 19% and 22%. Almost one third of pasta and bread, and 15% of dairy produce, are sold also through wholesale companies and distributors. This channel, thus, becomes the major distribution channel for the sector of agricultural processing. Businesses of mixed fodder and flourmilling sectors sell over one third of their output to other processing companies, using it as raw material for the production of end-product.

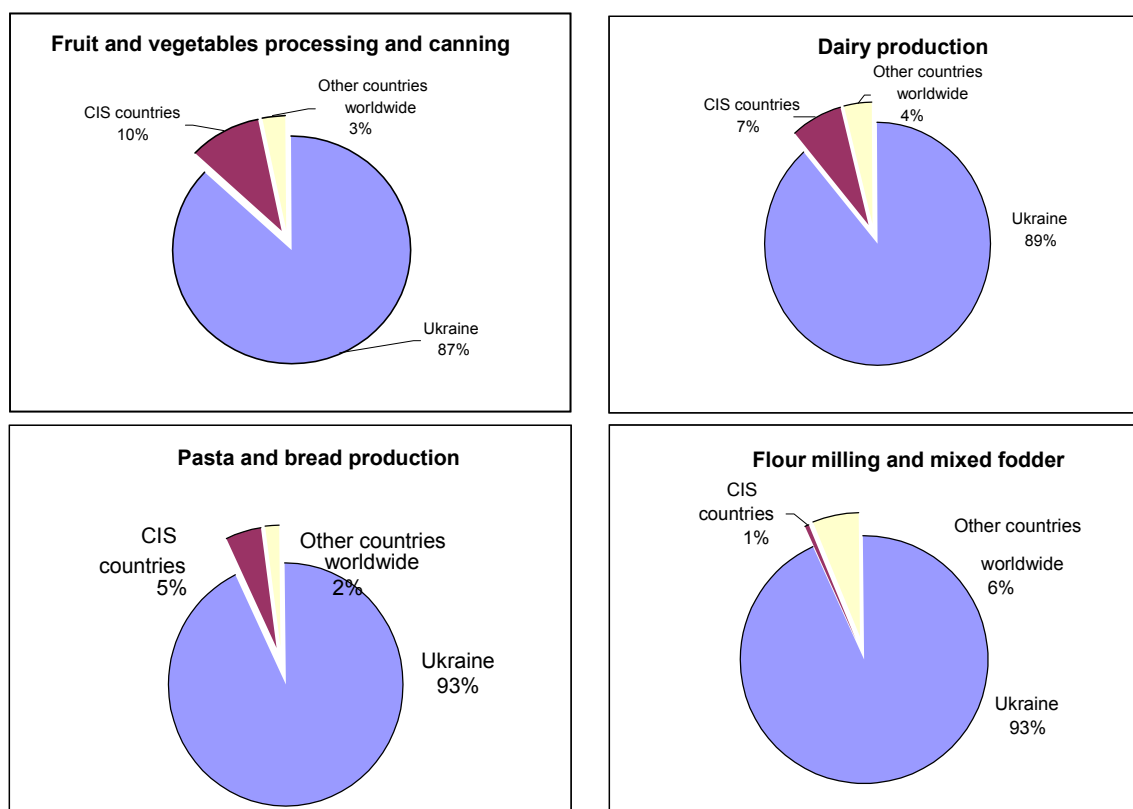
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Figure 16. Portion of each channel in the overall sales volume, % of the overall sale



If the distribution channels a processing business may employ are rather diverse, the major market where businesses sell their produce seems to be the domestic market. Nearly 90% of the overall output is marketed internally (Figure 17). All businesses without exception are oriented primarily at the internal market, and only one third of them sell their produce in the countries Commonwealth of Independent States (CIS). According to the survey, fruit and vegetable processors and dairy plants appear to have strongest positions on the CIS market: respectively, 48% and 40% of such companies operate there. However, the portion of produce exported to the CIS countries remains small: 10% for vegetable processors and 7% for dairy plants.

Figure 17. Portion of produce sold via main markets, % of the overall sales.

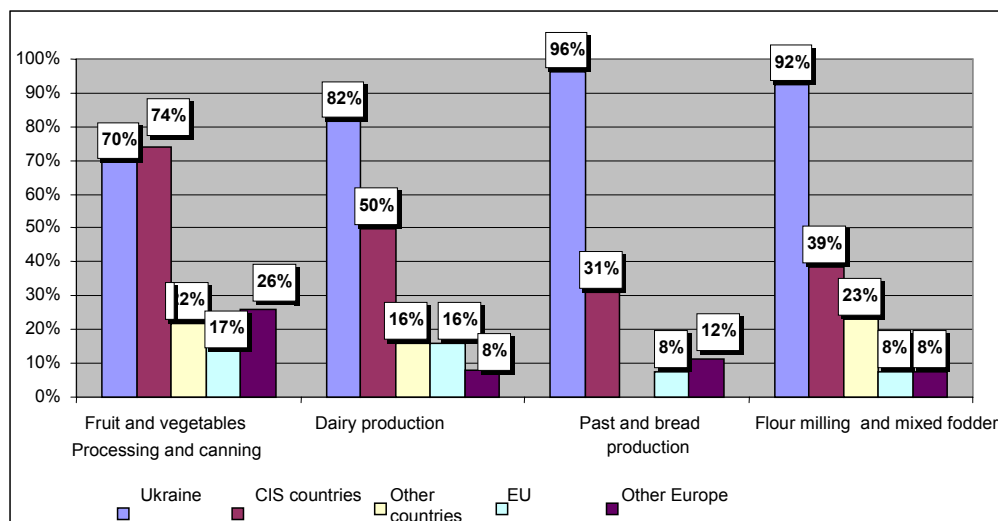


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Despite the growing export potential of the domestic processing industry, today only 7% of respondents export their produce to the EU. Volumes of such export are negligible, hardly reaching 1% of the overall output.

Accessing new markets is one of the marketing strategies pursued by the surveyed processing businesses. Although domestic market is likely to remain the primary sale area in the short run, almost half of respondents, 49% of the sample, noted they plan to gain a strong foothold in the CIS markets, first of all, in Russia (Figure 18). As regards the EU market, vegetable producers appear more optimistic about their prospects of entry to these markets. In view of this, it becomes clear why these businesses are the strongest advocates of the introduction of international quality standards.

Figure 18. Countries where processors plan to sell their produce, % of responses.



In the course of the survey, we also studied how processors establish new distribution channels. While setting up new distribution channels, the prevailing majority of processors tend to either rely on their own resources, or ship the output under preliminary order from customers: 57% of respondents noted that some categories of customers contact the processors on their own to place orders.

Growing competition in the sector of food producing emphasizes the importance of effective marketing. Today, the majority of the surveyed businesses (65% of the sample) have their in-house marketing departments and/or pursue specific product promotion strategies. Businesses tend to develop such marketing strategies, typically, for one year and address the following key issues: launch of an advertising campaign, new product line, expansion of distribution channels and targeting new markets, and adjusting their pricing policies with respect to pricing policies of their major competitors. It is important to note, that pricing seems to be more of a concern for flour-mills and mixed fodder producers, which are more exposed to fluctuations of purchase prices for grain.

The introduction of trademarks and brands seem to have become an integral part of the marketing: 88 of each 100 surveyed businesses believe it is worthwhile selling produce under a specific trademark, with 78 of those having already established such trademark. Dairy plants and vegetable processors appear to be leaders in the introduction of trade mark: respectively, 87% and 83% of such enterprises sell produce under trademarks. (See Table 3 below).

Table 3. Percentage of total processed food products sold under registered trademark (TM)

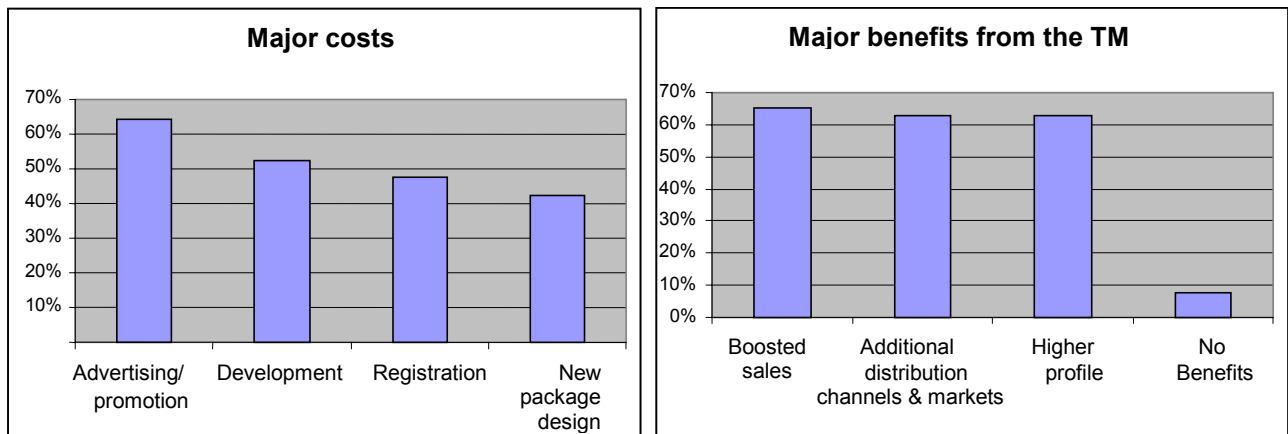
Product	% of TM products	Product	% of TM products
Milk	36	Fermented milk	21
Bread and confectionary	42	Tomato paste	21
Yogurt	42	Pasta	21
Butter	30	Sour cream	18
Kefir	27	Juices	16
Cans	26	Flour	15

The development and introduction of trademark is associated with additional costs. The costs of advertising and promotion constitute the major portion of such costs, which is reported by 64% of the surveyed businesses. Vegetable processors and dairy plants appear to be more active in the promotion of their trademarks. In addition to costs of advertising and promotion, another category of expenses is the fee for registration of a TM and its launch. Moreover, in many instances, the introduction of a TM requires that businesses use new packaging. Almost half of vegetable processors and dairy plants point at the need to modify existing or introduce a new packaging in parallel with the introduction of a new TM.

According to the survey, although the introduction of a trademark is associated with additional costs, it does have economic benefits (Figure 19). Almost two thirds of the surveyed enterprises admitted the following positive outcomes of a new TM: growth of sales, broader distribution channels and new markets, or higher profile of enterprise. Only 8% of the respondents stated they had no effect from the introduction of a new TM.

Speaking about positive effect from the introduction of trade mark in a sectoral context, a new TM helped 76% of dairy plants boost sales, and 68% of bakeries – to enter new markets or establish new distribution channels.

Figure 19. Major costs and benefits of a new TM, % of responses.



The prevailing majority of the developed trademarks is oriented, primarily, towards internal market. It was reported by 91% of the surveyed businesses. However, 26% of businesses have trade marks targeting CIS markets. Only 12% of respondents acknowledged that while developing trademarks, they bear in mind international markets.

It is interesting, though, that each thirteenth surveyed enterprise produces goods which are sold by another business under this business's trade mark. The portion of businesses producing goods under

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somebody else's trade mark is particularly large in fruit and vegetable industry: 26% of the surveyed businesses. These, as a rule are the most renowned trademarks, which place production orders with other businesses due to their own limited production capacities or with the purpose of boosting sales.

3.6 Internal and external barriers to development of the processing industry

- The external problems businesses most frequently face are those connected with attraction of external financing: high interest rates on commercial loans and limited access to long-term credits.
- Instability of legislation is one of the most acutely standing regulatory problems .
- Most respondents do not recognize procedures of registration/re-registration, licensing and certification, and inspections from government bodies as barriers to their day-to-day operations.
- The biggest concern among internal problems faced by respondents is worn-out fixed assets.

