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CLOTHING INDUSTRY

October 2006

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Sector Diagnostics

**CLOTHING INDUSTRY:
YEARS 2000 – 2005**

October 2006

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SUMMARY

SECTION 1. SECTOR'S MARKET STRUCTURE AND SCOPE

Ukraine has a well-developed clothing industry. Its clothing sector is developing, and is attractive for investment.

There are approximately TK clothing enterprises in Ukraine. More than 2300 (80%) of them are specialized. Both small companies and large companies are present in the sector.

The clothing sector includes enterprises making clothes in the following categories:

- Textile and knitted garments (coats, business suits, casual clothes, work wear and sports clothes, underwear and accessories);
- Leather garments.

The clothing production market is divided into two conventional groups, characterized by different suppliers, consumers, success factors, tendencies and prospects. These are enterprise groups that:

1. focus on production (external and internal tolling orders);
2. focus on sales (selling products on the domestic market and for export).

Enterprises in the first group use only goods made on commission. The second group uses primarily imported fabrics (Chinese, Italian), because these suppliers are more cost-effective than national textile producers.

Different product groups in the sector have different tendencies in terms of production volumes. For example, the share of leather goods in the production structure increased over 2000-2005 by three times: while in 2000 it equaled 0.5% of the sector's production, in 2005 it was already 1.5%. At the same time, that five-year period saw reductions in the shares of coat production (from 32 to 13% in the overall structure) and business clothes production (from 60 to 13.5%).

Meanwhile, the volumes and shares of work clothes (0 to 30%), sports clothes (0 to 7%), knitted wear (0 to 15%), and accessories (0.5 to 12%) increased. Underwear's share remained practically the same (7% in 2000 vs. 8% in 2005, in relation to the overall structure).

Sales volumes of Ukrainian clothing company products (in sales prices) over 2000-2005 also kept growing all the time. In 2000, sales volume, including export, was approximately 2 billion hryvnias. In 2001, this index went up by 13%. In 2002, the increase of sales volume was 6.5%, in 2003 – 14.2%, in 2004 – 25.8%. In 2004, therefore, sales of Ukrainian-made clothing products exceeded 3.4 billion hryvnias.

Clothing export (including tolling orders) shows a stable increase tendency (by 60% over 5 years). So does import volume, which more than doubled in 2005 as compared to 2004, partly due to approval of the government program for legalizing import of products into Ukraine.

The official level of investment in the Ukrainian clothing sector is very low. The highest value was reached in 2004, equaling 15 million hryvnias, which is far below the annual average level of the sector's investment (\$40 million USD).

The clothing production market in Ukraine shows signs of monopoly competition. There is low market concentration and serious differentiation of goods.

Market leaders include the clothing companies Trembita, Style, Volodarka, Mykhaylo Voronin and Gregory Arber.

The main characteristics of the modern clothing market in Ukraine are as follows:

- Ukraine's underdeveloped fashion industry makes clothing factories focus on production rather than on end users;
- Most of sector companies (70-80% of production) work under goods-on-commission schemes;
- The sector's logistical infrastructure is underdeveloped, which complicates distribution of finished products;
- Most sector enterprises have management problems, as well as problems with specialists and other personnel;
- A significant part of production is in the shadow sector, the statistics of which are not reflected in financial reports.

SECTION 2. PRODUCTION

Clothing production in Ukraine is characterized primarily by tolling schemes (based on goods-on-commission schemes). Clothing production levels over 2000-2005 show a stable natural growth tendency. Many sector companies are working actively on renovating production capacities and on innovating on the company level.

Dynamic investment in sector companies testifies to the fact that development is taking place, and is confirmed by an increase in production.

One problem with clothing production is insufficient protection of intellectual property rights. Some 12% of polled sector managers admit that products get copied in the sector, with most members of the poll's target group (18%) considering this a real problem within the industry. The sector is developing, but there is chaos and insufficiency.

SECTION 3. RAW MATERIALS AND RESOURCES

Fabrics, products of the textile industry, are the main raw materials for the clothing industry.

As of 2005, Ukrainian textile companies did not satisfy the clothing industry's needs for primary raw materials. Production of fashionable contemporary clothing requires a wide range of high-quality goods, which the textile industry is failing to provide in the needed volumes. Ukrainian fabrics are not as cost-effective as clothing factories need them to be, so factories have to buy fabrics from China and Italy.

Most clothing factories are still working on a goods-on-commission or import basis.

Export-oriented companies use solely imported fabrics.

The cost of energy represents a significant share of the clothing industry costs.

Enterprises operating according to goods-on-commission schemes or that export finished products find that their energy costs are a smaller part of total production costs. At the same time, only a quarter of the managers interviewed were prepared not to raise the prices of their products if energy costs rise.

SECTION 4. SALES

Sales of clothing made by Ukrainian enterprises have the following structure:

- Approximately 80% is sold on external markets (tolling, export);
- Approximately 20% is sold on the domestic market.

The sales volume of Ukrainian clothes keeps going up. In 2004, clothing producers sold 3.4 billion hryvnias' worth of clothes (2.8 billion hryvnias' worth were export and tolling orders). That exceeds the 2000 sales volume by more than three times (in factory prices).

The main leaders in Ukrainian clothing production are VAT Style, Trembita, Volodarka, Trottola, Kyiv Clothing Factory Zhelan', Melytopol Clothing Factory Elegant, Sophia, Donbass, Lviv Textile Company, Podillya, and Gregory Arber and Mykhaylo Voronin.

At the same time, none of the top ten companies hold more than 1-2% of the industry's total volume of clothing production.

Clothing sales occur via the following main distribution channels:

- Direct sales to end users (so said 36.7% of the interviewed managers of the sector companies);
- Sales via wholesale intermediaries (22.1%);
- Direct sales via proprietary retail networks (21.7%);
- Sales via retail intermediaries (19.5%).

On the domestic market, sector consumers buy clothes:

- In street markets (50%);
- In small stores (40%);
- In chain stores and brand stores (10%).

At the same time, clothing retail sales in large cities are as follows:

- In clothing markets (46%);
- In small stores (40%, including small stores in shopping malls);
- Via brand store chains (14%, including in shopping malls).

SECTION 5. COMPETITION

On the domestic market, the main producers compete with importers from Turkey, China, CIS, some EU countries, the US and Singapore.

The competition level in relation to end users on the domestic market (the 2005 volume of which experts peg at \$3.5 billion) depends on distribution channels and on the type of product. Competition is higher in areas of higher profitability.

Since roughly 80% of Ukrainian clothing is produced on a goods-on-commission basis, manufacturers of such clothing compete primarily with major tolling order clients. Success in such competition depends on two main factors: clothing quality and production cost. Clothing producers' primary competitive strengths are as follows:

- Potential sales to major wholesale foreign-country clients;
- Availability of equipment and qualified personnel, allowing for production of quality competitive products;
- Qualified corporate management (including financial management, which allows for efficient product cost and logistical management, which in turn allow for uninterrupted operations);
- Steady liaisons with designer groups and sales channels.

As for the end user domestic market, calculations based partly on State Statistics Committee data and partly on expert opinions indicate that 70-80% of it is in the shadows. At the same time, shadow sales of Ukrainian products represent 40% of total volume and the shadow share in the imported products sector equals roughly 80% of total volume.

Shadow import in the domestic market's structure takes the following forms:

- Black import and smuggled goods;
- Lowering the customs value of imported goods (by factors of twelve, and even hundreds of time);
- Understating declared volumes of imported goods;
- "Shuttle" import (illegal import in small quantities);
- Import of certain brands that are declared as cheaper brands.

The main goal of Ukrainian companies is to win a certain share of the domestic market away from the importers. The market concentration tendency is a positive factor in the development of sector enterprises. Integration into the sector is initiated primarily by trade operators interested in promoting Ukrainian clothes on the market, provided that selling such clothes is profitable.

SECTION 6. FINANCE

The main cost categories for enterprises in Ukraine are as follows:

- cost of materials and raw materials;
- labor costs;
- social funds payments;
- amortization costs;
- marketing and business administration costs.

Most sector enterprises (44.3%) operate without loss, 40.2% are profitable and 15.5% are unprofitable.

The average profitability level of sector leaders (based on official financial reports) is 6-11%.

The average production cost level of the leading companies is 60-70%.

Over 2000-2005, the profitability level remained practically the same for approximately 50% of sector companies. More than 30% of companies increased their profitability levels and 20% saw their profitability fall.

Most companies in the sector increased their sales (50%). At the same time, production costs also increased for most companies (60%) due to such factors as rising raw materials prices or increases in amortization funds as a result of equipment modernization.

In general, the sector's increased profitability in recent years has been mainly a function of rising sales volumes.

SECTION 7. EXPORT ACTIVITIES

Ukrainian clothing companies work on tolling orders and export finished products mainly to European countries (UK, Germany, Holland, Sweden, France, Denmark and Italy) and the US. Over 2000-2005, exports volumes of Ukrainian clothing products grew constantly. Over the period under consideration, export volumes increased by almost

60% (as compared to 2000), and in 2005 they exceeded \$571 million.

The main sales channel for sector products comes through Ukrainian companies' cooperation with foreign partners. The latter order clothing and provide the design, supply materials and handle

marketing and sales. Such cooperation is developed in the following ways:

- through cooperation with foreign-country partners;
- through personal connections;
- through participation in exhibitions, workshops, etc.;
- with the assistance of foreign missions, chambers of commerce and embassies;
- through Internet communications;
- with the assistance of business associations.

Obstacles to Ukrainian clothing exporters' presence on world markets include:

- administrative and bureaucratic barriers in Ukraine;

- strong competition;
- lack of competitiveness of products with regard to the "value for money" parameter;
- administrative and bureaucratic barriers in target countries;
- product quality is not competitive.

If Ukraine joins the WTO, the situation in the sector could improve significantly, because import into Ukraine would be that much more transparent, and new opportunities would develop for Ukrainian products.

Ukraine's joining the EU or Common Economic Space would also be positive influences in the sector.

SECTION 8. DEVELOPMENT

Clothing companies' main prospects for development depend on their development strategies, adjusted to their market orientations.

- Companies focused on foreign markets (working on goods-on-commission schemes) have the following strategic goals:
 - Standardization of quality management and certification under international standards;
 - Total management of costs and decrease of product costs;
 - Establishing and maintaining strong ties with foreign-country partners;
 - Taking full advantage of production capacities.
- Companies focused on the domestic market have to:
 - Maintain closer ties with designer groups;
 - Liaison with retail companies that can sell products and do brand marketing and promotion;
 - Optimize company logistical systems or build connections with other companies with access to the sector's infrastructure;
 - Take full advantage of production capacities and reach optimum profitability level;
 - Increase Ukrainian products' share of the domestic market.

Official volumes of investment into the clothing sector are insignificant (a maximum 15 million hryvnias in 2004), yet investments are needed to develop the sector.

Experts note that Ukrainian companies' demands for investment went unsatisfied. Some companies have less of a problem in this respect because they

have foreign partners who provide tolling orders and are interested in investing in them. Most of the sector's companies acknowledge the importance of international certification and of standardization of production processes. Both are components of product quality management.

However, most of the companies (more than 80%) lack certificates.

Only around 8% of the enterprises have certificates for the products they make. And only 5% of the companies have certified quality management systems.

The quality of Ukrainian clothing can therefore not be completely confirmed.

As for the lack of qualified company management, different solutions have been offered:

- Enterprises with significant foreign investment exploit the management expertise of their investors (e.g. Yunost' Clothing Factory);
- Rapidly developing companies hire consulting companies, which help them readjust the management system and make it efficient, while also making the company profitable and focusing it on strategic development.

The clothing sector has to overcome these macro-level problems:

- The fashion industry in Ukraine is undeveloped and there is skepticism about Ukrainian brands;
- The sector's infrastructure is underdeveloped;
- There is a lack of state support (shadow import is allowed to dominate, and

production and investment into the sector are taxed).

SECTION 9. REGULATORY ENVIRONMENT

Government bodies and industry unions are aware of the importance of increasing clothing export, and supporting companies who are involved in it. Ukraine's 2002 signing of an agreement with the EU to abolish quantitative limitations on imports of Ukrainian textile products to European markets is evidence of that.

Also, the Ukrainian Association of Light Industry Enterprises and the State Customs Service have signed a memorandum of cooperation to combat shadow clothing imports into Ukraine.

Most of the problems that clothing companies have to face, however, are associated with the sector's regulatory environment, rather than with the companies' own internal situations.

The main hindrances affecting activities of sector companies on a macro-level are as follows:

- Inspections by regulatory agencies;
- Registration and re-registration;
- Receiving the licenses and permits;
- Export-related procedures;
- Certification and standardization.

Taxation of production and investment, meanwhile, are putting a brake on the process of renovating the equipment necessary for production.

SECTION 10. BUSINESS ASSOCIATIONS

There are three major business associations in Ukraine that are capable of influencing activities of clothing companies: the State Association Ukrlegprom, the National Association Leather and Shoes Union of Ukraine, and the Trade and Production Concern Textile-Contact.

The sector's associations, however, do not completely do they work they claim to want to do.

They are incapable of solving the sector's problems on a macro-level or of creating a common information space that would stimulate development and resolve important issues.

Most of companies, regardless of their size, are not members of business associations.

RESEARCH METHODOLOGY

RESEARCH GOAL AND OBJECTIVE

The goal for the research of Ukrainian clothing sector over the 2000-2005 period was to study the situation and identify trends.

The clothing sector includes companies engaged in making:

- Textile and knitted garments (coats, business clothes, casual wear, work wear, sports garments, and accessories)
- Leather goods

The main research **objectives** are to:

1. Identify primary changes in the clothing sector in Ukraine over the period of 2000-2005.
2. Describe the structure and volume of the sector's market as well as the dynamics.
3. Make conclusions on changes in the volume and structure in the sector based on statistical analyses and information on market segmentation by merchandise sectors, production volume, sector export and import structure and volume, and the volume of direct foreign investment into the sector's enterprises.
4. Describe in detail the situation with production in the Ukrainian clothing sector, using the following criteria: production organization and structure, technical equipment of sector's companies, as well as research and design activities in the sector.
5. Describe in detail the raw materials base of the sector. Indicate the changes in main producers of raw materials and degree of sufficiency of raw materials supply for domestic (Ukrainian) production facilities, raw materials supply models in the sector, and efficiency of energy resources use by the sector companies.
6. Study the sales of the sector companies' products. Describe and evaluate distribution channels of the sector's products.
7. Describe the sector's market and evaluate the competition on the market, namely the level of competition in the sector, main competitive strengths in the sector, and influence of the shadow sector on the overall activities.
8. Describe financial situation in the sector and name the primary manufacturers. Identify the cost structure of the sector's enterprises as well as their profitability level.
9. Assess export activities of the sector companies, describe structure and volume of

exports, describe the consequences of cooperation with worldwide organizations.

10. Determine the development prospects of Ukraine's economy in the clothing sector: main directions of production development, switching to international quality standards, analysis of the level and structure of investment into the sector development for the past five years.

11. Analyze the regulatory environment for the sector companies, study the administrative barriers hindering the activities in the sector, and describe the degree of influence of the sector's companies on the regulatory environment.

12. Describe the degree of companies' participation in business associations of different kinds.

DATA COLLECTION AND THE METHODOLOGY

In the process of analyzing the clothing sector State Statistics Committee's information was used (with regard to the volume of foreign investments, production, sales, export/import, manufacturing in monetary and in kind terms), company financial reports data, and information from the press. Using this data, we were able to perform market segmentation and define the main tendencies observed over the past 5 or 6 years.

In addition to the said sources, we interviewed managers of 123 clothing companies in 2005, where the respondents answered a number of questions associated with specific features of the production, basic results and difficulties of business activities, and characteristic features of their companies.

Based on the interview data, we performed structural analyses of the enterprises and their activities, mainly with regard to production volumes and export activities on each of the sections of the questionnaire. Also, we performed correlation analyses of the main results using the Pierson correlations method. Statistics package SPSS13 was used for interviews results.

Additionally, we performed a regression analysis of the factors influencing the increased profitability of the sector companies using the least squares and logistics method. More detailed descriptions of the regression analysis method is stipulated in the corresponding section. Stata 9.2 software code was used for the regression analysis.

In the "Competition" section, two approaches were used for the analysis of specific market environment: the market concentration coefficient and the Herfindahl-Hirschman Index, using the following formulae:

$$HHI = \sum_{k=1}^m D_k^2, \text{ where}$$

HHI, Herfindahl-Hirschman Index
D_k, market share of large enterprise "k"
m, number of large enterprises

$$CR(3) = \sum_{k=1}^{m=3} D_k, \text{ where}$$

CR(3), concentration coefficient of the three largest enterprises

D_k, share of the large enterprise

m = 3, the number of researched enterprises

TERMS AND ABBREVIATIONS

The following abbreviations, terms, and definitions are used in this study:

CES – Common Economic Space.

CJSC – Closed joint stock company.

Coats – Men's and women's coats, jackets and raincoats.

EU – European Union.

ISO – International Standard of Quality.

Knitted Wear – Knitted clothes and garments.

KVED – A classifier of economic activity types, DK 009:2005, approved by the Order of the State Committee of Ukraine on Technical Regulation and Consumer Policy (Derzhspozhyvstandart) as of 26 December 2005, No.375.

Large sized business – Enterprise with over 1,000 employees.

Medium sized business – Enterprise with 50 to 1,000 employees.

OJSC – Open joint stock company.

Own Production – All types of production.

PC – Production Company.

Shadow Import – The import of goods (a) illegally exported from countries of their origin and illegally imported to Ukraine, or (b) legally exported from countries of their origin, but illegally imported to Ukraine, or (c) shuttle imports.

Small Business – Enterprise with less than 50 employees.

STA – State Tax Administration of Ukraine.

Tolling – System of processing goods made on commission.

TOV – Limited Liability Partnership (LLC or Ltd.)

Unregistered Manufacturers – Businesses or entrepreneurs not registered as economic entities, or those not providing accounts and reports required for state statistics accounting and reporting.

VAT – Value-Added Tax.

Wear/garments/clothes – Men's and women's clothes, coats, suits, dresses, jackets, skirts, trousers, shirts, and blouses.

Wholesale Trade in Clothing Products – Wholesale trade in the following types of commodities: clothes and linens, home-use textiles, knitted wear and underwear, socks and pantyhose, hats, furs and fur coats (according to the classification of State Statistics Committee of Ukraine).

WTO – World Trade Organization.

SECTION 1. SECTOR'S MARKET STRUCTURE AND VOLUME

Before we analyze production and sales tendencies for Ukrainian-made clothes, let us state certain facts about Ukraine's clothing sector as of early 2006.

First, experts say there is a crisis in the sector, because of Ukraine's underdeveloped fashion industry. For this reason, most Ukrainian consumers look to Western brands.

Second, most of companies work predominantly according to tolling schemes. According to the experts, around 70-80% of clothes production in Ukraine is provided by tolling orders.

Third, Ukraine's clothing industry infrastructure is underdeveloped.

Fourth, most companies have internal problems associated primarily with poor management. We are going to describe them later. First we will analyze state statistics data related to companies' activities.

During 2000-2005, according to the State Statistics Committee, light industry production increased by 1% in monetary form and by 13% in kind (not taking into account the significant increase in accessories production).

The overall number of companies working in the industry increased by 21%, and in 2004 and 2005, amounted to almost 2,900 companies. At the same time, roughly 80% of companies (more than 2300) are specialized.

SECTOR SEGMENTATION BY MERCHANDISE GROUPS

In 2004, the State Statistics Committee decided to change the classification of light industry goods in Ukraine.

It is worth noting that the switch to the new classification and calculation system for light industry products was not explained properly with regard to how certain categories in the old classification were replaced by new ones. The State Statistics Committee transferred information

During 2000-2004 clothing product sales in Ukraine increased from 1,985.1 million hryvnias to 3,431.3 million hryvnias, i.e. by almost 73%.

The State Statistics Committee collected statistics on export and import in the industry for the year 2005. This information differs significantly from the data used by the Ministry of Industrial Policy, which is possibly due to the different government agencies' using different information sources (see "Methodology").

According to the State Statistics Committee, export volume of clothing industry products in 2000 equaled \$370.6 million, or 2016.1 million hryvnias (at the rate of 5.44 hryvnias per dollar). During 2000-2005, export volume increased by 71.4% and in 2005 equaled \$635.3 million dollars, or 3,225.7 million hryvnias (at the rate of 5.12 hryvnias per dollar).

Clothing products import volume, according to the State Statistics Committee, in 2000 equaled 229.3 million hryvnias and from 2000-2005 increased by 5.5 times. It amounted to 1,304.9 million hryvnias in 2005.

In 2000-2005, overall foreign investment into the sector's enterprises consisted of roughly 45.5 million hryvnias. Experts do not consider that amount sufficient for the sector's development.

on 2003 production volumes into a classifier effective since 2004 (in natural kind figures). This classifier used to have 48 entries (in its main and secondary parameters), but starting in 2004 the number of the entries increased to 74 (also main and secondary ones).

Thus statistics for clothing company activities can be conventionally broken down into two periods: 2000-2003, and 2004-2005.

TABLE 1.1. CLASSIFICATION OF CLOTHING PRODUCTS, USED THROUGH 2003
(Information provided by the State Statistics Committee)

Clothing industry product classification categories (2000-2003)
Clothing products, thousand hryvnias
Clothing products for children, thousand hryvnias
Coats, short coats, thousand
Coats, short coats, for children, thousand
Coats, short coats, for women, thousand
Raincoats, mackintoshes, cloaks, thousand
Raincoats for children, thousand
Raincoats for women, thousand
Suits, thousand
Suits for children, thousand
Suits for women, thousand
Suits for men, thousand
Suits, windproof and waterproof, thousand
Suits for winter sports, with thermal insulation, thousand
Judo garments, thousand
Jackets, thousand
Jackets for children, thousand
Jackets for men, thousand
Dresses (including dressing gowns and sun dresses), thousand
Dresses for children, thousand
Trousers (including work wear and women's trousers), thousand
Trousers for children, thousand
Trousers for men, thousand
Trousers for work, thousand
Out of the overall number of trousers: tennis shorts, thousand
Skirts, thousand
Skirts for children, thousand
Blouses, thousand
Blouses for children, thousand
Jackets, windbreakers (including work wear), thousand
Jackets, windbreakers for children, thousand
Jackets, windbreakers for men, thousand
Shirts, thousand
Shirts for children, thousand
Underwear, cotton and other fabrics, thousand
Sports shorts, thousand
Bed linen, thousand
Diapers and other clothes for newborn babies, thousand
Comforters and quilts, thousand
Out of the overall quantity of clothing products: special purpose wear (all types) for supply to trade organizations, thousand hryvnias
Gloves, thousand pairs
Textile hats (except felt hats), knitted hats and fur hats, thousand
Sleeping bags, thousand
Corselets, thousand
Coats, genuine leather coats, thousand
Genuine leather jackets, thousand
Genuine leather suit-coats, thousand

TABLE 1.2. CLASSIFICATION OF CLOTHING PRODUCTS, USED SINCE 2004
(Information provided by the State Statistics Committee)

Clothing industry classification categories (2003 – 2004)
Coats and raincoats made of genuine or artificial leather, thousand
Clothes sets made of genuine or artificial leather, thousand
Jackets, windbreakers, jackets, blazer jackets, women's jackets, genuine or artificial leather blazer jackets, thousand
Trousers and skirts, genuine leather or artificial leather or combinations, thousand
Work wear, for men and for boys, made of fabric, thousand
Jackets, jackets, windbreakers and work wear, for men and for boys, made of fabric, thousand
Trousers, breeches, shorts and other wear for work, for men and for boys, made of fabric, thousand
Coveralls with breast pockets and breast-bands, for men and for boys, made of fabric (except for coveralls 18.21.30), thousand
Work wear and sets, for women and girls, made of fabric, thousand
Jackets, windbreakers, jackets, women's jackets and work wear, for women and for girls, made of fabric, thousand
Trousers, breeches, shorts, etc., work wear, for women and for girls, made of fabric, thousand
Coveralls with breast-pockets and breast-bands, for women and for girls, made of fabric, thousand
Other work wear (aprons, overalls, coveralls, etc.), for men and for boys, made of fabric, thousand
Other work wear (aprons, overalls, coveralls, etc.), for women and for girls, made of fabric, thousand
Knitted wear - total, thousand
Knitted wear, outer clothing, thousand
Outer clothing - knitted wear, thousand
Coats, short coats, raincoats, cloaks, anoraks, jackets, windbreakers, thermal insulated jackets and windbreakers (including ski jackets) and similar knitted wear, for men and for boys, thousand
Suits, sets, jackets, blazer jackets, windbreakers, trousers, breeches, coveralls with breast pockets and breast-bands, knitted shorts, for men and for boys, thousand
Knitted suits, for men and for boys, thousand
Knitted jackets, for men and for boys, thousand
Jackets and blazer jackets, windbreakers, knitted, for men and for boys, thousand
Trousers and breeches, knitted, for men and for boys, cotton, thousand
Trousers and breeches, knitted, for men and for boys, wool, thousand
Trousers and breeches, knitted, for men and for boys, artificial fibers, thousand
Coveralls with breast pockets and breast-bands, shorts (except for swimming trunks) and similar knitted wear, for men and for boys, thousand
Coats, short coats, cloaks, anoraks, windbreakers, jackets and windbreakers with thermal insulation (including ski jackets) and similar knitted wear, for women and for girls, thousand
Coats, short coats, mantelets, raincoats and similar knitted wear, for women and for girls, thousand
Anoraks, raincoats and jackets, windbreakers, jackets and windbreakers with thermal insulation (including ski jackets), etc., knitted wear, for women and for girls, thousand
Suits, sets, women's jackets, blazer jackets, windbreakers, dresses, sun dresses, skirts, culottes, trousers, breeches, Coveralls with breast pockets and breast-bands, knitted shorts, for women and for girls, thousand
Suits, knitted, for women and for girls, thousand
Sets, knitted, for women and for girls, thousand
Women's jackets and blazer jackets, windbreakers, knitted, for women and for girls, thousand
Trousers and breeches, knitted, for women and for girls, thousand
Coveralls with breast pockets and breast-bands, shorts (except for swimming trunks) and similar knitted wear, for women and for girls, thousand
Dresses and sun dresses, knitted, for women and for girls, thousand
Skirts and culottes, knitted, for women and for girls, thousand
Coats, short coats, raincoats, cloaks, parkas and alaskas, and same products for men and boys, made of fabric, thousand

Jackets, thermal insulated anoraks (including ski jackets), raincoats and jackets, windbreakers and similar products for men and boys, made of fabric, thousand
Suits for men and for boys, made of fabric, thousand
Sets for men and for boys, made of fabric, thousand
Jackets and blazer jackets, windbreakers, pullovers and similar products for men and for boys, made of fabric, thousand
Trousers, breeches for men and for boys, made of fabric, thousand
Coveralls with breast pockets and breast-bands, for men and boys, made of fabric, thousand
Shorts (except for swimming trunks) for men and for boys, made of fabric, thousand
Coats, short coats, cloaks, raincoats, thermal-insulated jackets like parkas and alaskas, and similar products for women and for girls, made of fabric, thousand
Jackets, windbreakers and similar products for women and for girls, made of fabric, thousand
Suits for women and for girls, made of fabric, thousand
Sets for women and for girls, made of fabric, thousand
Women's jackets and blazer jackets, jackets, windbreakers, pullovers and similar products for women and for girls, made of fabric, thousand
Dresses and sun dresses for women and for girls, made of fabric, thousand
Skirts and skirt-trousers for women and for girls, made of fabric, thousand
Trousers and breeches for women and for girls, made of fabric, thousand
Coveralls with breast pockets and breast-bands for women and girls made of fabric, thousand
Shorts for women and for girls, made of fabric, thousand
Underwear, knitted, thousand
Clothes and accessories for small children under 86 cm, knitted, machine-made or hand-crafted, thousand
Sports suits and other clothes types, thousand
Knitted mittens, thousand pairs
Shawls, scarves, neck-scarves (comforters), mantillas, veils, etc., knitted, thousand
Shawls, scarves, neck-scarves (comforters), knitted, thousand
Clothes and accessories for small children under 86 cm, made of fabric, thousand
Sports suits and other garments (vests, coveralls, etc.), for men and for boys, made of fabric, thousand
Sports suits and other garments (vests, coveralls, etc.), for women and for girls, made of fabric, thousand
Ski suits, made of fabric, thousand
Handkerchiefs made of fabric, thousand
Shawls, scarves, neck-scarves (comforters), mantillas, veils, etc. made of fabric, thousand
Ties, bow-ties and cravats, made of fabric, thousand
Mittens and gloves made of fabric, thousand pairs
Mittens and gloves, leather, thousand pairs
Belts, ammunition belts, etc., leather, thousand
Special purpose wear, thousand
Hats and other head-ear, hairnets, thousand
Other headgear, thousand

This report analyzes production of clothing, including textile, knitted wear and leather garments. The information was provided by the State Statistics Committee for the period 2000-2005, in natural form (by thousand items) and in monetary form (by thousand hryvnias). Segmentation of the clothing market was performed in several directions.

First, all garments were split into the categories "clothes for men," "clothes for women," and "clothes for children," plus another category containing all products that don't fall into age or gender categories.

Second, garments were split into leather clothes, textile clothes and knitted wear. The leather clothes group has such sub-groups as jackets, windbreakers, raincoats, suit jackets and accessories.

Textile and knitted wear have more categories by product types. After 2003, knitted wear was moved into an independent category. All textile and knitted wear was broken down into the following categories: outerwear, business and casual wear, work wear, sportswear, underwear, accessories.

Below is a table comparing the categories included in each segment.

**TABLE 1.3. COMPARISON OF CLASSIFICATION CATEGORIES BY YEAR: from 2000 to 2005
(Analytical data)**

Classification categories	2000 – 2003	2003 – 2005
Clothing products	Total amount in two main categories: textile and knitted wear products and leatherwear	
Textile and knitted wear garments	The aggregate of detailed subcategories (outerwear, business and casual wear, work wear, sportswear, accessories)	
Outer clothing	Coats and short coats Raincoats Jackets, windbreakers	Coats and short coats Jackets, windbreakers Outer knitted wear
Coats and short coats	Textile garments from same category, divided into clothes for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Coats, short coats, mackintoshes, cloaks, anoraks, raincoats and jackets, windbreakers, thermal-insulated jackets and windbreakers (including ski jackets) and similar knitted wear products, parkas, alaskas, divided into men's and women's clothes, without a separate children's clothes category.
Raincoats	Textile products of same category, split into the categories: "for men," "for women," and "for children"; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Not listed as separate category.
Outer knitted wear	Not listed as a separate category.	Textile products of same category, without gender division.
Jackets, windbreakers	Textile products of same category, split into the following categories: for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Anoraks, raincoats and jackets, windbreakers, thermal-insulated jackets, windbreakers (including ski jackets), etc., knitted wear, split into the following categories: for men and for women, without separate children's category.
Business clothes and casual clothes	Aggregate of the detailed subcategories (suits, jackets, dresses, trousers, skirts, blouses, shirts)	
Suits	Textile products of same category, split into the following categories: for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Suits, sets, jackets, blazer jackets, windbreakers, trousers, breeches, coveralls with breast pockets and breast-bands, knitted shorts, knitted suits, overalls with breast-bands, shorts (except for swimming trunks) and similar products, knitted dresses, sun dresses, skirts, culottes, trousers, breeches, coveralls with breast pockets and breast-bands, knitted shorts, split into the following categories: for men and for women, without separate children's category.

Jackets	Textile products of same category, split into the following categories: for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Jackets, women's jackets and blazer jackets, windbreakers, pullovers and similar products, split into the following categories: for men and for women, without separate children's category.
Dresses	Textile products of same category, split into the following categories: for women and for children; Women's clothes calculated as difference between overall quantity and children's clothes.	Dresses and sun dresses without separate children's category
Trousers	Textile products of same category, split into the following categories: for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Trousers, breeches and shorts, split into the following categories: for men and for women, without separate children's category.
Skirts	Textile products of same category, split into the following categories: for women and for children.	Skirts and skirts-trousers without separate children's category.
Blouses	Women's clothes calculated as difference between overall quantity and children's clothes.	Not listed as a separate category.
Shirts	Textile products of same category, split into the following categories: for men, for women and for children; Clothes for men, calculated as the difference between overall quantity and women's and children's clothes.	Not listed as a separate category.
Work clothes	Out of the total quantity of special purpose clothing (all types), clothing made for trade organizations	Aggregate, by categories (suits, jackets, trousers, jackets, windbreakers, other work clothes)
Suits	Not listed as a separate category.	Work sets and suits, coveralls with breast pockets and breast-bands, split into the following categories: for men and for women, without separate children's category
Jackets	Not listed as a separate category.	Jackets, jackets, windbreakers and blazer jackets, for work, for men and for boys, made of fabric.
Trousers	Not listed as a separate category.	Trousers, breeches, shorts, etc. (work wear), split into the following categories: for men and for women, without separate children's category.
Jackets, windbreakers	Not listed as a separate category.	Jackets, windbreakers for women.

Other work clothes	Not listed as a separate category.	Other work clothes (aprons, overalls, coveralls, etc.), special purpose clothes.
Sports clothes	Aggregate of the detailed subcategories (suits, underwear, other)	
Suits	Suits windproof and waterproof, suits for winter sports, with thermal insulation, judo garments.	Sports suits, ski wear and other types of clothes.
Other	Sports shorts, tennis shorts.	Not listed as a separate category.
Underwear	Underwear, cotton and other fabrics, diapers and other clothes for newborn babies, corselets not split into categories.	Clothes and accessories for small children under 86 cm, knitted, machine-made or hand-crafted, knitted underwear not split into categories.
Accessories	Aggregate of the detailed subcategories (ties, shawls, scarves, headgear, gloves, etc.)	
Ties	Not listed as a separate category.	Ties, bowties and cravats
Shawls, scarves	Not listed as a separate category.	Shawls, scarves, neck-scarves (comforters), mantillas, veils.
Head gear	Textile hats (except felt hats), knitted hats and fur hats	Hats and other headgear; hairnets.
Gloves	Gloves.	Mittens and gloves.
Other	Not listed as a separate category.	Handkerchiefs.
Leather garments	Aggregate of the detailed subcategories (coats, jackets, windbreakers, jackets, accessories, suits, made of leather)	
Coats	Coats and short coats without splitting into categories.	Coats and raincoats, made of leather, or artificial leather, or combinations.
Jackets, windbreakers	Same category products, not split into categories.	Jackets, windbreakers, jackets, women's jackets, blazer jackets.
Jackets	Leather products of same category not split into categories.	Not listed as a separate category.
Accessories	Not listed as a separate category.	Mittens and gloves, belts, ammunition belts, etc.
Suits	Not listed as a separate category.	Sets.

Hereafter, sector goods will be split into categories according to the following generalized classification:

- Textile and knitted wear:
 - Outer clothing (coats and short coats, raincoats, knitted clothing, jackets, windbreakers);
 - Business clothes and casual wear (suits, jackets, dresses, trousers, skirts, blouses, shirts);
 - Work clothes (suits, jackets, trousers, jackets, windbreakers);
 - Sportswear (suits, etc.);
 - Underwear;
 - Accessories (ties, shawls and scarves, headgear, gloves, etc.).
- Leather garments:

- Coats;
- Jackets, windbreakers;
- Suit jackets;
- Accessories;
- Suits.

While reviewing the data analysis, the State Statistics Committee's methodology must be taken into account: "All enterprises provide accounts characterizing their activities in general. Such accounts include balance sheets and financial accounts, form 1 - entrepreneurship, statistics forms about labor, etc. Depending on the type of activities they are involved in, enterprises provide specific other accounts. E.g., accounts for manufactured products are submitted by production enterprises, and sales accounts are provided by enterprises declaring wholesale or

retail sales as their primary activity. As for export and import, all transactions registered by the

customs office are taken into account." (State Statistics Committee.)

CONCLUSIONS

1. The clothing products classifier was changed in Ukraine in 2004, which explains significant structural changes in production, sale and export of clothing sector products since 2004.

2. Classification of Ukrainian-made clothes became more detailed than it was between 2000 and 2003, which makes possible a more detailed analysis of the structure of clothing industry production since 2004.

3. Ukraine's clothing industry has a few peculiar features that make analyzing its mechanisms quite special. These features are:

- an underdeveloped fashion industry;
- clothing factories that work primarily in tolling schemes;
- an underdeveloped sector logistical structure;
- internal management problems at clothing enterprises.

PRODUCTION SCOPE BY SEGMENTS, 2000-2005

The years 2000-2005, according to the State Statistics Committee, saw three increases in clothing production in Ukraine (2000-2001, 12.9%;

2002-2003, 10.6%; 2004-2005, 12.5%) and two falls (2001-2002, 1.4%; 2003-2004, 27.2%), as table 1.4 makes clear.

TABLE 1.4. CLOTHING PRODUCTION DYNAMICS OVER 2000-2005 IN MONETARY FORM, THOUSAND HRYVNIA (Information provided by the State Statistics Committee)

Clothing production, by categories, thousand hryvnias	2000	2001	2002	2003	2004	2005
CLOTHING PRODUCTS	509 639.4	575 556.8	567 231.4	627 397.1	456 984.2	513 917.1
TEXTILE AND KNITTED WEAR	508 314.7	572 829.4	565 107.8	622 348.1	548 821.7	506 269.0
Outer clothing	163 180.8	158 829.3	170 546.8	186 658.9	65 755.2	66 153.4
coats, short coats and raincoats	97 658.8	88 937.0	104 574.2	109 508.7	58 913.7	62 877.1
mackintoshes	11 380.1	9 615.9	7 980.5	8 313.6		
jackets, windbreakers	65 522.0	69 892.3	65 972.6	77 150.2	6 823.5	3 276.3
Business clothes and casual clothes	304 605.2	375 214.2	351 941.8	395 769.0	62 250.3	70 014.2
suits	983.9	1 252.0	754.6	2 418.5	36 864.3	37 723.6
jackets	92 339.0	118 752.8	116 814.1	127 571.2	8 598.2	11 958.0
dresses	26 154.1	23 806.2	17 234.4	16 389.4	3 194.2	3 505.5
trousers	82 879.1	114 069.6	116 009.2	143 769.2	10 417.8	12 231.8
skirts	28 534.5	26 610.4	23 245.8	30 417.9	3 175.9	4 595.3
blouses	45 820.0	53 242.5	48 872.6	48 699.3		
shirts	27 894.6	37 480.7	29 011.1	26 503.5		
Work clothes					13 7145.3	155 195.2
suits					78 262.9	85 891.9
jackets					23 590.4	32 687.9
trousers					4 370.6	8 207.0
jackets, windbreakers					3 251.0	5 475.4
other					27 670.4	22 933.0

Sports clothes	42.6				26 801.9	35 159.5
suits					26 801.9	35 159.5
other	42.6					
Underwear	37 787.5	38 785.9	39 699.8	39 920.2	34 918.9	41 622.8
Accessories	2 698.6		2 919.4		55 431.5	60 619.2
ties					289.5	455.4
shawls and scarves					1 670.6	1 814.3
head gear	2 698.6	1 423.7	2 919.4		18 261.9	19 465.1
gloves					24 677.6	25 828.9
other					10 531.9	13 055.5
Knitted wear					66 518.6	77 504.9
LEATHER GARMENTS	1 324.7	2 727.4	2 123.6	5 049.0	8 162.6	7648.1
coats		18.0			133.7	769.6
jackets, windbreakers	1 324.7	2 709.4	2 123.6	5 049.0	3 341.8	2 402.1
accessories					4 501.3	4 361.6
suits					185.8	114.8

It is worth noticing that clothing production in 2004 decreased almost at the level of 2000. This, after three significant production increases, in 2001, 2003 and 2005.

An almost identical situation comes to light when we analyze the dynamics of the industry's production results (table 1.5.).

Note that the significant production increase in 2004 and 2005 is explained by the change in how clothing industry products are classified, namely a more detailed accounting of accessories (see "Accessories" entry in the table 1.5.).

TABLE 1.5. CLOTHING PRODUCTION DYNAMICS OVER 2000-2005 IN KIND, THOUSAND
(Information provided by the State Statistics Committee)

Clothing production, by categories, thousand	2000	2001	2002	2003	2004	2005
CLOTHING PRODUCTS	113 335.6	126 851.4	135 294.8	133 649.2	415 094.0	420 640.0
TEXTILE AND KNITTED WEAR	113 315.7	126 819.4	135 261.5	133 616.6	414 312.0	420 014.5
Outer clothing	6 092.8	6 997.4	10 334.5	6 108.0	5 160.5	4 662.4
coats, short coats and raincoats	2 156.5	2 099.0	2 564.8	2 400.2	4 252.1	3 994.2
mackintoshes	291.7	317.8	281.4	275.5		
jackets, windbreakers	3 644.6	4 580.6	7 488.3	3 432.3	908.4	668.2
Business clothes and casual clothes	35 060.6	43 975.2	39 857.4	39 154.0	32 624.3	29 297.5
suits	1 645.3	2 312.8	2 220.6	2 681.9	2 848.1	2 594.9
jackets	4 556.8	6 469.7	5 399.3	4 926.0	6 387.3	6 560.8
dresses	2 359.1	1 893.9	1 689.9	1 366.7	1 216.2	1 262.6
trousers	11 781.1	16 802.4	16 577.1	17 252.8	18 763.7	16 055.5
skirts	3 876.9	3 556.2	3 117.0	3 485.2	3 409.0	2 823.7
blouses	7 040.7	7 436.9	6 598.2	6 266.9		
shirts	3 800.7	5 503.3	4 255.3	3 174.5		
Work clothes	47 488.0	49 186.0	60 234.0	65 672.0	11 952.6	11 861.6
suits					2 693.4	2 838.9
jackets					1 844.7	2 154.1
trousers					2 544.5	2 531.9
jackets, windbreakers					100.1	123.4
other					4 769.9	4 213.3

Sports clothes	6.2	33.0	21.7	174.2	2 023.2	2 050.8
suits	0.8	11.9	0.4	145.3	2 023.2	2 050.8
other	5.4	21.1	21.3	28.9		
Underwear	11 764.3	10 555.4	9 242.2	8 416.9	25 659.5	26 844.8
Accessories	12 903.8	16 072.4	15 571.7	14 091.5	300 403.7	308 083.6
ties					34.6	133.7
shawls and scarves					457.0	337.6
head gear	497.8	452.0	643.8	793.6	273 525.8	280 204.6
gloves	12 406.0	15 620.4	14 927.9	13 297.9	16 651.0	17 165.6
other					9735.3	10 242.1
Knitted wear					36 488.2	37 213.8
LEATHER GARMENTS	19.9	32.0	33.3	32.6	782.0	625.5
coats		0.5			9.1	1.4
jackets, windbreakers	19.9	31.5	33.3	32.6	64.6	67.4
accessories					678.5	525.5
suits					29.8	31.2

TABLE 1.6. CLOTHING PRODUCTION DYNAMICS OVER 2003-2005, NEW CLASSIFICATION, IN KIND, THOUSAND

Production volume, in kind, according to the classification effective since 2004.	Year		
	2003	2004	2005
CLOTHING PRODUCTS, thousand items	320 342.1	415 094.0	420 640.0
TEXTILE AND KNITTED WEAR	319 289.9	414 312.0	420 014.5
Outer clothing	5 248.4	5 160.5	4 662.4
coats, short coats and raincoats	4 152.2	4 252.1	3 994.2
mackintoshes	1 096.2	908.4	668.2
Business clothes and casual clothes	29 714.1	32 624.3	29 297.5
suits	2 305.5	2 848.1	2 594.9
jackets	5 539.5	6 387.3	6 560.8
dresses	1 167.4	1 216.2	1 262.6
trousers	17 122.9	18 763.7	16 055.5
skirts	3 578.8	3 409.0	2 823.7
Work clothes	10 790.3	11 952.6	11 861.6
suits	2 475.7	2 693.4	28 38.9
jackets	1 644.1	1 844.7	2 154.1
trousers	1 982.1	2 544.5	2 531.9
jackets, windbreakers	34.4	100.1	123.4
other	4 654.0	4 769.9	4 213.3
Sports clothes	1 494.7	2 023.2	2 050.8
suits	1 494.7	2 023.2	2 050.8
Underwear	18 765.8	25 659.5	26 844.8
Accessories	223 632.9	300 403.7	308 083.6
ties	7.8	34.6	133.7
shawls and scarves	228.7	457.0	337.6
head gear	201 948.9	273 525.8	280 204.6
gloves	16 443.9	16 651.0	17 165.6
other	5 003.6	9 735.3	10 242.1
Knitted wear	29 643.7	36 488.2	37 213.8

LEATHER GARMENTS	1052.2	782.0	625.5
coats	0.6	9.1	1.4
jackets, windbreakers	48.0	64.6	67.4
accessories	989.6	678.5	525.5
suits	14.0	29.8	31.2

Table 1.6., showing the results of clothing production in 2003 according to the classifier effective since 2004, suggests there was moderate growth in accessories production (34.3%).

There was therefore a negative dynamic in clothing production in monetary form, although production in kind (natural form) increased by 29.6%. Such significant growth was due to an increase in accessories production. Accessories are hardly a relevant part of clothing production. So below we are going to study changes in production volume in the main categories.

Increase in clothing production in 2001 and 2003 is partly explained by the increase of foreign

investment in clothing sector companies in the previous years (2000 and 2002). Correspondingly, the fall in production by Ukrainian companies in 2002 and 2004 was partly associated with the decrease of investments in the clothing industry between 2001 and 2003

The decrease in production in 2004 (in monetary form) can be partly explained by the influence of certain negative factors of a macroeconomic and microeconomic nature. Questionnaires filled out by 20 clothing industry companies indicated what caused the 2004 production decrease. See table 1.7.

TABLE 1.7. MAIN CAUSES OF THE DECREASE IN CLOTHING PRODUCTION IN 2004 (Results of polling of 20 clothing companies)

No	Problem
1	Imperfect tax legislation system in Ukraine; VAT and taxation of salary fund.
2	Lack of government regulation of customs policy issues.
3	High cost of electricity.
4	High cost of imported equipment (outdated equipment).
5	Small domestic market (high competition. low purchasing capacity).
6	Lack of circulating assets, high interest rates for credit.
7	Problems with supplying sufficient quantities of raw materials to production facilities (high cost of raw materials and consequently of finished products).
8	Lack of qualified specialists and workers, high rotation rate due to low salaries.
9	Lack of designers and, consequently, inability to keep up with fashion trends; low competitive ability.
10	Lack of stable markets in which to sell finished products.

Here are several statements from the Industry Ministry:

- *Light industry has overcome a 10-yea- long crisis in which it cut 350 thousand jobs and reduced its share in the country's industrial production to 1.1%.*

For the past five years, light industry has been increasing production steadily, seeing a 13.6% increase in 2004.

However, since the beginning of the current year, the increase has slowed down and the rise over the past 7 months was only 2.8% (shoe production has even decreased by 12%).

Some 1.6 thousand jobs have been lost over the last 6 months. This was due to the implementation of collateral securities applied for raw materials for goods made on commission, to the sudden drop in the US dollar and euro exchange rate, and to

the significant amount of re-export of leather raw materials via Moldova, which was equal to one-third of the whole quantity of this type of raw material in Ukraine.

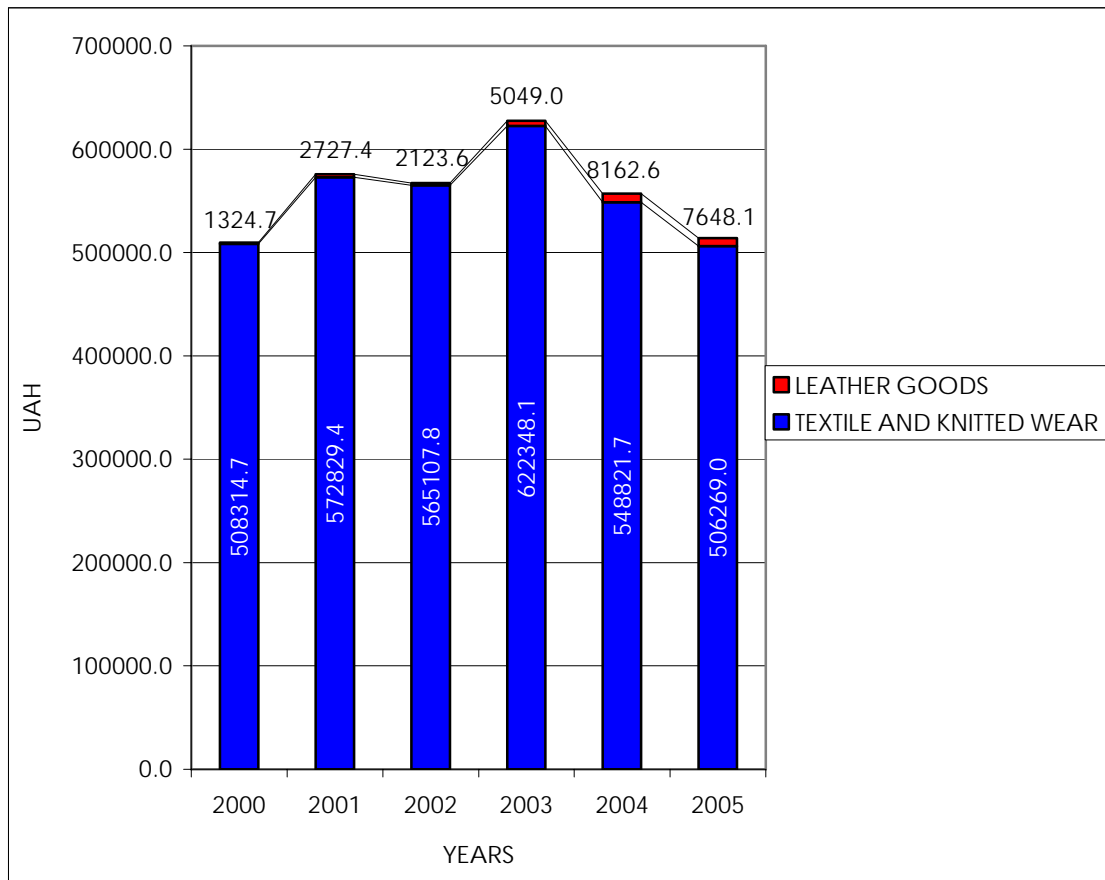
- *As of the early 2004, light industry had 4.8 thousand companies, with 152 thousand jobs. In 2004, the dynamic in light industry was positive.*

The production volume index from 2004 to the past year was 113.6%, breaking down as follows: textile production — 119.2%; production of ready-made clothes and fur — 112.1; production of leather small goods, travel goods and shoes — 112.5%.

- *According to the State Statistics Committee of Ukraine, the consumer price index (inflation index) in August 2004 as compared to this July was 99.9%; from January-August, 2004*

— 104.3%; between January, 1998 and August, 2004 — 214.1%.

DIAGRAM 1.1. DYNAMICS OF CLOTHING PRODUCTION IN MONETARY FORM, IN 2000 - 2005 , THOUSAND HRYVNIAS



Between 2000 and 2004, clothing production rose and fell several times. In 2001, (in monetary form), clothing production increased almost by 13% and equaled 575.6 million hryvnias. In 2002, production volume reduced slightly (by 1.5%), though in 2003 it increased again, by 10.6% and amounted to 627.4 million hryvnias. In 2004, specialists noted a rise in clothing production, in relative prices, of 13%.

At the same time, according to the State Statistics Committee, in monetary form, clothing production

in 2004 decreased by 16.4% (diagram 1.1.). This difference is explained partly by the specifics of calculation in "relative prices."

A good example of the changes in the production structure according to the 2003 and 2004 production structures can be had by comparing production structure before and after the classifier changes were introduced (diagrams 1.2., 1.3., 1.4.).

DIAGRAM 1.2. DYNAMICS OF CLOTHING PRODUCTION IN NATURAL FORM, IN 2000-2005, ACCORDING TO THE CLASSIFIERS OF THE CORRESPONDING YEARS (2000-2003, and since 2004), THOUSAND ITEMS

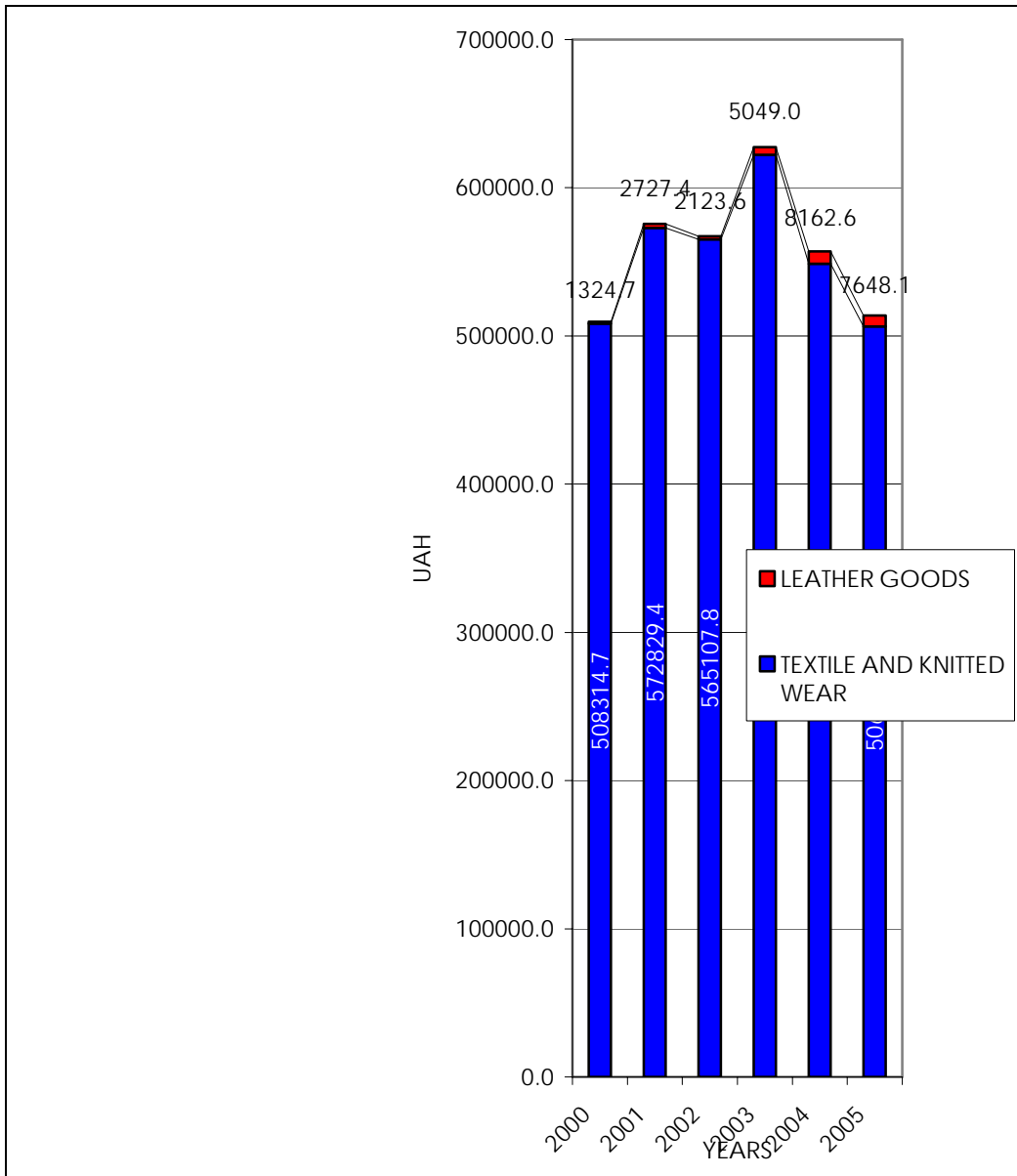
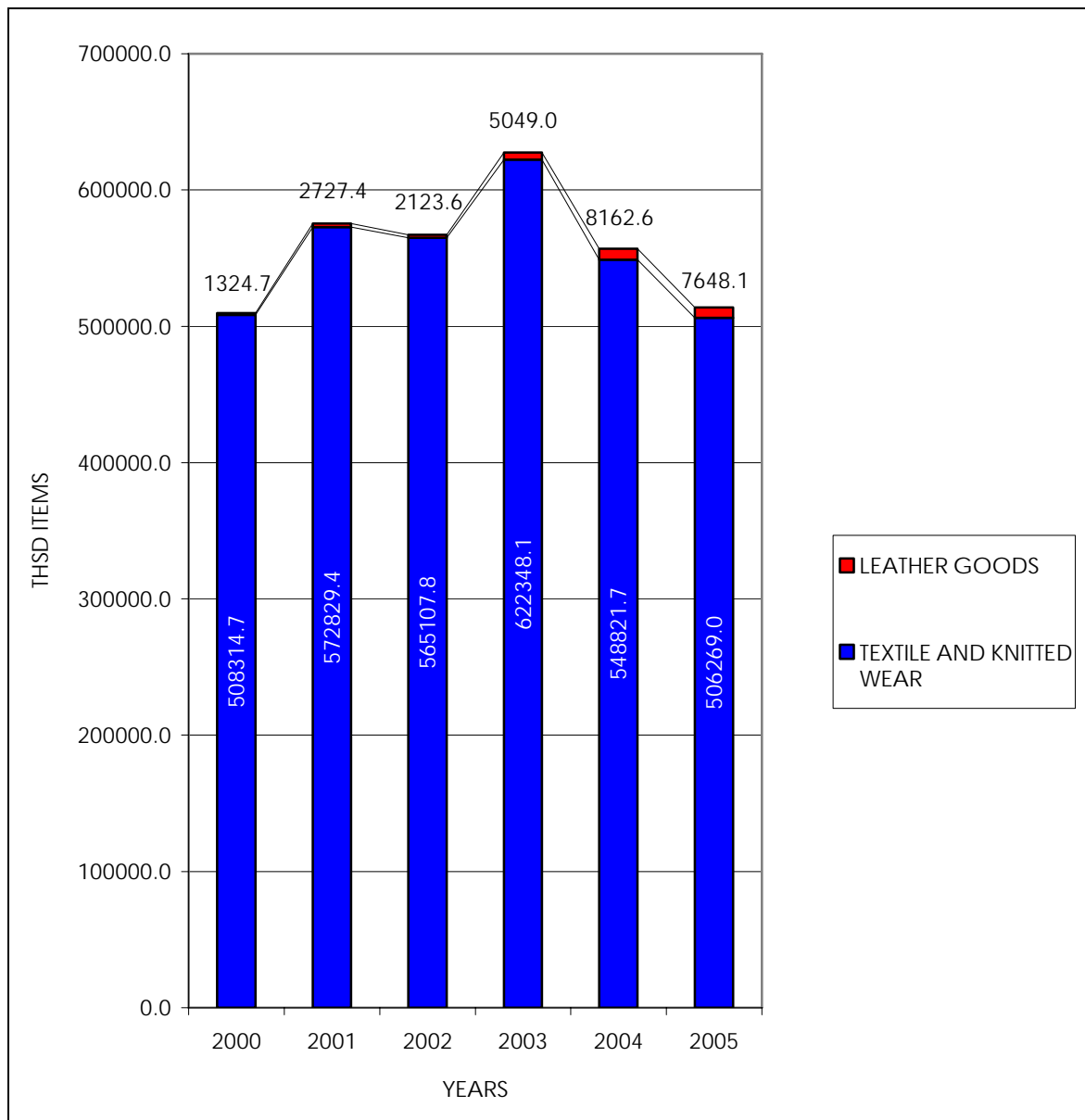


DIAGRAM 1.3. DYNAMICS OF CLOTHING PRODUCTION IN NATURAL FORM, IN 2000-2005, ACCORDING TO THE CLASSIFIER EFFECTIVE SINCE 2004, THOUSAND ITEMS



Because knitted wear was an independent category in the 2004 classifier, the shares of other clothing categories in the overall structure decreased significantly (in natural form). In particular, the share of business clothes and casual clothes fell by 28.5%, as compared to

2003; of work wear by 81.6%; of accessories by 86.1%. The shares of other categories increased: of outer clothing by 2.4 times; of sportswear by 10.6 times; of underwear by more than twice (diagram 1.4.).

DIAGRAM 1.4. STRUCTURE OF SECTOR'S PRODUCTION IN THE MAIN CATEGORIES, IN 2000 - 2005 , THOUSAND HRYVNIAS

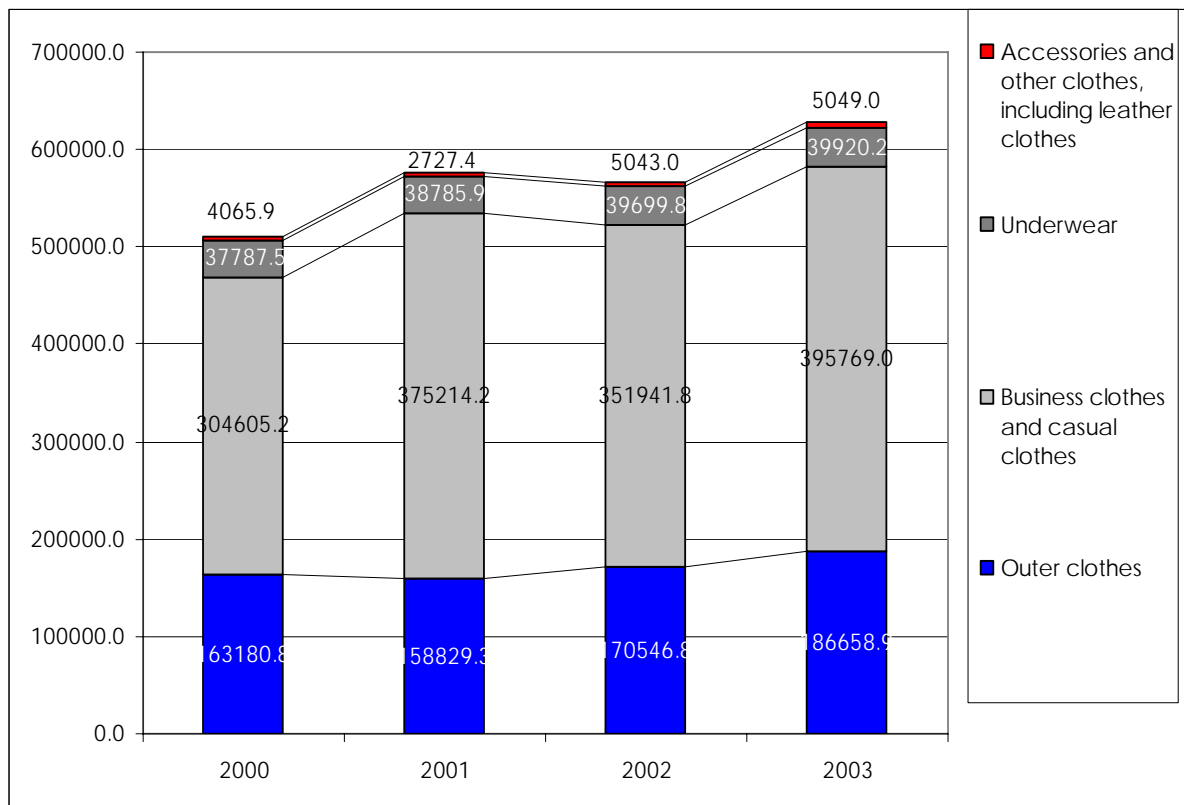
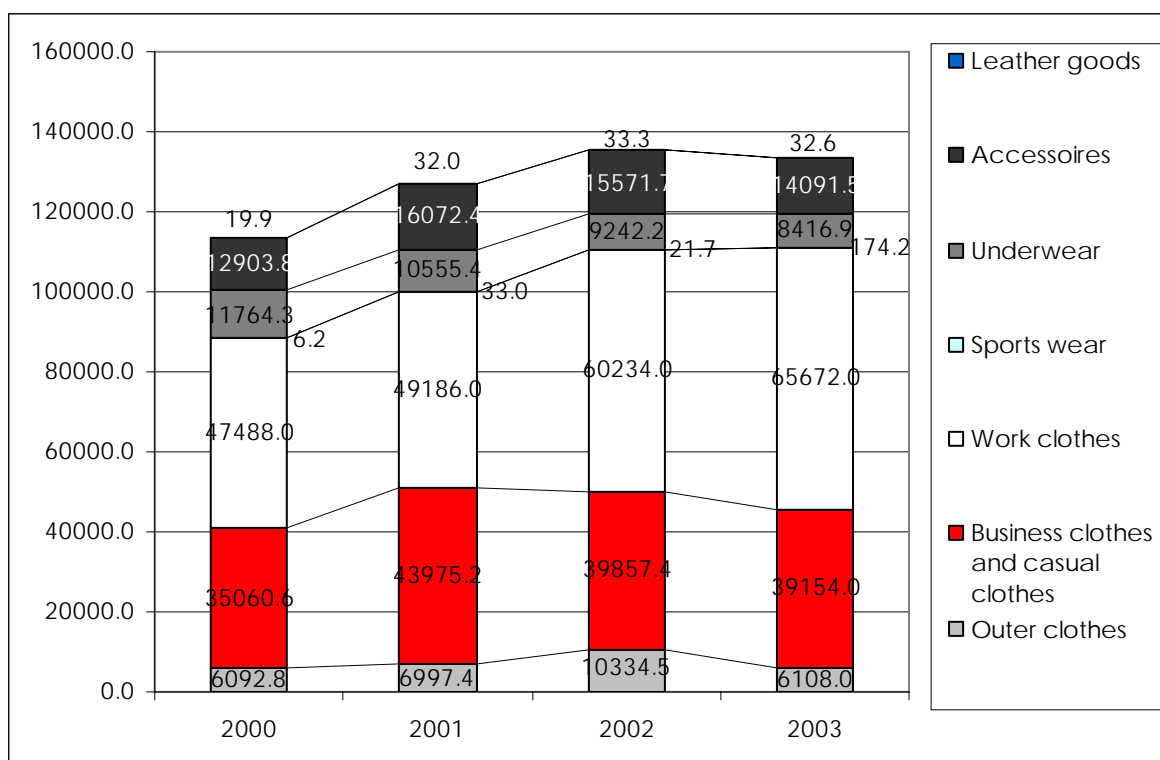


DIAGRAM 1.5. STRUCTURE OF SECTOR'S PRODUCTION, IN MAIN CATEGORIES, IN 2000 - 2003, AND IN 2003 - 2005, THOUSAND ITEMS



Since the knitted wear category in the clothing production structure was segregated into a separate category in 2004, production volumes in other categories of clothing products, like business clothes, casual clothes, and work wear accessories, fell significantly.

Outer clothes production dynamics

Let us review outerwear production dynamics from 2000-2005 (diagram 1.6.).

Production volumes of coats, short coats and raincoats in 2000-2005 saw minor fluctuations:

in 2001, production volume went down by 2.7%, in 2002 it increased by 22.2%, in 2003 it went down again by 6.4%, in 2004 it increased by 2.4%, and in 2005 it went down by 6.1%.

As for raincoats, production stayed at the level of roughly 300 thousand items per annum, from 2000 through 2003. Since 2004 the "raincoats" category was included in the general category "coats, short coats and raincoats." Therefore, since 2004, this category has acquired a higher absolute value.

Jacket production in 2000, amounted to 3644.6 thousand items. In 2001 this figure increased by 25.7%. In 2002, jacket production volume increased by 63.5% and equaled more than 7 million items. In 2003, this figure fell significantly (by 54.2%). In 2004, jacket production fell again, down to 17.1%, and in 2005 it fell by another 26.4%.

Dynamics of production of work wear, sports wear and knitted wear, underwear and accessories

Let us look at the changes in the structure of production of work wear and sportswear, underwear, accessories and the separate knitted wear category, which was established in 2004 (diagram 1.7.).

In 2000-2004, work wear production volume grew continuously. In 2000, it equaled 47.5 million. In 2001, it increased by 3.6%; in 2002 by 22.5%; in 2003 by 9%. In 2004, production volume of work wear increased again by 10.8%, and in 2005 it decreased in comparison with 2004, by 0.8%.

Production volume of sportswear in 2000 equaled only 6.2 thousand. In 2001, production volume increased more than 5 times and equaled 33 thousand items. In 2002, production volume went down by 34.2%. In 2003 production of sportswear in Ukraine increased by more than 5 times. In 2004, production volume of sportswear increased again, by 35.4%, and in 2005 it rose by another 1.4%.

Production of underwear decreased in 2000-2003, but in 2004 a tendency for production to

increase became apparent. In 2000, underwear production volume equaled 11.8 million items. In 2001, production volume went down by 9%, in 2002 by 8.6%, and in 2003 by 9.1%. In 2004, underwear production volume increased by 36.7%, and in 2005 by another 4.6%.

Accessories production volume in 2001 increased as compared to 2000, by 24.6%. In 2002 and 2003, production volume decreased. In 2004, the increase of accessories production in comparison with 2003 was 34.3%. In 2005, accessories production volume increased by another 2.6%.

Until 2003, knitted products were not segregated into a separate category; therefore the dynamics of knitted wear production are analyzed starting with the year 2003. That year, production volumes of knitted wear equaled almost 30 million items. In 2004, production volume increased by 23.1%. In 2005 there was a 2% production increase in this category.

Business clothes production dynamics

Now we will analyze the dynamics of business clothes production (diagram 1.8.), by categories: suits, jackets, dresses.

The suit production volume in 2000 was 1.6 billion items. In 2001, this figure increased by 40.6%. In 2002, suit production somewhat decreased (by 4%). In 2003, suit production increased by 20.8%. In 2004, as compared to 2002, production rose by 23.6%, but in 2005 there was a 8.9% decrease.

Suit jacket production in 2000 exceeded 4.5 billion items. In 2001, it increased by almost 42%. In 2002, jacket production fell by 16.5%, and in 2003 by another 8.8%. In 2004 the jacket production volume began growing again, by 15.3%. This tendency persisted, and in 2005 production increased by 2.7%.

Production of dresses by Ukrainian clothing companies decreased in 2000-2003. In 2004, production of dresses increased by 4.2%, and in 2005 by 3.9%, as compared to 2004.