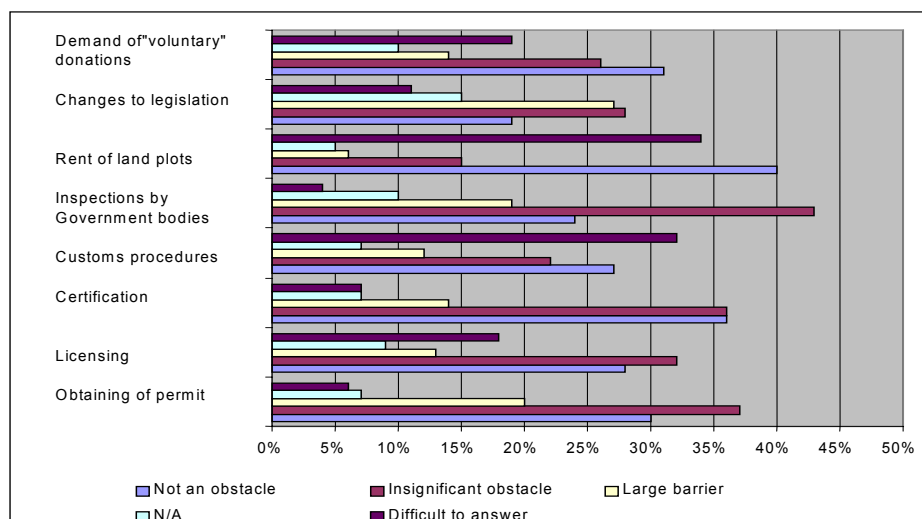
As was noted before, agriculture produce processing is one of the most dynamically developing sectors of the Ukrainian economy. However, findings of the survey demonstrate that development of these sectors is hindered by external and internal barriers. External barriers stem from inefficiencies of regulatory environment. Nevertheless, most of them are not viewed by respondents as very large barriers, which practically halt day-to-day operations. It is important to say that most respondents demonstrated unanimity in the determination of problem and clearly understand the extent of its complexity.

Most frequently, businesses face problems related to the attraction of external financing. High interest rates on commercial loans and limited access to long-term loans rank highest among the worst problems. Respectively, 52% and 44% of respondents recognized it either large or very large barrier for their business development. Long and complex procedure of bank loan application is a barrier for the development of 41% respondents' businesses. However, most businesses hardly consider lending as an obstacle, rating it as a small barrier.

Respondents were requested to rank regulatory problems by their complexity (Figure 20). The suggested circle of problems included registration/re-registration procedures, licensing and certification, inspections by government bodies and frequent changes to legislation regulating business operations. According to the survey findings, respondents do not tend to recognize the suggested problems as barriers to their operations. Instability of the legislative framework, however, was frequently rated by respondents (42% of the sample) as a large or very large barrier to their operations. Of note, 69% of the surveyed vegetable processors called frequent changes to legislation a large and rather large barrier.

While instability of legislation is a matter of concern for many respondents, answering the question "Are there any specific resolutions, laws or clauses hindering/restricting development of your business?", most of them said "No". Those, who believe that such legislation does exist (36% of the surveyed businesses), bear in mind, first of all, clauses related to tax implications and VAT refund.

Figure 20. Rating of barriers related to business regulations, % of responses.



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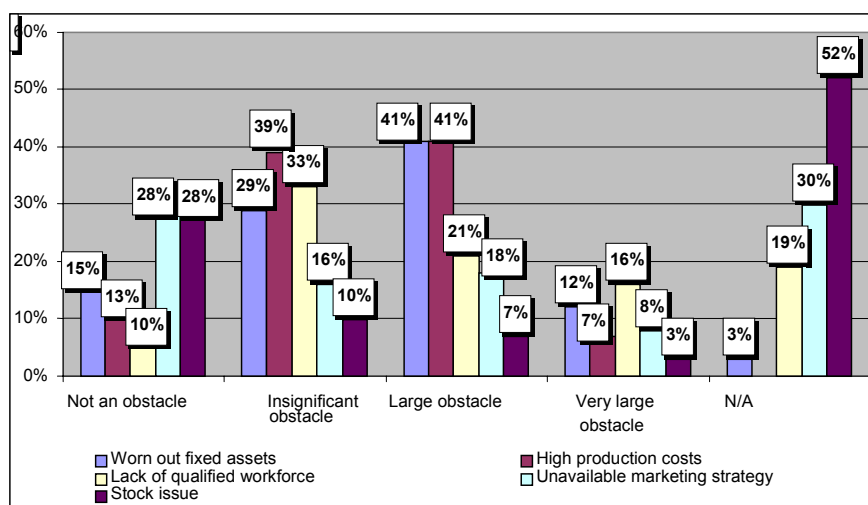
In the course of the survey, we also tried to establish how recent microeconomic changes in the country have impacted respondents' perceptions of the problems. Today, the prevailing majority of respondents note that the level of inflation and instability of foreign exchange rate do not present barriers to their business activity. General stabilization of economic situation has also contributed to the growth of population's purchasing power and, consequently, greater demand for processing industry's output. Only one third of respondents tend to believe that the limited solvent demand is a great barrier to their operations. Most of these (44%) are vegetable processors.

Despite this up-beat attitude, the prevailing majority of respondents (73%) tend to believe that the existing level of taxation and tax administration constitute a large or fairly large barrier. Prices for energy resources appear to be a concern for the majority of the surveyed businesses: 75% of respondents openly state that high cost of energy resources is a considerably barrier in their business.

In their attitudes towards evolution of competition in their respective sectors, respondents split almost equally. Almost half of the surveyed businesses (48%) call terms of competition unfair, and recognize them a large or fairly large barrier in their activity. However, 51% of the survey participants do not share this opinion.

In addition to external barriers faced by businesses, there are internal obstacles (Figure 21). The survey participants distinguish three most acute problems in the list of suggested barriers. Worn-out assets seem to be the top-ranking concern. 53% of businesses called this problem a large or fairly large barrier in their business activity, while only 15% of respondents do not regard exhaustion of fixed assets as a barrier. In the industrial context, the problem of worn-out assets appear to be a larger concern for vegetable sector: 69% of such businesses call this problem a serious or a rather serious internal obstacle.

Figure 21. Rating of Main internal barriers, % of responses.



High production cost of outputs is a serious problem for 48% of the surveyed businesses. This high cost may be explained by both high prices for energy resources, specifically distinguished by respondents among external obstacles, and by the need for upgrade of production facilities.

The survey findings in the area of enterprise staffing came somewhat by a surprise. A lack of skilled personnel is a large barrier for 21% of businesses, and a very large barrier for 16% of respondents. It is interesting, that only 10% of businesses do not regard the lack of qualified staff as a problem, while additional 19% noted that this question is irrelevant. As for the excessive low-skilled staff, the majority of respondents do not believe it is a problem or note that this question is irrelevant.

3.7 Investment activities and development prospects

- Most businesses have recently invested into new equipment, renovation of premises and machinery, and purchase of new transportation vehicles for business operations.
- Internal sources of funding, such as retained earnings and accrued depreciation constitute major source of investments for the surveyed businesses.

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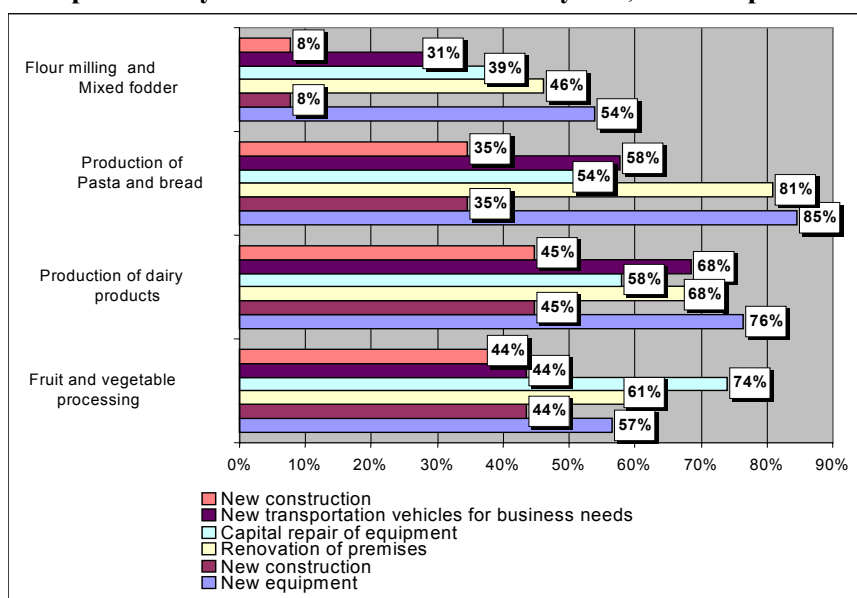
- Although in the last three years surveyed businesses have actively invested, most of them feel the need for additional investment funds.
- Upgrade of production is recognized the highest priority for businesses' in the long run, while access to additional market was ranked as the second most important priority.

Although volumes of output of the processing industry has not reached levels of 1990's, the last three years witnessed active investment activity and increase of output among the respondents. Analyzing the survey findings one may note that the majority of businesses have invested into new equipment, renovation of premises and machinery, and purchase of new transportation vehicles for business needs. However, certain sectoral variations may be distinguished in investment activities.

While 71% of the general sample reported they purchased new equipment in the last three years, the portion of such businesses in bread and dairy sectors is even bigger totaling 85% and 76% respectively (Figure 22). The prevailing majority of bread baking companies (81%) performed also capital renovation of premises, while the average portion of such in the sample is lower, equaling only 67%.

In addition to the above mentioned steps, over one third of enterprises (37%) sponsored new construction and over half (55%) purchased new transportation vehicles for business needs. These steps may be interpreted as evidence of processing businesses' rather optimistic vision of future prospects.

Figure 22. Major steps taken by businesses in the last three years, % of responses



In the general capital expenditures of processing businesses, investment in new purchase of equipment constitute nearly 17%. This seems to be the highest percentage among the other expenditure categories. Moreover, 13% of investment is incurred in connection with major upgrade of equipment. Once again, these data may evidence that technical upgrade of production is the top priority in the surveyed businesses' investment activity. New construction takes 13% of the total investments.

Expenditures on product marketing and promotion programs stand out as a separate cost category. Growing competition in the processing sector requires that businesses allot special funds for these purposes: Over two third of businesses (69%) noted that they have such a line in their budgets. On average, advertising and marketing-related expenses constitute less than 10% of businesses' overall investments.

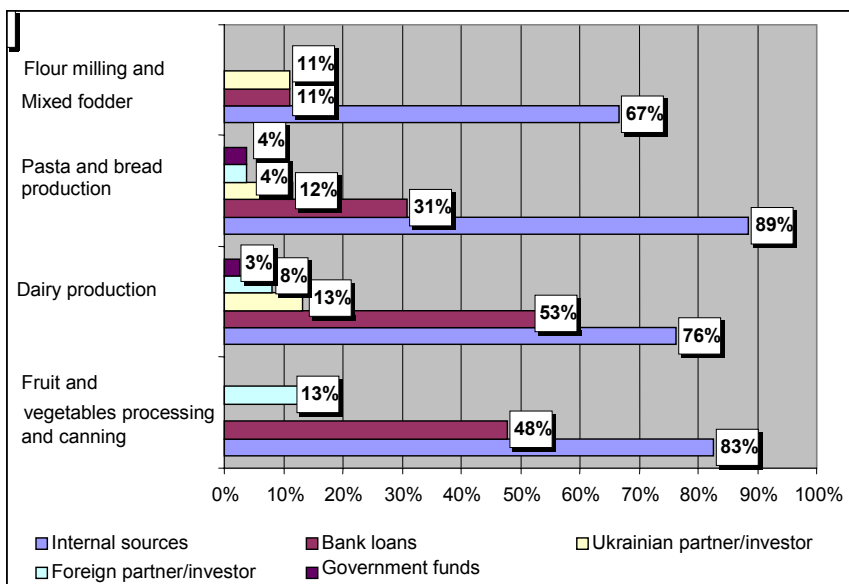
In investment activities, businesses tend to rely primarily on their own resources. Internal savings, such as retained earnings and depreciation accruals, represent the major source of investment for 80% of the surveyed businesses (Figure 23). In addition, 42% of the sample respondents obtained bank loans. As was demonstrated by the survey findings, dairy plants are more likely to obtain commercial loans (53%) than the other categories of respondents. Approximately one tenth (9%) of businesses attract funds of

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Ukrainian partners. Finally, 7% of businesses used funds of a foreign partner/investor. These, typically, included vegetable processors and dairy plants.