DIAGRAM 1.6. DYNAMICS OF PRODUCTION OF OUTER CLOTHING, BY CATEGORIES, IN 2000-2003 and 2003-2005, THOUSAND ITEMS

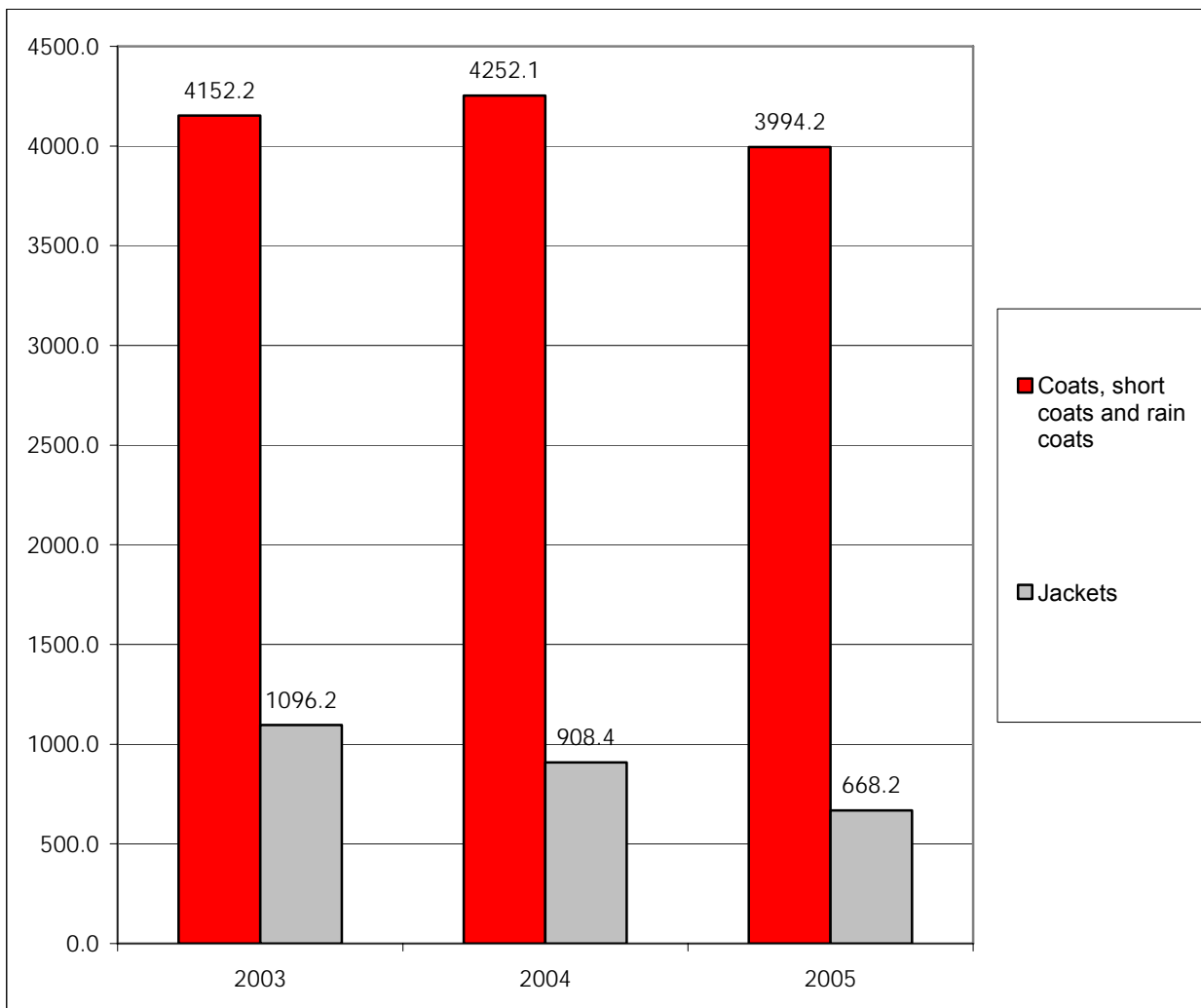
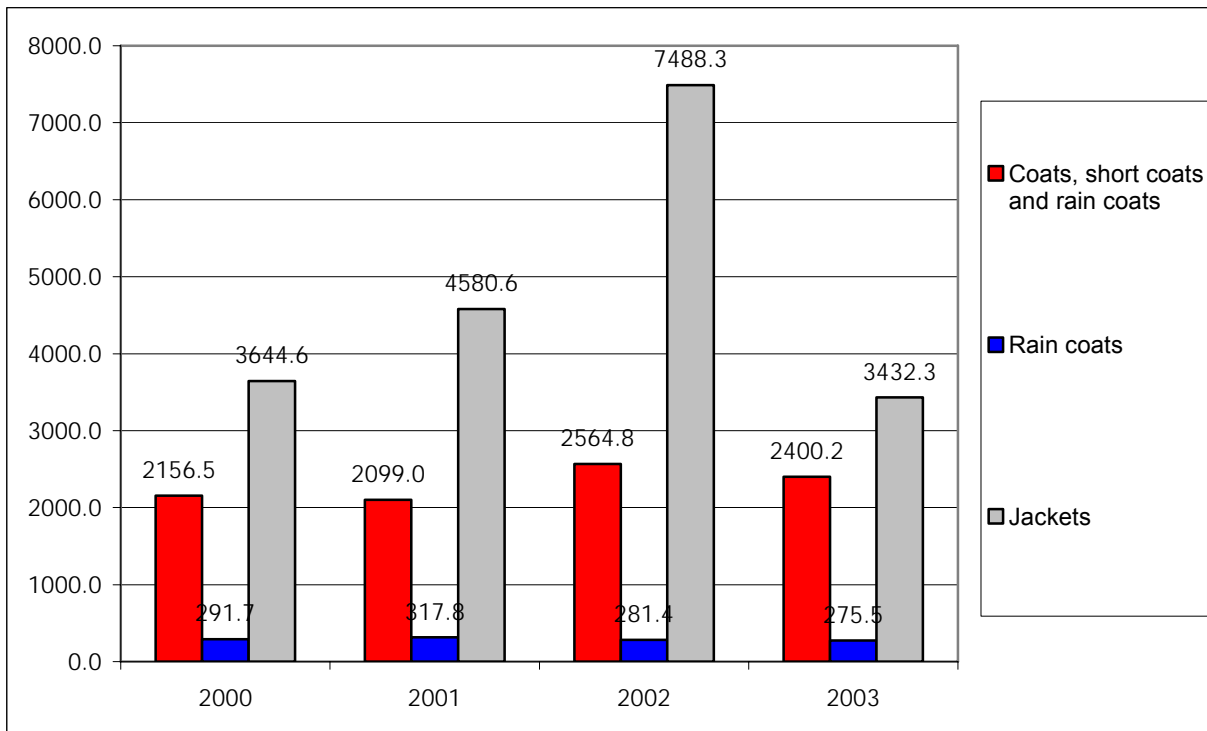


DIAGRAM 1.7. DYNAMICS OF PRODUCTION OF WORK WEAR, SPORTSWEAR, KNITTED WEAR AND ACCESSORIES AND UNDERWEAR IN 2000-2003 and 2003-2005, THOUSAND ITEMS

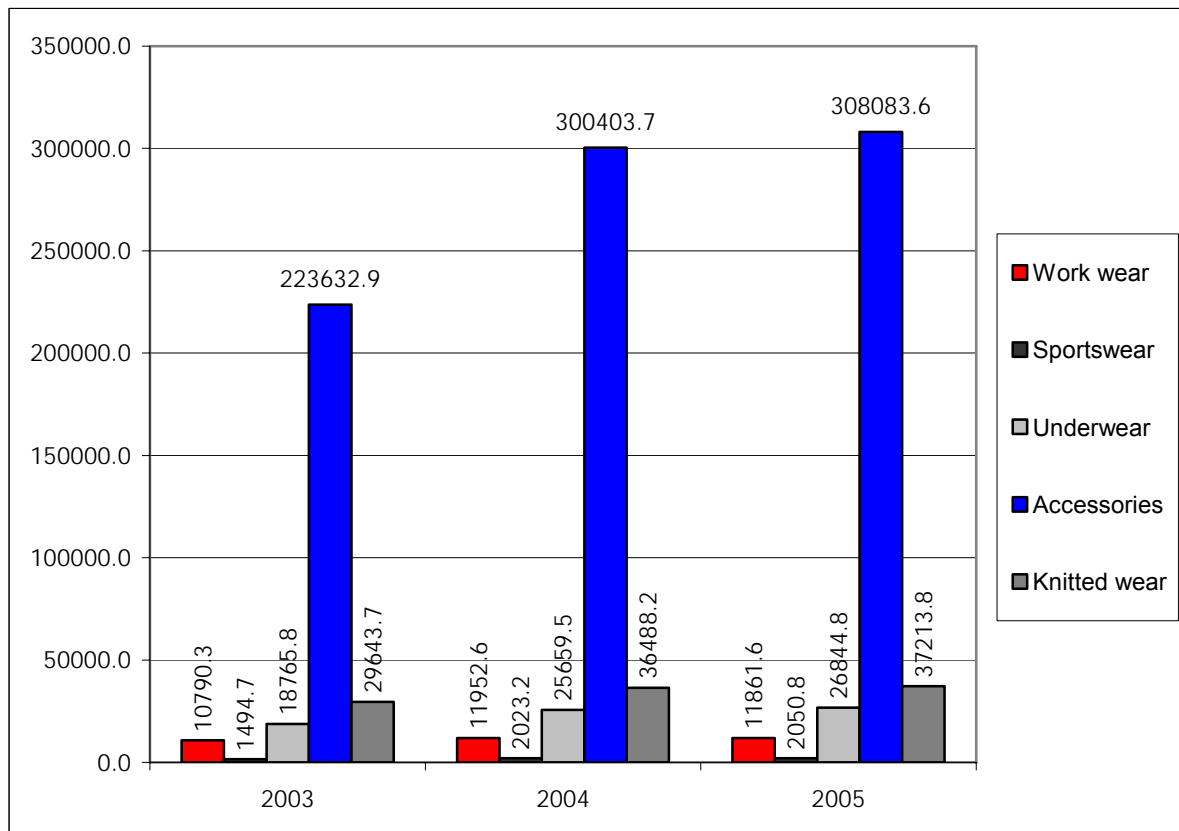
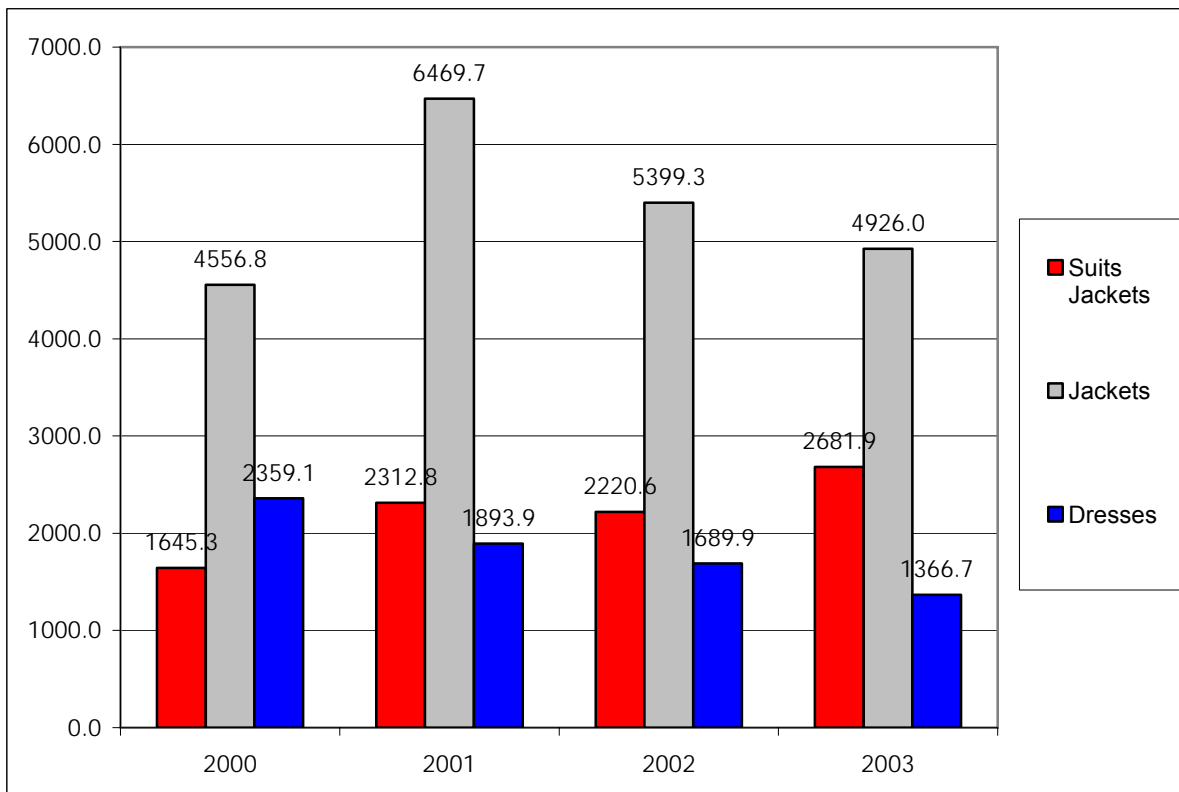


DIAGRAM 1.8. DYNAMICS OF BUSINESS CLOTHES PRODUCTION, BY THE FOLLOWING CATEGORIES: SUITS, JACKETS, DRESSES, IN 2000-2003 and 2003-2005, THOUSAND ITEMS



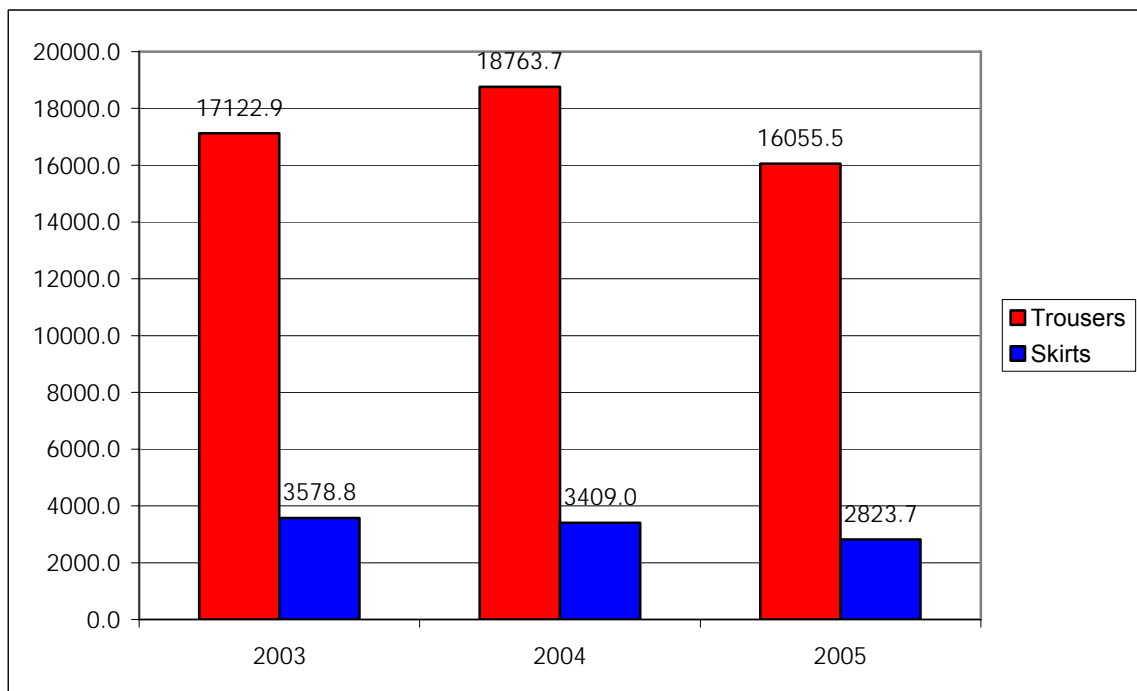
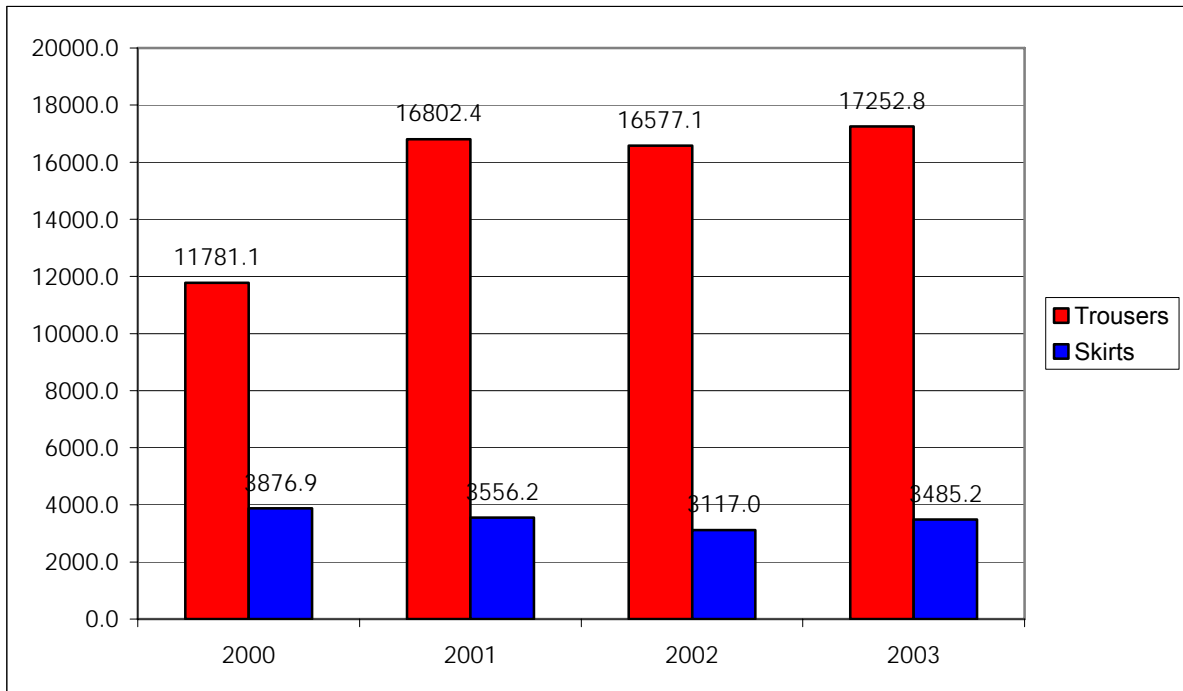
Let us analyze the dynamics of trouser and skirt production in 2000-2005 (diagram 1.9.).

In 2000, trouser production volume was almost 12 million items. In 2001, this figure increased significantly, by 42.6%. In 2002, trouser production volume went down by 1.3%. In 2003, trouser production increased again by 5.7%. In 2004, the increase was 9.6%. In 2005, trouser production volume went down by 14.4%.

The production volume of skirts in 2000 equaled roughly 3.9 million items. In 2001-2002, production of skirts went down.

In 2003, skirt production increased 11.8%. In 2004, production went down by 4.7%, and in 2005 it went down another 17.2%.

DIAGRAM 1.9. BUSINESS CLOTHES PRODUCTION DYNAMICS: TROUSERS, SKIRTS IN 2000-2003 AND 2003-2005, THOUSAND ITEMS



Dynamics of production of blouses and shirts

Let us now analyze the dynamics of blouse and shirt production in 2000-2005 (diagram 1.10.).

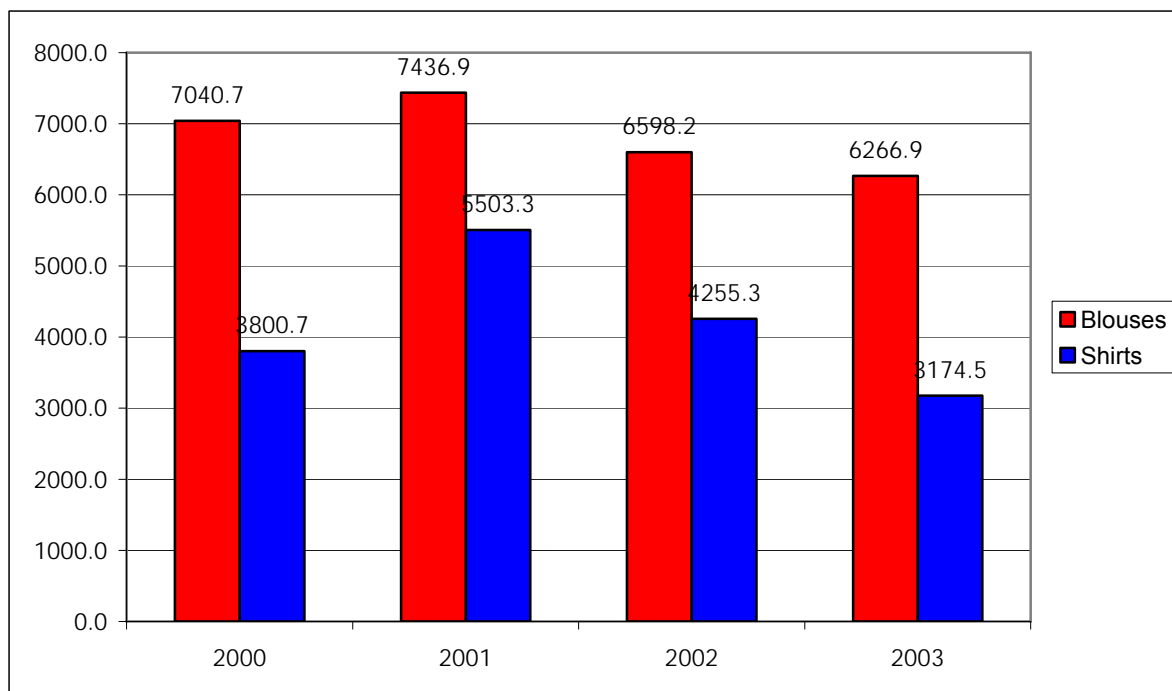
In 2000, production volume of blouses exceeded 7 million items, and production of shirts was almost 4 million items. In 2001, production of blouses increased by 5.6%, and production of shirts by 44.8%. In 2002-2003, production of blouses and shirts went down, respectively, by

11.3% and 5% (for blouses) and by 22.7% and 25.4% (for shirts).

After 2004, there are no more separate categories of blouses and shirts production in the state classifier.

It is possible to say that goods from these categories were partly included in the "knitted wear" category.

DIAGRAM 1.10. DYNAMICS OF BUSINESS CLOTHES PRODUCTION IN THE FOLLOWING CATEGORIES: BLOUSES, SHIRTS, IN 2000-2003, THOUSAND ITEMS

**Dynamics of leather clothes production**

Now we'll turn to the dynamics of leather clothes production in 2000-2005 (diagram 1.11.).

Until 2003, jackets were the main type of leather good being produced. In 2000, leather jacket production volume was roughly 20 thousand items. In 2001, this figure increased by 58.3%. In 2002, the increase was 5.7%. In 2003, leather jacket production volume went down by 2.1%.

In 2003, according to the 2004 classifier, 600 leather coats, 14,000 leather suits and 990,000

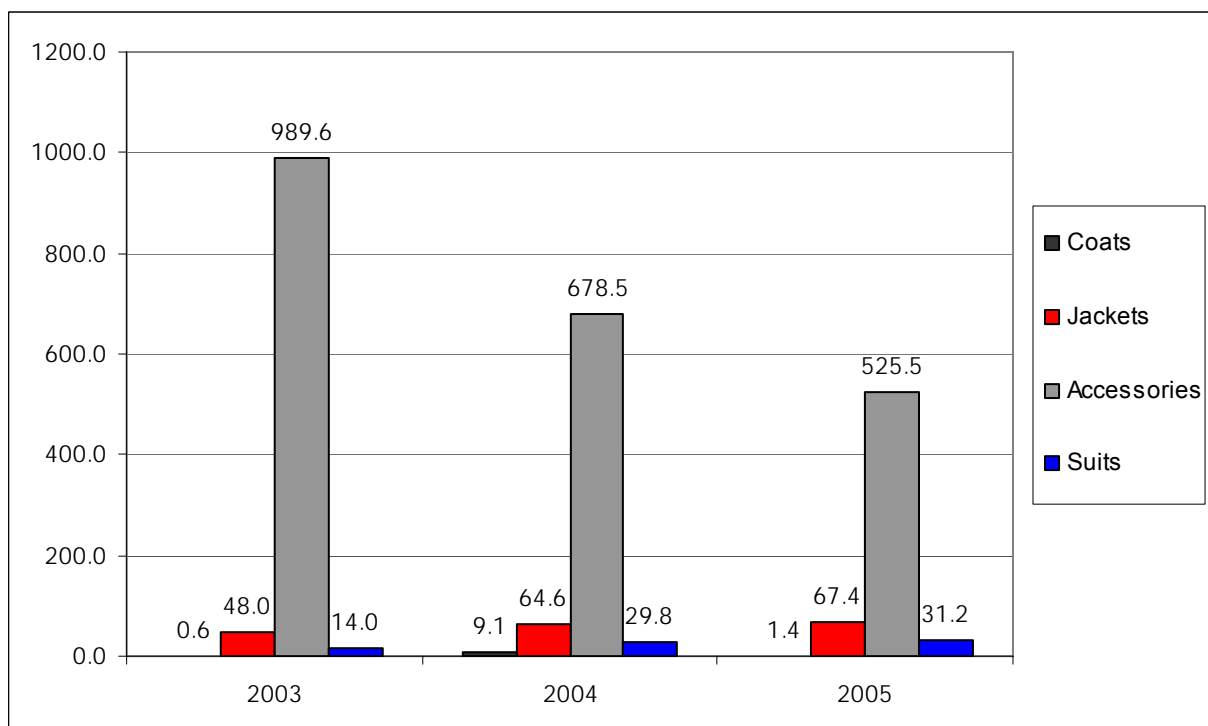
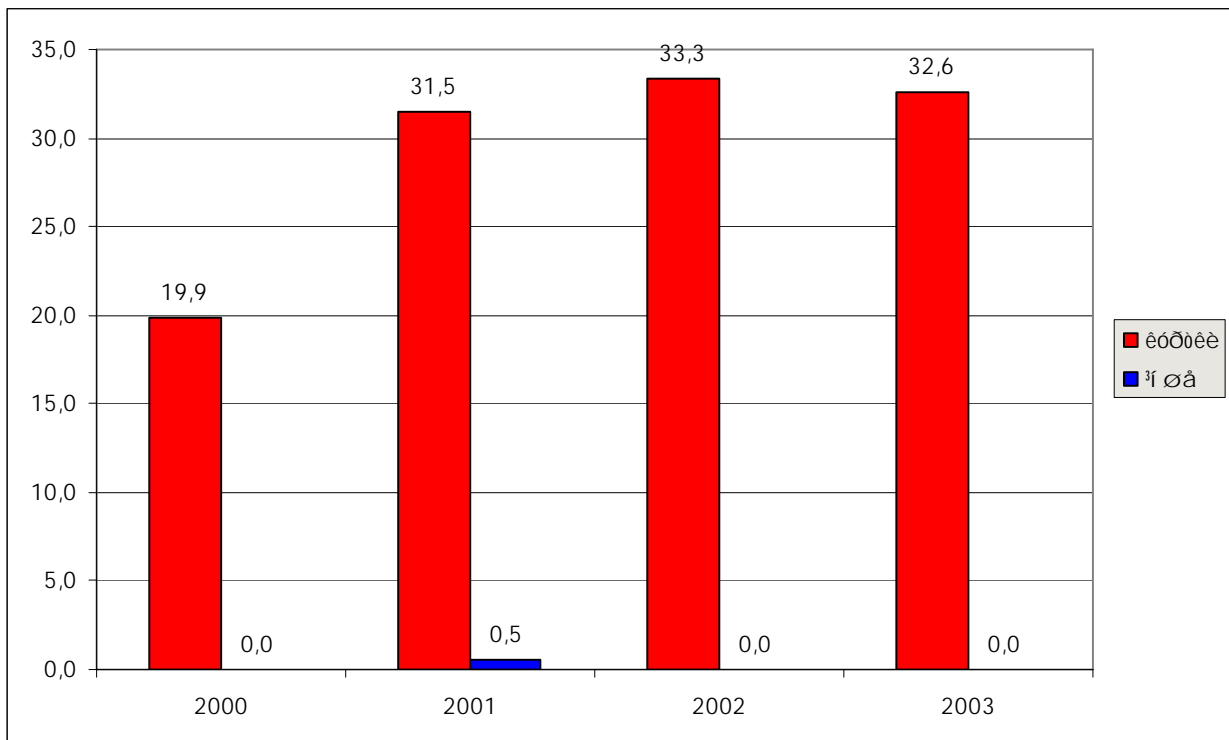
leather accessories were made. The production volume of leather accessories went down by 31.4% in 2004 and by another 22.5% in 2005.

The production volume of leather coats increased in 2004, by more than 15 times. In 2005 it decreased, as compared to 2004, by 84.6%.

Production of leather jackets increased in 2003-2005, by 34.6% in 2004 and by 4.3% in 2005.

Production of leather suits also had a positive growth tendency. It doubled in 2004 and increased by 4.7% in 2005.

DIAGRAM 1.11. LEATHER CLOTHES PRODUCTION DYNAMICS IN 2000-2003 AND 2003-2005 , THOUSAND ITEMS



In 2000-2003, the number of clothing companies in Ukraine kept growing. In 2001, it went up by 8.5%, as compared to 2000 (diagram 1.13.). In 2002 it went up by 9.8%, as compared to 2001. In 2003 it went up by 7.8%, as compared to 2002. There were thus 3002 enterprises in the sector in 2003. Of them 2389 were specialized clothes producers. In 2004, the number of enterprises in the industry fell by 3.8%. At the same time, the share of specialized companies

in the industry in 2000-2004, stayed practically unchanged and equaled roughly 80%. It was 80.8% in 2000, 78% in 2001, 79.7% in 2002, 79.6% in 2003, and 80.6% in 2004,

The increase of specialized companies' share in 2004, and the decrease in the overall number of enterprises in the industry indicate that

specialized companies are gradually replacing other companies.

DIAGRAM 1.12. DYNAMICS OF THE NUMBER OF ENTERPRISES IN THE INDUSTRY, number of enterprises

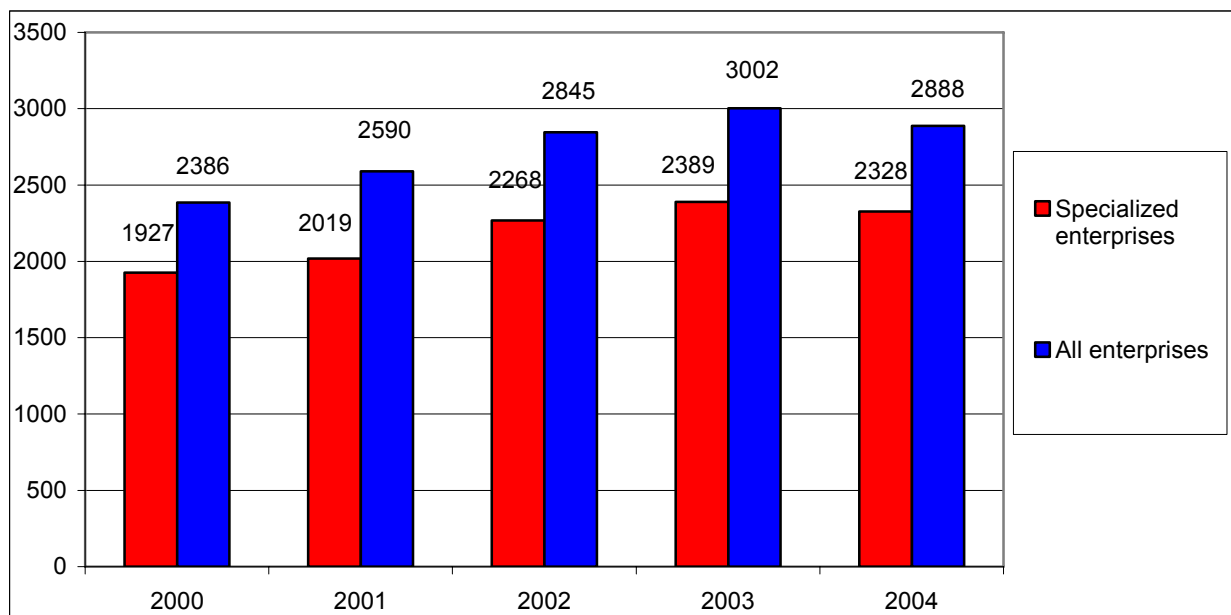


TABLE 1.8. NUMBER OF ENTERPRISES WORKING IN THE SECTOR (Information provided by the State Statistics Committee)

Number of enterprises in the industry	2000		2001		2002		2003		2004,	
	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises
Leather clothes production	16	23	15	24	16	23	20	29	25	44
Knitted wear production	1 911	2 363	2 004	2 566	2 252	2 822	2 369	2 973	2 303	2 844
Work wear production	365	602	387	669	433	700	438	719	440	708
Outer clothes production	1 308	1 543	1 375	1 673	1 565	1 863	1 698	2 028	1 633	1 899
Underwear production	143	191	151	228	155	246	150	245	131	239
Production of other types of clothes and accessories	95	162	91	166	99	184	83	186	99	245
Total	1 927	2 386	2 019	2 590	2 268	2 845	2 389	3 002	2 328	2 888

CONCLUSIONS

1. In 2000-2004, according to State Statistics Committee, light industry production increased by 0.8% in monetary form and more than three times in natural form.

2. The overall number of companies working in the industry increased by 21% to equal 2888 companies in 2004. At the time, the share of specialized companies in the overall structure equaled roughly 80%.

3. Due to changes to the classification of clothing industry products in Ukraine, the structure of production in the sector changed significantly. Production in the categories: "knitted wear," "underwear," "sportswear," "outer clothing" and

"leather garments" increased significantly, while production volume in the categories: "business clothes and casual clothes," "work clothes" and "accessories" fell seriously.

4. Decrease of production volumes in the category "business clothes and casual clothes" was due to the fact that in 2004, the subcategory "jackets" was absent in the general classifier. Therefore, Ukrainian manufacturers ceased making suit jackets separately from suits. However, production of suits balanced the overall production volume in the category "business clothes and casual clothes" because of its significant increase, which was reflected in the clothing export structure for 2004.

SALES VOLUME, BY SEGMENTS, IN 2000-2004

In 2000-2004, the clothing products sales volume in Ukraine (including both domestic and export sales) kept on growing.

In 2000, sales volume was around 1167 million hryvnias (diagram 1.13.). In 2001, this figure increased by 13%, and exceeded 2245 million hryvnias. In 2002 sales volume increased by 6.5% and equaled roughly 2390 thousand hryvnias. In

2003, it increased by 14.2% and in 2004 by 25.8%. In 2004, clothing products sales volume exceeded 3431 million hryvnias.

Analyzing the sales structure by year, we can conclude that sales volume increase was proportional in each of the clothing categories: leather clothes, work wear, outer clothing and underwear, other clothing and accessories.

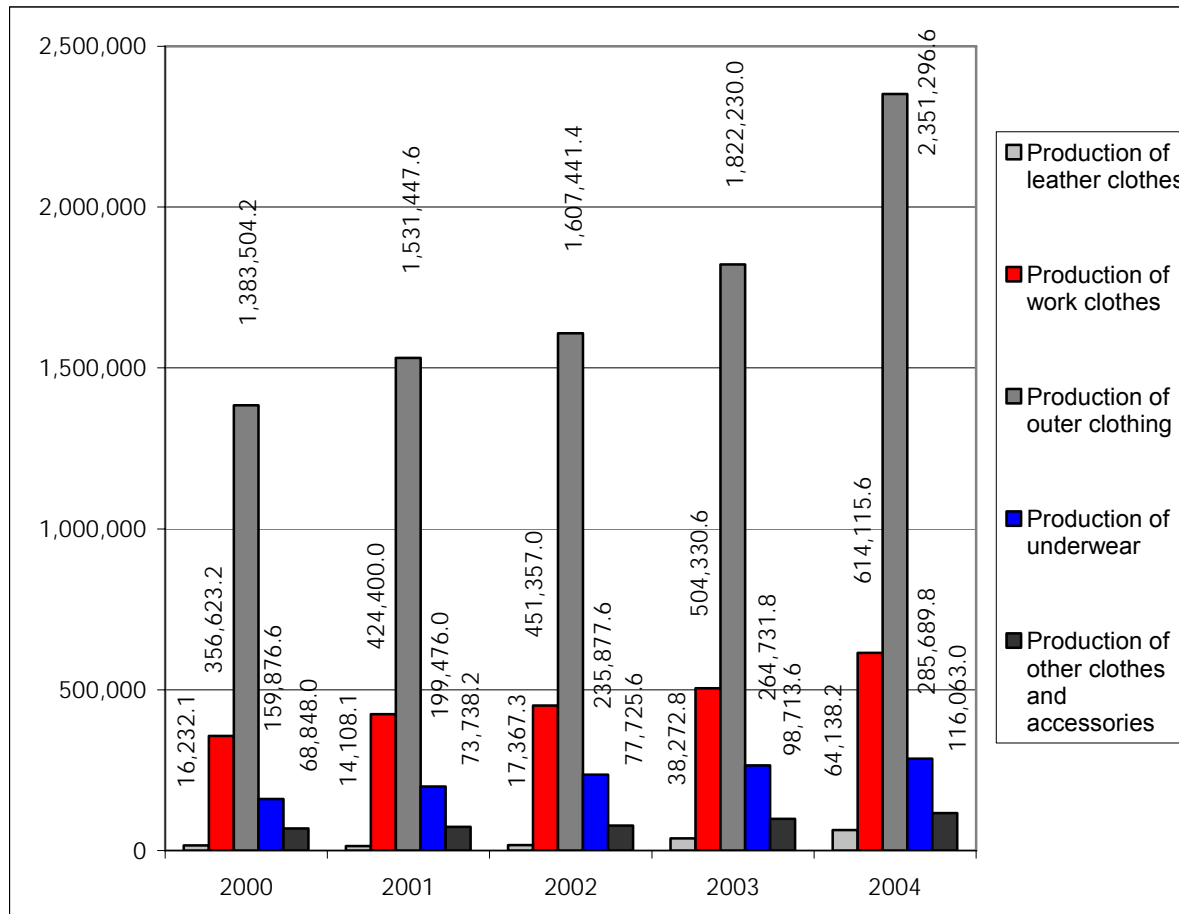
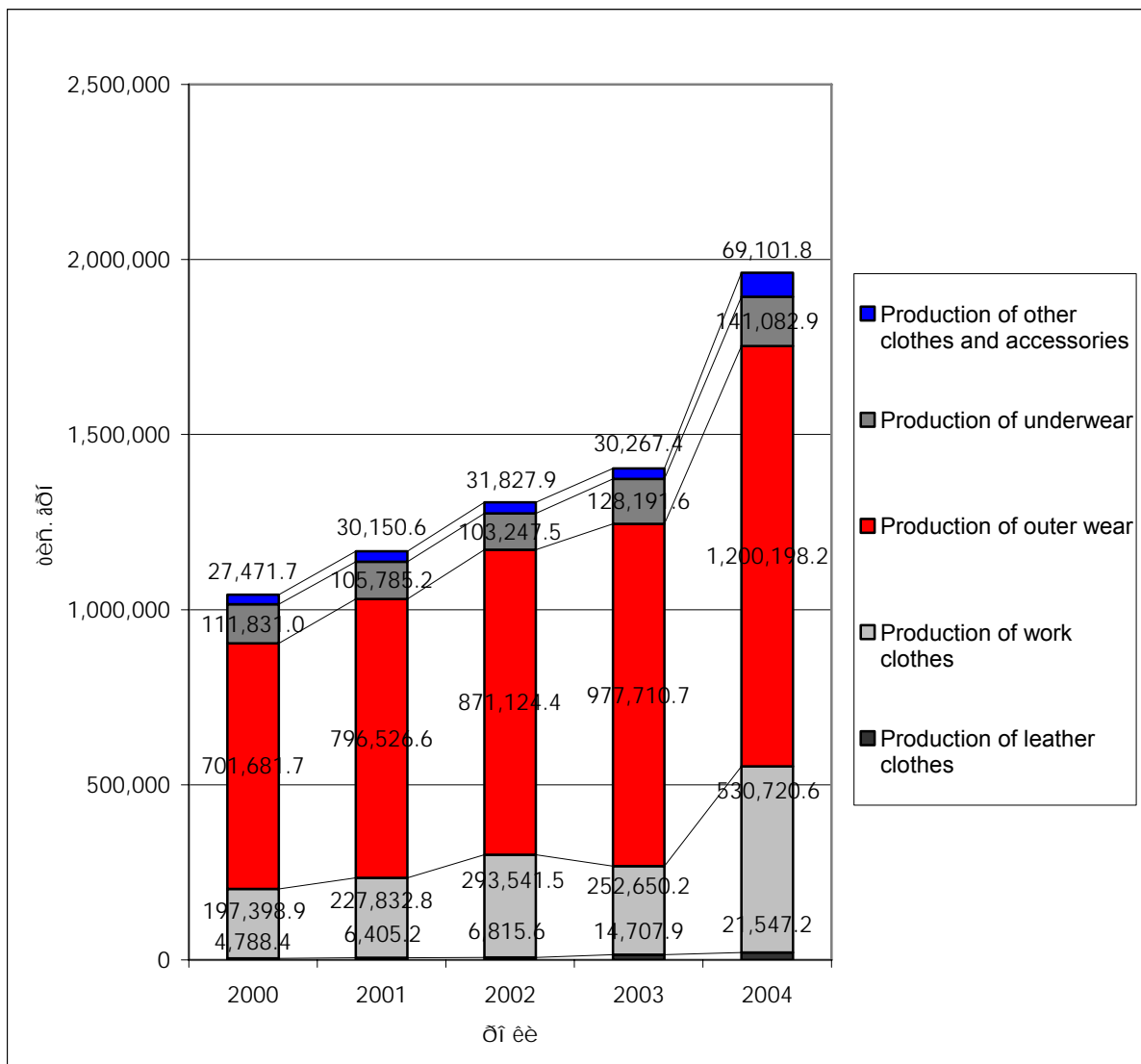
DIAGRAM 1.13. DYNAMICS OF THE SALES STRUCTURE, THOUSAND HRYVNIAS