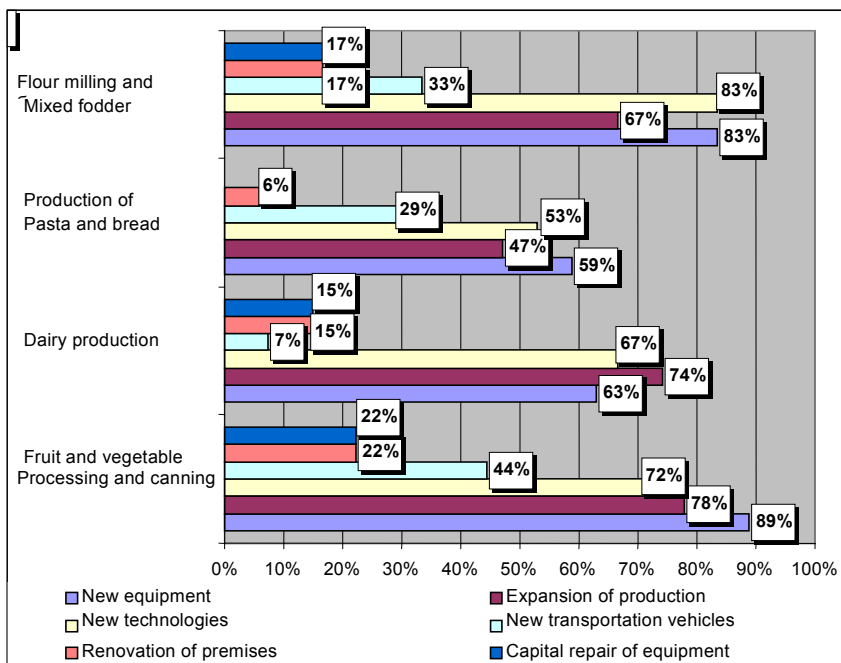
The portion of foreign investment remains insignificant and does not exceed 10% of the total outside investment resources.

Figure 23. Main sources of investment, % of businesses that engaged in investment activity .



Although in the last three years the surveyed businesses have been investing actively, most of them feel the need for additional investment. It was reported in responses given by 68% of businesses. As may be seen in Figure 24, businesses tend to need investments for purchase of new equipment (71%), expansion of operations (68%) and implementation of new technologies (66% of responses). Businesses from vegetable sector are more likely to feel the need for new equipment (89%), which is quite logical, because according to this survey, these businesses have the most worn-out fixed assets. These businesses feel the greatest need for money in order to introduce new production technologies.

Figure 24. Breakdown of investment needs, % of responses

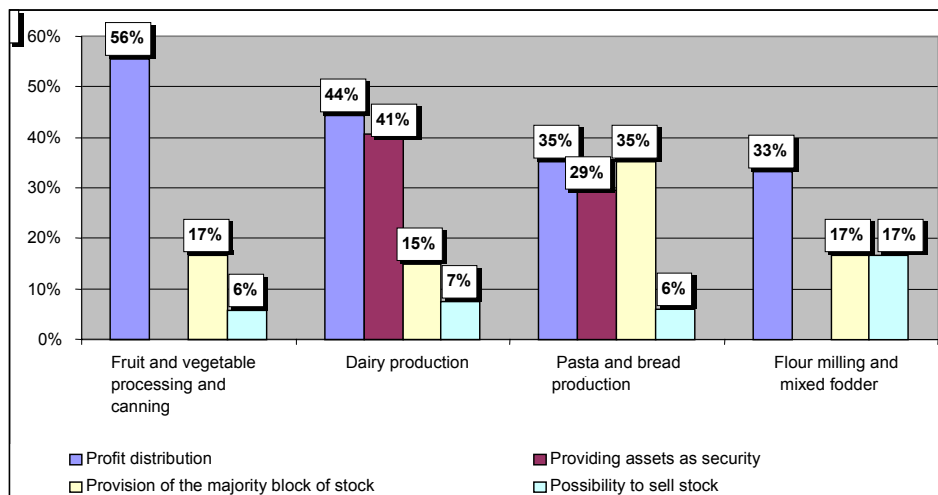


SPECIFICS OF FARM PRODUCE PROCESSING AND MARKETING IN UKRAINE

The size of investment needed by businesses to upgrade production facilities and expand operations, varies from equity investment of 50,000 USD to investment loans sized over 5,000,000 USD. Only two of 68 businesses which need investment, could not clearly define their investment needs. Although the size of needed investment resources varies from business to business, one third of respondents admitted they needed investment in the range of 1 to 4 million USD. Dairy plants tend to need over 1 mln. USD worth of investment.

Among major strategies of attracting investors, businesses cited distribution of business's profit between investors (44%), provision of business's assets as security (32%) and handing to investor of the majority block of shares (21% of the surveyed businesses). One third of all bakeries were prepared to provide investors with the majority blocks of shares (Figure 25).

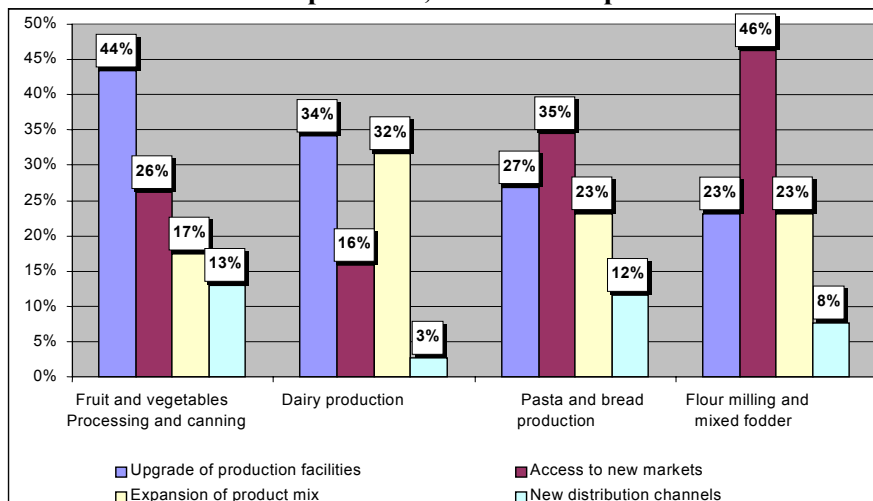
Figure 25. Ways businesses are prepared to encourage a prospective investor, % of responses.



It is evident that an external investor is hard to convince to invest unless a business runs fully transparent operations and provides potential investor with all information required to commit an investment. According to the survey, today most businesses understand these requirements and are willing to comply with them. As a particular step to encourage investment, respondents cited the provision of prospective investors with marketing study results and calculation of the project pay-back, as well as historical data on financial performance. 19% of businesses are also ready to sign an investment memorandum at the request of investor.

Finally, one of the survey questions related to major priorities of businesses in the short run. It is no wonder that according to the survey, upgrade of production facilities was rated as the top priority (Figure 26). This was reported by one third of respondents. Businesses in vegetable sector appear to be more concerned with the upgrade of production: 44% of the surveyed businesses.

Figure 26. Businesses' short-term priorities, % of the sample.



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Access to new markets was ranked second in the list of most important development priority. New market entry is particularly important for flourmills, mixed fodder producers and bakeries. It was reported by 46% and 35% of such businesses respectively. One fourth of businesses admit they would focus their main efforts on the expansion of product mix. It is interesting that in the dairy sector, one third of the surveyed enterprises quote expansion of product mix as their top priority.

4. SPECIFICS OF FOODSTUFFS MARKETING BY WHOLESALE AND RETAIL SECTORS

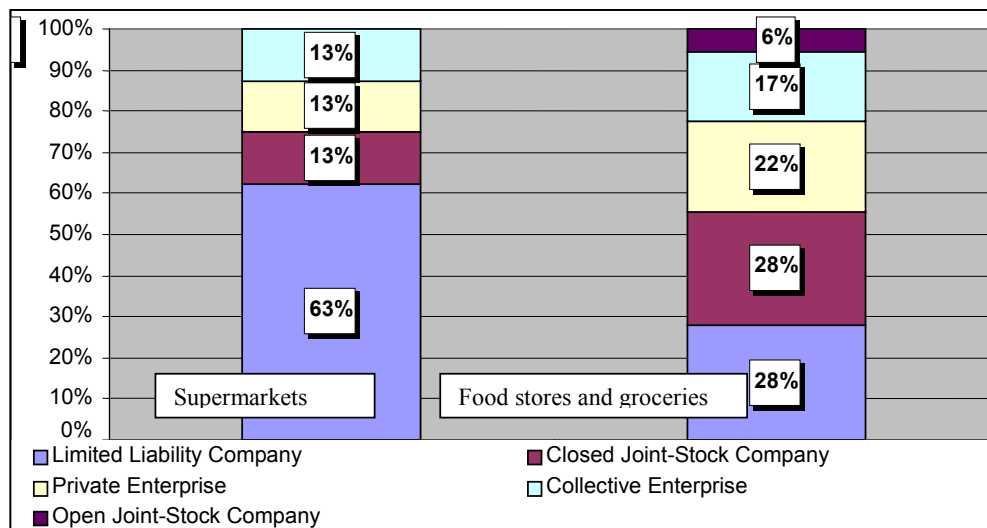
4.1 Profile of the Surveyed Businesses

- Half of the surveyed supermarkets began operations after 1999, while the majority (one third) of food stores and green groceries was established before 1991.
- Commercial enterprises exist in three main organizational forms: limited liability companies, closed joint-stock companies, and private enterprises.
- The prevailing majority of supermarkets state they belong to supermarket chains. Supermarket chains generally have broader retail network, and in some cases the number of retail outlets in a chain reaches 20.
- There is a strong competition between two main categories of retail enterprises: wholesale-retail markets and supermarkets.

Growing internal demand and stabilized industrial production have positively impacted the development of wholesale and retail trade, particularly, of food products (both fresh and processed). Last years witnessed an emergence on the Ukrainian market of earlier inexistent types of commercial enterprises, i.e. supermarket chains and food stores. Of the three groups of researched enterprises, supermarkets appear to be the youngest market players. Half of the surveyed supermarkets began their business after 1999, while a third of food stores and greengroceries were established before 1991.

Nowadays, three organizational forms prevail in the retail sector: limited liability companies, closed joint-stock companies and private enterprises (see Figure 27). Limited Liability Company is dominating among organizational forms of respondents (44%). It is interesting to mention that 10 from 16 interviewed supermarkets are established as limited liability companies, as this form appears to be more convenient for a founder from the management and administration points of view.

Figure 27. Organizational forms of the surveyed enterprises, % of the total number of respondents.