TABLE 1.9. SALES VOLUME OF ENTERPRISES WORKING IN THE SECTOR (Information provided by the State Statistics Committee)

Sales volume of the enterprises working in the sector	2000		2001		2002		2003		2004,		9 months of 2005
	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized	overall number of enterprises	specialized
Leather clothes production	4 788.40	16 232.10	6 405.20	14 108.10	6 815.60	17 367.30	14 707.90	38 272.80	21 547.20	64 138.20	10 999.70
Knitted wear production	1 038 383.30	1 968 852.00	1 160 295.20	2 229 061.80	1 299 741.30	2 372 401.60	1 388 819.90	2 690 006.00	1 941 103.50	3 367 165.00	1 265 879.60
Work wear production	197 398.90	356 623.20	227 832.80	424 400.00	293 541.50	451 357.00	252 650.20	504 330.60	530 720.60	614 115.60	399 602.00
Outer clothing production	701 681.70	1 383 504.20	796 526.60	1 531 447.60	871 124.40	1 607 441.40	977 710.70	1 822 230.00	1 200 198.20	2 351 296.60	719 045.50
Underwear production	111 831.00	159 876.60	105 785.20	199 476.00	103 247.50	235 877.60	128 191.60	264 731.80	141 082.90	285 689.80	102 219.60
Production of other clothing and accessories	27 471.70	68 848.00	30 150.60	73 738.20	31 827.90	77 725.60	30 267.40	98 713.60	69 101.80	116 063.00	45 012.50
Total	1 043 171.70	1 985 084.10	1 166 700.40	2 243 169.90	1 306 556.90	2 389 768.90	1 403 527.80	2 728 278.80	1 962 650.70	3 431 303.20	1 276 879.30

DIAGRAM 1.14. DYNAMICS OF CLOTHING SALES BY SPECIALIZED ENTERPRISES, THOUSAND HRYVNIA



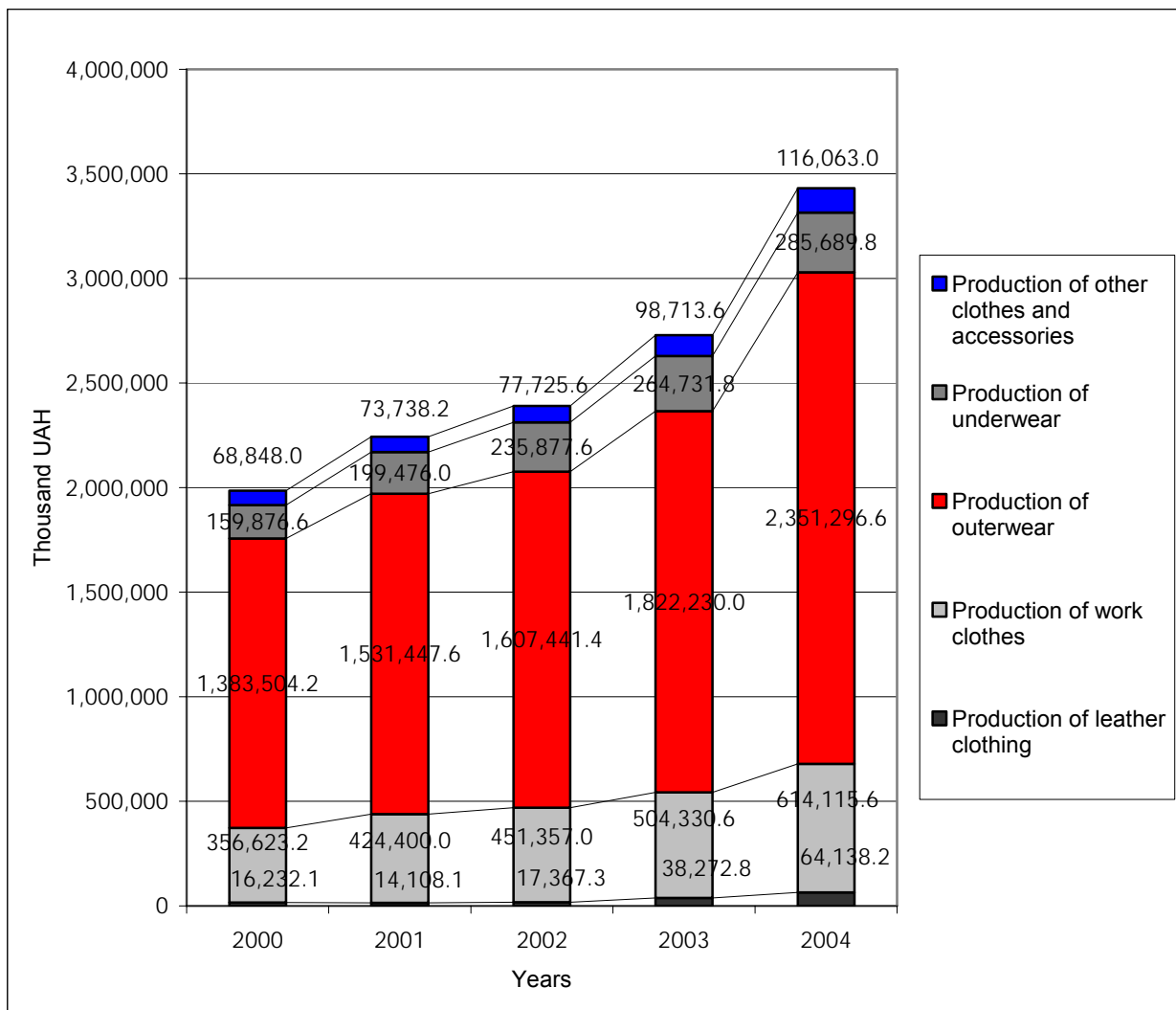
The sales dynamics for specialized clothing enterprises are quite similar to the dynamics for other enterprises in the sector. There was a steady increase in 2000-2004. The highest sales volume increase was recorded in 2004, by 25.8% (diagrams 1.14., 1.15.).

One explanation for this is Ukraine's stricter import policy.

The State Statistics Committee's clothing sales data includes information about sales of imported clothing.

So even when clothing production went down in 2004, there was no fall sales volume because a significant portion of the clothing imported into Ukraine had been legalized.

DIAGRAM 1.15. DYNAMICS OF CLOTHING SALES BY SECTOR ENTERPRISES, THOUSAND HRYVNIA



CONCLUSIONS

1. Clothing sales volume in Ukraine in 2000-2004 increased from 1985.1 million hryvnias to 3431.3 million hryvnias – that is, by almost 73%.

2. The rise in sales of clothing products in 2000-2004 was similar in all the main production categories. The positive tendency might be a function of the high quality of Ukrainian clothing

products and their relative competitive ability on domestic and foreign markets.

3. The gradual, stable increase in Ukrainian clothing products sales witnesses to the gradual expansion of the clothing and accessories consumption market for Ukrainian products.

SECTOR EXPORT STRUCTURE IN 2000-2004, MAIN EXPORTERS

In 2000-2005, Ukrainian clothing export volume grew continuously.

TABLE 1.10. SECTOR PRODUCTS EXPORT VOLUME (INFORMATION PROVIDED BY THE STATE STATISTICS COMMITTEE)

Clothing products export volume, thousand USD	2000	2001	2002	2003	2004,	2005
Clothing and accessories, textiles, except for knitted wear	357 565.03	419 535.47	420 499.31	472 431.65	553 992.33	571 009.52
Coats, raincoats, mackintoshes, anoraks (sports waterproof jackets, windbreakers with zipper), jackets, windbreakers for men and boys	21 757.72	23 344.52	18 204.32	21 994.41	22 344.94	27 356.52
Coats, raincoats, mackintoshes, anoraks (sports waterproof jackets, windbreakers with zipper), jackets, windbreakers and similar products for women and girls	60 114.23	62 630.24	71 797.01	70 129.15	80823.6	78 945.76
Three-piece (two-piece) suits, sets, jackets, pants, coveralls with breast-bands, breeches and shorts (except for swimming trunks), for men and boys	66 872.15	85 194.25	97 678.67	114 416.19	145 113.07	167 572.58
English-type women's two-piece dresses, sets, women's jackets, dresses, skirts, culottes, pants, coveralls with breast-bands, breeches and shorts (except for swimming trunks), for women and girls	117 835.76	152 196.76	142 780.02	161 948.67	198034.95	196 699.32
Shirts and shirts with short sleeves, for men and boys	21 164.64	22 051.71	15 150.30	14 417.38	13339.87	13 812.71
Blouses, shirts and shirts with short sleeves, for women and girls	28 429.15	32 862.01	31 996.67	29 016.81	30384.54	22 476.97
Tank-tops, underpants, drawers, nightgowns, pajamas, bathing robes, dressing gowns and similar products, for men and boys	282.22	108.05	128.12	100.26	172.53	16.12
Tank-tops and shirts, combinations or underdresses, undershirts, panties, nightgowns, pajamas, peignoirs, bathing robes, dressing gowns and similar products, for women and girls	398.94	319.02	647.07	740.45	944.47	1 230.33
Children's clothing and accessories	2 619.12	1 819.14	1 402.68	1 130.78	973.91	980.81
Commercially-produced clothing made of materials representing a separate merchandise category	3 746.81	4 277.64	4 741.14	9 266.74	7909.47	7 855.99
Tracksuits, ski suits, tank-tops, shorts and swimming trunks; other clothing	1 377.35	16 789.52	16 990.60	24 963.50	29 736.03	28 149.42
Bras, belts, corsets, suspenders, garter belts, garters and similar products and their parts, knitted wear or other	1 644.95	16 736.89	17 198.35	21 419.12	21 225.63	21 915.27
Head-scarves and handkerchiefs	15 174.70	0.00	0.00	0.10	0.31	0.22
Shawls, scarves, headscarves, neck-scarves (comforters), mantillas, veils and similar products	14 930.11	168.91	31.15	23.96	61.78	51.34

Ties, bowties and scarves	1.18	0.05	8.13	5.44	22.90	84.53
Mittens and gloves	553.09	493.14	1 218.83	1 902.81	1 910.18	2 835.09
Other commercially-made accessories, parts of clothing or parts of accessories	662.91	535.36	474.12	913.11	843.73	944.32
Used clothing or other products	0.00	8.26	52.13	42.77	150.42	82.22

Ukrainian clothing products sales volume in 2000 equaled \$370.6 million USD (diagram 1.16.). In 2001, export volume of sector enterprises products increased by 19% and equaled \$441.1 million USD. This fast growth in export of Ukrainian clothing was a direct result of the overall increase in clothing production in Ukraine in 2001; this increase amounted to almost 13% in monetary form or 12% in kind.

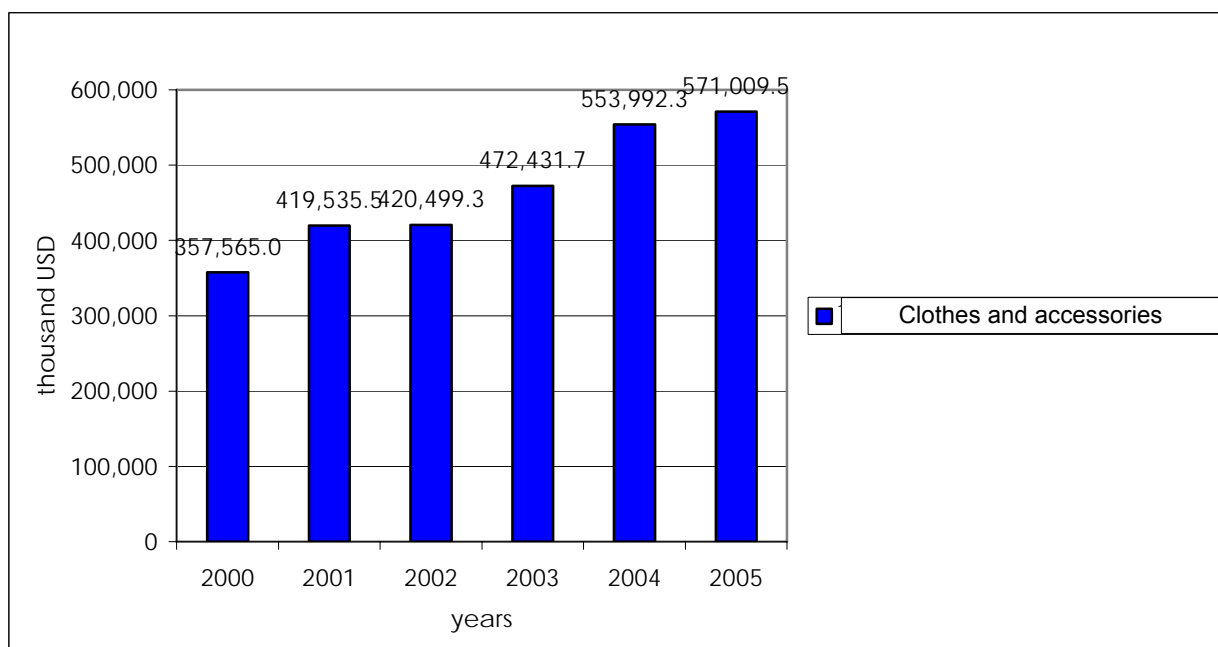
In 2002, the export volume of Ukrainian clothing products stayed at the same level as it was in 2001. The increase was minor, of a mere 1.2%. This reduction in the export volume increase rate was due to a fall in clothing production in 2002 (roughly 1.6% in monetary form). The positive side of this was that such a minor fall in production did not lead to a fall in clothing product export volume.

In 2003, clothing product export volume increased by 19.2% to equal \$532.3 million USD. Again, this increase in export was a result of a rise in clothing production in 2003 – of 10.6% in monetary form.

The third significant increase in clothing product export occurred in 2004. Specialists say this was a result of a 2004 production increase of almost 13% in relative prices, although according to the State Statistics Committee production volume in 2004 went down by 16.4% in monetary form and by 4.5% in natural form.

In 2005, clothing industry export volume stayed at the same level it was in 2004, with a minor increase of 1%.

DIAGRAM 1.16. SECTOR PRODUCT EXPORT DYNAMICS, THOUSAND USD



Clothing products export structure in 2000-2005 also underwent certain changes (diagram 1.17.). Let us review them toward analyzing the following main structural components of the export picture:

- coats, raincoats, mackintoshes, anoraks – i.e. "outer clothing";
- suits;
- shirts, blouses, tank-tops;
- children's clothing;
- work clothes;
- sports wear;
- other clothing and accessories;
- other products.

Outer clothing export share in the overall clothing export structure fell in 2000-2005, equaling 18.6%

in 2005 as compared to 22.9% in 2000. At the same time, outer clothing's share in the overall export structure increased slightly two times (in 2002 and 2005), while decreasing significantly in 2001, 2003 and 2004. That the last increase in outer clothing export occurred in 2005 lets us assume that its share in the overall structure of Ukraine's clothing industry is slowing growing.

Suit export holds the largest share in the overall export structure of Ukrainian clothing. Also, the share of suits in overall export structure (except for a 2003 share decrease that was possibly due to a fall in clothing production, in particular of business and casual clothing), saw a growth tendency. In 2005, the share of suits in the overall clothing export structure equaled 63.8% (in 2000 it equaled 51.7%).

This information allows us to conclude that the export of Ukrainian suits should be promoted, as suits yield more than 50% of the clothing industry's export profits.

Sportswear's share in the overall export structure in 2000-2005 rose significantly, from 0.4% to 4.9% (more than 10 times).

The share of children's clothes and work wear in the export structure is insignificant. Jointly, the

share of these two categories was below 2% during all of 2000-2005

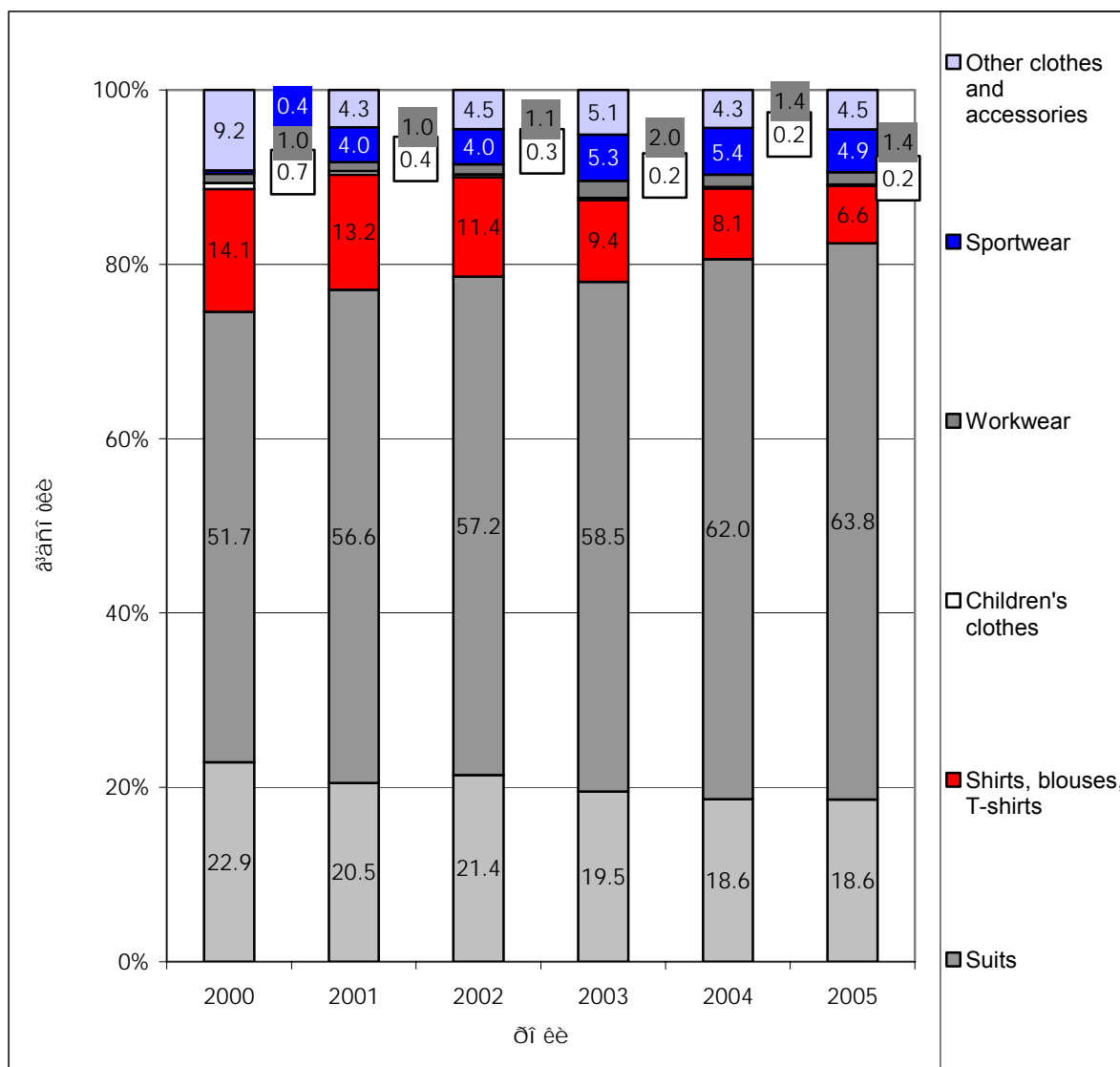
The export share of different clothing products combined into the "other clothing" category in 2000 equaled 9.2%. In 2001 there was a significant decrease and this figure went down to 4.3%. In 2002, this category's share in the overall export structure stabilized and equaled 4.5%. After minor fluctuations in 2003-2004, this category's share equaled 4.5% again in 2005.

TABLE 1.11. MAIN UKRAINIAN ENTERPRISES - EXPORTERS OF CLOTHING PRODUCTS

(<http://www.smida.gov.ua/emitents/search/?type=AT>)

No	Enterprise name	Region (city)	Export countries
1	VAT* Barska Clothing Factory	Vinnitska	Great Britain
2	VAT Bryankovchanka	Luganska	No data
3	VAT Galychyna	Kyiv	No data
4	VAT Grono	Zakarpatska	Germany, Holland, USA, Slovak Republic
5	VAT Drogobyske Clothing Enterprise Zorya	Lvivska	England, Sweden
6	VAT Zymogoryanka	Luganska	No data
7	VAT Elegant	Zaporiz'ka	Germany, England, Belgium
8	VAT Yevpatoriyska Clothing Factory	Crimea	No data
9	VAT Yenakiyevska Clothing Factory Mriya	Donetska	France
10	VAT Zolochivska Clothing Factory	Lvivska	Great Britain, France, Denmark
11	VAT Zoryanka	Kyrovograd	France, Germany
12	VAT Kyivska Clothing Factory Zhelan'	Kyiv	No data
13	VAT Kyrovska Clothing Factory Kifadro	Luganska	France
14	VAT Kozyatynska Clothing Factory	Vinnitska	Great Britain
15	VAT Kramo	Luganska	USA
16	VAT Mogyliv-Podilska Clothing Factory Alisa	Vinnitska	No data
17	VAT Stryiska Clothing Factory Stritex	Lvivska	No data
18	VAT Sophia	Kyivska	No data
19	VAT Style	Luganska	Germany, Great Britain
20	VAT Trottolo	Lviv	Great Britain, France, Denmark
21	VAT Tulchynska Clothing Factory	Vinnitska	No data
22	VAT Ukrrogest Beregivsta Clothing Factory	Zakarpatska	Italy
23	VAT Tsyurupinska Clothing Factory Yunist'	Khersonska	No data
24	VAT Chernigivska Clothing Factory Elegant	Chernigiv	No data
25	VAT Clothing Enterprise Mayak	Rivnenska	No data
26	VAT Clothing Factory named after Tynyakov	Kharkiv	No data

* VAT – Public Corporation (Open Joint-Stock Society)

DIAGRAM 1.17. DYNAMICS OF SECTOR PRODUCTS EXPORT, %**CONCLUSIONS**

1. According to State Statistics Committee, clothing industry products export volume in 2000 reached \$370.6 million USD, or 2016.1 million hryvnias (at the rate of 5.44 hryvnias per 1 US dollar). In 2000-2005, export volume increased by 71.4% and in 2005 reached \$635.3 million USD, or 3225.7 million hryvnias (at the rate of 5.12 hryvnias per 1 US dollar).

2. According to the information provided by the Ministry of Industrial Policy, over the first 9 months of 2004, clothing industry products export equaled \$798 million US dollars.

3. Taking into account the stable growth of Ukrainian clothing products export, it is possible to conclude that services provided by Ukrainian companies according to tolling orders are competitive on the world market.

SECTOR IMPORT STRUCTURE IN 2000-2005, MAIN IMPORTERS

Clothing product import in Ukraine in 2000-2005 grew constantly (diagram 1.18.). In 2000 clothing products import in Ukraine equaled \$58.6 million US dollars. In 2001, clothing import increased by 34.3%, and equaled \$78.7 million US dollars. In 2003, import increase reached 20.8% and pushed the import amount up to \$95 million US dollars. In 2003 and 2004, the increase of import equaled 48% and 2.5%, respectively, and clothing import

volume went up to \$140.7 and \$144.2 million US dollars, correspondingly.

In 2005, clothing import into Ukraine exceeded \$300 million US dollars, which was twice as much as the import level in 2004. In general, in 2000-2005, clothing import into Ukraine exceeded \$821 million US dollars.

According to the State Statistics Committee's classification, clothing industry import and export is split into the following two major categories:

- clothes and accessories, textile, except for knitted wear;
- other ready-made textile products; sets; also - rags.

In 2000-2005, clothing industry import in these main categories fluctuated as follows:

- in 2001 import in all categories saw a certain increase (40.5%);
- in 2002 and 2003, the 2001 tendency was maintained fully (there was a 20.2% increase);
- in 2004, import in the "clothing and accessories" category fell by 2.8%, but overall import volume maintained the growth tendency in the "other ready-made textile clothing" category (7.6%);

- in 2005, the import in "clothing and accessories" category almost tripled. There was also growth in the "other ready-made textile clothes" category, of 23.1%;
- in 2005, the clothing industry import structure changed in two main categories. Until 2005, the share of "clothing and accessories" and "other ready-made textile products" was almost equal (45/55-50/50). In 2005, the share of "clothing and accessories" increased to almost 70% of the total volume of imported clothing products, and the share of "other ready-made textile products" went down to 30% of the industry's overall import.

According to the Ukrlégprom Association, the main importers into Ukraine are Turkey, China, Eastern and Western European countries and CIS countries. Minor quantities are also imported from Latin America, the USA and Singapore.

DIAGRAM 1.18. SECTOR PRODUCTS IMPORT DYNAMICS, THOUSAND USD

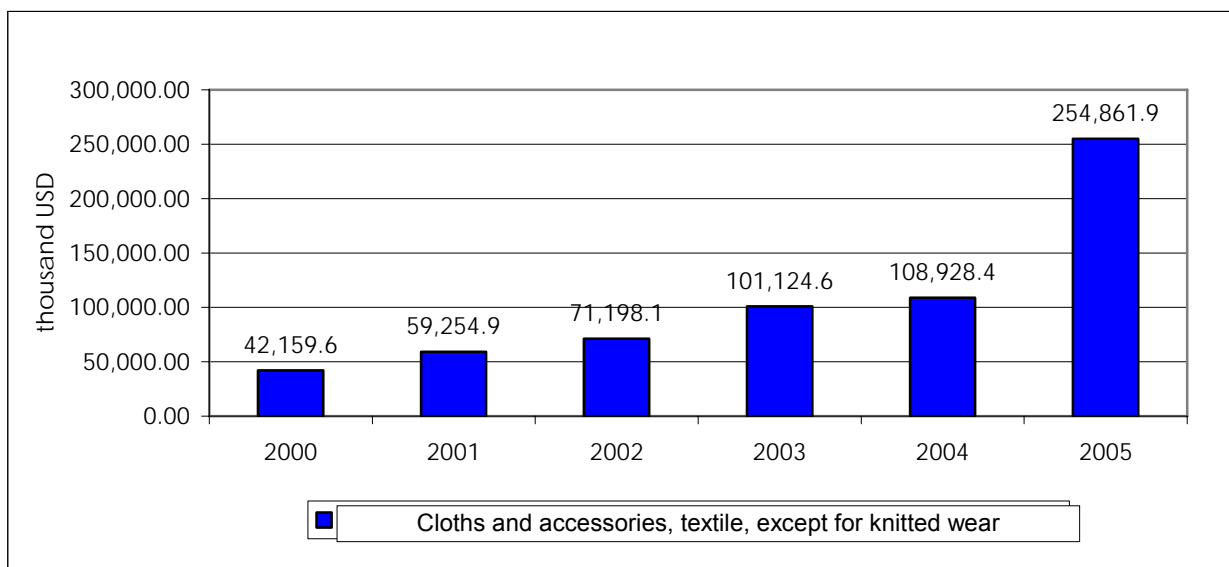
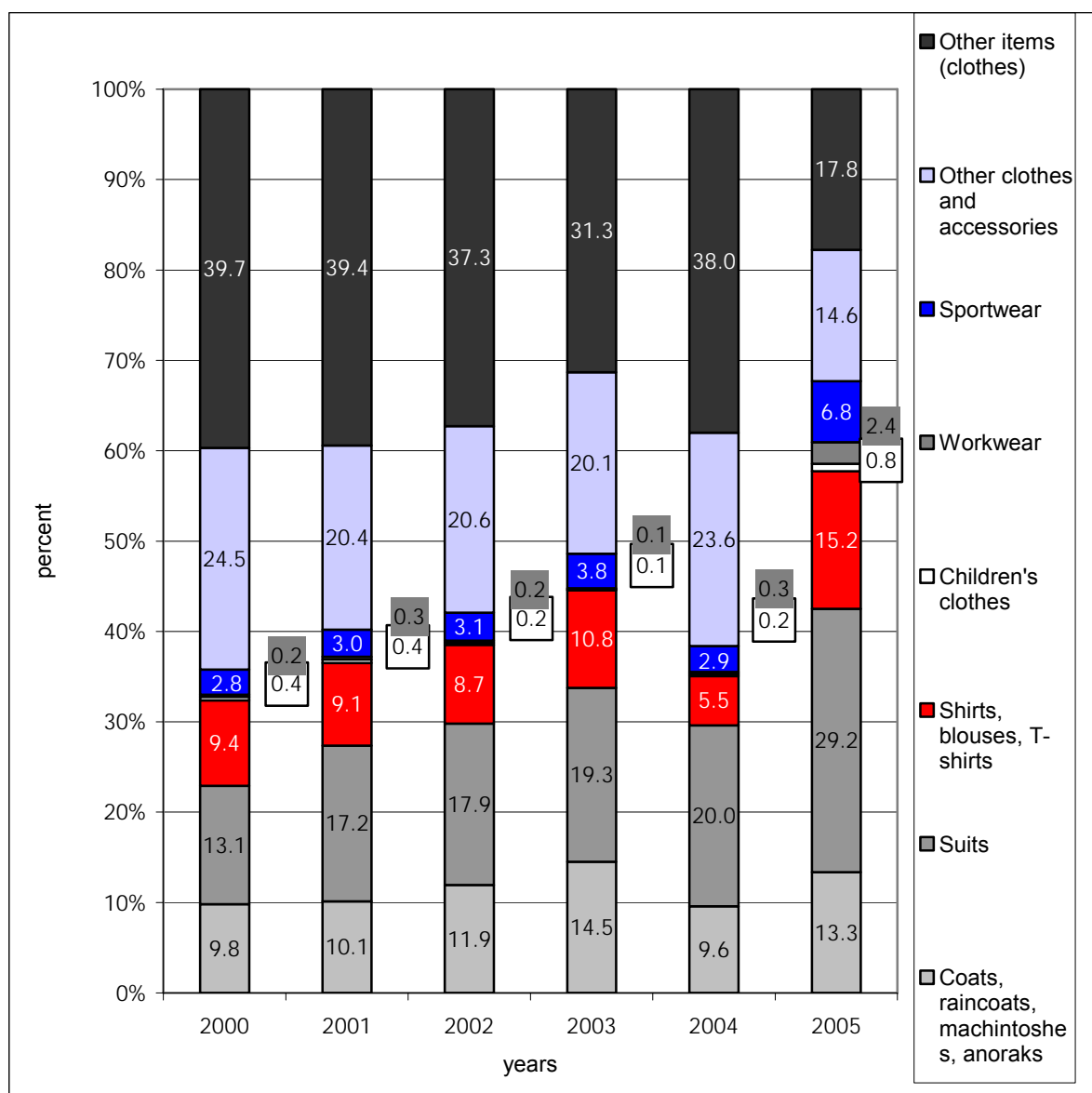


TABLE 1.12. SECTOR'S IMPORT VOLUME (Information provided by the State Statistics Committee)

Clothing products import, thousand USD	2000	2001	2002	2003	2004,	2005
Clothes and accessories, textile, except for knitted wear	42 159.64	59 254.87	71 198.12	101 124.59	108 928.36	254 861.94
Coats, raincoats, mackintoshes, anoraks (sports waterproof jackets, windbreakers with zipper-lock, jackets, windbreakers for men and boys	2 934.65	4 084.04	5 263.32	8 636.33	5943.62	19 577.76
Coats, raincoats, mackintoshes, anoraks (sports waterproof jackets, windbreakers with zipper-lock), jackets, windbreakers and similar products for women and girls	1 203.92	1 914.97	3 225.03	6 021.38	4499.14	14 427.06
Three-piece (two-piece) suits, sets, jackets, pants, coveralls with breast-bands, breeches and shorts (except for swimming trunks), for men and boys	3 184.75	5 650.85	6 011.41	8 576.89	9265.15	39 575.83
Two-piece dresses, sets, women's jackets, dresses, skirts, culottes, pants, coveralls with breast-bands, breeches and shorts (except for swimwear), for women and girls	2 341.68	4 566.37	6 717.81	10 901.98	12 527.48	34 747.70
Shirts and shirts with short sleeves, for men and boys	2 692.80	3 712.46	3 809.47	7 097.16	2 535.62	17 350.62
Blouses, shirts and shirts with short sleeves, for women and girls	388.38	763.95	1 153.89	1 494.78	1 770.04	7 749.18
Tank-tops, underpants, drawers, nightgowns, pajamas, bathrobes, dressing gowns and similar products for men and boys	484.37	300.80	314.88	662.48	409.38	2 151.73
Tank-tops and shirts, combinations or underdresses, underskirts, nightgowns, panties, pajamas, peignoirs, bathrobes, dressing gowns and similar products, for women and girls	414.83	641.38	926.04	1 665.55	1228.47	11 537.38
Children's clothing and accessories	165.99	234.26	157.36	104.37	234.45	2 080.86
Commercially-produced clothing made of materials representing a separate merchandise category	98.14	173.10	164.22	128.48	276.28	6 051.30
Suits, tracksuits, ski-suits, tank-tops, panties and Speedos; other clothing	1 175.24	1 781.72	2 220.00	3 860.52	3 113.12	17 250.95
Bras, belts, corsets, suspenders, garter belts, garters and similar products and their parts, knitted or other	6 113.84	6 642.67	7 139.74	8 782.95	9 500.60	18 109.72
Head-scarves and handkerchiefs	55.24	50.12	76.76	159.65	78.48	332.88
Shawls, scarves, head-scarves, neck-scarves (comforters), mantillas, veils and similar products	112.99	266.06	380.53	790.51	710.41	1 425.01
Ties, bow-ties and neck-scarves	146.45	224.93	165.56	256.44	233.19	594.23
Mittens and gloves	78.14	180.84	313.35	389.43	338.35	353.74

Commercially-produced accessories, other, parts of clothing or parts of accessories	3 829.61	4 706.96	6 607.00	9 916.59	14 859.52	16 294.79
Used clothing and other products	16 738.62	23 359.39	26 551.75	31 679.10	41 405.06	45 251.20

DIAGRAM 1.19. SECTOR PRODUCTS IMPORT DYNAMICS, %
(Information provided by the State Statistics Committee)



If we take a more detailed look at the structure of imported products (diagram 1.19.), it is possible to segregate several general categories of imported products:

- coats, raincoats, raincoats, anoraks or "outer clothing";
- suits;
- shirts, blouses and tank-tops;
- children's clothing;
- work clothes;
- sports wear;
- other clothing and accessories;
- other products.

Such a classification allows us to have a better perspective on the structure of clothing import into Ukraine during 2000-2005.

We can make the following conclusions about the structure of outer clothing import into Ukraine:

- in 2000-2003, the share of outer clothing in overall clothing industry product structure grew steadily and equaled 9.8%, 10.1%, 11.9%, 14.5% respectively;
- in 2004, the share of outer clothing in the overall structure of clothing industry products import fell to 9.6%;
- by 2005, the share of outer clothing in the overall import structure had already risen to 13.3%.

Suit import in the overall import structure equaled 13.1% in 2000, and due to steady increase in 2000-2005 (17.2% in 2001, 17.9 in 2002, 19.3% in 2003, 20.0% in 2004), by 2005 it reached 29.2% of the overall structure.

Blouse, shirt and T-shirts import saw insignificant fluctuations, and in 2000-2005 went up from 9.4% to 15.2% in the overall structure, after a serious decrease (up to 5.5%) in 2004.

The share of children's clothes and work wear in the overall structure increased significantly, going up to 0.8% and 2.4%, correspondingly. Until 2005 the import share in these categories was just 0.1%-0.3%, almost negligible.

The share of sportswear import went up significantly in 2005. While in 2000-2004 it equaled roughly 3%, in 2005, it rose to almost 7%.

The share of other types of clothes and accessories and other items in 2005, decreased significantly (from almost 40% to 18%). This might be explained by the fact that in 2004-2005 imported clothes were put into a more detailed classification as compared to 2000-2004.

The State Statistics Committee export and import data for 2005 differs significantly from the information used by the Ministry of Industrial Policy, possibly because these two organizations use different sources of information (see Methodology).

CONCLUSIONS

1. Clothing industry product import volume, according to the State Statistics Committee, in 2000 equaled 229.3 million hryvnias and in 2000-2005 increased more than 5.5 times. In 2005, therefore, it equaled 1304.9 million hryvnias.

2. According to Ministry of Industrial Policy information, over the first 9 months of 2004, import volume amounted to \$616.6 million US dollars.

3. In 2000-2005, clothing industry import volume grew continuously. In 2001, the increase was

40.5%, in 2002 it was 20.2%, in 2003 it was 42%, in 2004 it was 7.7%, and in 2005 it was almost 134%.

4. The increase was mainly driven by such products as outer clothing, suits, shirts, blouses and tank-tops, and sportswear.

5. The main importers of clothing to Ukraine are Turkey, China and the countries of Eastern and Western Europe.

DIRECT FOREIGN INVESTMENT VOLUME, IN 2000-2005.

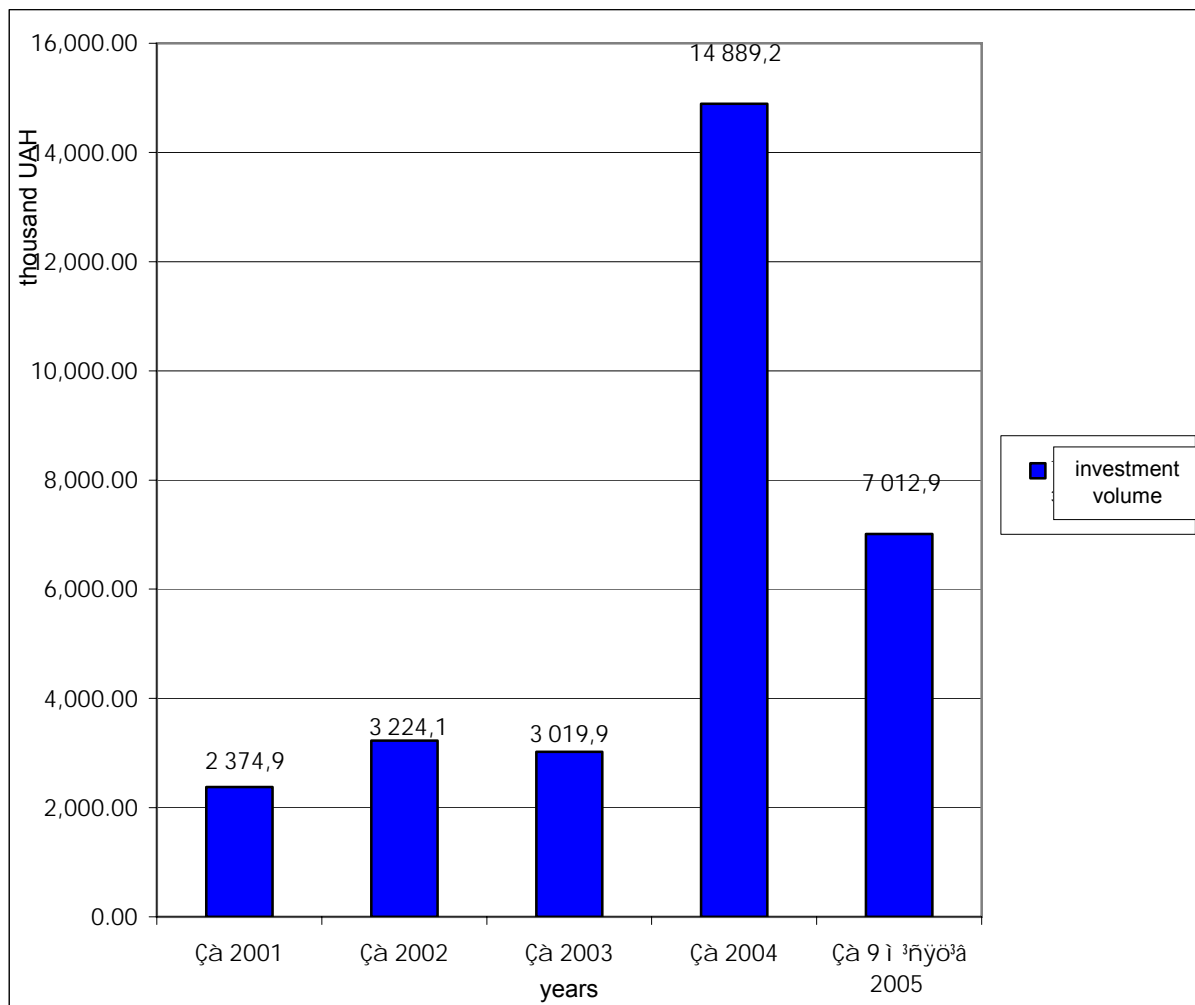
Over the past few years (2000-2005), clothing production in Ukraine received minor investments from foreign countries. A positive tendency characterizes foreign investment into Ukraine's clothing industry (diagram 1.20.).

As of early 2001, Ukraine's clothing industry received almost 15 million hryvnias in foreign investments. Additional investments in 2001 equaled 2.37 million hryvnias. In 2002, the amount of invested funds, as compared to 2001, increased by 36%, and equaled 3.22 million hryvnias over that year. In 2003, the increase tendency slowed a bit (it was 94% of 2002 investment), although already in 2004 investment

volume had increased by 5 times as compared to 2003, to equal 14.9 million hryvnias.

Experts say that the 2004 increase in Ukrainian clothing production was in part due to a rise in foreign investment.

Over the first 9 months of 2005, foreign investment into the Ukrainian clothing industry exceeded 7 million hryvnias. Assuming that investment rates remained steady in 2005, we can conclude that annual investment equaled roughly 9.3 million hryvnias. This testifies to a certain slowdown in the investment rate. Though insignificant, this sum exceeds investment sums prior to 2004.

**DIAGRAM 1.20. DYNAMICS OF FOREIGN INVESTMENT INTO THE SECTOR ENTERPRISES,
THOUSAND HRYVNIA**

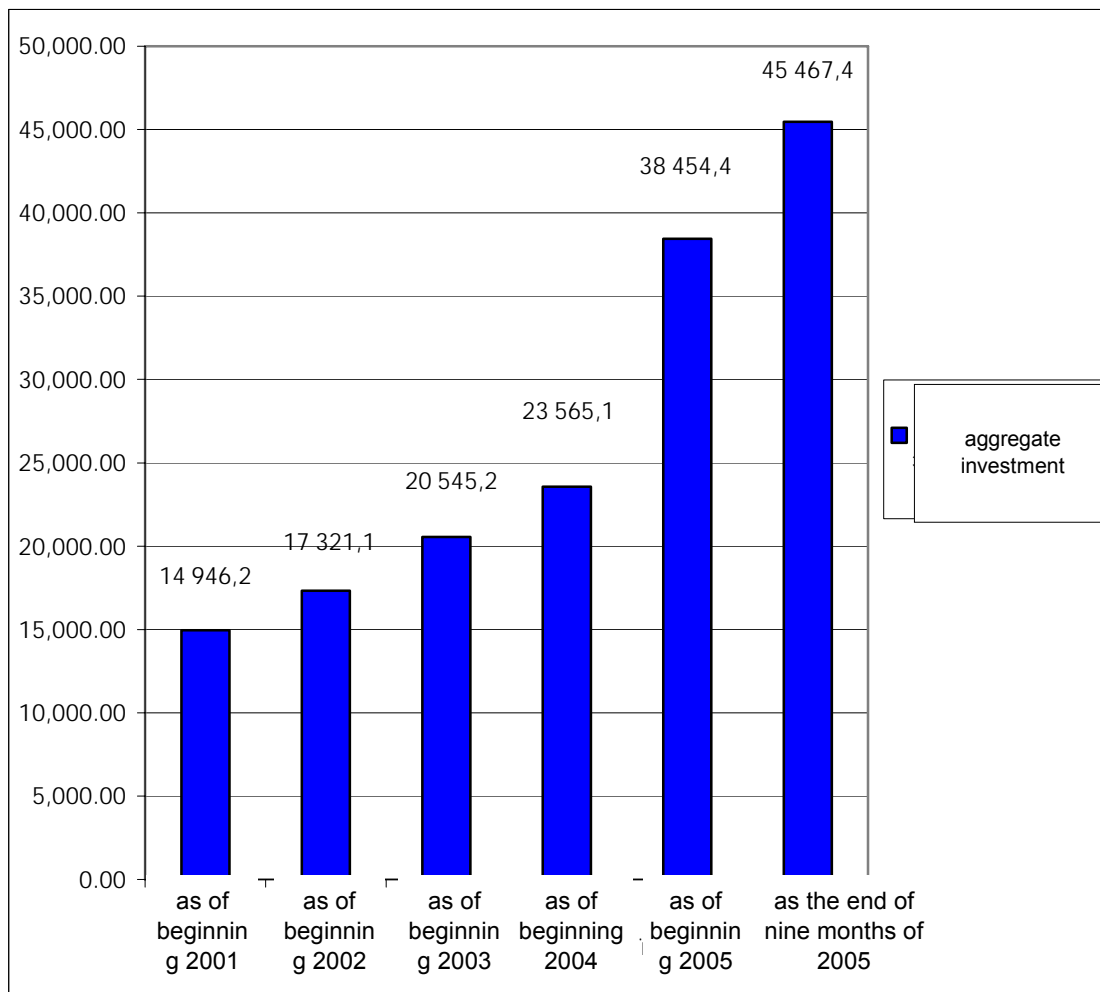
Due to regular foreign investment into the clothing industry in 2000-2005 its absolute quantity grew steadily (diagram 1.21.). In 2000-2005 the volume of foreign investment exceeded 45 million hryvnias. In 2001-2004 the amount of aggregate foreign investment increased by 15.9% (in 2001), 18.6% (in 2002), 14.7% (in 2003), and 63.2% (in

2004). It increased by 18.2% during 9 months of 2005.

However, despite the significant increase in volumes of annual average investment into the sector's companies in 2004, experts note that investment into the sector is still insufficient.

TABLE 1.13. VOLUME OF INVESTMENT INTO THE SECTOR'S ENTERPRISE (Information provided by the State Statistics Committee)

Investment into industry enterprises, thousand hryvnias	Direct foreign investment										
	As of the beginning of 2001	In 2001	As of the beginning of 2002	In 2002	As of the beginning of 2003	In 2003	As of the beginning of 2004,	In 2004,	As of the beginning of 2005	Over 9 months of 2005	At the end of 9 months of 2005
Production of leather clothes	0.00	0.00	0.00	0.00	0.00	0.00	0.00	314.89	314.89	-27.43	287.46
Production of textile clothes	14 946.23	2 374.91	17 321.14	3 224.09	20 545.23	3 019.90	23 565.13	14 574.36	38 139.49	7 040.40	45 179.89
Production of work wear	259.30	-2.48	256.82	158.05	414.87	980.79	1 395.66	1 385.28	2 780.94	-66.34	2 714.60
Production of outer clothing	12 800.75	2 046.08	14 846.83	2 016.62	16 863.45	1 814.75	18 678.20	7 469.02	26 147.22	4 147.40	30 294.62
Production of underwear	1 317.94	323.12	1 641.06	929.88	2 570.94	197.81	2 768.75	577.58	3 346.33	1 572.18	4 918.51
Production of other clothes and accessories	568.24	8.19	576.43	119.54	695.97	26.55	722.52	5 142.48	5 865.00	1 387.16	7 252.16
Total	14 946.23	2 374.91	17 321.14	3 224.09	20 545.23	3 019.90	23 565.13	14 889.25	38 454.38	7 012.97	45 467.35

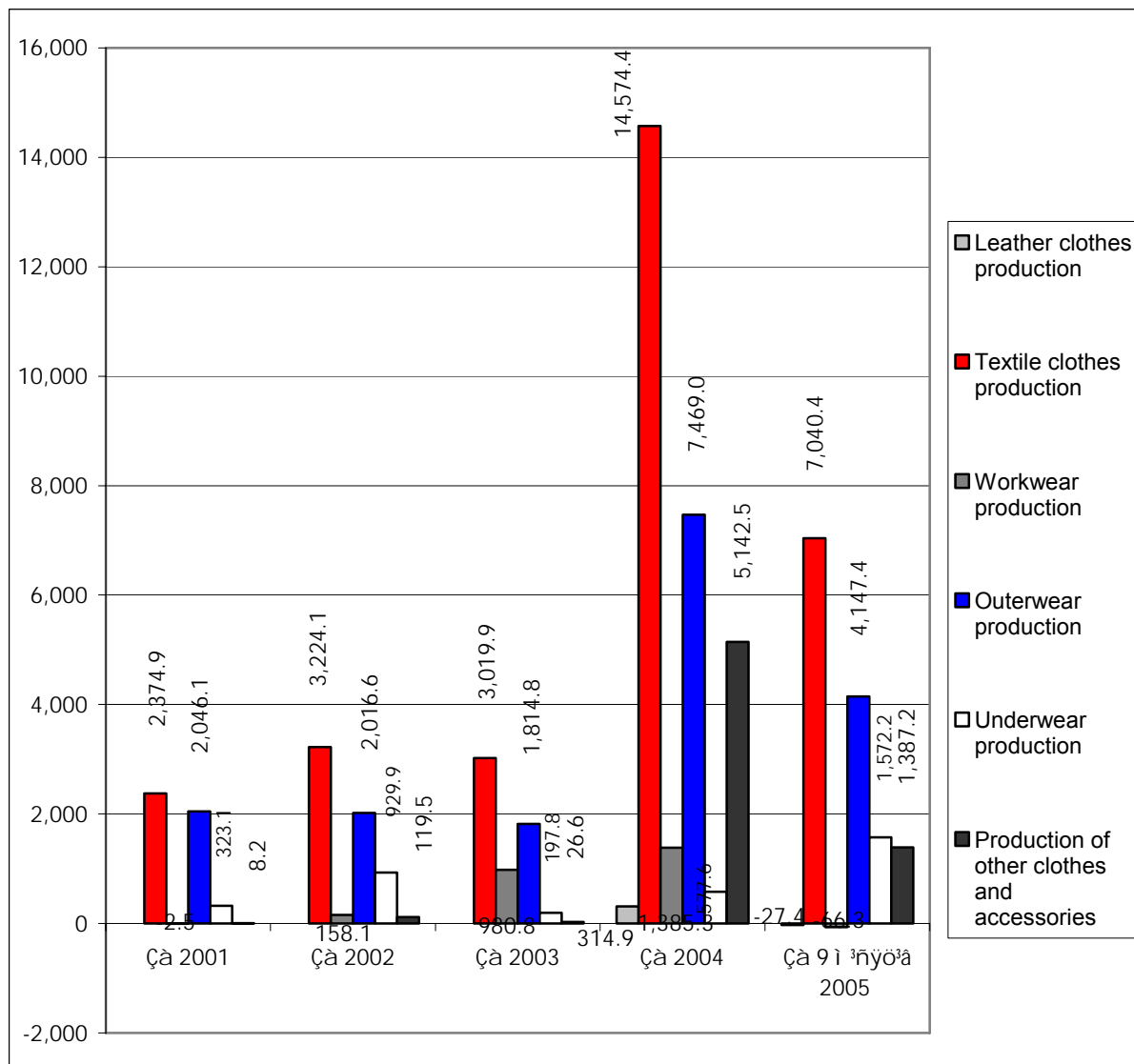
DIAGRAM 1.21. AGGREGATE INVESTMENT INTO THE SECTOR'S ENTERPRISES, THOUSAND HRYVNIA

The overall picture of investments into clothing industry of Ukraine by foreign investors looked as follows:

- a minor increase in 2001;
- a minor decrease in 2002;
- a major increase (by almost 5 times) in 2004, (diagram 1.22.).

Over the first 9 months of 2005, the clothing industry of lost roughly 100 thousand hryvnias in foreign investment. This money was taken away from leather clothes producing companies (27.43 thousand hryvnias) and from companies making work wear (66.34 thousand hryvnias). This was one of the factors that slowed the foreign investment increase rate in 2005.

DIAGRAM 1.22. DYNAMICS OF INVESTMENT INTO THE CLOTHING SECTOR, THOUSAND HRYVNIA



CONCLUSIONS

1. In 2000-2005, foreign investment into the clothing industry of Ukraine increased from 14.9 million hryvnias to 45.5 million hryvnias

2. The year 2004 saw a particularly large increase in foreign investment into the clothing sector.

This is more of a result of foreign investors' confidence in Ukrainian industry than of an improvement in the sector's products.

This is confirmed by the steadily growing volume of Ukrainian clothing export.

3. The increase of foreign investments into Ukraine's clothing enterprises and the growth of confidence in them are positive sector tendencies.

4. The main causes of production decrease in Ukraine in 2004 were as follows, according to manufacturers:

- the imperfection of Ukrainian legislation, in particular with regard to state tax and customs policy;
- a lack of qualified personnel (seamstresses, specialists, designers, managers);
- poor domestic sales capacity in Ukraine due to, first, the population's low purchasing capacity; and, secondly, to Ukrainian products low competitiveness on account of high production costs and outdated fashions;
- a deficit of circulating assets and high interest rates.

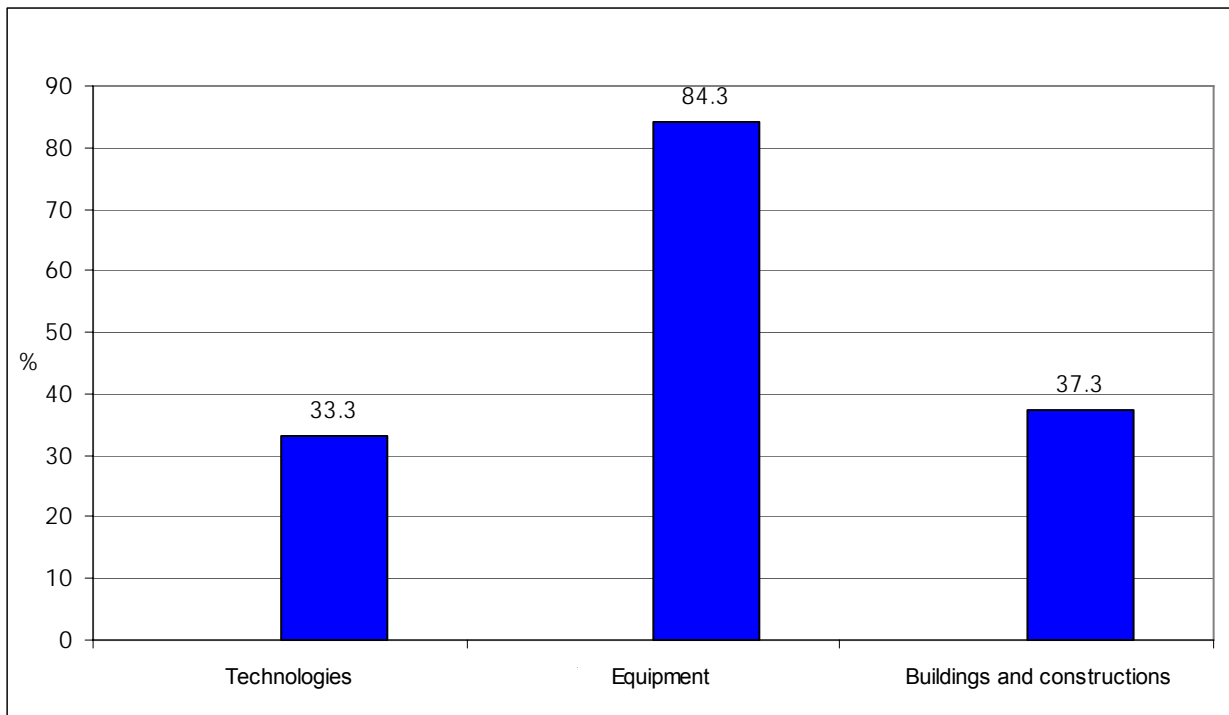
SECTION 2. PRODUCTION

SECTOR ENTERPRISES' EQUIPPING AND RE-EQUIPPING RATES

Since most Ukrainian clothing factories work on tolling schemes, one possible way of developing the clothing sector is obtaining investments for modernizing production and mastering new products that could be popular on both the domestic and foreign markets.

Interviews show that most funds are invested into modernization of fixed assets, in particular into production equipment (diagram 2.1.).

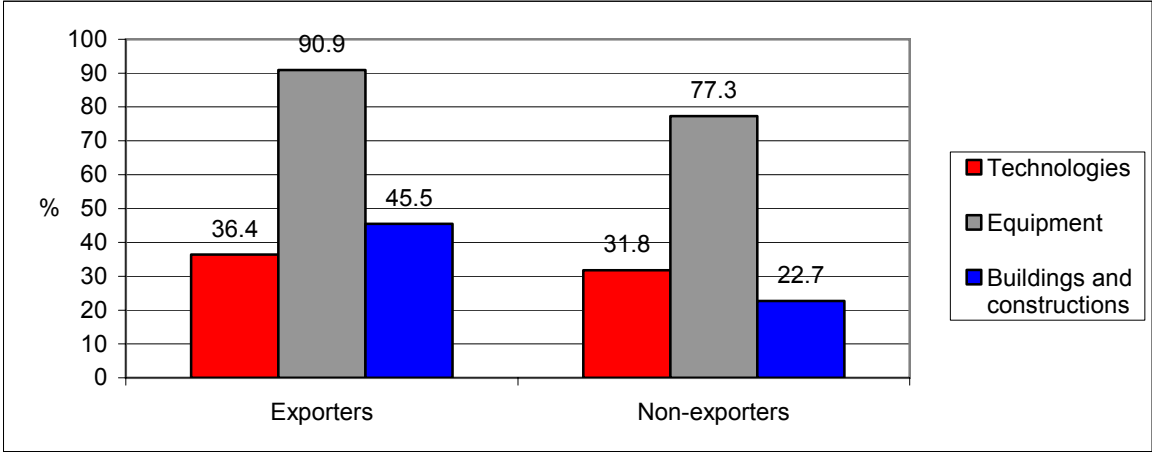
DIAGRAM 2.1. STRUCTURE OF INVESTMENTS IN THE SECTOR, 2005, %



Companies with significant export share tend to invest more in equipment. They have to keep improving their products to maintain competitive ability on foreign markets. Investment structure

among non-exporters witnesses to the high level of competition on the domestic market, however, and this leads manufacturers to maintain quality levels (diagram 2.2.).

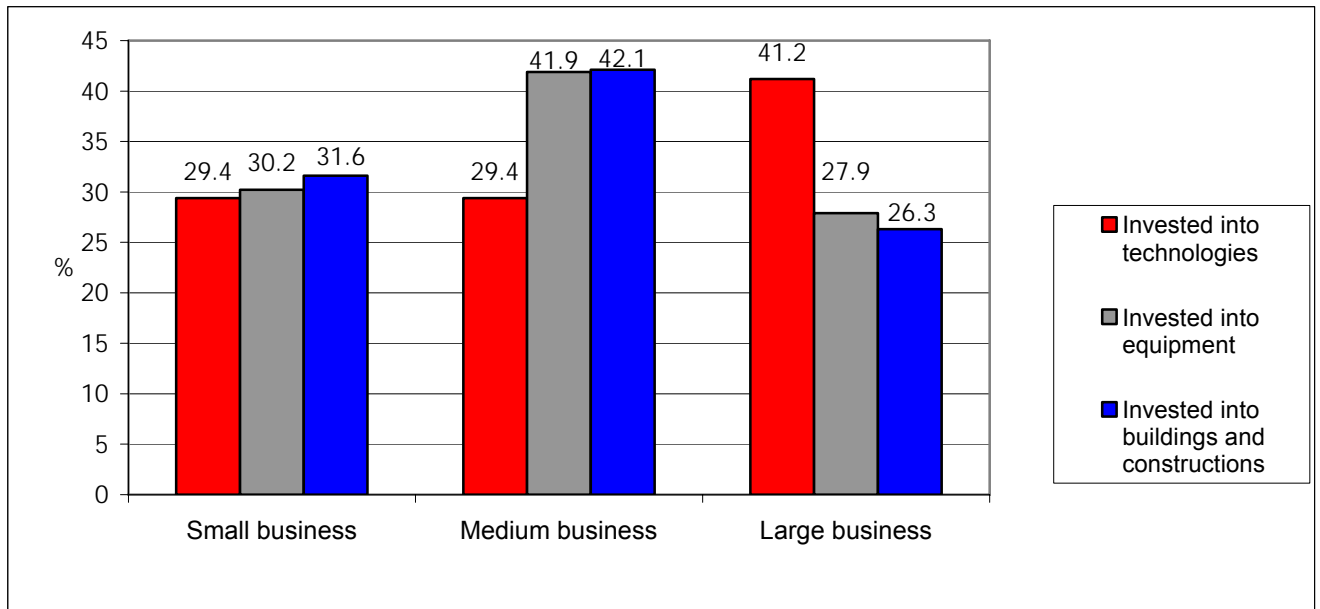
DIAGRAM 2.2. STRUCTURE OF INVESTMENT BY EXPORT ORIENTATION, %



Almost 50% of medium businesses' funds are invested in equipment and buildings/constructions, while a third is invested in technologies. Large businesses are usually on a

different level when it comes to modernization, so most of them invest in technologies: energy-saving, recycling, closed cycle technologies, etc. (diagram 2.3).

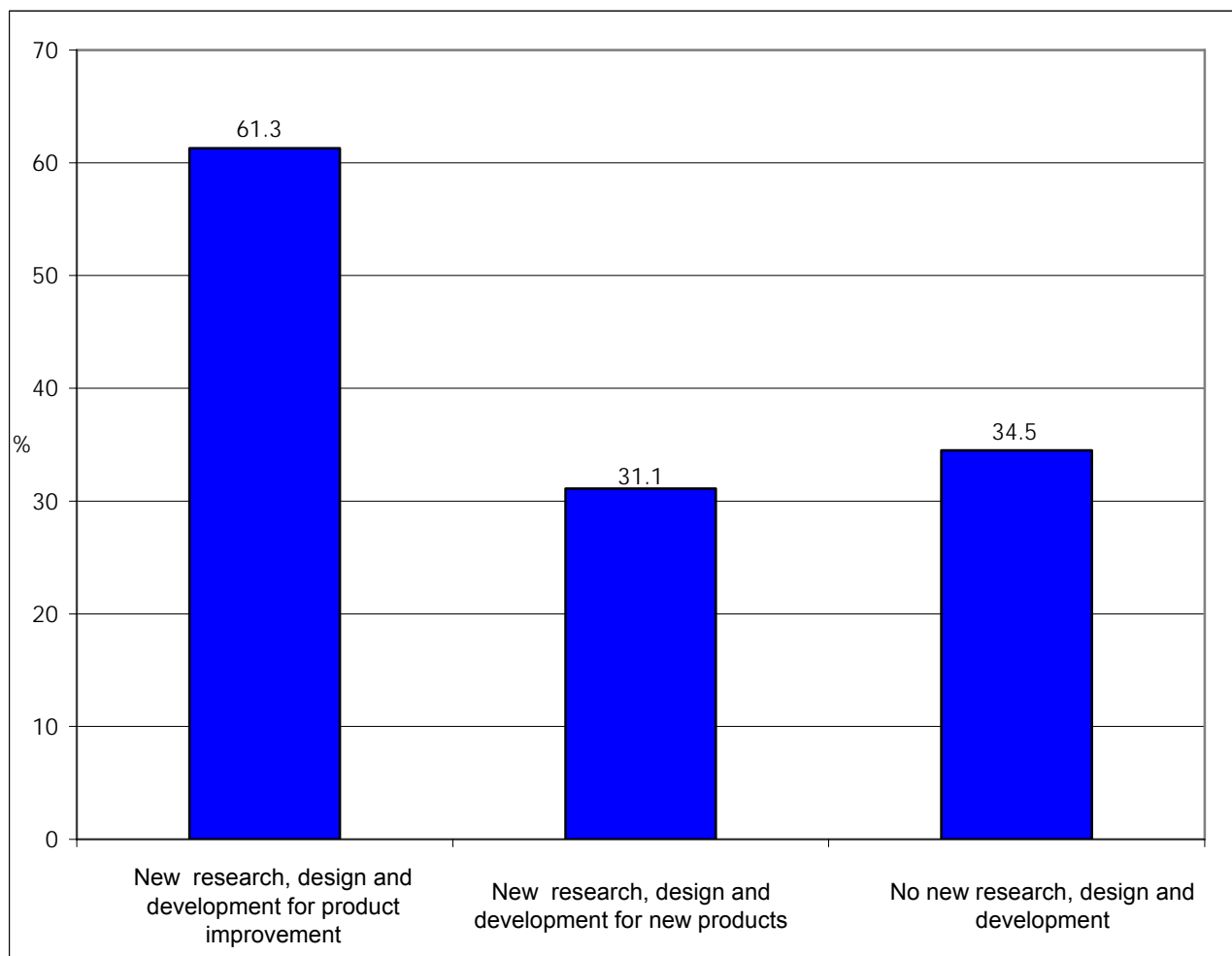
DIAGRAM 2.3. STRUCTURE OF INVESTMENTS DEPENDING ON THE SIZE OF ENTERPRISE, 2005 , %



INNOVATIVE ACTIVITIES OF THE SECTOR'S ENTERPRISES

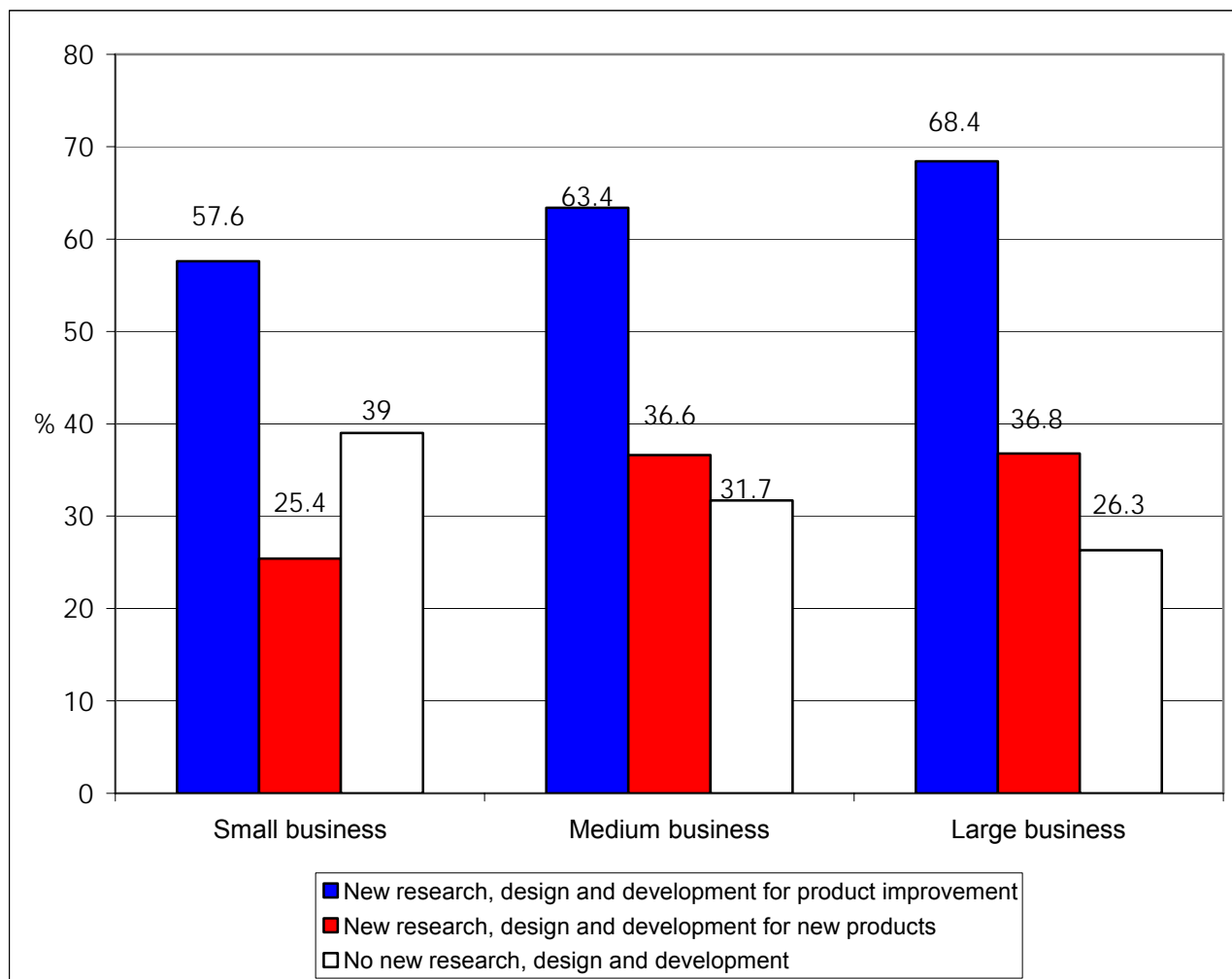
Questionnaires were sent to enterprises about their 2003-2005 activities in the areas of product and design improvement and implementation of new technologies. More than 50% of the interviewed enterprises answered that they performed design and development work over the past three years to

improve their products. One-third of them performed research and development towards creating new products. One third of other companies performed no design and development work (diagram 2.4).

DIAGRAM 2.4. IMPLEMENTATION OF NEW RESEARCH, DESIGN AND DEVELOPMENT, %

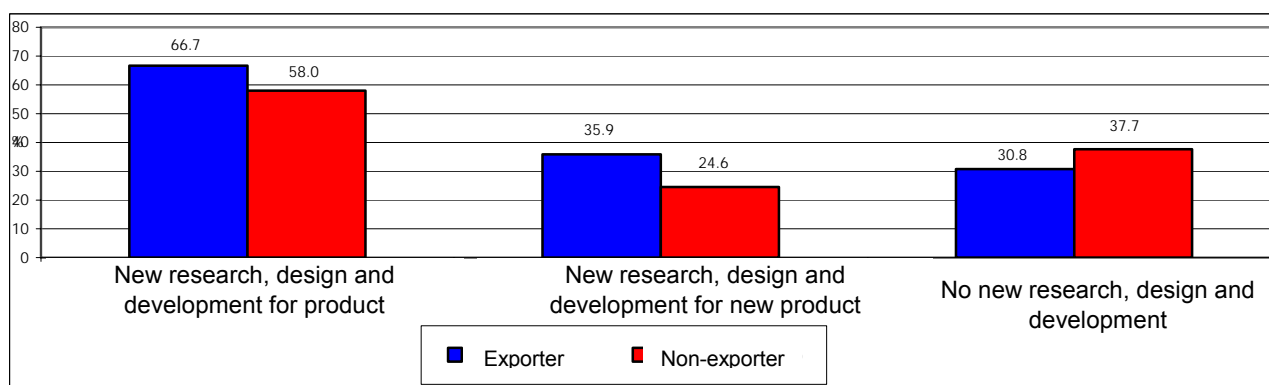
Large enterprises invest more in new development and research than do medium and small businesses (diagram 2.5.). Small businesses tend

to engage in innovative activities less than do other companies, as the research shows.

DIAGRAM 2.5. RESEARCH AND DEVELOPMENT, PERFORMED BY ENTERPRISES, DEPENDING ON THE SIZE OF BUSINESS, %

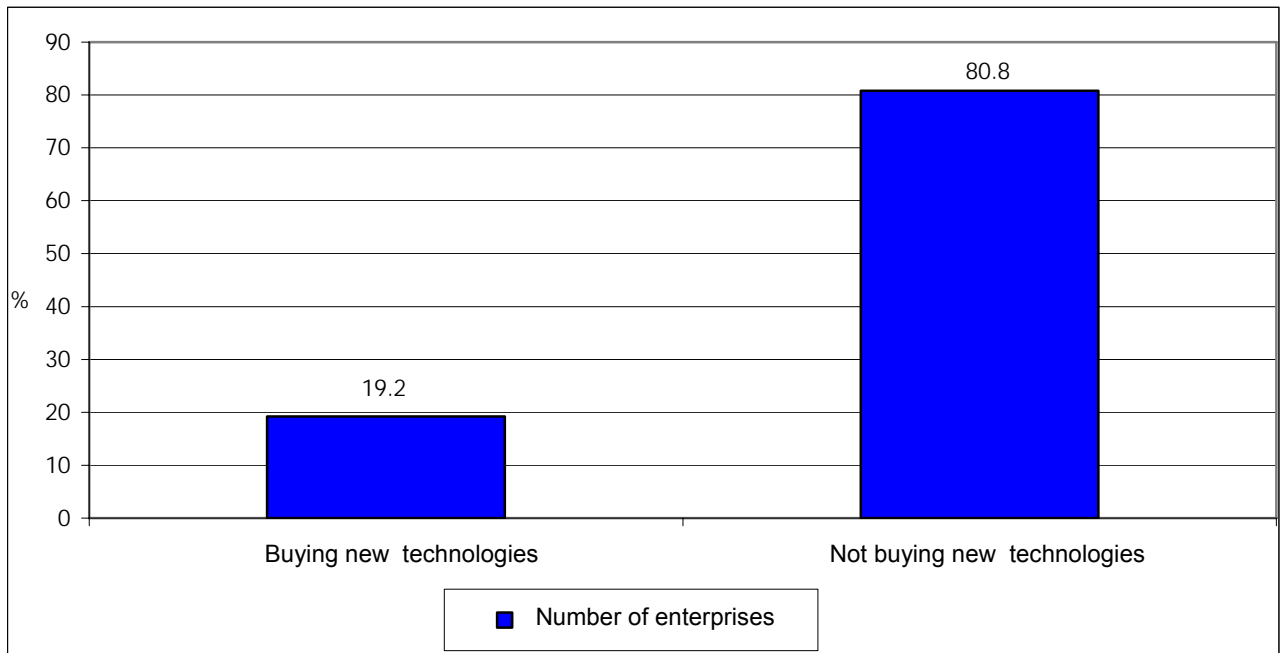
The research determined that most enterprises selling their products on foreign markets engaged in innovative activities (diagram 2.6). This could be

evidence of stricter quality requirements and of faster response times to changes on foreign markets.