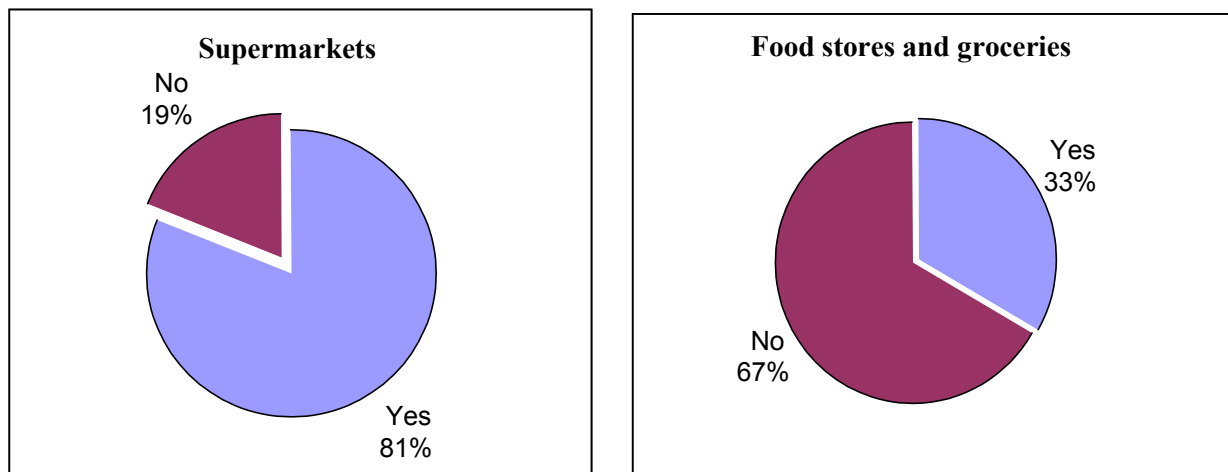
Organizational forms of food stores and green groceries tend to be most diverse of all surveyed businesses and include limited liability companies, closed joint-stock companies, private and collective enterprises. This variety of forms may be explained by shops and groceries, which differ in sizes, sales volumes and specialization.

A distinctive feature of supermarkets is that most of them belong to retail chains. The developed retail network is part and parcel of supermarkets in the countries where these enterprises have been existing for many decades. However, sizes, choice of goods and geographical coverage of Ukrainian supermarket chains do not always correspond to the classical definition of “a supermarket”.

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Today, the vast majority of supermarkets (13 out of 16 interviewed) admitted their affiliation to supermarkets chains (Figure 28). One third of interviewed food stores and groceries also claimed they belonged to store chains. These included both specialized shops (greengroceries and sea-food shops) and the shops of a wide range of products. However, food-store chains appear to be most developed in the capital city (Kyiv).

Figure 28. Retail enterprises belonging to store chains, percent of the total number of respondents.



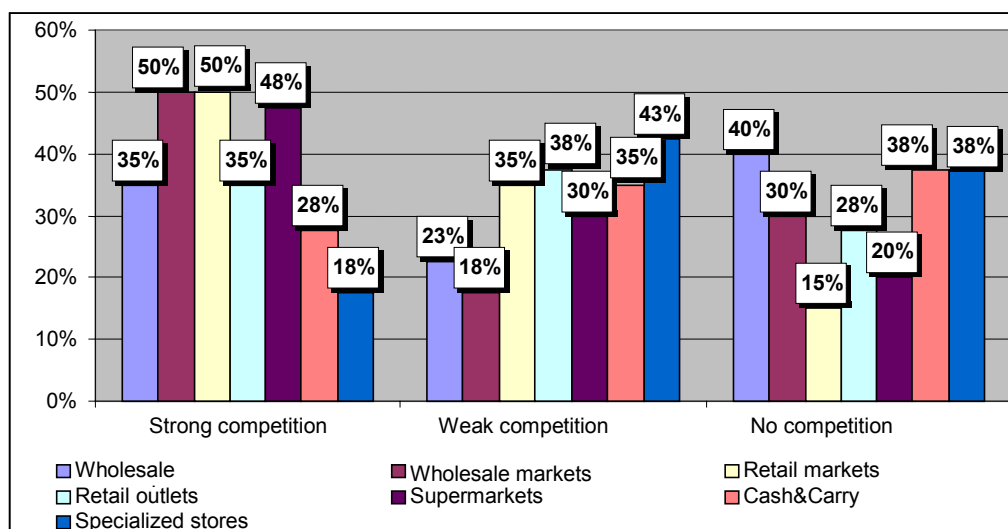
An average chain of supermarkets or food stores consists of 6 outlets. The supermarkets appear to have more developed retail network, with some chains encompassing up to 20 shops. The development wholesale markets may be evaluated by the number of points of sale within their territory. On average, there are 402 points of sale within a wholesale market. However, this figure is aggregated, while actual number of selling points at the researched markets rang from 30 to 1300 such points.

At present, numerous trade enterprises entering the Ukrainian market contribute to a growing competition in the wholesale and retail sector. In our survey, we tried to define the level of competition faced by different trade enterprises and identify strongest competitors. The main results are presented in Figure 29. The respondents almost unanimously admit they feel strong competition on the part of two principal categories of enterprises: wholesale and retail markets and supermarkets (50% and 47% of respondents respectively). This unanimity in responses was observed in all three categories of respondents.

The respondents were not so unanimous though when asked about small outlets (stalls and booths). One third of respondents, mostly food stores, thinks there is a strong competition on the part of small outlets. Another third thinks the competition is weak, and less than a third (predominantly supermarkets) don't recognize competitors in these small outlets.

The answers demonstrate that supermarkets are very well aware about their competitors, knowing them by sight. *Furshet, Silpo, Velyka Kyshenya and Billa* food supermarket chains were most frequently quoted as strong competitors.

Figure 29. Level of competition between trade enterprises, percentage of respondents.



4.2 Product mix

- Strengthening of processing enterprises and introduction of new trade marks and brands lead to broader of product assortment in Ukrainian stores.
- Although domestically produced goods represent major portion of the product range, all enterprises-respondents sell imported products as well. Supermarkets stock the biggest portion of imported products in all goods categories.
- Lack of similar Ukrainian-made produce is the primary reason for the trade enterprises to stock imported fresh fruits and vegetables (exotic and early fruits and vegetables) as well as cereals and prefab mixes (instant breakfasts) and canned vegetables (vegetable mixes in convenient package).

The range of shelved goods may serve an indication of how well wholesale and retail enterprises are developed. Strengthening of processing enterprises and new trade marks and brands, on one hand, and increased consumer demand for food products, on the other hand, have significantly expanded the range of products offered by Ukrainian shops. Although Ukrainian stores lag behind their counterparts from the developed countries by the choice of goods, we can expect that the tendency of expanding product range will persist in future.

As we expected, supermarkets have the widest assortment of goods: 9,307 items on average, with the largest number of goods on the list reaching 26,000. The product range in food stores and groceries, is 1,849 items, while in some shops the number reaches 3,400 items. This survey findings on the choice of goods at the wholesale markets came by surprise. An average wholesale market sells 451 items of produce. This wide assortment may be explained by the fact that Ukrainian wholesale markets offer not only fresh fruits and vegetables, like in other countries, but also processed farm products.

It is interesting to note that the range of fresh vegetables and fruits at the wholesale markets is smaller (24) than that in food stores and green groceries (28) and in supermarkets (29 items on offer). This situation may be possibly explained by the fact that wholesale markets sell large quantities of same products, while green groceries and supermarkets offer goods of wider assortment in an effort to meet various demands and tastes of their customers.

Nowadays, domestic Ukrainian produce makes up the main portion of the range of commodities. It is a result of both high quality of local goods and the introduction of well-known national brands and marks. At the same time, the survey results demonstrate that all respondents sell imported products of the following commodity groups:

- Fresh fruits and vegetables
- Canned vegetables, including juices

SPECIFICS OF FARM PRODUCE PROCESSING AND MARKETING IN UKRAINE

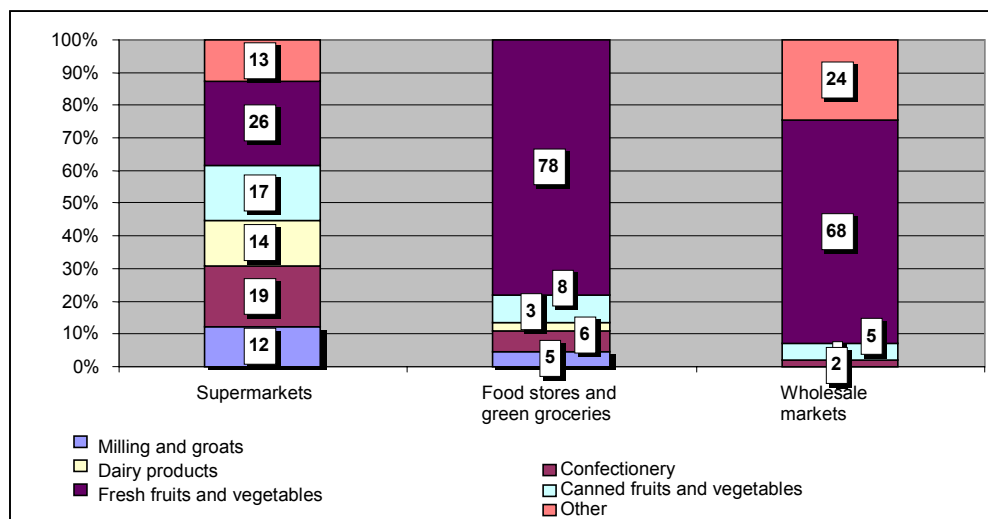
- Confectionery
- Dairy products
- Cereals and prefab mixes

The proportion of imports in goods turnover varies both by specific commodity group and type of enterprise. It's no wonder that supermarkets with the widest product mix have biggest portions of imports in all categories of goods.

Supermarkets and greengroceries tend to have the biggest portions of imported fresh fruits and vegetables on their shelves: 19% and 23% of their respective total turnovers. 13% of confectionery and 12% of canned products sold in supermarkets also come from abroad. Except for fruits and vegetables, food stores tend to stock products of mostly domestic origin Imports' share in all other commodity groups is under 4%.

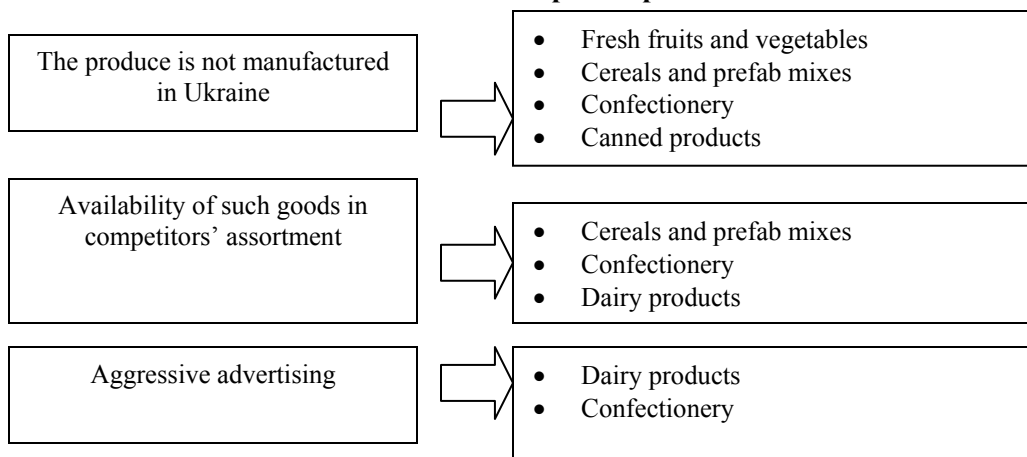
Analysis of the imports structure demonstrates that supermarkets import all commodity groups, while food stores and green groceries import only fresh fruits and vegetables. Imported fresh fruits and vegetables represent a 26% share of total imported goods sold by supermarkets, against 78% of overall import of food stores and green groceries. Confectionery products rank second in the total list of imported goods: 19% of the total import of supermarkets and 6% of food stores and green groceries.