DIAGRAM 2.6. NEW RESEARCH AND DEVELOPMENT, PERFORMED BY ENTERPRISES, BY EXPORT ORIENTATION, %

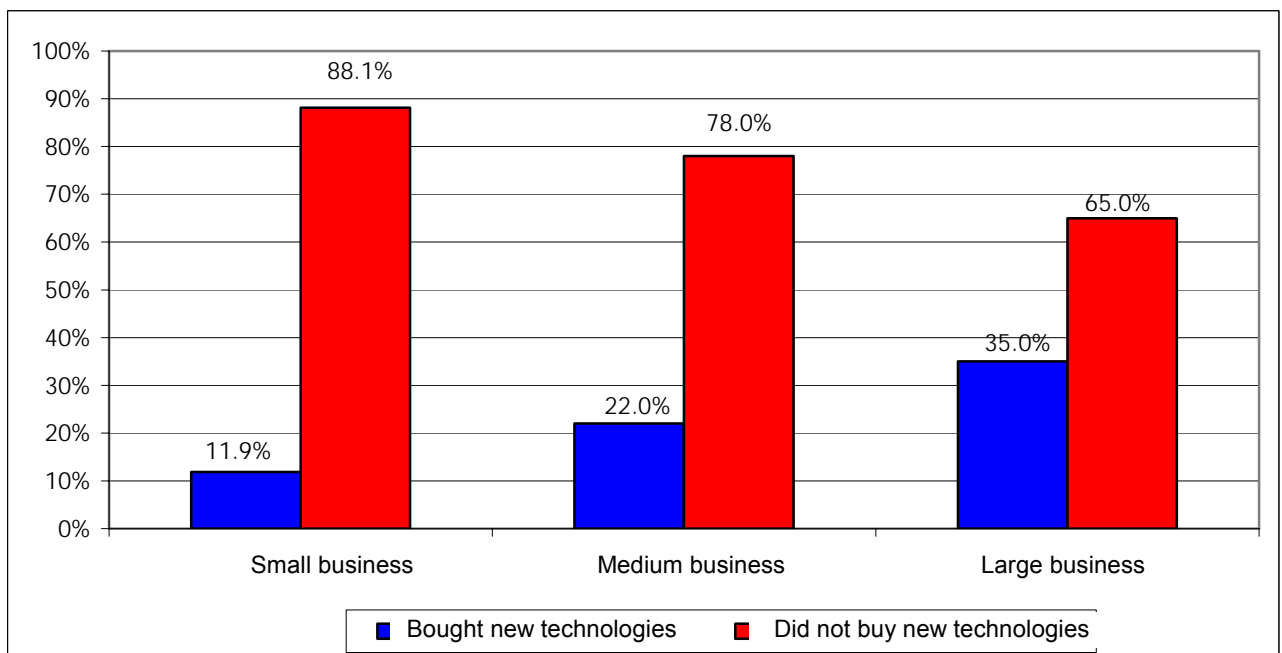
Looking at 2003-2005 numbers for new technologies oriented toward helping satisfy market demand, one notices the low level of innovative

activities among most sector companies. Only 19% of all companies launched new technologies during the past three years (diagram 2.7).

DIAGRAM 2.7. IMPLEMENTATION OF NEW TECHNOLOGIES BY ALL ENTERPRISES, %

Large, medium and small businesses have varying innovation policies. Only 12% of small businesses and 22% of medium businesses launched new technologies. Large businesses made major investments in new technologies to satisfy market

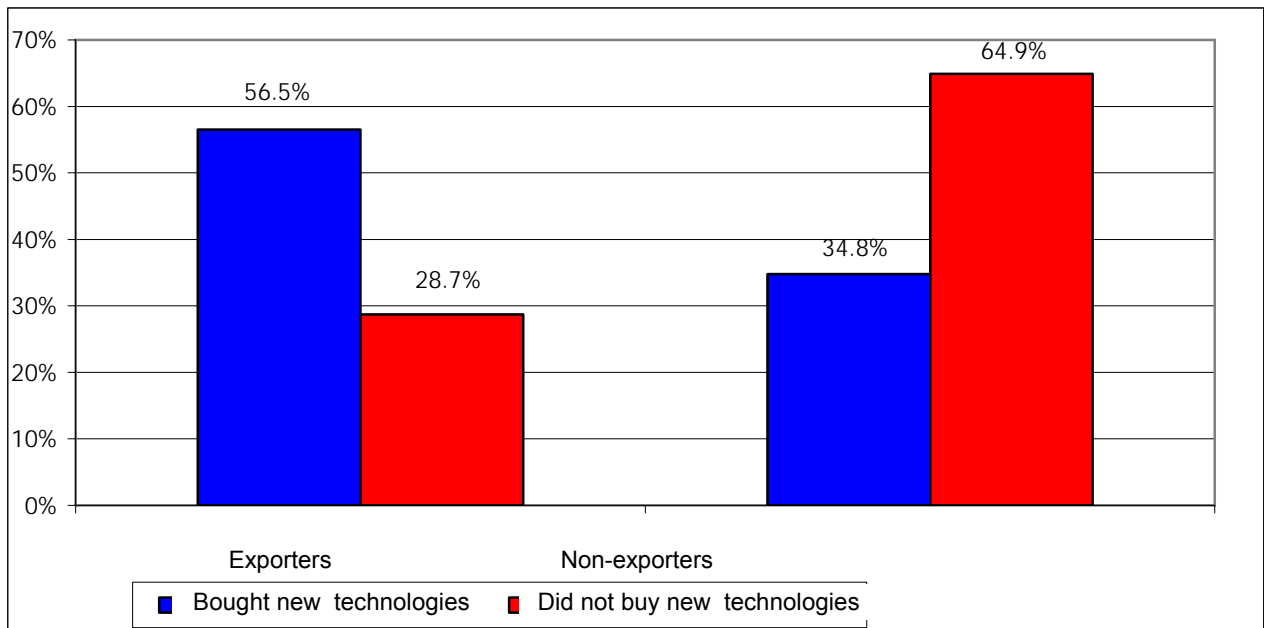
demand (diagram 2.8.). The difference can be explained by small businesses' lack of access to financial resources. Large businesses, by contrast, have enough money to launch new technologies.

DIAGRAM 2.8. IMPLEMENTATION OF NEW TECHNOLOGIES, BY THE SIZE OF ENTERPRISE, %

The interdependence between new technologies and export activities suggests that exporters spend more on innovation because they have to maintain

product quality. Launching new technologies is a way of competing for customers (diagram 2.9).

DIAGRAM 2.9. IMPLEMENTATION OF NEW TECHNOLOGIES BY EXPORT ORIENTATION, %



Research results show that illegal replication of clothing models is not very typical of the clothing sector (diagram 2.10), though it remains a

noticeable problem for the sector's enterprises (2.11).

DIAGRAM 2.10. FREQUENCY OF ILLEGAL REPLICATION OF CLOTHING MODELS IN CLOTHING SECTOR, %

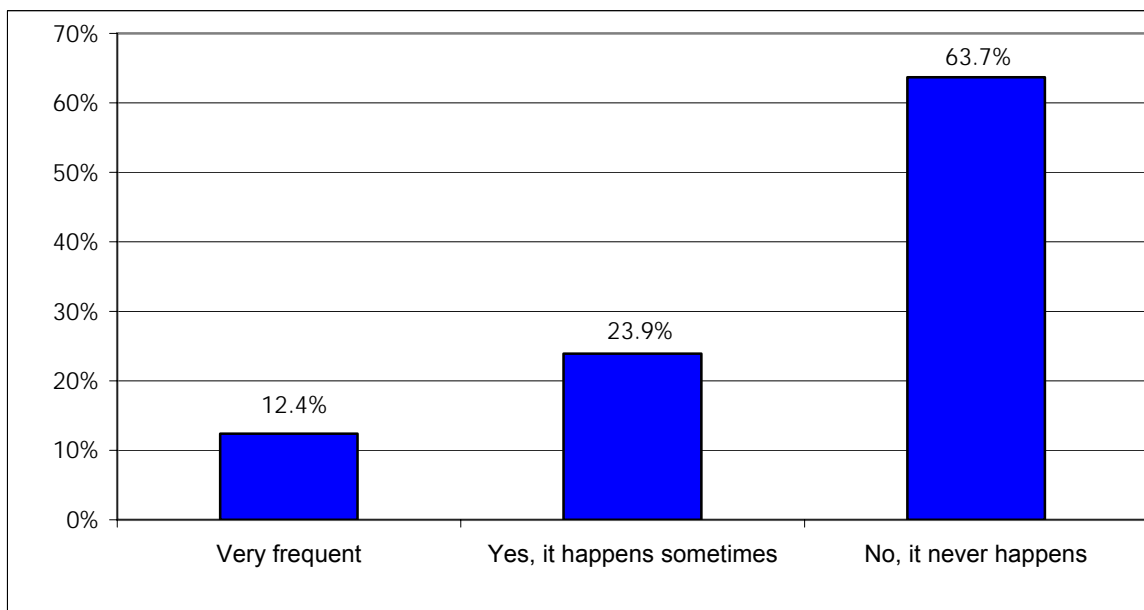
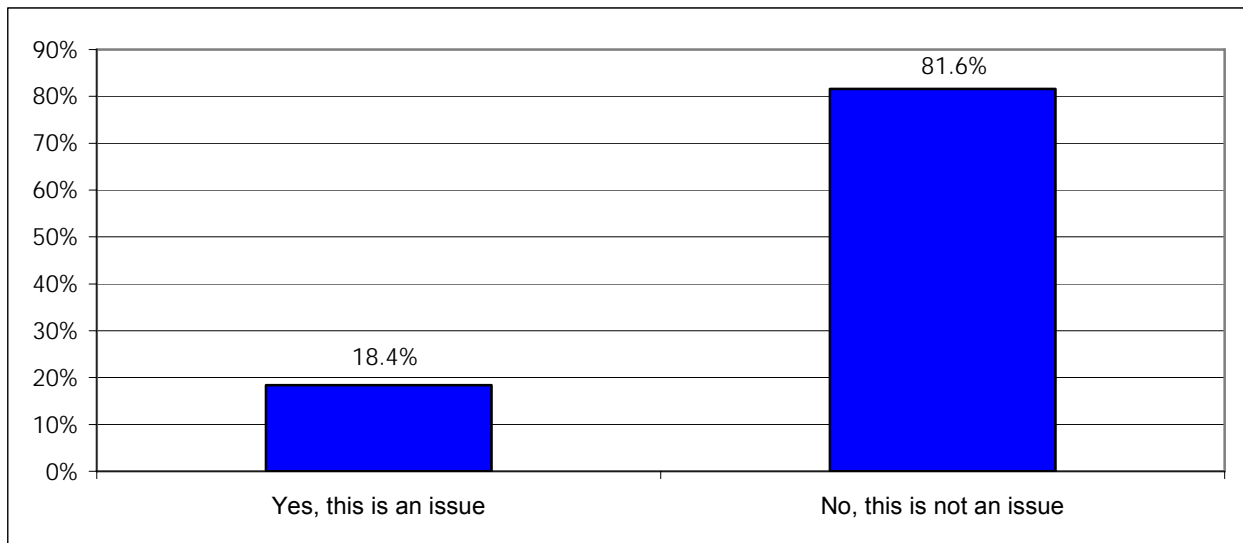


DIAGRAM 2.11. ILLEGAL REPLICATION OF CLOTHING MODELS



CONCLUSIONS

1. A main characteristic of Ukraine's clothing industry is that roughly 80% of finished products are made on tolling schemes.

2. The intensity of capital investment in the sector confirms that its growth and development are being assumed.

Both large and medium/small businesses are participating in this development.

3. Most companies are both improving products and developing new ones. The majority of large companies and export-oriented companies are implementing new technologies.

4. Only 12% of the interviewed sector managers admitted that illegal replication of clothing models is an issue. However, 18% of them think it is an important issue today.

SECTION 3. RAW MATERIALS AND RESOURCES

DESCRIPTION OF RAW MATERIALS MARKET AND RAW MATERIAL PRODUCERS

The clothing industry's main raw materials are fabrics and small wares.

A deficit of proper raw materials is one issue faced by Ukrainian production. Experts say Ukrainian textile enterprises focused on making large quantities of fabrics, while the product mix is poor and quality is low. However, according to Yuri Cherniy, the deputy director of the department for developing the light, furniture and woodworking industries at the Ministry of Industrial Policy, over the past 6-8 years Ukraine's textile industry had seen several positive changes and is already capable of partially satisfying the clothing industry's raw materials needs.

At the same time, expert opinion holds that clothing factories selling goods at medium and medium-high prices still have to buy their raw materials in foreign countries.

According to the Ministry of Industrial Policy, Ukraine's textile industry in 2004 produced 105.6 million m² of fabrics, a 140.8% rise as compared with 2003.

Raw materials suppliers include roughly 80 national manufacturers and more than 50 major importers.

The structure of the raw materials market is as follows: 80-85% of raw materials (by quantity of materials) are imported, while 15-20% are domestic.

The main countries from which Ukraine imports fabrics are Russia, Italy, Germany, Holland, England, Turkey, India, China and Korea.

Fabric manufacturers

The fabrics sector of Ukraine's textile industry makes cotton, wool and linen.

Gradually, major players are emerging on the market. They include Textile-Contact, Textica, Home Textile, Chaykovsky Textile and TNK.

The **cotton** industry includes spinning, weaving, twisting/threadmaking and dyestuff production.

The largest cotton factories are in Kherson and Ternopil (cotton industrial complexes), Donetsk (a cotton-making and spinning mill), and Nikopol (a twisting/threadmaking industrial complex). There are also cotton facilities in Kyiv, Kharkiv, Chernivtsy, Ivano-Frankivsk, Lviv, Poltava,

Kolomya, Korostyshiv and Radomushl. In 1998, Ukraine's cotton industry provided for 62.5% of overall fabrics production.

The **wool industry** is represented by initial wool processing facilities, yarn production, and production of fabrics and other materials.

Enterprises and branches are located in Chernigiv, Kharkiv, Kyiv, Donetsk, Kryvyi Rig, Odessa, Lugansk, Sumy, Cherkassy, Boguslav, and some towns in Chernivtsy and Zakarpattya regions. Wool fabrics constitute 7.8% of overall fabric production.

Ukraine's **linen industry** uses its own raw materials.

The main manufacturers of linen products are located in Rivne, Zhytomyr, Chernigiv and Lviv regions. There is a hemp/jute processing factory in Odessa and a rope factory in Kharkiv.

Linen fabrics account for roughly 11.3% of overall fabric production in Ukraine. This industry's products fully satisfy Ukraine's needs, and some products are even exported.

The **silk industry** is largely associated with production of artificial fibers and makes roughly 8.8% of overall quantity of fabrics.

Enterprises are located in Kyiv, Cherkassy, Lugansk and Lisichansk.

Leather production

Over the past few years the leather industry has worked under conditions of a raw leather deficit. This is because Ukraine's livestock population has fallen more than two times as compared to 1990, and because there has been a mass export of hide from Ukraine. The government used its power to prevent re-export of hide by countries with which it has free-trade agreements and stabilized the leather raw materials market. Supply of leather materials to leather clothing manufacturers created favorable conditions for the increase of leather product volume.

Enterprises of this branch are concentrated in Lviv, Mykolayiv and Ivano-Frankivsk regions.

In 2004, Ukraine's leather companies made 37.3 thousand tons of tanned leather (without further processing).

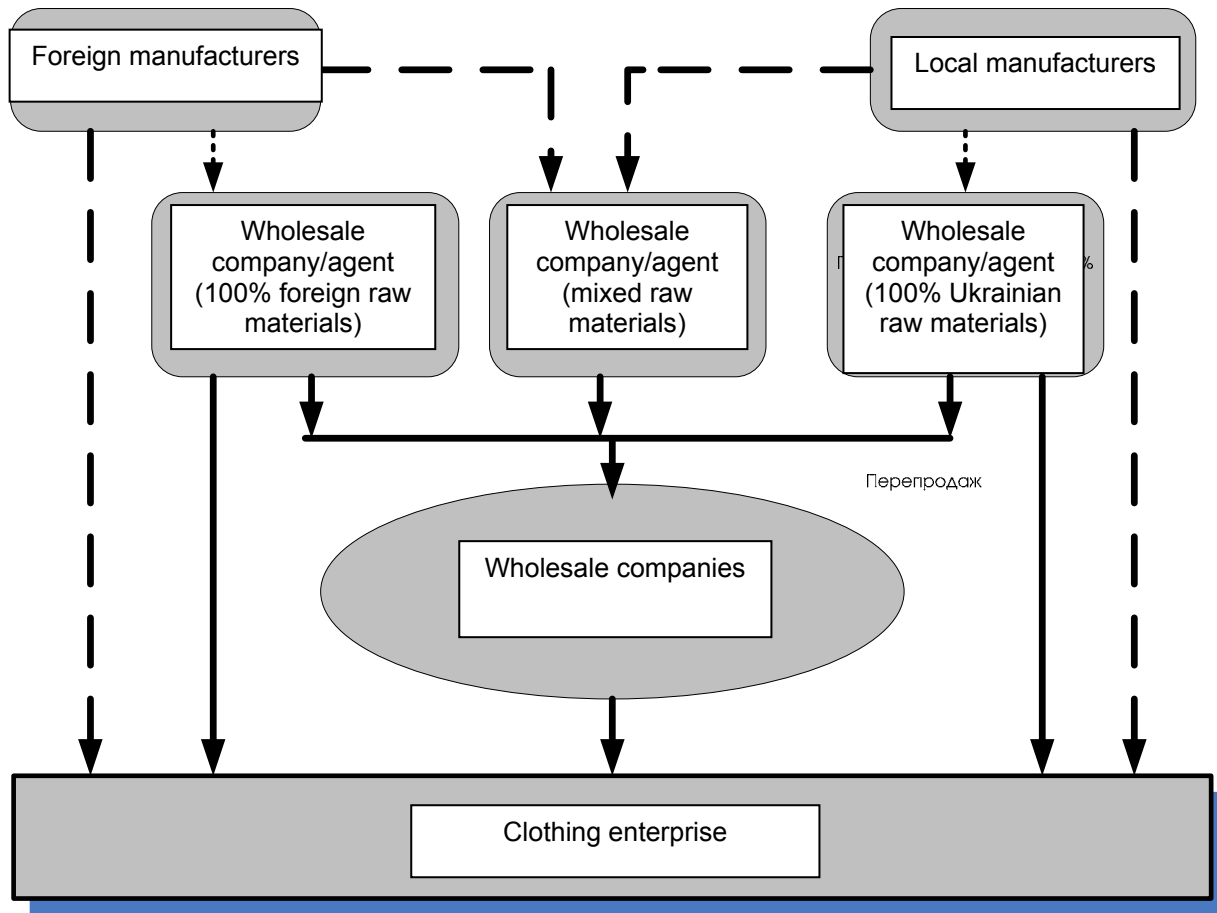
Post-tanning processed leather production equaled 3391.6 thousand m².

MODELS OF SUPPLY OF THE RAW MATERIALS USED BY SECTOR ENTERPRISES

Clothing enterprises purchase raw materials (fabrics, thread, buttons, zippers, etc) primarily through the distribution system with a very well

developed wholesale link (Fig.3.1.). Raw materials distribution system has at least two wholesale trade levels.

FIGURE 3.1, RAW MATERIALS SUPPLY SYSTEM



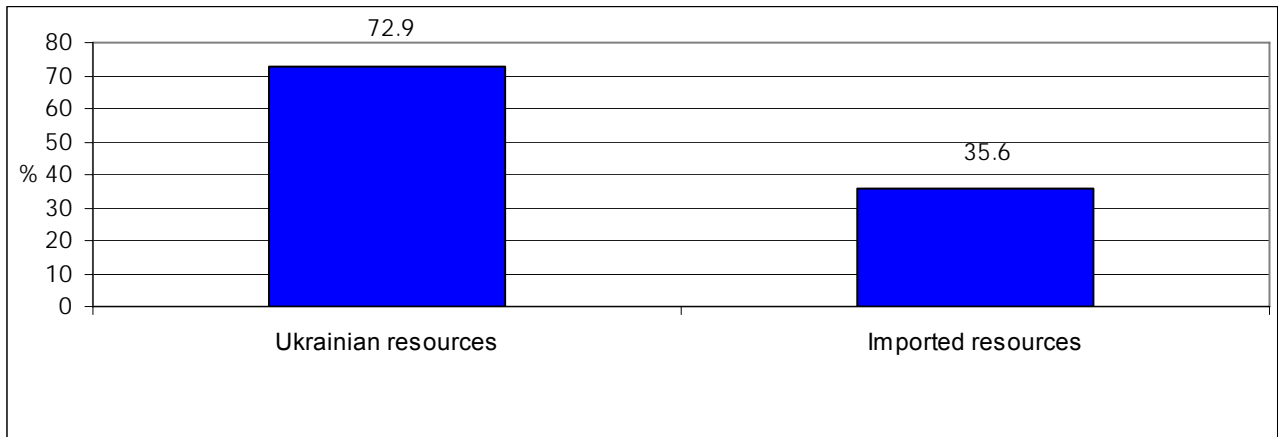
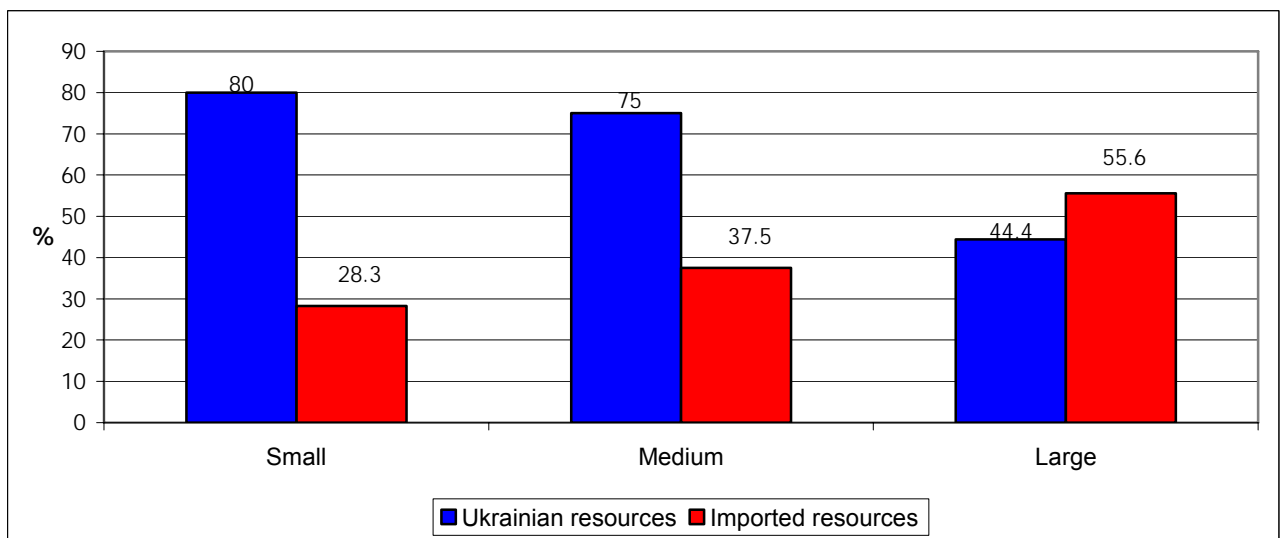
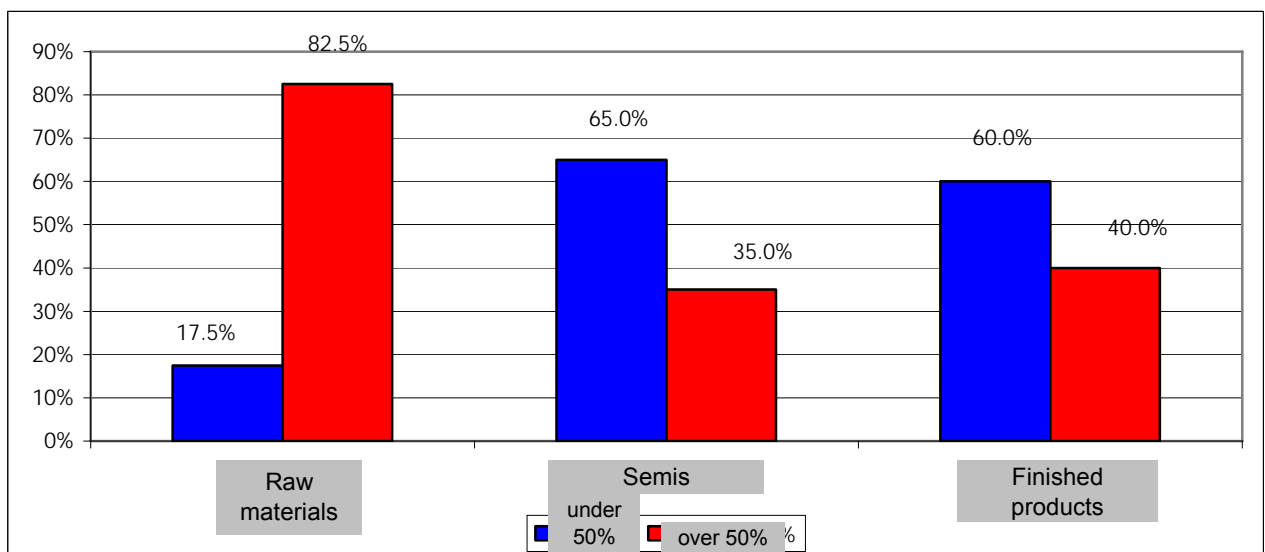
A reduction in barter has been a positive sign. At the end of 2004, the share of barter operations in the overall distribution structure equaled 2.7%, while at the beginning of this year it was 4.1 %.

Since companies to an 80-95% extent rely on tolling contracts with major companies from Germany, France, USA, Italy, Great Britain and elsewhere, the range of clothing products is determined by foreign orders.

According to interview results, most enterprises use national resources in their production prices

(diagram 3.1.). At the same time, large companies tend to use more foreign raw materials than Ukrainian materials, which could be an evidence of more frequent use of tolling schemes (diagram 3.2).

This indicates that large companies have to power their large production capacities with low-profit orders. In the resource cost structure, more than 50% of expenses are for raw materials. This is true for almost all enterprises (diagram 3.3.).

DIAGRAM 3.1 RESOURCES STRUCTURE, BY ORIGIN, %**DIAGRAM 3.2. RESOURCES STRUCTURE, BY ORIGIN, DEPENDING ON THE SIZE OF ENTERPRISE, %****DIAGRAM 3.3. STRUCTURE OF ENTERPRISES' FUNDS ALLOCATED FOR RESOURCES, %**

Companies that sell their products on the domestic market use more Ukrainian raw materials than do enterprises who work on foreign markets. Companies operating on foreign markets use more imported resources than do companies selling in Ukraine. This witnesses to the fact that most tolling

orders come from foreign countries. In general, 324 Ukrainian clothing factories use tolling orders.

According to open sources and experts, 70-80% of Ukrainian clothing production is represented by goods made on commission.

The main reasons Ukraine's clothing industry uses such schemes are:

- the country's underdeveloped fashion industry, which leads local consumers to focus on Western brands;
- large production capacities that have to be loaded, and a large percentage of production personnel not engaged in production;
- a lack of proper raw materials (Ukrainian clothing manufacturers who enjoy high demand, like Gregory Arber, mostly use imported fabrics, thus increasing the cost of finished products significantly);
- the large quantities of "black" and "gray" clothing imported into Ukraine.

ENERGY RESOURCE UTILIZATION STRUCTURE AND EFFICIENCY

Electricity is clothing factories' main energy resource, representing 9-10% of product cost structure on average. One-third of the interviewed enterprises said electricity's share in overall 2005 product cost was less than 5%. Small businesses consume the lowest quantity of electricity (under 5%). For most medium businesses, energy costs represent 5-10 % of product cost. For most large enterprises they represent 10-20 %.

Enterprises use mainly the following cost-reduction measures:

- saving costs on raw materials
- improving technologies and equipment.

This means enterprises can implement energy-saving technologies to decrease product costs. At the same time, however, enterprises also tend to save on raw materials. This could result in lower product quality.

TABLE 3.1. WAYS OF REDUCING PRODUCTS COST

Method of cost reduction	Share of enterprises using this method, %
Technology and equipment upgrades	29.7
Saving on raw materials	27.7
Transferring to cheaper energy carriers	21.8
Saving on salary funds	21.8
Refusal to buy new equipment or develop production	18.8

There is an interesting relationship between money spent on energy and enterprises' export orientation. Companies focused on foreign markets (primarily European ones) have lower energy costs (9.5% on the average) that do enterprises focused on the domestic market

(13.5%). This is because export-oriented companies (including those using tolling schemes) have a larger percent of loaded production capacities and less downtime, and so use their electricity more effectively.

CONCLUSIONS

1. The decrease in bartered products volume has been a positive clothing sector tendency.
2. Companies focused on the domestic market mostly use Ukrainian raw materials.
3. Companies focused on export tend to use imported raw materials.
4. Despite renewed production at most textile factories, national fabrics manufacturers fail to satisfy clothing factories' needs.
5. Enterprises focused on foreign markets have lower energy costs.
6. If energy costs increase, one-fourth of the sector's enterprises are willing to decrease the cost of products, and only 9% (primarily small businesses) will increase the prices of finished products.

SECTION 4. SALES

In the past, Ukrainian consumers have preferred clothing from Poland, China and Turkey, which has caused a certain decline in Ukraine's clothing sector. Over the past 5–7 years, however, tolling cooperation between Ukrainian clothing factories and foreign companies has stimulated partial revival of factories' work and stimulated development.

This sort of operation is an interim measure, and operations should be refocused on the domestic market, particularly on improving design and marketing. National companies should increase their presence in the existing distribution channels.

ANALYSIS OF SALES VOLUME OF THE SECTOR'S MAIN PRODUCERS

Some clothing enterprises in the industry post relatively high sales in relation to the sector's overall sales volumes. However, no enterprise has more than a 2% in the overall sales structure of Ukrainian-made clothing.

In 2004, Ukrainian clothing factories sold 3.4 billion hryvnias' worth of products. Specialized clothing enterprises sold roughly 2 billion hryvnias' worth.

Let us analyze Ukrainian clothing sales as of 2004. (Official information on overall sales and on sales volumes of individual companies is fully available only for 2004.)

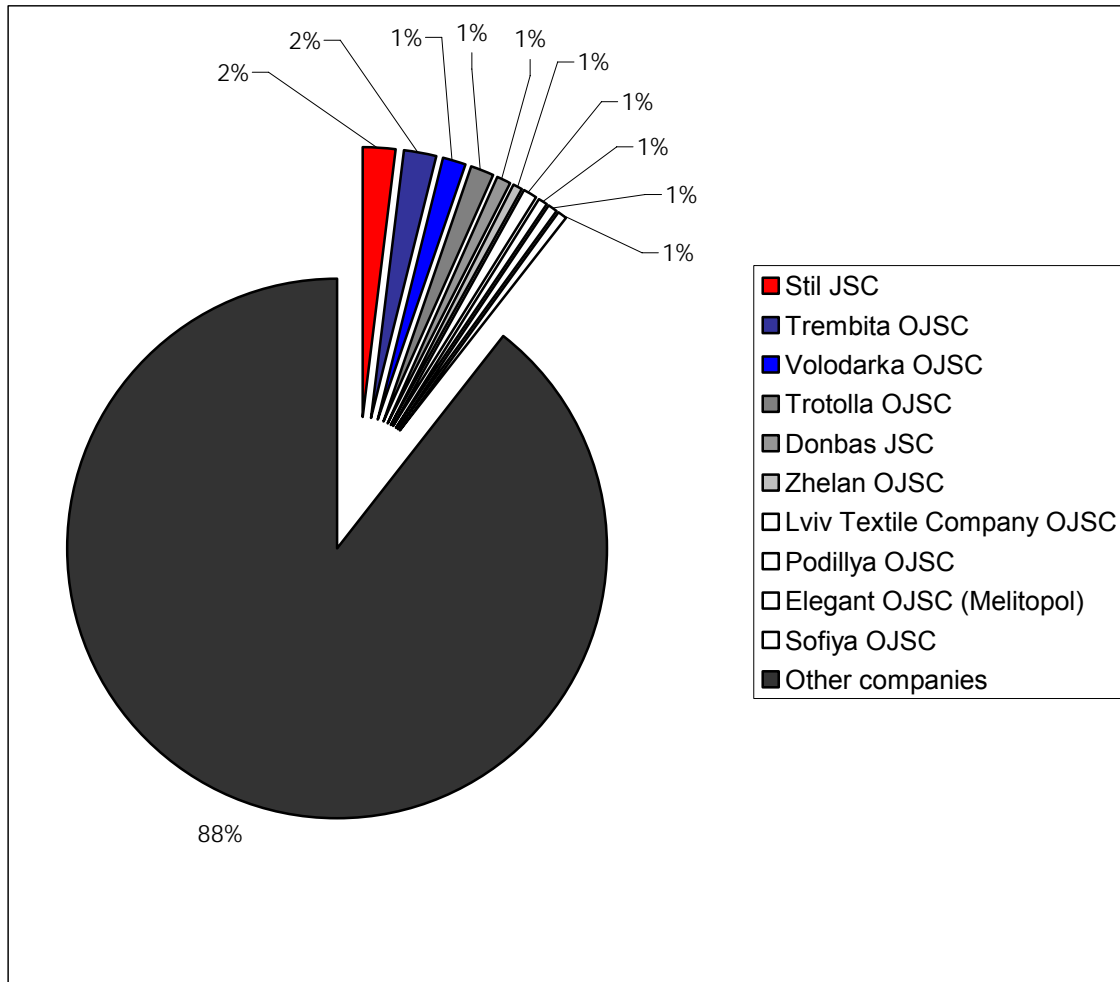
Table 4.1 presents the top ten companies, closed corporations or public corporations in terms of sales.

TABLE 4.1. LEADERS IN UKRAINIAN CLOTHING SALES, 2004

No	Clothing sales leaders on Ukraine's market	Net income from products sales	Cost of sold products	Net profit/loss	Profitability	Profitability norm
1	VAT Style	40 616.9	26 864.4	4 478.6	11.0	66.1
2	VAT Trembita	34 160.5	28 747.4	374.0	1.1	84.2
3	VAT Volodarka	28 380.8	20 467.9	1 013.1	3.6	72.1
4	VAT Trottola	26 642.3	23 197.4	78.8	0.3	87.1
5	ZAT Donbas	16 357.1	13 033.6	550.4	3.4	79.7
6	VAT Kyivska CF Zhelan'	14 177.9	10 633.3	-1 002.3	-7.1	75.0
7	ZAT Lvivska Textile Company	12 255.9	11 536.8	-1 350.8	-11.0	94.1
8	ZAT Podillya	12 239.3	9 891.3	-313.2	-2.6	80.8
9	VAT CE Elegant (Melitopil)	11 595.0	7 726.0	506.0	4.4	66.6
10	VAT Sophia	10 028.0	9 814.0	-1 598.0	-15.9	97.9

Shares of clothing sales leaders among specialized

companies are shown in diagram 4.1.