Figure 30. Proportion of imported goods, percentage of overall import



Non-existent Ukrainian products is the main explanation of why stores offer imported products (Figure 31). This makes the retailers sell imported fresh fruits and vegetables (tropical and early fruits and vegetables), cereals and prefab mixes (instant breakfasts) and canned vegetables (vegetable mixes in convenient package)

Figure 31. Main reasons for retailers to shelve imported produce.



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The second most frequently cited explanation of stocked imported products is the availability of such goods in the respondents' competitors' assortment. This is particularly true for cereals and confectionery. A broad advertising campaign plays an especially important role for the sales of dairy produce and confectionery. Finally, over a third of enterprises-respondents admitted that an aggressive advertising is their key incentive to purchase imports.

Among other explanations of the inclusion of imported products into retailers' product mix, respondents also mentioned the lack of attractive and competitive packaging of Ukrainian products (cereals and prefab mixes) and insufficient quantity of locally manufactured products. It is interesting to note that none of the respondents stated that it was better quality of imported products that urged them to sell the imports. The same tendency may be observed in all basic commodity groups.

4.3 Products supplied to the wholesale and retail network and their quality requirements

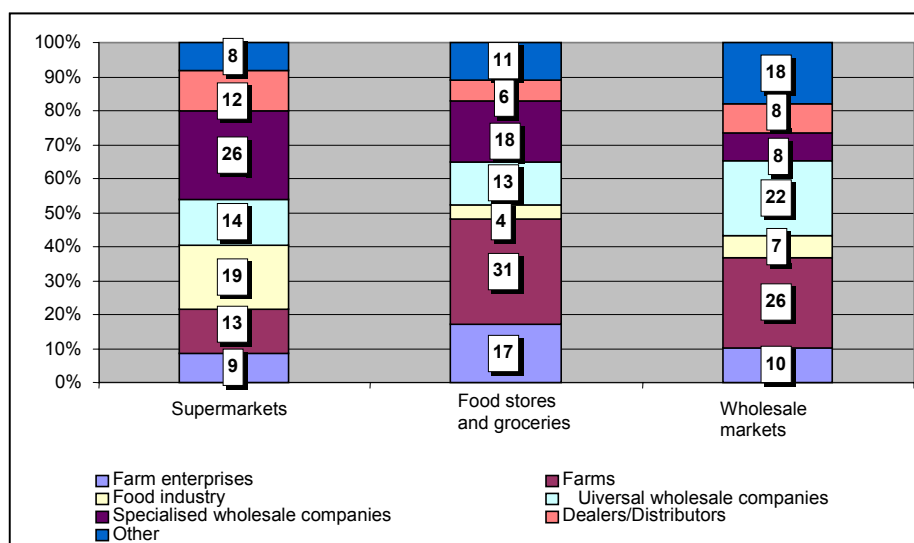
- Working with different categories of suppliers, the trade enterprises have quite diversified supply channels. However, over a half of all goods are supplied to the retail network by specialized and universal wholesale companies and food processors.
- The price is the major factor driving the choice of supplier.
- Most commonly, enterprises use two forms of payment for supplied goods: they tend to either accept goods on consignment and make full payment after sale (full billing).
- Most respondents feel that the quality of domestically made products is steadily improving, especially fruits and vegetables, dairy products, cereals and confectionery.
- Storage conditions, production technology and quality of inputs used by producers, as well as conditions of transportation of ready products determined the quality of goods.

A group of questions was dedicated to specifics of supply of products to the retail network and work with suppliers. It is clear that reliable suppliers and a sustainable flow of supplies are two important preconditions for a business to be successful.

Nowadays, retailers work with different categories of suppliers, thus having rather diverse supply channels: private family farms and farm enterprises, whole range and specialized wholesale companies, food industry companies, dealers and distributors of food producers. It was somewhat unexpected to find out that farms supply products to 70% of the surveyed retailers, although their proportion in the total volume of supplies remains small. Nevertheless, 75% of supermarkets work with private family farms.

Almost a half of respondents works with specialized companies (45%), and over a third – with whole range wholesale companies (38%). Supermarkets have the widest supplier network, and it is no wonder, considering the fact that they carry the widest variety of goods among all surveyed enterprises (figure 32).

Figure 32. Proportion of suppliers in the total volumes of supplies of a retail enterprise.



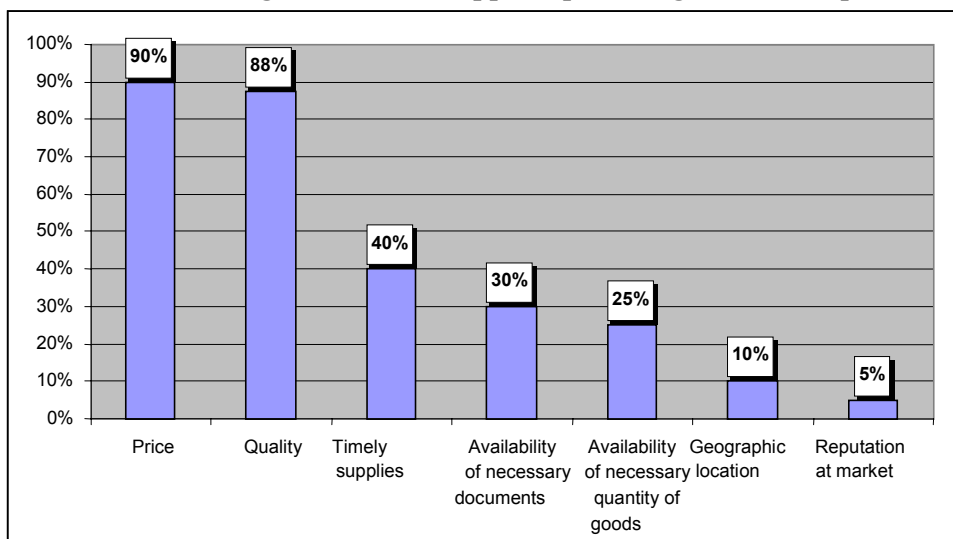
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The proportion of each supplier in the total volumes of stocked products varies depending on a retailer. Specialized and universal wholesale companies, and food enterprises supply over a half of marketable products (mostly fresh fruits and vegetables) to the supermarkets' network (59%). Private family farms account for 13% of the overall supplies of goods shelved in supermarkets. This is, prevalently, fresh fruit and vegetables.

Food stores, green groceries and wholesale markets purchase the major part of their commodities from private family farms (31%), universal wholesale companies (18%) and farm enterprises (17%). Main suppliers for wholesale markets are private farms (26%) and universal wholesale companies (22%).

Although retailers work with different types of suppliers, the main factors for the choice of supplier are quite similar. According to the survey results, for the predominant number of respondents, price is key for the choice of supplier. As may be seen in Figure 33, price was quoted by 90% of the respondents. For supermarkets, the price is of vital importance.

Figure 33. Main factors influencing the choice of supplier, percentage of total responses.

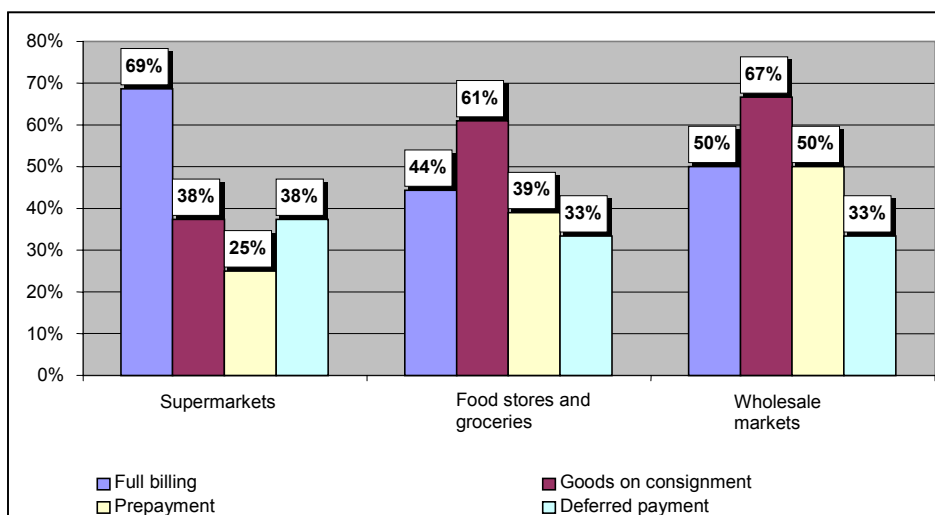


In addition to price, quality of goods also plays a very important role in choosing supplier (reported by 88% of respondents). For food stores and green groceries, quality even overweighs price. These retail enterprises purchase small amounts of produce to satisfy diverse consumers' demands on the limited floor area.

Timely and stable supplies were important for 40% of the surveyed enterprises, including 56% of supermarkets, for whom a quick turnover of goods is key to ensure large volumes of sale. Supermarkets appear to be most demanding to commercial goods coming to their shelves. In addition to factors listed above, over a third of interviewed supermarkets (38%) require that suppliers provide necessary documentation with the supplied commodities. Half of the surveyed wholesale markets as well as enterprises selling bulk batches of goods want to make sure they will have the needed quantity of products before signing a contract with supplier.

Working with different categories of suppliers, the retail and whole enterprises resort to different forms of payment for supplied goods. The received data demonstrate two forms of payment most commonly used by retailers: goods accepted on consignment and full billing. The first form is used by 55% of the surveyed respondents, being particularly popular with supermarkets: 69% of supermarkets accept goods on consignment.

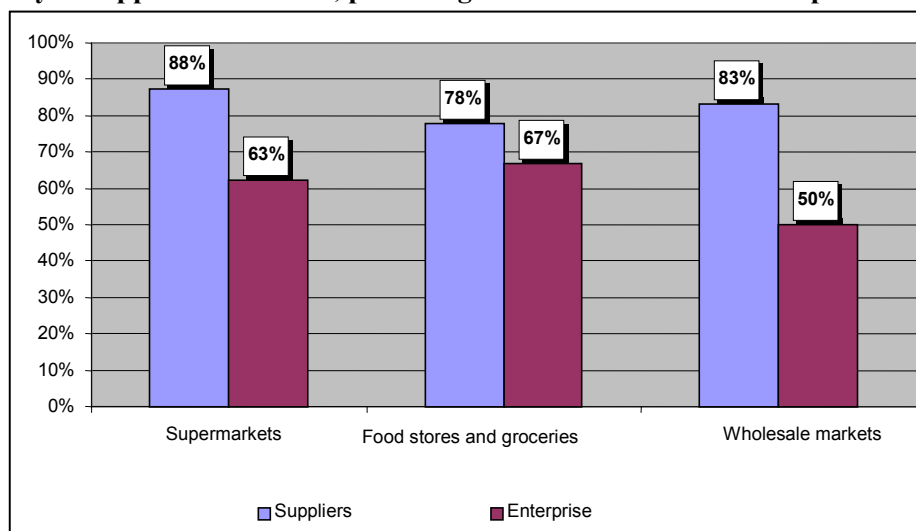
Figure 34. Forms of payment for supplied products, percentage of the total number of answers.



53% of respondents use full billing arrangements, including four of the six surveyed wholesale markets and 61% of food stores and green groceries. Another third of respondents use prepayment and deferred payments (half of the interviewed wholesale markets use deferred payment). The average deferments are 15 days for supermarkets, 9 days – for food stores and green groceries, and 6 days for wholesale markets. In some cases, supermarkets postpone final payment for as long as 30 days. The size of prepayment varies from supplier to supplier, with its average being 19% of the total contract value.

Supplies may be delivered at the expense of either supplier or retailer (Figure 35). However, in most cases (83% of all responses), suppliers use their own transport fleet and cover the relating expenses themselves. This tends to be most common for supermarkets.