DIAGRAM 4.1. SHARES OF LEADERS OF THE UKRAINIAN CLOTHING MARKER IN THE OVERALL STRUCTURE, %

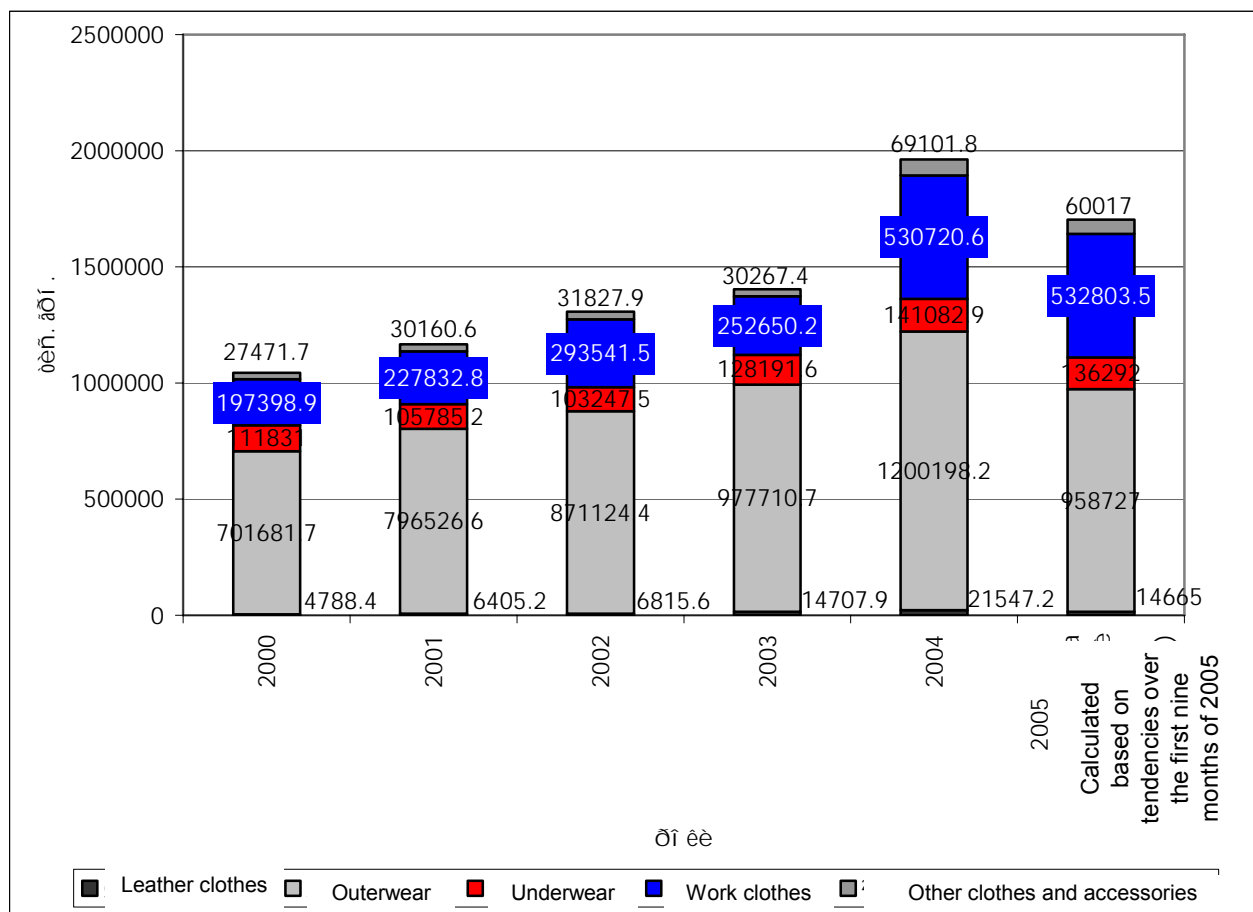
Let us analyze the dynamics of Ukrainian clothing products sales in 2000-2005 (diagram 4.2.) Sales volume of Ukrainian leather clothes grew slowly in 2000-2002.

In 2003, sales volumes of leather clothes more than doubled. In 2004, the increase was also significant: sales volume increased by 46.5% and exceeded 21.5 million hryvnias.

Sales volume of outer clothes went up in 2000-2004, and in 2004 exceeded 1.2 billion hryvnias. In 2005, this figure fell by 20% and amounted to almost 960 million hryvnias (according to calculations based on tendencies observed over the first 9 months in 2005).

Sales volumes of underwear in 2000-2005 practically did not change, remaining within the 100-140 million hryvnia range. Sales volumes of work wear increased significantly in 2004-2005. While in 2000-2003 this figure equaled 200-300 million hryvnias per annum, in 2004 sales volumes of work wear made by specialized companies exceeded 530 million hryvnias. They stayed at the same level in 2005.

Sales volumes of other types of clothes and accessories in 2000-2003 equaled about 30 million hryvnias, and in 2004 rose to almost 70 million hryvnias. In 2005 sales went down by 14%, and equaled 60 million hryvnias.

DIAGRAM 4.2. DYNAMICS OF UKRAINIAN CLOTHING PRODUCTS SALES, THOUSAND HRYVNIAS

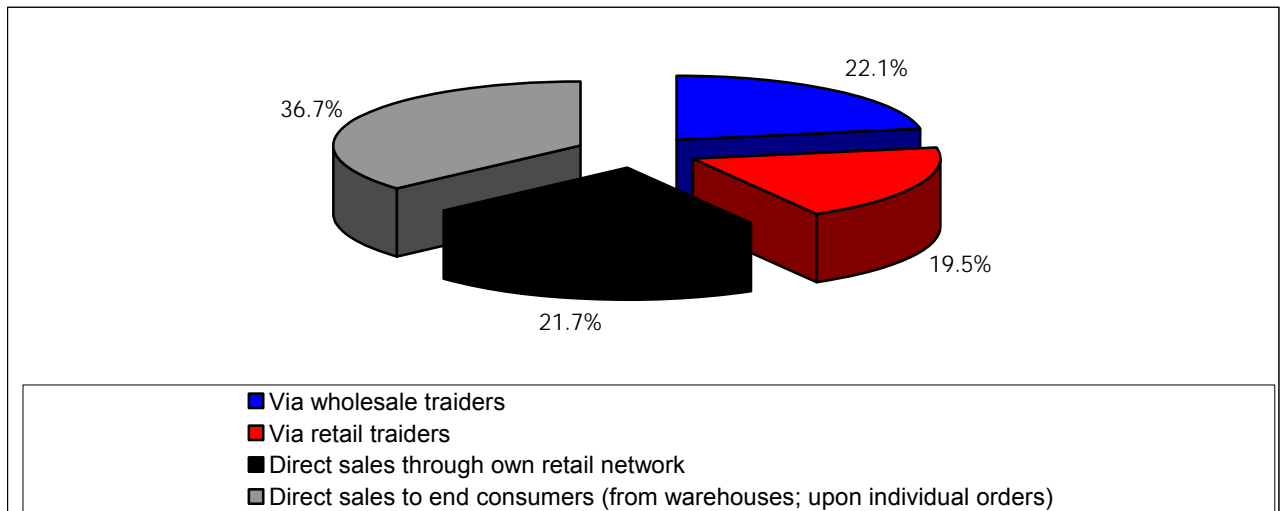
ANALYSIS OF DISTRIBUTION CHANNELS OF THE SECTOR

The distribution channels typically used by Ukrainian manufacturers (such as sales of standard product mixes from to wholesale traders) have become inefficient. They are hindering enterprises from building their own capacities in response to changing requirements and consumer priorities.

Energetic companies are seeking new and more profitable distribution channels, selling their products to retailers or developing their own retail networks. They are thus responding to a competitive market and building up their own financial capacities.

The Ukrainian clothing sales structure is represented by the following main channels (diagram 4.3.):

- direct sales via own retail networks;
- direct sales to end users;
- sales via wholesale traders;
- sales via retail traders.

DIAGRAM 4.3. SALES STRUCTURE BY MEANS OF SALE, %Direct sales through own retail network

Direct sales through a company's own proprietary retail network presuppose a strong, well-developed company brand. A chain of retail outlets allows a manufacturer maximum profitability. This profitability level can run anywhere between 30% and 400% (e.g. for companies like Mykhaylo Voronin or Gregory Arber).

However, retail distribution channels bring certain risks:

- financial: major capital investment is needed to establish retail networks or develop brands;
- marketing: it is difficult to compete with franchised world famous brands that can boast brand awareness and client loyalty. It may be difficult to switch consumer focus to Ukrainian clothing.

To hedge against these risks, it is advisable to do the following:

- analyze target market potential and choose a promising market segment in which the company can be competitive;
- define brand positioning parameters;
- develop a quality product;
- do efficient promotion and PR;
- organize an efficient logistics system;
- establish good client service at sales points;
- update product mix by using clothing collections;
- spend money on marketing and design/development.

Since clothing sales through proprietary retail outlets are an image-focused way of promoting products for end users, they should have consistent standards:

- sales facility design should be standard;

- prices should be the same throughout Ukraine;
- client service requirements in all stores should be standard;
- special offers, discounts, etc. should be simultaneous everywhere.

Franchising allows for the efficient development of a brand presence in the regions, without a major capital investment. But it necessitates an efficient logistics platform and proper brand awareness and loyalty.

Direct sales to end users (from warehouses, upon individual orders, etc.)

Directly selling to end users is the most popular distribution channel. It has three variations:

- making and selling exclusive to special order;
- making and selling to corporate order (e.g. Gregory Arber's collection for the Soccer Federation of Ukraine);
- selling old collections' warehouse remainders at lower prices.

Production of exclusive clothes by Ukrainian designers is highly profitable, though the sector is limited. Individual orders make for neither stable profits nor efficient production.

Production and sales of clothing to corporate order is not common in Ukraine today. Most companies consider this sort of work promising, however, because the segment is just beginning to form. It therefore has high demand potential. This sales channel has its own advantages (like mass production of typical products and the possibility of landing contracts with major clients) and could provide stable income for a clothing company that makes large batches of products (e.g. for Ukrainian Railway Administration, for major retailers, etc.).

Inefficiency of production and sales risks are not problems here.

Selling remainders through warehouses allows companies to recover the costs of products not sold on time.

The very fact that such a sales mechanism is needed is, of course, a negative.

But it can allow manufacturers to transition into a new way of doing business that is focused on demand and not on production capacity, especially when goods sold to average citizens are at issue.

Sales via wholesale traders.

Distribution via wholesale traders is the least profitable but also the lowest-risk channel, from the operational point of view.

It has two important forms:

- when a company makes and sell its own products, which allows for scale effects and provide a certain financial stability;

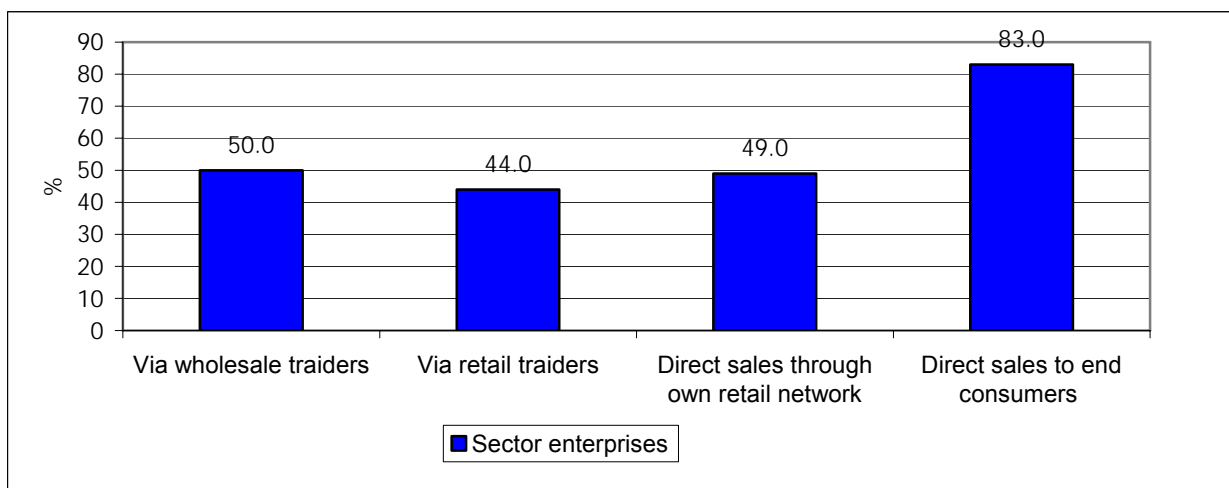
- working under tolling schemes; this gives companies a stable, if low, income and lets them pay their employees.

Sales via wholesale traders, therefore, are important for ensuring minimum stability. They are a forced interim measure from the point of view of tolling, and a priority measure from the point of view of sales of a company's own products. In the interim, such sales help enterprises progress into more complex and profitable market segments.

Sales via retail traders.

Sales of Ukrainian clothes via retail traders involve sales both by major players on the clothing market (department stores and specialized clothing markets), and by private retail entrepreneurs.

DIAGRAM 4.4. DISTRIBUTION CHANNELS USED BY ENTERPRISES, %



Retailers hold a significant share of the clothing sales structure because they work in the best-attended sales venues (clothing markets, trade centers), where the volume of sales amounts to 70% of Ukraine's overall clothing sales. Retail is therefore a priority from the point of view of replacing imported products with Ukrainian ones in the medium and low price segments.

Retail has medium profitability and a medium risk level, and lets manufacturers forecast and plan future production volumes.

It is vital to focus on demand when new collections or lots are being planned, because the main risk in clothes retail is failing to give consumers what they want.

Restructuring corporate activities to focus on end users is difficult, because retail requires major capital investments, and because sales do not always cover production costs. But participating in retail gives enterprises a feel for market dynamics. It can also foment the sort of efficiency companies

need to develop their production, focusing it on boosting productivity and extending product range.

Large businesses, the main focus of our study, dominate sales (see diagram 4.4), while their presence in retail networks is minimal. This testifies to the potential inherent in developing marginal channels without ceding position in traditional sales channels.

Ukrainian companies' heightened activity in different sales channels can help win back the market from the foreign companies permeating it at present. These foreign companies are skillful in their sales strategies, and sometimes use dumping as a strategy.

Clothing retail in major cities has the following structure:

- 46% of products (in monetary form) are sold through clothes markets;
- 40% are sold through small stores (including boutiques in trade centers);

- 14% are sold through brand chains (including departments in trade centers).

In small towns, the share of sales through clothing markets is even bigger. The influence of brand chains and specialized boutiques is getting stronger.

One clothing sales format that has yet to be developed is sales via large clothing stores (like H&M, etc.). The first attempt to move in this direction was TUSO, but because of its product range, it did not become popular with mass consumers.

CONCLUSIONS

1. The ready-made clothes sales structure is developing by using as a model the experience of well-developed markets, but is not coming up with its own know-how. The structure is inert, and not characterized by the level of structural transformation that can bring the industry to a new level and win the domestic market from importers. Despite the positive tendencies of past years, Ukrainian companies hold only a 15-20% share of the market (according to different studies).

2. Ukrainian clothing companies are represented in all four main sales channels: direct sales through their own retail network, direct sales to end users, sales via wholesalers and sales via retailers.

3. The top priority sales channel for Ukrainian manufacturers is direct sales via own retail networks. At the same time, the wholesale traders channel is also used quite often (including the tolling orders system). This system is efficient for mass production on the condition that activities are correctly organized.

4. Ukrainian manufacturers use mixed distribution systems and different depth channels.

5. None of Ukraine's clothing factories hold more than 1-2% of the clothing market.

SECTION 5. COMPETITION

Ukraine's clothing market is a monopolist one:

- Many enterprises offer differentiated products. Each satisfies only a small piece of overall market demand for specific product groups.
- The market includes manufacturers of mutually exclusive products; they conclude agreements on a wide range of prices.
- Due to product differentiation, each enterprise has a monopoly on its own version of product.
- Certain barriers hinder market access (with regard to access to distribution channels, brand loyalty, major investments into equipment), but it is simple to access the market because of undervalued assets on the clothing market. The rejuvenation of many enterprises by means of long-term partnership agreements (e.g. CP Yunist' with HUGO BOSS) testifies to this.
- The market is not fully transparent from the point of view of capacity and the market's actual structure and segmentation.
- Companies try to increase their advantages by exploiting the individual characteristics of the products they offer.
- Sector companies sell differentiated versions of the same basic products, although there are so many enterprises that none of them significantly influence other enterprises. Products can be differentiated by quality, features, style, etc.
- Buyers see different product features and pay different amounts for them. Sellers try to create different marketing offers for different market segments using not price as a tool, but also trademarks/brands, advertisements, and other promotional and marketing instruments.

- The demand curve is elastic, though enterprises can raise prices without losing their customers. This is because enterprises' offers include elements that are important for defined consumer groups. On the other hand, since the goods differentiated, enterprises can lower prices, but this means they won't win over their competitors' clients.

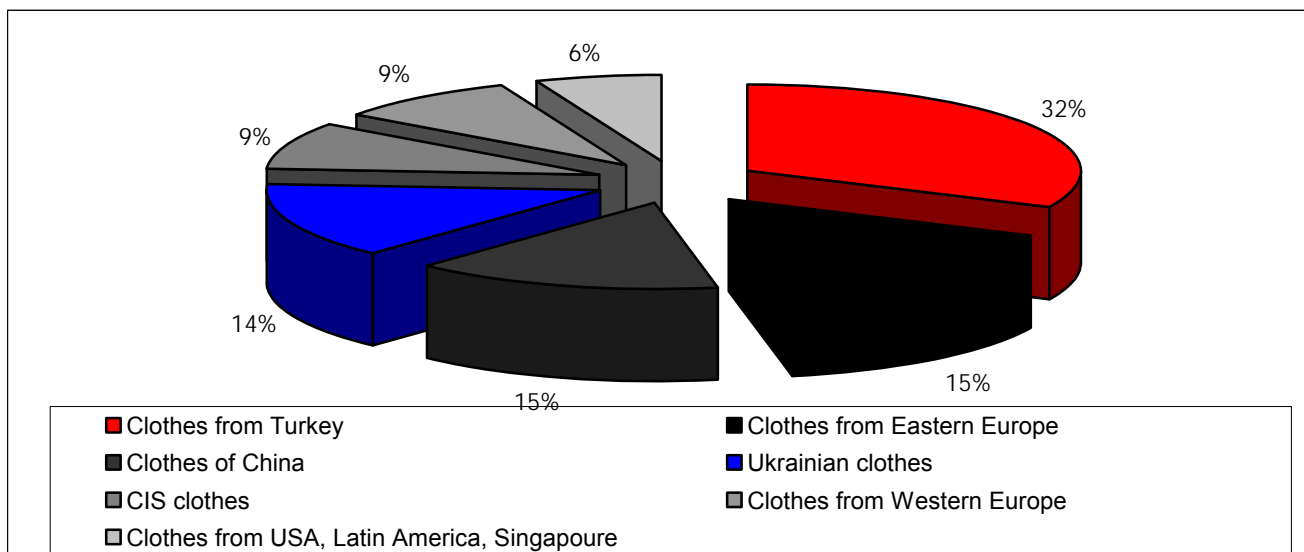
The classical competition model shows that the most important competition in the clothing market is not to win end users. It is rather to win contracts with intermediaries, like tolling clients (major customers) or large wholesale traders. Such intermediaries are capable of securing a certain volume of orders, allowing manufacturers to plan their production processes and foresee resource demand (human resources, money).

It is difficult for national manufacturers to compete for end users with professional traders because the latter predominantly sell imported products or products designed in foreign countries. They use franchising schemes, which gives them efficient access to retail technologies.

Ukrainian companies' biggest competitors on the domestic market are manufacturers from Turkey, China, and Eastern Europe (diagram 5.1).

Andriy Sanin, director of VAT Kharkivska CF, says today's market necessitates fast renewal of the product mix and that former "industry giants" are too slow to react to changing market demands. He says the best chances for success belong to companies that can react quickly to changes in demand. Large enterprises have to invest more money into maintaining their competitive ability.

DIAGRAM 5.1. STRUCTURE OF CLOTHING SALES ON THE DOMESTIC MARKET OF UKRAINE, 2004 (ACCORDING TO UKRLEGPROM ASSOCIATION OF UKRAINE), %



Efficient tools for retail competition include correct positioning (e.g. affordable business clothes, clothes for women), a clear understanding of the market's stylistic and price segmentation, and the ability to inform consumers about such advantages.

The market has not yet been structured, so there are many opportunities for manufacturers to generate competitive market offers for efficient participation in different sales channels.

Entering retail channels, however, is not a guaranteed solution for an enterprise's problems. Operation via wholesale traders under long-term partnership agreements and with efficient logistics could bring success, too. Under such circumstances, the Ukrainian clothing sector could begin to compete globally with Eastern Europe, China and Turkey for major Western trade network orders where such factors as quality, timeliness and reliability in contract performance are highly valued.

PRIMARY MARKET PLAYERS

Taking into account how statistics are currently produced, the insufficient transparency in the sector and a lack of factual data, it is difficult to determine the market shares of main market players. There exists no verified or published information on enterprises' income, or on what market volumes they share in general and by segment.

Experts assume there has been 20-30% market growth rate over the past 3 years and an overall market volume of \$3.5 billion US dollars. Taking into account experts' assumptions that national manufacturers have 15-20% of market share, about the same volume of export (Source: Information provided by the State Statistics Committee), and a production volume of \$570-600 million US dollars, it is possible to state that as of 2005 the clothing sector equaled roughly \$800 million US dollars

Low sales levels are also due to tolling schemes used by enterprises, when gross income (proceeds, turnover) includes primarily the cost of services for making clothes (\$7-13 US dollars for a men's suit,

on the average, in Ukraine). This equals 10-20% of a product's overall production cost. So nominal figures for Ukrainian companies' activities are seriously understated.

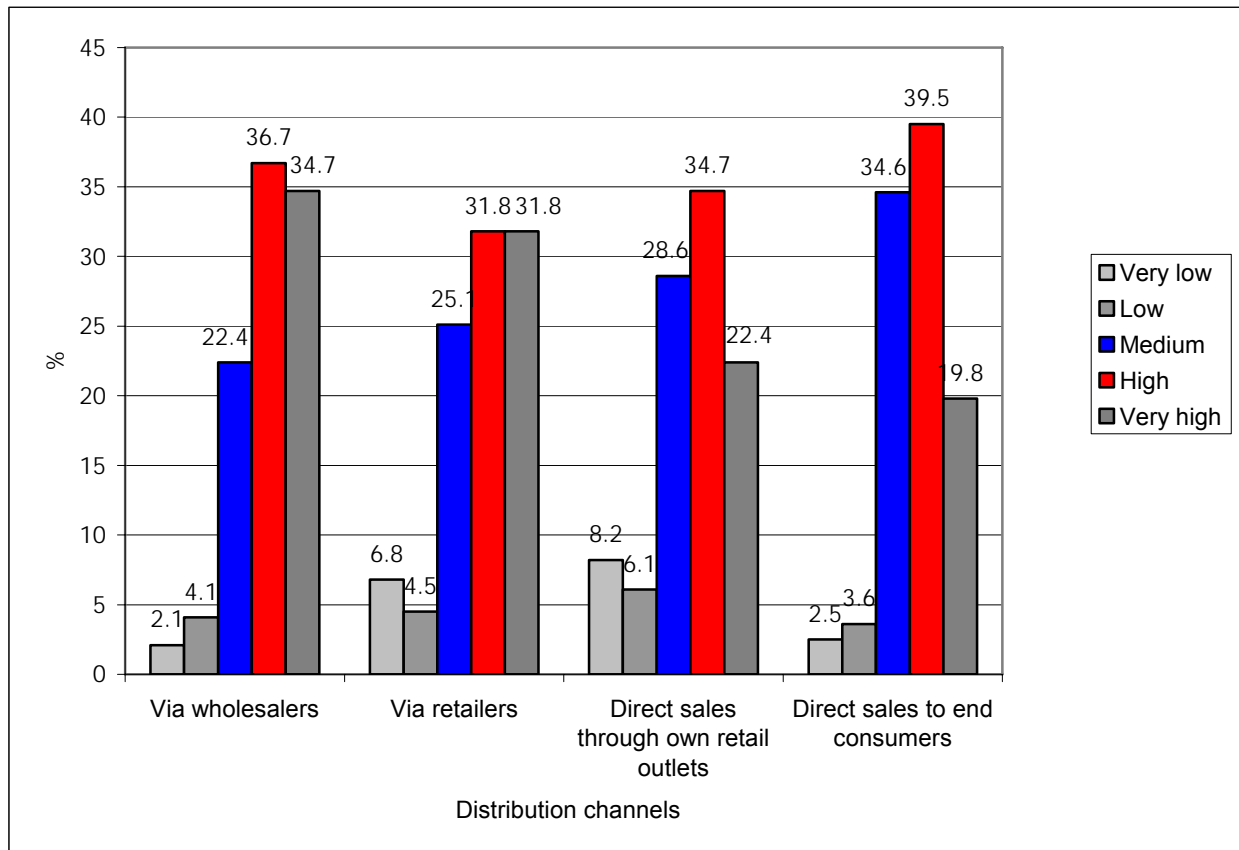
Significant changes in the formation of the influential players holding serious market shares (up to 10%) could happen as a result of changes to how enterprises are associated (mergers, absorption). These processes will primarily be initiated by trade companies. Vertical orientation strategies will be used to reduce operational costs, on the condition that companies get their own production bases.

Horizontal integration is less probable, because the financial capacities of clothing producers won't allow them to spare funds for asset acquisition. That's because it is more important for them to load up their own production capacities. That is basically the key development strategy element for many clothing companies.

LEVEL OF COMPETITION AND COMPETITIVE ADVANTAGES OF DIFFERENT ENTERPRISES OF THE SECTOR

Competition level was determined based on classical criteria and on the opinion of enterprise managers who filled out questionnaires.

According to the questionnaires, most managers believe that the market competition level is medium-high or medium (see diagram 5.2.).

DIAGRAM 5.2. LEVEL OF COMPETITION, BY DISTRIBUTION CHANNELS, %

Enterprises that managed to enter high-margin sales channels seem to share a less conservative attitude. At the same time, classical manufacturers are more skeptical about the "unoccupied and underpopulated market" assumption. Taking into account the thesis that "business exists only in retail trade on the market," ideas about a medium competition level are realistic, and correspond to the actual situation on the market.

At the same time, the quality of competition depends on the participation of enterprises in distribution channels. There is higher-quality competition for consumers in retail channels, where marketing tools, designer solutions for clothes, and modern sales technologies are used. For wholesale channels, the key factors are price and relative product quality.

Expert assessments indicate that the clothing sector contains 3-5 enterprises whose 2005 proceeds exceeded 50 million hryvnias and on the average equaled 60 million hryvnias. We can statistically calculate market concentration indices:

- *Herfindahl-Hirschman Index (HHI)* is deemed the most adequate indicator of competition intensity. The higher the HHI, the more influential the enterprise.
- *Concentration Index (CR-3)* – sum of the shares of the three largest companies on the market.

Market volume – 4 050 million hryvnias (expert assessment)

Weighted average share of major players = $60/4050 \cdot 100 = 1.5\%$

- $HHI = (1.5^2) \cdot 5 = 11.25$ units
- $CR(3) = 1.5 \cdot 3 = 4.5\%$.

The HHI (taking into account existing norms) indicates the lack of market concentration and a changing competitive environment.

CR (3) confirms the existence of conditions under which a highly competitive market can be created, and also shows the insignificant success of existing market leaders' attempts to win market space.

Taking into account the existing medium level of competition and the lack of market concentration, it is essential for enterprises to improve or master some key skills.

Basic competitive advantages for the clothing sector are:

- direct contact with foreign large wholesale traders;
- equipment for making high-quality competitive products;
- qualified product cost management;
- flexibility of production lines, production organization and logistics processes;

- good connections with customers - enterprises or designer groups - and sales channels;
- qualified personnel.

PRIMARY MARKET PLAYERS' ACTIVITIES ANALYSIS

Given the unstructured and fragmented nature of Ukrainian domestic market competition, it is advisable to define the key players. Criteria must be used that demonstrate how intense their market operations are, as indicated by their desire to enter new markets and the forms their cooperation with partners or consumers takes.

To enter new regional markets, enterprises form their own network branches or conclude long-term agency agreements with intermediaries who have access to retail sales channels.

Reformatting the offers (according to consumer target groups) allows enterprises to establish new stylistic and price segments on the domestic market.

The key market players, therefore, are the enterprises that:

- Master new operation formats and distribution channels.
- Have significant experience and are able to influence and determine market development in the context of new segment formation, the use of new marketing instruments, etc.
- Use horizontal integration to expand the scale of their business.
- Attempt to expand their sales channels regionally.

It is typical for key players to take measures that are characteristic of successful Western companies. These companies work to develop the fashion industry and to cooperate with well-known designers toward creating their own attractive designer solutions.

At the same time, to understand enterprises' activities and market structure clearly, key production players must be differentiated from from key sales players.

The production market is represented by major clothing factories established during the Soviet era (except for Gregory Arber), and focused on mass production of a limited product mix and on wholesale channels or warehouse sales.

Enterprises that integrated their business into existing distribution chains found that their ability to influence the market increased significantly. Such enterprises include Gregory Arber, Mykhaylo Voronin, Style and Trembita.

The existing level of competition should be reviewed in the context of market segments classified according to price, style (business clothes, sports clothes), target group (women, men, children) and product (outer clothing, underwear, etc) parameters.

Existing information on major manufacturers indicates that their positions remained unchanged over the past 4 years (see table 5.1).

TABLE 5.1. MAIN CLOTHING MANUFACTURERS IN UKRAINE

Enterprise name, VAT	Enterprise name, ZAT	Enterprise name, other
VAT Zarya	ZAT Alisa	KP Kiyanka
VAT Volodarka	ZAT Arsanina	KP Slavutich
VAT Grono	ZAT Vorskla	Dynamo Company
VAT Zhelan'	ZAT Dnypro	Private Enterprise Mykole
VAT Kramo	ZAT Donbas	TOV Edelweiss-Lego
VAT Mayak	ZAT Kashtan	TOV Kozhtex
VAT Selena	ZAT Kremtex	TOV Nimpheya
VAT Sophia	ZAT Lesya	TOV Rostex International
VAT Style	ZAT Lyubava	TOV CF Gregory Arber
VAT Trembita	ZAT Lvivska Textile Company	
VAT Trottole	ZAT Overti	
VAT Clothing Factory named after Tynyakov	ZAT Podillya	
VAT CE Elegant	ZAT Santa-Ukraine	
	ZAT Uzhgorodska CF	
	ZAT Ukraine	
	ZAT JV Vesna	
VAT = Public Corporation	ZAT = Close Corporation	KP = Communally-Owned Enterprise TOV = LTD

A number of companies managed to renovate their production lines with the help of leasing mechanisms, and with the assistance and at the request of their strategic partners/clients. They increased production volumes in kind and were selective in their cooperation with tolling partners. They moderately increased the cost of own services.

Also, work under tolling schemes allows using innovations of foreign manufacturers for production of own products thus increasing the competitive ability in wholesale and retail channels on the domestic market of Ukraine.

CONCLUSIONS

1. Competition intensity depends on distribution channels. In low-margin channels, competition is higher than in high-profit retail channels that require serious management efforts and efficient marketing to win users.
2. The domestic market is insufficiently saturated and has high growth potential, a large capacity and much potential for increased competition.
3. The market is not currently structured according to spheres of influence. This means there is potential for opening up new style and price segments.
4. Specialists' forecasts and industry experience indicate that vertical integration is intensifying. This will stimulate quality concentration on the market; there will emerge influential players capable of driving growth and promoting a positive image for Ukrainian clothing internationally.
5. An information vacuum in the sector's statistics means precise data about market volume and, correspondingly, about market shares of key players, is unavailable.

SHADOW SECTOR ROLE

The shadow sector plays a significant role on Ukraine's clothing market. This is partly because manufacturers want to lessen their tax burdens. The market's main sales portion is also in the shadows due to shadow import of clothing into the country.

As companies become more interested in cooperation with large investors, doing efficient PR, etc., transparency will increase.

The shadow clothing market in two ways:

- by evaluating shadow production's share of the domestic market in manufacturers' prices;
- by evaluating shadow production's share of the domestic market in end user's prices .

Experts say some 15-25% of the clothes sold on the domestic market are produced in the shadows.

Shadow sales of clothes on the domestic market account for 70 - 80% of sales.

Using State Statistics Committee information and expert evaluations we can calculate approximate shadow sector shares for clothing production and sales. (We will use the 2004 information, because it is more complete and clear in comparison with other years' data).

According to the data, 19.4% of the clothes sold on the domestic market are produced in the shadows. This corresponds to expert assessments (table 5.2.).

TABLE 5.2. PRODUCTION VOLUME OF CLOTHES FOR THE DOMESTIC MARKET OF UKRAINE AND OVERALL VOLUME OF THE MARKET, THOUSAND HRYVNIAS

Production volume	Registered local production, acc. to State Statistics Committee	Unregistered local production (expert assessment)	Overall volume of local production	% of unregistered, in the overall volume
Textile and knitted wear clothes	457.0	110.0	567.0	19.4

Shadow import of clothing products is performed in several ways:

- black import or contraband;
- understating customs value of imported goods;
- understating declared volumes of imported goods;
- so-called "shuttle import" - clothes are imported in small quantities, privately, without declaration;
- products are declared as cheap (e.g. well-known brands are declared as second-hand clothes).

All these steps are used to avoid taxation or lessen taxation.

Experts say that as of 2004 the clothing sales volume on the domestic market was equal to \$3 billion US dollars or 15 billion hryvnias (in end buyer's purchase prices).

According to experts, 85% of products on the domestic market are imported clothes, and 15% are Ukrainian clothes.

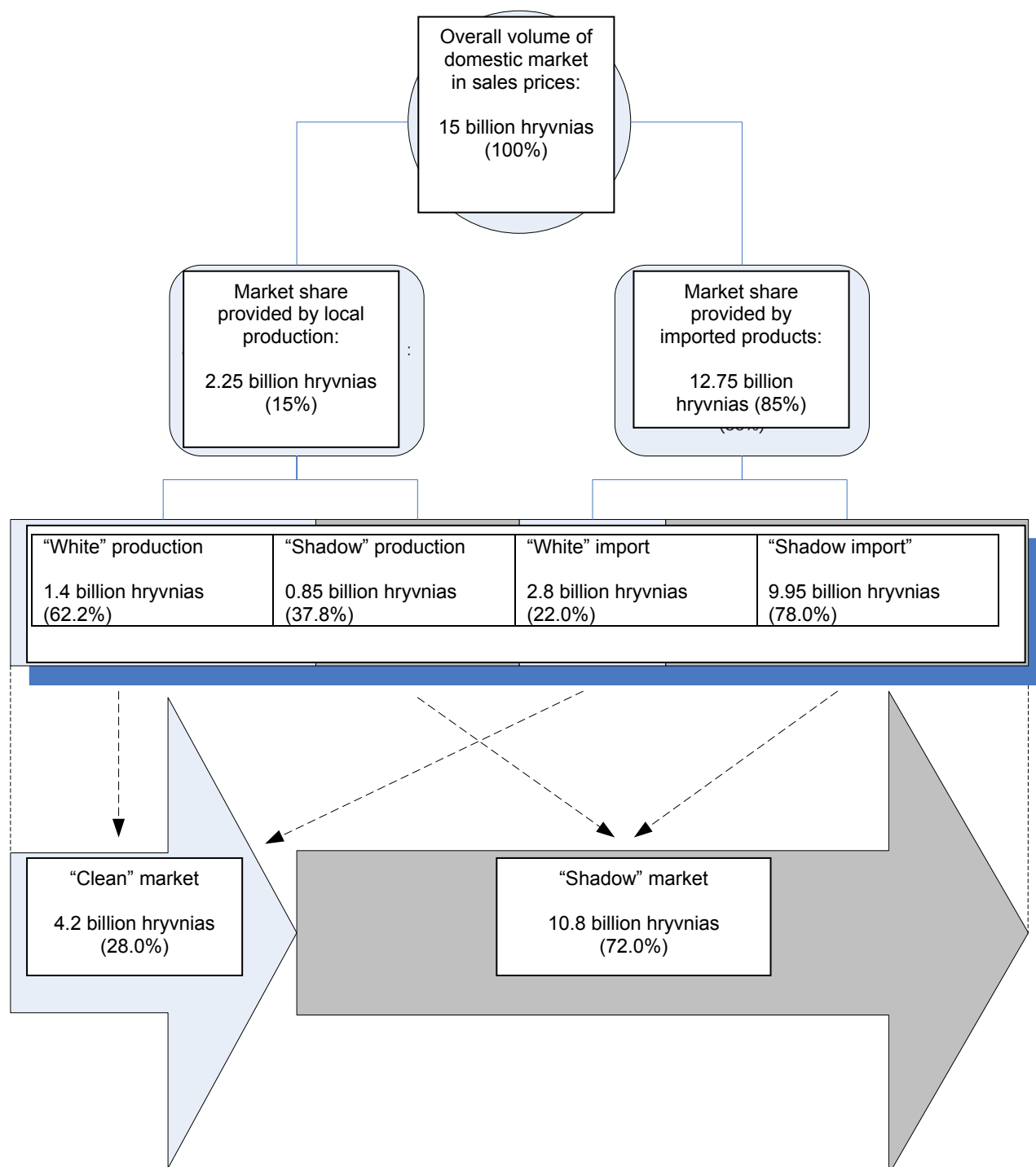
The registered sales volume of clothing factory products is 3.5 billion hryvnias, including 2.8 billion for export (earlier we mentioned that 80% of the Ukrainian clothing industry works on tolling schemes).