Figure 35. Delivery of supplies to retailers, percentage of the total number of responses.

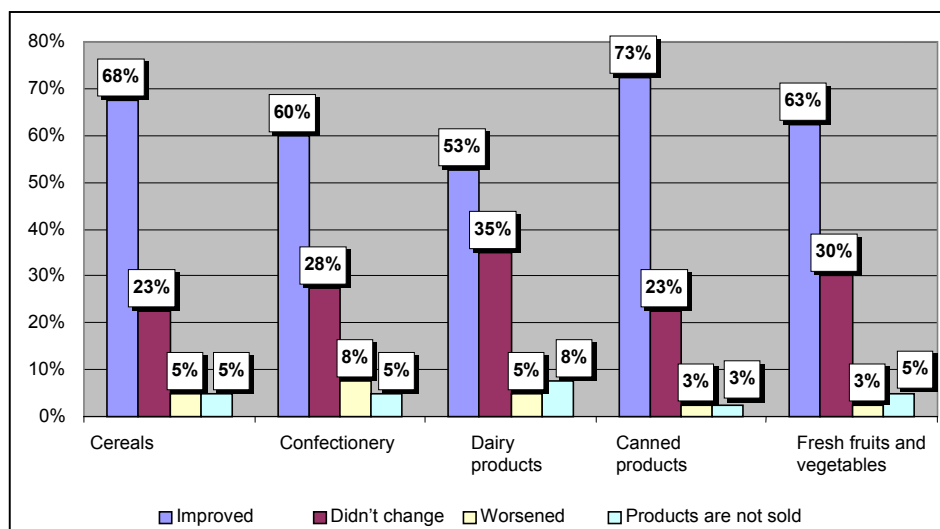


Speaking about advantages and disadvantages of working with different categories of suppliers, respondents admit that low price is the obvious advantage of agriculture enterprises, while the strength of private farms is high quality of products. Reasonable prices and good quality offered by processing companies were recognized their as strong points of working with them. As regards wholesale companies and distributors, the broad mix of offered products stands out as their main strength. In terms of disadvantages, most frequently respondents complained about low quality of products (agriculture enterprises) and high purchasing price (universal wholesale companies).

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The quality of goods supplied to retailers was in focus of this survey as well. The steadily improving quality of domestic products provide the main explanation of their present dominance on shelves of local shops. As demonstrated by results of the survey, the majority of respondents observe steady improvement of the quality of locally manufactured products in all main product categories (Figure 36). First of all, it relates to canned fruits and vegetables, dairy, cereals and confectionery.

Figure 36. Changes in the product quality in the last two years, percentage of the total number of answers.

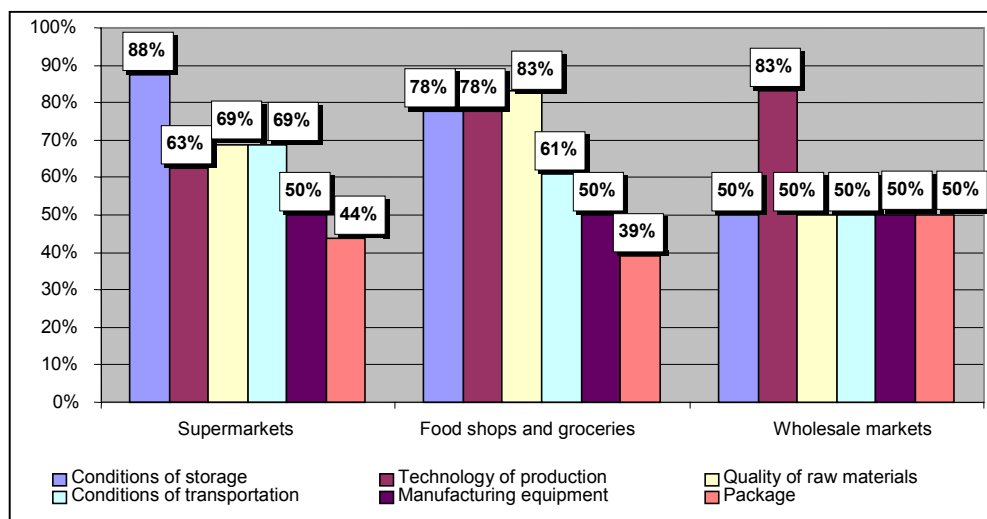


Of all categories of respondents, supermarkets were most appreciative of changes in the quality of products. It may be explained, first of all, by supermarkets' higher requirements to the quality of local products in order to ensure their quick selling.

The respondents were unanimous that storage conditions, technology and quality of raw materials used by producers, as well as conditions of transportation are the key for the quality of finished products (Figure 37). Besides, the quality of perishable goods directly depends on the quality of package and how it is handled during the transportation. The last factor was recognized very important by a half of the interviewed wholesale markets selling fresh fruits and vegetables.

Storage conditions provided by retailers until goods are sold also affect consumer qualities of products. In view of that, respondents were asked whether they had special storage space/premises. The vast majority of respondents (83% of the sample and 82% of the surveyed supermarkets) said they have such facilities. Four out of six interviewed wholesale markets also have area to store products before sale.

Figure 37. Main factors of product quality sold by trade enterprises, percentage of the total number of responses.



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In this survey, we were curious to know whether retailers return unsold products to suppliers, and if so, at whose expense (Figure 38). According to the received data, this practice looks more common for fresh fruits and vegetables (45% of respondents) than for processed farm products (30% of respondents return this type of goods). Supermarkets are most likely to return fresh vegetables (50% of the surveyed supermarkets), while 40% of food stores and green groceries return processed food products.

Figure 38. Proportion of trade enterprises returning unsold products to suppliers, percentage of the total number of respondents.



Unsold products may be returned at either supplier's or retailer's expense. Supermarkets are more likely to return the goods at the supplier's expense, as in most cases, they accept the products on consignment. Food stores and green groceries may return unsold products either at supplier's or at their own expense.

4.4 Sale of fresh fruits and vegetables

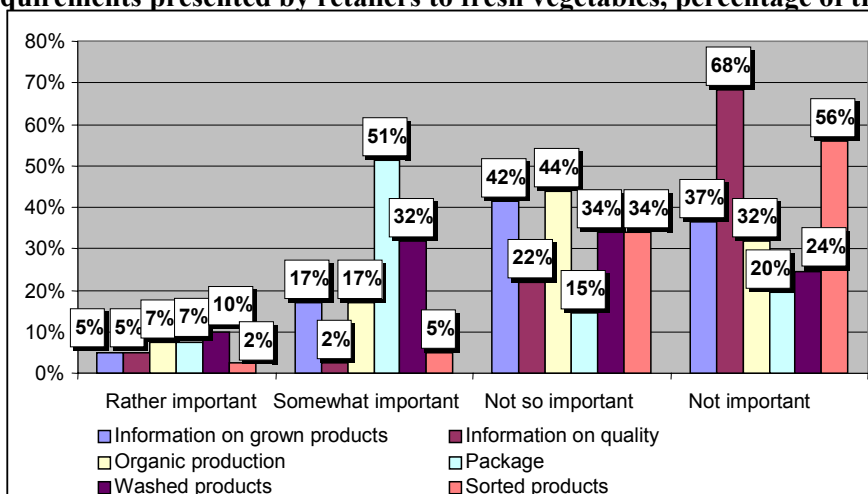
- Fresh fruits and vegetables make up nearly 20% of the total turnover of supermarkets, 40% - of food stores and green groceries, and 88% - of wholesale markets.
- Package is one of the main requirements regarding to fresh vegetables.
- Frequency of purchases of fresh fruits and vegetables by retailers depends first of all upon the size of consumers' demand. Potato, cabbage, onions and apples are purchased most frequently.
- The highest retail margin is charged by food stores and green groceries.

Fresh fruit and vegetables is the vital part of the product mix in retail and wholesale sector. According to the obtained data, fresh fruit and vegetables account for nearly 20% of the total goods turnover of supermarkets, 40% - of food stores and green groceries, 88% - of wholesale markets. Nowadays, retailers regularly offer basic types of fruit and vegetables in demand with consumers.

In order to be marketable, fresh fruit and vegetables have to meet a number of requirements (Figure 39). Availability of package appears to be of primary importance for 58% of the surveyed retailers, especially for supermarkets. Not only package makes the products easier to transport and handle, it also helps to preserve their qualities and provide additional information to consumers. According to the survey, wholesale markets receive most of fruit and vegetables packaged (65% to the total volume), while nearly half of fruit and vegetables sold through supermarkets (45%) are supplied already packaged. . This percentage for food stores and green groceries is about 26%.

In the opinion of respondents, the quality of package of fresh fruits and vegetables generally fails to meet requirements of retailers. This is particularly true for such vegetables as pepper, onions and tomatoes. The package quality of potato and cabbage seems to be the only one meeting expectations of trade enterprises.

Figure 39. Requirements presented by retailers to fresh vegetables, percentage of the total answers.



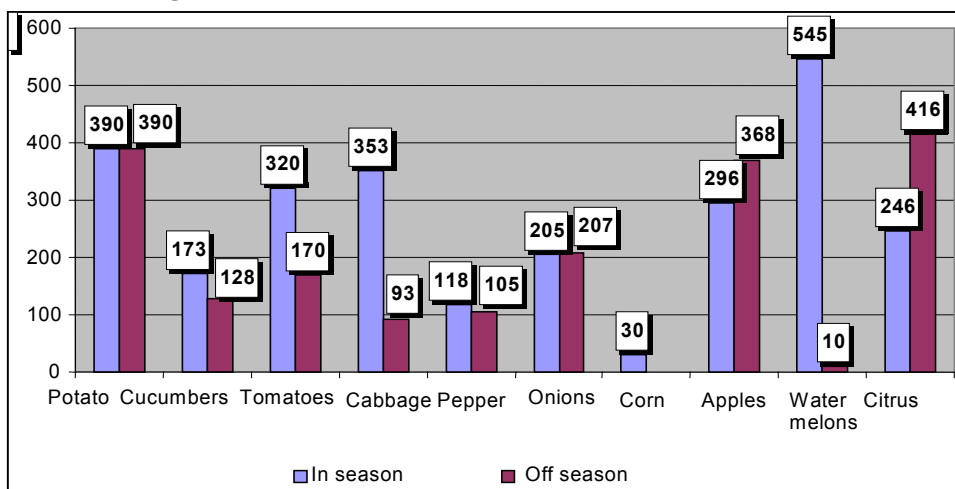
Supermarkets appear to be the most demanding buyers of fresh fruits and vegetables. The prevailing majority of the surveyed supermarkets and most food stores and groceries require vegetables to be washed. Moreover, in order to make fruits and vegetables appearance more attractive, most supermarkets (88%) and half of food stores and green groceries add value by giving fruit and vegetables primary processing: washing, sorting and packing. Most of the wholesale and retail sector enterprises put no additional requirements to fruit and vegetables, i.e. exhaustive information on the quality, and do not require quality certificates.

The survey also asked how frequently retailers purchase fruit and vegetables, and whether sales volumes vary from season to season. As was expected, the frequency of purchases depends upon specific produce, and, consequently, the demand for it. Speaking about produce, most frequently purchased products are potatoes, cabbage, onions and apples, i.e. basic products of every day demand.

Average sales volume of fruit and vegetables varies by produce and retail enterprises. Wholesale markets tend to have the largest sales volumes. Potatoes, cucumbers, onions and cabbage rank the highest by sales volumes. For example, an average wholesale market sells 67.5 tons of potato in the season of growing, and 10 tons in off season. Sales volumes of water melons in the season reach 225 tons.

While sales volumes of fruits and vegetables at wholesale markets, food stores and green groceries depend on the seasonality irrespective of the produce, for supermarkets the seasonality looks not as much important. Average monthly volume of potato is 390 kg both in and off the season. The difference between monthly volumes of apples sold in and off the season is not big: respectively 390 kg and 296 kg (Figure 40).

Figure 40. Average monthly sales volumes of main crops by supermarkets in season (April – October) and off season, kg

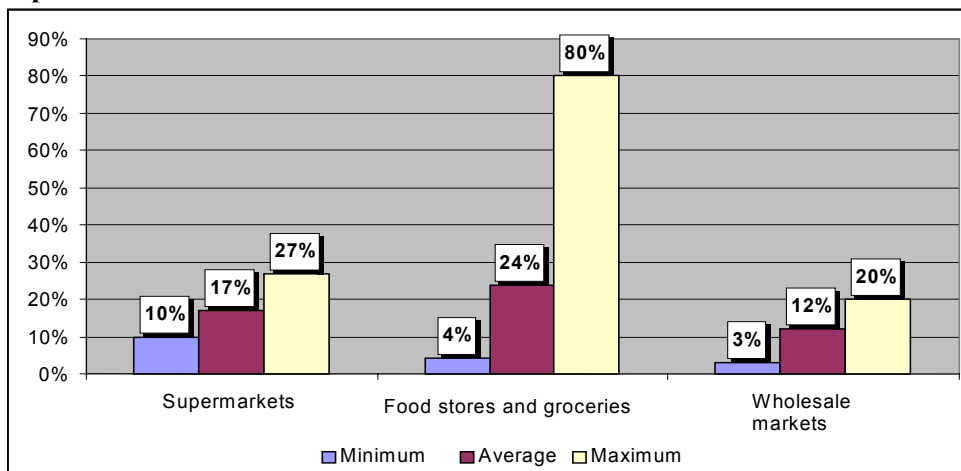


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One of the questions of the survey was about a retail margin for fresh fruits and vegetables. As data reveal, the margin is biggest in food stores and green groceries - 24% on top of purchase price. These trade enterprises also have biggest variations in retail margins: the difference between the maximum and minimum values is nearly 4 times. The highest retail margins of food stores and green groceries may be explained by their attempts to buy small wholesale lots and sell them at the retail price with the maximum profit. Unlike supermarkets, these enterprises do not have economies of scale.

The average size of retail margin charged by supermarkets is 17%. In contrast to the other types of enterprises, all surveyed supermarkets have almost equal size of retail margins irrespective of retail chains they may belong. The wholesale markets appear to have lowest retail margin, 12% on average.

Figure 41. Size of retail margin for fresh fruits and vegetables charged by trade enterprises, percent of the purchase price



Organic food grown free of mineral fertilizers and plant protection chemicals, is a new and yet unfilled segment on the vegetable market. It is commonly known, however, that organic production is more expensive than conventional. In these conditions, domestic market of organic products may be limited to consumers with high income level. This is why we tried to find out whether trade enterprises will be willing to sell organic products, provided that its costs will be at least 1.5 times higher than the cost of traditionally grown products.

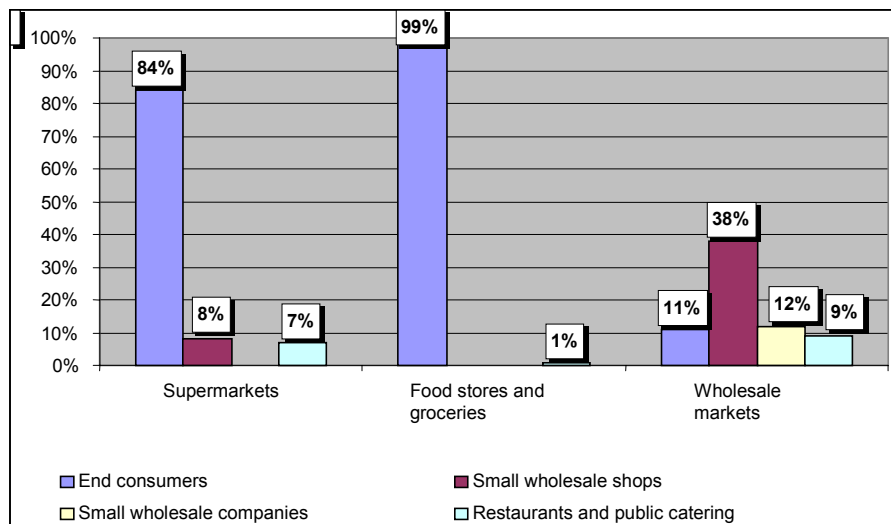
The respondents expressed unanimity in their willingness to sell such products. While only 61% of supermarkets, food stores and green groceries are ready to sell organic products, 5 out of 6 interviewed wholesale markets said they would like to expand their assortment to include organic products.

4.5 Distribution channels and main marketing strategies

- Final consumers represent main category of buyers in supermarkets, food stores and green groceries. Wholesale markets focus at small retail stores and small wholesale companies.
- Supermarkets pursue most aggressive marketing policy in the wholesale and retail sector. They have special departments and staff in charge of marketing.
- Expenses related to marketing and advertising are not yet big: for most respondents, they represent less than 1% of the total sales volume.

Nowadays, trade enterprises sell their products to a wide range of consumers: population, restaurants and public caterers, small wholesale companies and government-funded organizations (schools, kindergartens, etc). However, according to the survey, the portions of different categories of consumers in the total sales volume vary (Figure 42). Population represents the main category of buyers in supermarkets, food stores and green groceries accounting for over 80% of the retail goods turnover and nearly all turnover of green groceries and food stores. 8% of the supermarkets' turnover fall on small wholesale shops. Wholesale markets focus mainly on small shops and wholesale companies, which buy over two thirds of wholesale markets turnover.

Figure. 42. Proportion of different sale channels in the total sales volumes, percent of total sales

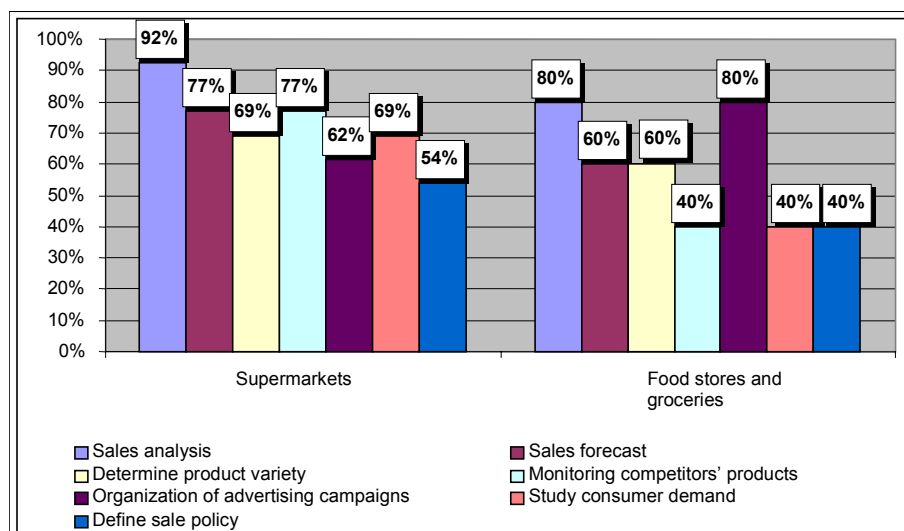


New approaches to marketing that were effectively used by trade enterprises, eventually have resulted in the rapid growth of wholesale and retail sectors and brought about many new market players. As the competition grows, trade enterprises are forced to find new ways to boost their sales, i.e. conduct promotion events, enter new markets and raise “loyal” customers.

Supermarkets appear to be pursuing the most aggressively marketing policies among the other trade enterprises.. Most of such enterprises (80% of the surveyed supermarkets) have special marketing departments and staff in charge of produce promotion. Meanwhile, neither 70% of the surveyed food stores and groceries nor wholesale markets have special staff to deal with marketing issues.

Marketing departments oversee a wide range of tasks, including sales analysis and forecast, determining optimal variety of goods to sell, studying consumers demand and running advertising campaigns (Figure 43). Most of marketing departments, particularly, those in supermarkets, also monitor competitors’ sales volumes and prices.

Figure 43. Objectives of marketing specialists of trade enterprises, percentage of answers.

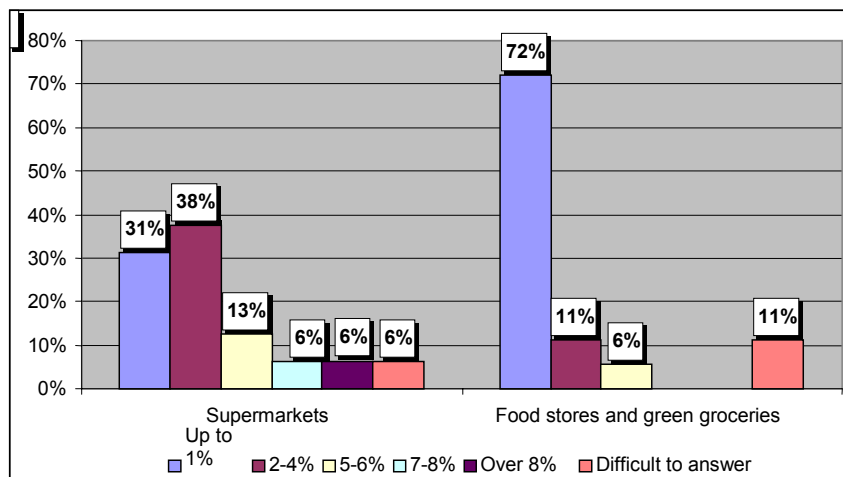


Today supermarkets organize a variety of events in order to attract more buyers. Special discounts, sample tasting, direct advertising techniques have become an integral part of supermarkets’ marketing strategy used by over 80% of the surveyed supermarkets. As a special service, 44% of the surveyed stores offer delivery to buyer’s place. Food stores, green groceries and wholesale markets are more likely to offer free sample tasting and special discounts.

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The above mentioned events aimed at attracting buyers require that trade enterprises have budget provisions to fund marketing and promotion campaigns. Size of such provisions is still small as marketing expenses represent for most respondents (55% of the sample) less than 1% of the total sales volume. Meanwhile, over a third of supermarkets (38%) admitted they spend 2% to 4% of the sales volume on marketing and advertisement.

Figure 44. Expenses related to marketing and advertisement as percentage of total sales, % of responses.



4.6 Operation upgrades and need for investments

- In the last 5 years, the prevailing majority of the surveyed supermarkets ran new constructions and purchased new equipment.
- Over two thirds of enterprises relied upon their internal sources of funding, i.e. retained earnings and depreciation accruals, while upgrading operations.
- Only one third of the surveyed enterprises said they needed external investment. Such investments are mostly need to expand production: boost sales and purchase new equipment.
- The prevailing majority of respondents think that procedures of business registration, obtaining permits and licenses, certification and rent of land plots and premises do not present a barrier to the development of their businesses.

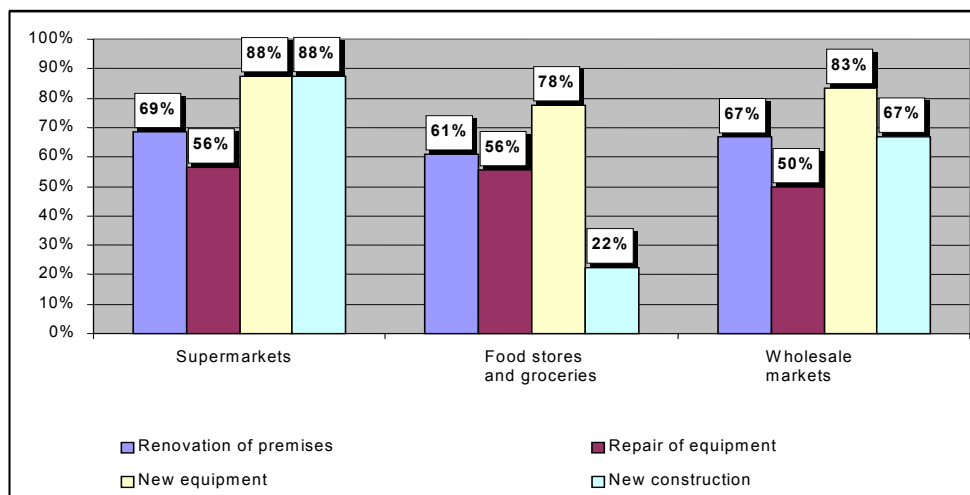
Wholesale and retail sector is a dynamically developing sector of the national economy. This statement is proved by results of this survey (see Figure 45). In the last 5 years, 88% of the surveyed supermarkets were involved in new construction or purchased new equipment. These figures are slightly lower for other trade enterprises, however, nearly two thirds of food stores and wholesale markets performed capital renovation of their premises and almost half of them repaired their equipment.

While performing upgrade of production most of the surveyed trade enterprises (69%) relied on their own internal sources of funding. This include retained earnings and depreciation accruals. Only 17% of the surveyed enterprises (mostly supermarkets) used bank loans. In addition to the said sources of funding, 14% of participants used funds provided by their foreign partner/investor.

Foreign partners/investors were particularly important for supermarkets – a third of them expanded and/or upgraded their operations with help of foreign partners. Generally, analysis of the survey findings demonstrates that supermarkets tend to have the most diversified investments sources. Possibly, it was one of the major preconditions for their rapid entry and gaining a strong foothold in wholesale and retail market

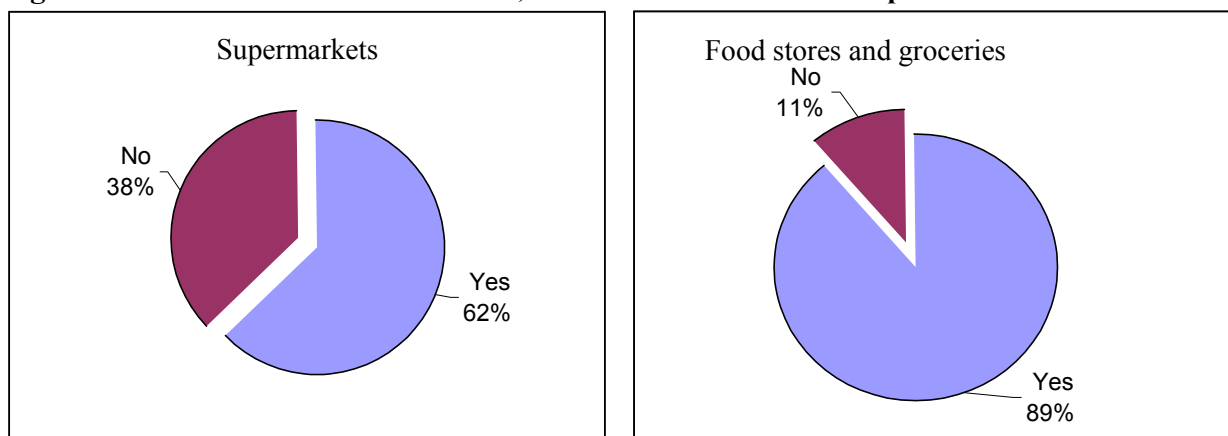
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Figure 45. Portion of enterprises taking the said steps, % of the total number of respondents.



It is interesting to note, that while being actively involved in the investment activity, only a third of the surveyed enterprises said they needed to attract external investments (Figure 46). For comparison, 68% of the surveyed food industry enterprises would like to obtain external investments. Half of the wholesale markets and a third of supermarkets in the sample also would like to get external investments. An average value of the desired investment is 1.8 mln. USD for supermarkets and 2.6 mln. USD for wholesale markets. Food stores and green groceries that expressed their need for external investments were not ready to specify the size of such an investment.

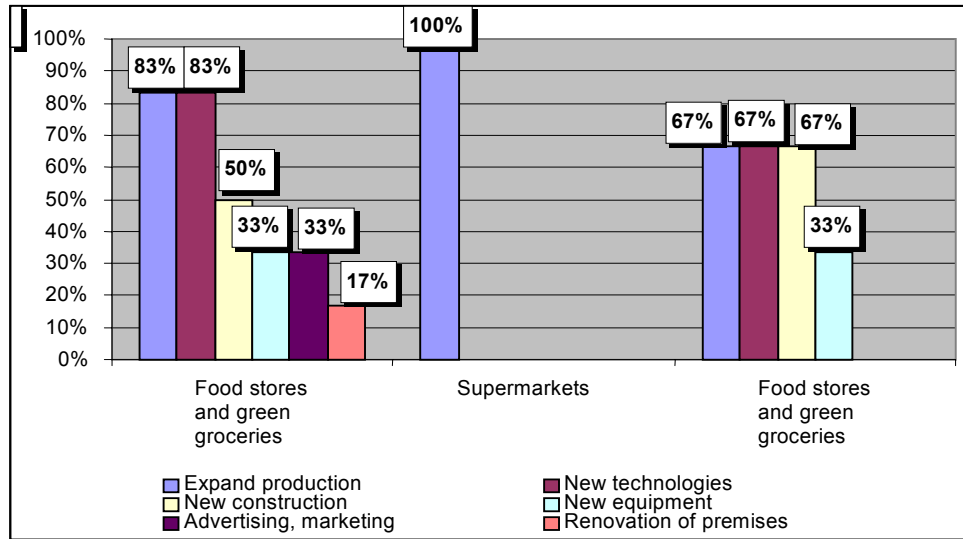
Figure 46. Need for external investments, % of the total number of respondents



Answering the question what enterprises would do to attract an investor, many of them said they were ready to share their future profit. In order to obtain needed funding, enterprises are also ready to provide an investor with calculations of project pay-back and analyze main project-associated risks. These answers serve evidence of the realization by enterprises the need to be transparent as the primary precondition to encouraging external investor to step into their business.

Respondents tend to need external investments primarily to expand production: to boost sales (80% of answers) and purchase new equipment (Figure 47). This is particularly true for the surveyed supermarkets: all of them intend to channel future investments into expanded production. The obtained data proves that surveyed trade enterprises are really serious about strengthening their positions in the wholesale and retail market.

Figure 47. Reasons for investment needs, percentage of the number of businesses needing investments.

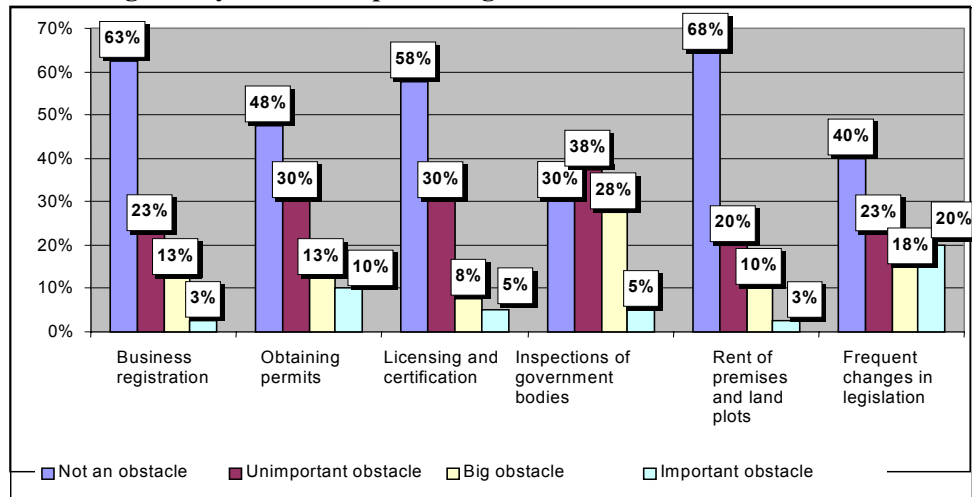


A half of enterprises (45%) needing investments think that they can pay them back in 3-5 years.

Despite the fact that this study did not focus on regulatory policy issues as a particular subject of the present study, a group of questions touched upon external obstacles for the development of wholesale and retail trade. Before we talk about impact of specific administrative and legal procedures on business operations, it should be noted that the majority of respondents do not perceive these procedures as obstacles. It is interesting to note that these results differ from the answers obtained from processing enterprises.

The prevailing majority of respondents believe that procedures of business registration, obtaining permits and licenses, certification, rent of land plots and premises should not be considered presently as obstacles for the development of their businesses (Figure 48). However, two exceptions to the general trend have to be mentioned. Tax inspections and other inspections by government bodies are viewed by a third of respondents as big and serious barriers for the development of their businesses.

Figure 48. Main regulatory obstacles, percentage of the total number of answers.

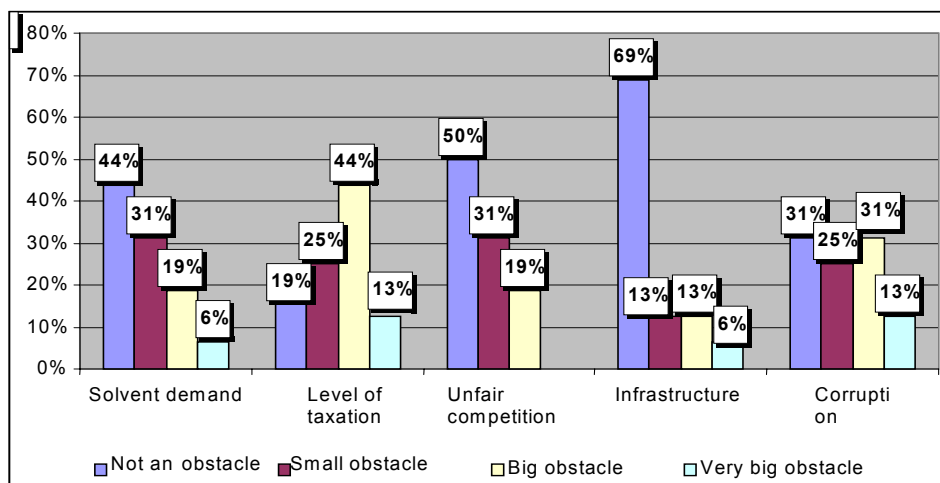


Speaking about obstacles related to funding of operations, high interest rates on bank loans ranked highest –28% of respondents believed it is a big or a very big obstacle to their business. Additional 22% of respondents were concerned with rates of depreciation accruals. The latter obstacle is particularly painful for food stores and green groceries (33%), while only 12% of interviewed supermarkets recognized it as big or very big obstacle.

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Of all macroeconomic factors influencing operations of enterprises, the level of taxation and administration of taxes itself were recognized as worst problems. Over a half of respondents (56%) admitted that these issues are a big, or sometimes, a very big obstacle for their businesses. For comparison, only 18% of respondents believe that the level of taxation and administration of taxes are not obstacles or are small obstacles for their businesses. Supermarkets have the most critical attitude to this issue. Nearly two thirds of such enterprises say that the level of taxation and administration of taxes are big or very big obstacles.

Figure 49. Main macroeconomic obstacles for businesses, % of the total number of answers.



The underdeveloped production, transport and finance infrastructure were ranked by respondents second in the list of barriers. 28% of the surveyed enterprises believe it was an obstacle for their activity (33% of respondents among food stores and green groceries).

Answering the question “*Are there any orders, laws, normative documents hampering or limiting business activity of your enterprise?*”, the majority of respondents (78%) gave a negative answer. However, this, probably, means that the majority of trade enterprises have adjusted to the existing “rules of the game” rather than the Ukrainian legislation does a very good job in regulating business operations of trade enterprises.