Thus, the sales volume of Ukrainian clothing factories' on the domestic market is 0.7 billion

hryvnias. Experts say that purchase price of clothes is twice the manufacturer's cost. I.e., approximately 1.4 billion hryvnias' worth of Ukrainian-made clothes are sold on the market.

The volume of legal import of clothes into Ukraine in 2004 was roughly 0.56 billion hryvnias. According to experts, end users' purchase price is at least five times higher. Therefore, legal import can be estimated at roughly 2.8 billion hryvnias

According to the data, overall clothes sales on Ukraine's market is 72%. This corresponds to the experts' estimates (see figure. 5.1).

FIGURE 5.1. STRUCTURE OF SHADOW SEGMENTS OF DOMESTIC CLOTHES MARKET IN UKRAINE, AS OF 2004

The estimated loss to Ukraine's budget from understatement of imported light industry products (including clothing) in Q2 of 2005 alone exceeded 1 billion 58 million hryvnias. Cooperation between the Ministry of Industrial Policy and the State Customs Service toward controlling light industry good import has had a positive influence on the industry.

Due to increased control, the customs value of imported goods in 2004 increased by 5-10 times and illegal import volumes fell significantly. Another positive influence on the industry's development was the "Stop the Contraband!" program initiated by

the government in 2005, for the purpose of preventing smuggling.

The key current negative factor, however, is the domestic market's deterioration.

According to statistics for 6 months of 2005, the quantity of imported clothes and shoes as compared to the corresponding period of the past year increased by dozens of times, to reach unprecedented levels.

Comparative statistics for Italy and Ukraine for supply of certain light industry products in Q1 of

2005 (in million dollars) confirms our assessment of overall market volume.

TABLE 5.3. IMPORT VOLUME FOR CERTAIN CATEGORIES OF GOODS FROM ITALY (INFORMATION FOR TWO COUNTRIES: UKRAINE and ITALY), MILLION USD

Goods category	Exported to Ukraine from Italy (information from Italy)	Imported to Ukraine from Italy (State Statistics Committee's data)	How many times less
Two-piece dresses, English type	10.5	0.4	26.3
Stockings, socks	3.6	0.1	45.0

Cooperation between the Ministry of Industrial Policy and State Customs Service toward controlling light industry goods import had a positive influence on the industry. Due to increased control, the 2004 customs value of imported goods rose by 5-10 times and the volume of illegal import of light industry goods fell by 10-25 times, according to the Statistics Ministry. This created the preconditions for growth in light industry production for the domestic market. Certain companies increased

production for the domestic market to the level of 20-30%, against 5-10% in 2003. However, the situation on the domestic market remains difficult because there is serious inconsistency between Ukraine's customs statistics with the statistic of countries where the goods originate. The discrepancy is one of up to 100 times in the case of Italy. This indicates that significant amounts of imported light industry goods are not accounted for.

CONCLUSIONS

1. The shadow market's share in Ukraine is very large and is estimated by experts at roughly 70-80%.

At the same time, the share of unregistered production of clothes in Ukraine equals 15-25% of overall production, thus negatively impacting the influence of Ukrainian companies on the domestic market.

2. A significant share of the market's shadow segment is composed of illegal or partly illegal clothing import (black import or contraband, understated prices or quantities of goods, shuttle import).

3. Stricter import control rules implemented in 2004 decreased the volume of illegal import by 10-15 times (according to experts).

4. Replacing illegal import by legal import could boost payments into the state budget and improve national companies' ability to compete with imported products.

5. If the companies step up activities by borrowing money for business development, they could cut into the shadow segment. This would improve corporate management and raise the difficult issues of capitalization increase and strategic partnership effectiveness. Transparency would therefore improve.

SECTION 6. FINANCE

MAIN FACTORS DETERMINING COSTS IN PRODUCTION, IN DIFFERENT SEGMENTS OF THE SECTOR

To analyze the main issues relating to costs, we reviewed 545 large/medium and 1861 small businesses working in the clothing sector, according to the KVED Classifier.

Data provided by the State Statistics Committee showed (diagram 6.1) that the clothing sector has a significant labor compensation share.

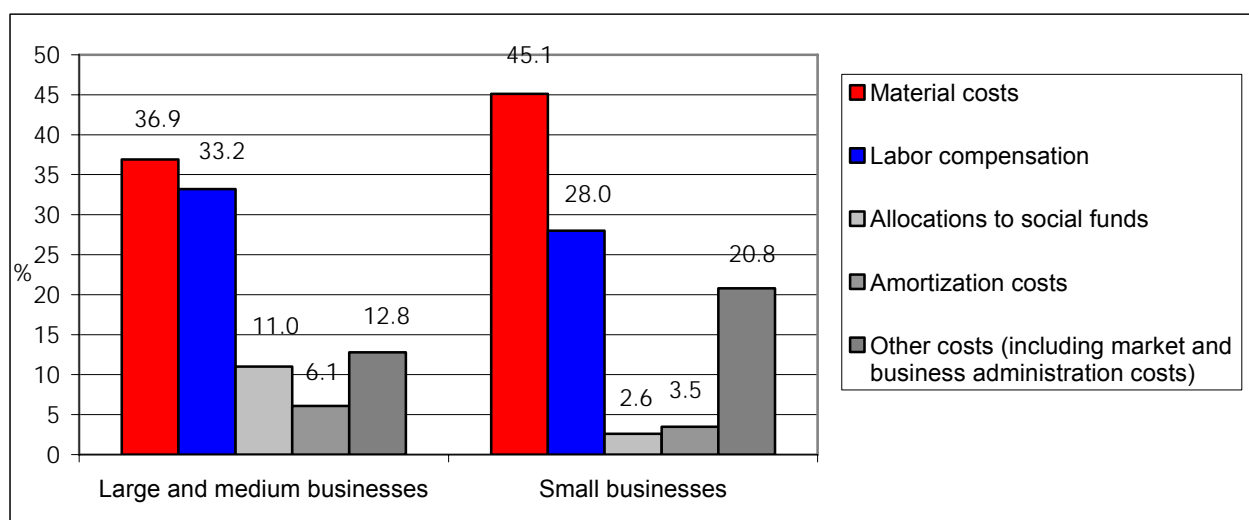
The cost structure of small businesses is similar to that of large and medium businesses. However, small businesses have fewer allocations for social programs. Amortization costs for large and medium businesses are higher than those for small businesses. This is because they spend a lot of

money. The simplified taxation system used by most small businesses is manifested in its allocations to social programs.

The main cost entries for clothing companies in Ukraine are as follows:

- material costs;
- labor compensation;
- allocations to social funds;
- amortization costs;
- marketing and business administration.

DIAGRAM 6.1. COST STRUCTURE OF LARGE/MEDIUM BUSINESSES AND SMALL BUSINESSES, %

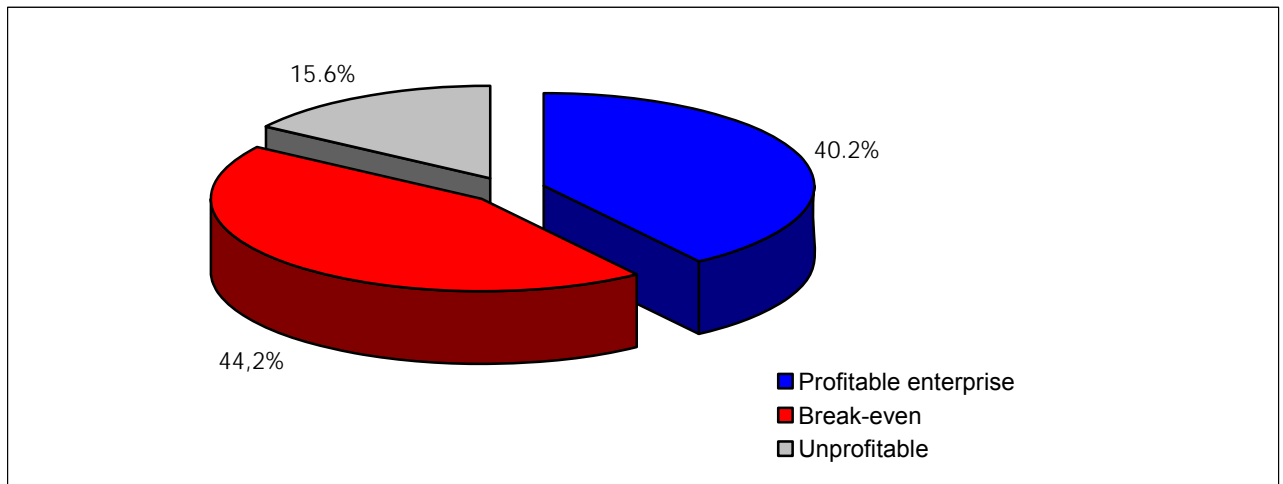


AVERAGE PRODUCTION PROFITABILITY BY SEGMENT

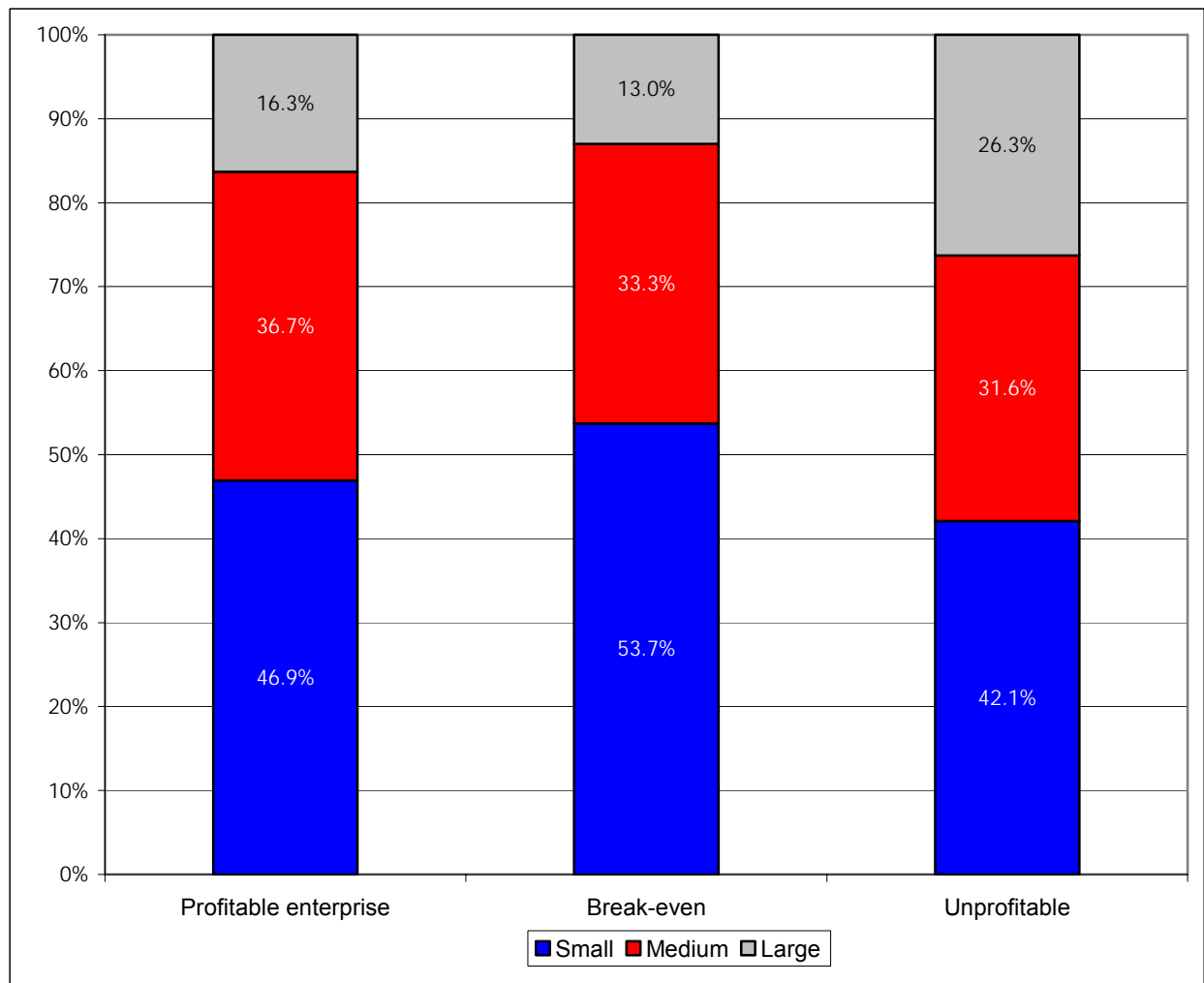
To analyze and calculate this, we reviewed large, medium and small enterprises in the sector. Despite promising signs of improvement, the financial standing of sector companies remains complicated. The results of financial activities of enterprises over the 11 months of 2004 showed that 64.7% out of them were profitable and made 140.4 million hryvnias in profit. The rest of them, 35.3%, were unprofitable and experienced losses to the amount

of 142 million hryvnias. Note that it is difficult to assess actual financial standing on the basis of the accounting because its information is usually incomplete.

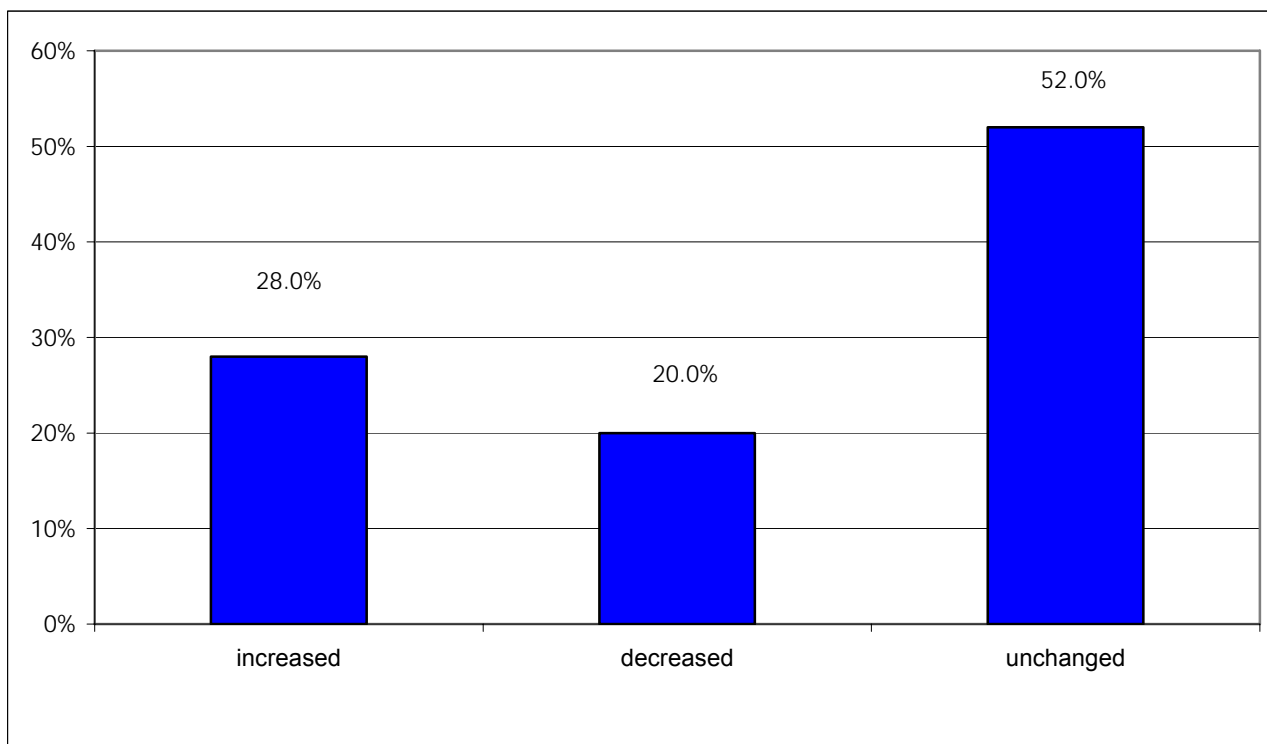
In 2005, the situation improved significantly. Roughly 40% of the enterprises were profitable (diagram 6.2.). Of these, 83% are large and medium businesses (diagram 6.3.).

DIAGRAM 6.2. PROFITABILITY STRUCTURE OF ALL ENTERPRISES OF THE SECTOR, %

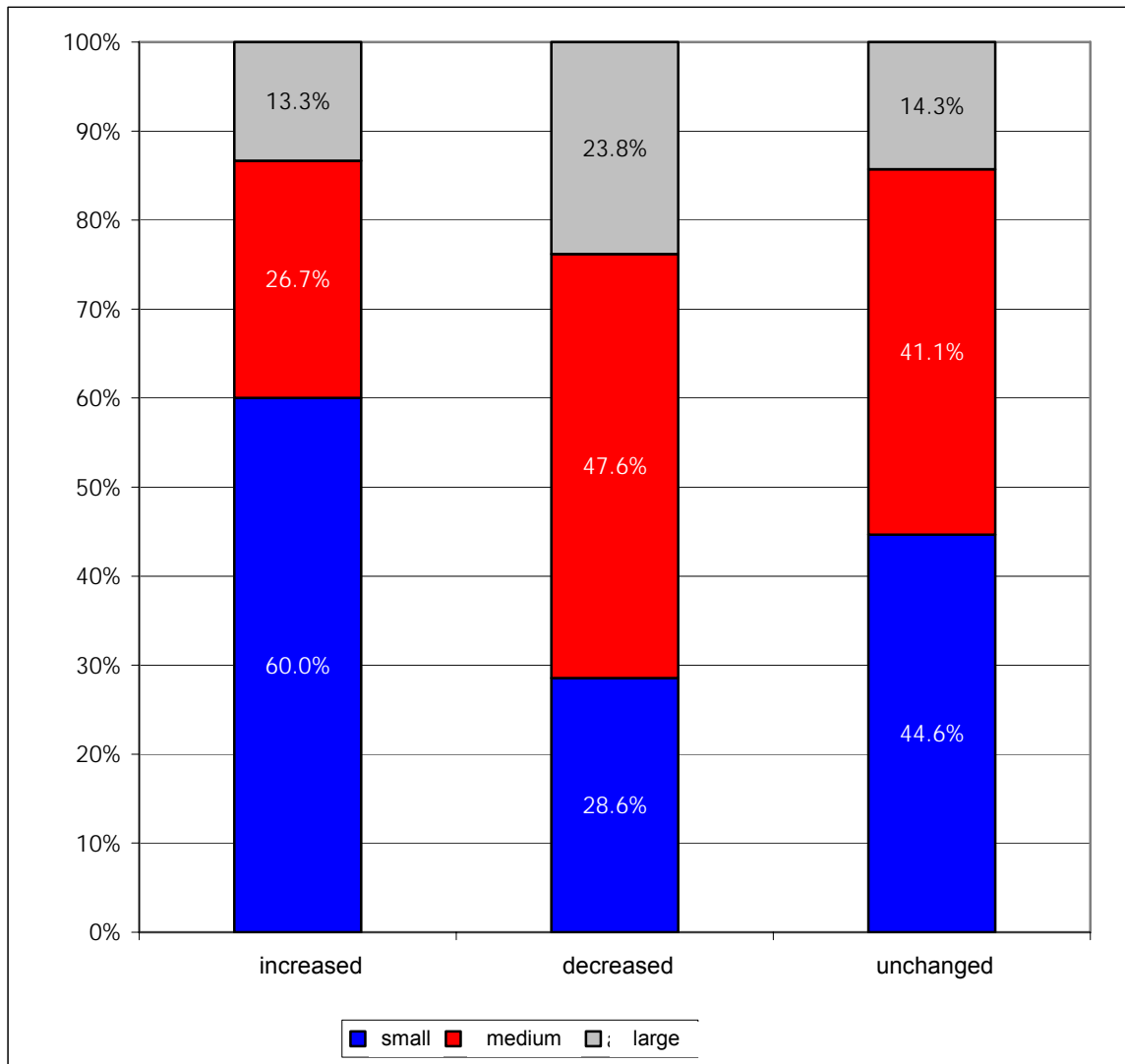
At the same time, many small businesses, roughly covering operational costs (diagram 6.3.).
48% of all the small businesses in the sector, are

DIAGRAM 6.3. STRUCTURE OF PROFITABILITY OF THE SECTOR'S ENTERPRISES, BY SIZE, %

Production profitability of the majority of enterprises unchanged (diagram .6.4.).
(small, medium and large) remained practically

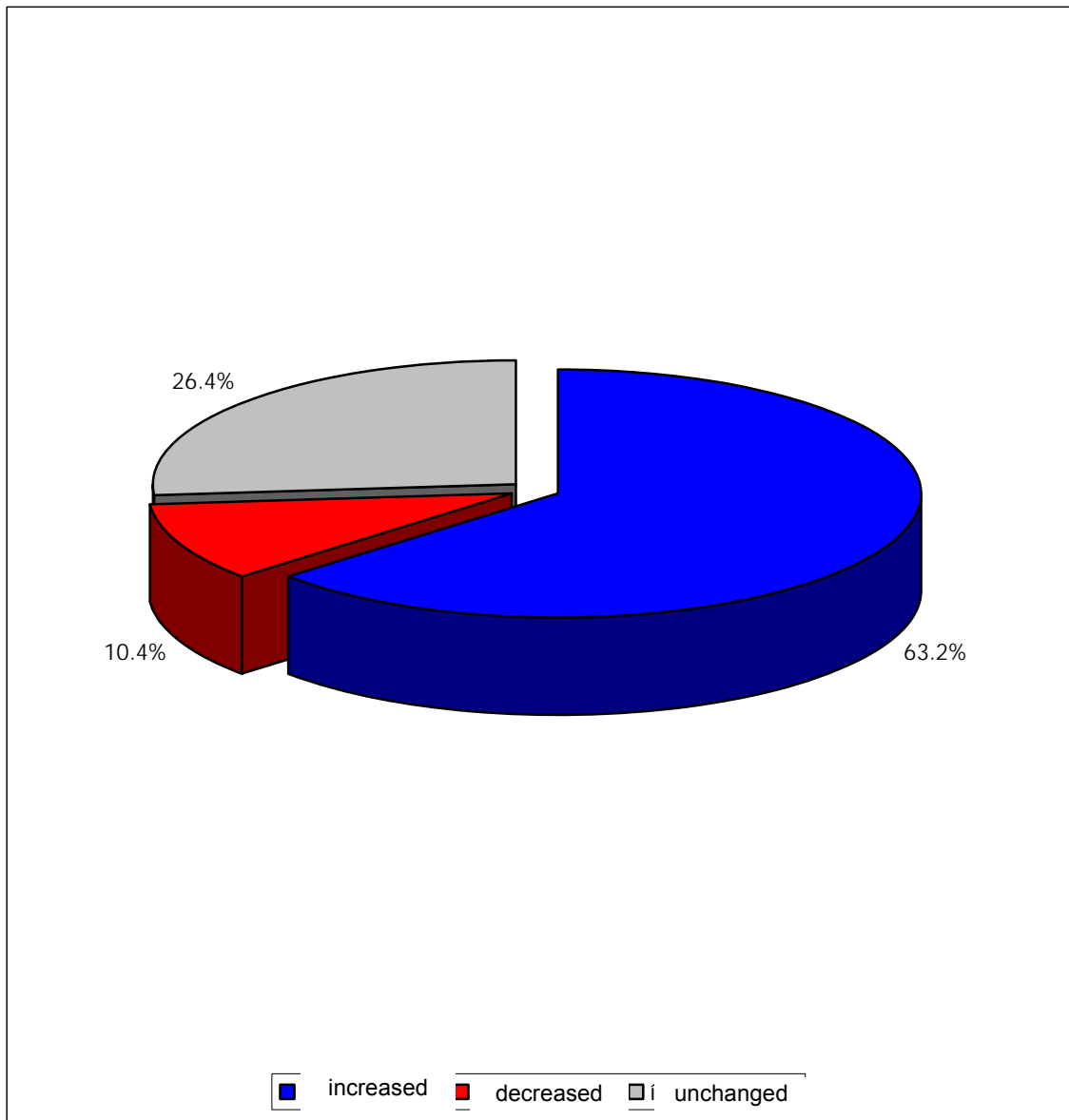
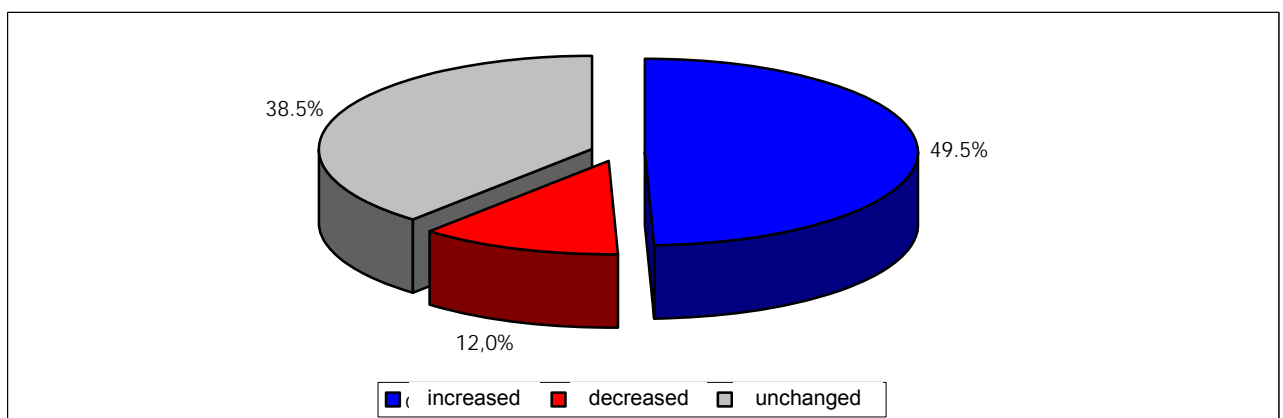
DIAGRAM 6.4. PROFITABILITY OF PRODUCTS OF ALL ENTERPRISES IN THE SECTOR, %

Most of the enterprises whose profitability increased (see diagram 6.5.) were small and medium businesses (see diagram

DIAGRAM 6.5. PROFITABILITY OF SECTOR ENTERPRISES, BY SIZE, %

At the same time, even though profitability stayed the same or increased, most sector enterprises saw cost increases in 2005, as compared to the previous year (see diagram 6.6.). Therefore,

profitability went up primarily because of the sales volume increase that was typical for half of the enterprises, in fact (see diagram 6.7.).

DIAGRAM 6.6. COST, FOR ALL ENTERPRISES, %**DIAGRAM 6.7. SALES VOLUME, %**

Official information for the financial results of the market leaders (Joint-Stock Companies) lets us analyze the following issues:

- profitability of the sales leaders;
- the most profitable companies (VAT and ZAT);
- production cost leaders in the sector.

The analyzed data is from 2004.

TABLE 6.1. INFORMATION ON FINANCIAL STANDING OF SECTOR LEADERS (JSC)

No	Clothing sales leaders (on Ukraine's market, as of 2004)	Net income from products sales thousand hryvnias	Cost of sold products, thousand hryvnias	Net profit (loss), thousand hryvnias	Profitability, %	Ratio: cost to sales price, %
1	VAT Style	40616.9	26864.4	4478.6	11.0	66.1
2	VAT Trembita	34160.5	28747.4	374.0	1.1	84.2
3	VAT Volodarka	28380.8	20467.9	1013.1	3.6	72.1
4	VAT Trottola	26642.3	23197.4	78.8	0.3	87.1
5	ZAT Donbas	16357.1	13033.6	550.4	3.4	79.7
6	VAT "Kyivska CF Zhelan'	14177.9	10633.3	-1002.3	-7.1	75.0
7	ZAT "Lvivska Textile Company	12255.9	11536.8	-1350.8	-11.0	94.1
8	ZAT Podillya	12239.3	9891.3	-313.2	-2.6	80.8
9	VAT CE Elegant (Melitopil)	11595.0	7726.0	506.0	4.4	66.6
10	VAT Sophia	10028.0	9814.0	-1598.0	-15.9	97.9

TABLE 6.2. PROFITABILITY LEADERS IN THE SECTOR (JSC)

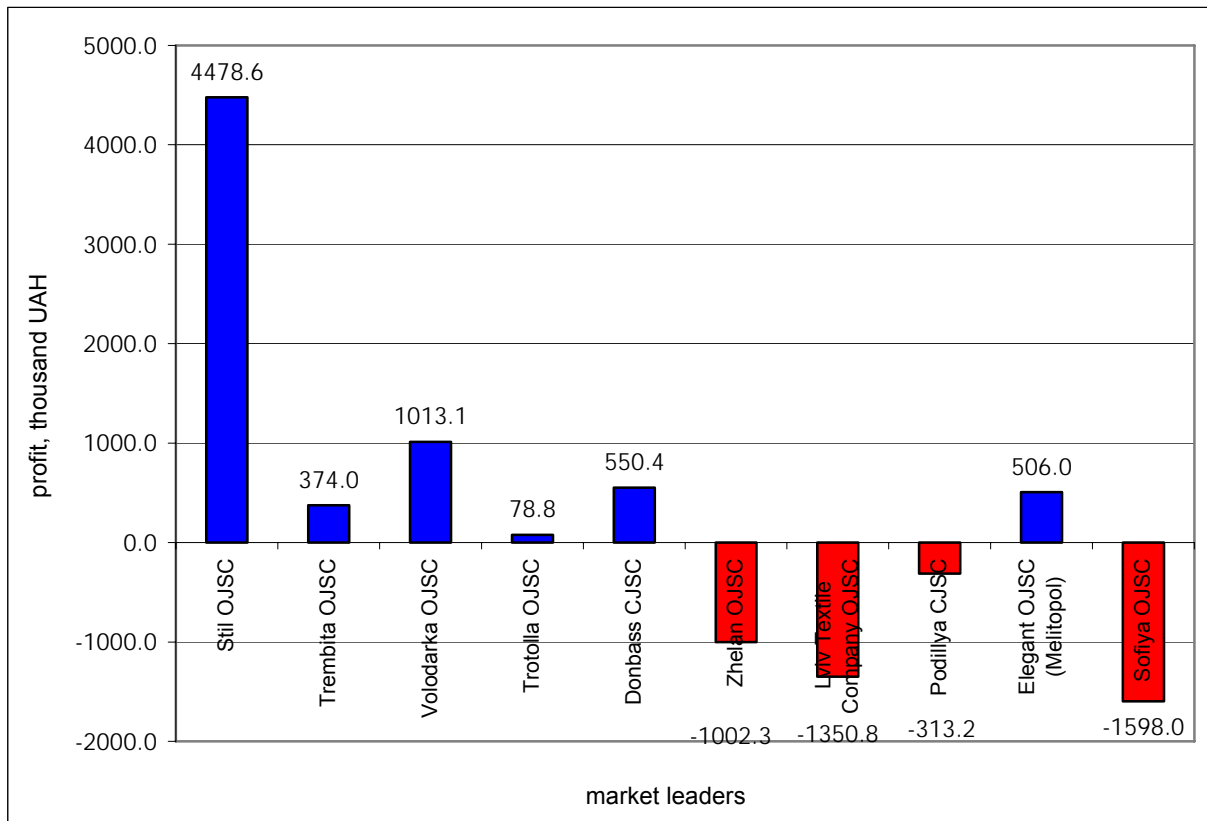
No	Profitability leaders (as of 2004)	Net income from products sales thousand hryvnias	Net profit (loss), thousand hryvnias	Profitability, %
1	VAT Style	40616.9	4478.6	11.0
2	VAT Kozyatynska Clothing Factory	1292.4	130.9	10.1
3	VAT Clothing Enterprise Mayak	2548.4	203.3	8.0
4	ZAT Kremenchukska VT, Kremtex Firm	8001.1	616.3	7.7
5	VAT Dobryanska CF Polissya	933.7	64.0	6.9
6	VAT Yevpatoriyska Clothing Factory	813.0	48.4	6.0
7	VAT Ivano-Frankivsk VTSP Galychyna	7304.0	430.0	5.9
8	VAT CE Elegant (Melitopil)	11595.0	506.0	4.4
9	VAT Volodarka	28380.8	1013.1	3.6
10	ZAT Donbas	16357.1	550.4	3.4
11	VAT Zoryanka	6923.0	188.0	2.7
12	VAT CF Elegant (Chernigiv)	7702.7	178.1	2.3
13	Kyiv ZAT Kashtan	9623.3	216.7	2.3

TABLE 6.3. PRODUCTION COST-SAVING LEADERS (JSC)

No	Production cost-saving leaders (as of 2004)	Net income from products sales, thousand hryvnias	Cost of sold products, thousand hryvnias	Share of production cost in the product price, %
1	VAT Clothing Enterprise Mayak	2548.4	1559.2	61.2
2	VAT Style	40616.9	26864.4	66.1
3	VAT CE Elegant (Melitopil)	11595.0	7726.0	66.6
4	ZAT Kremenchukska VT, Kremtex Firm	8001.1	5573.8	69.7
5	VAT Volodarka	28380.8	20467.9	72.1
6	VAT Kyivska CF Zhelan'	14177.9	10633.3	75.0
7	Kyiv ZAT Kashtan	9623.3	7322.0	76.1
8	VAT CF Elegant (Chernigiv)	7702.7	6069.8	78.8
9	ZAT Donbas	16357.1	13033.6	79.7
10	ZAT Podillya	12239.3	9891.3	80.8

Sales leaders (JSCs) are not always profitable, however (diagram 6.8).

DIAGRAM 6.8. SALES LEADERS OF THE SECTOR, 2004, THOUSAND HRYVNIAS



1

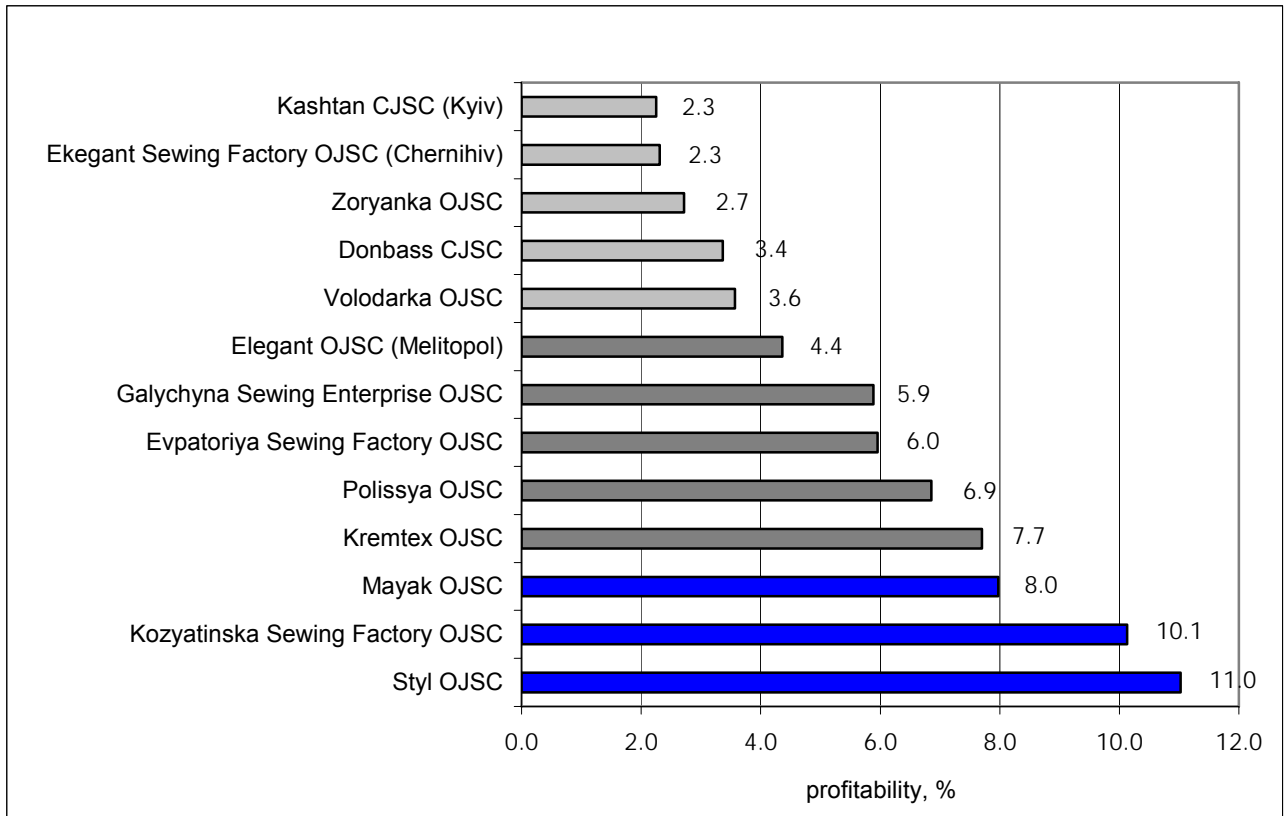
The list of the sector's profit leaders is different from the sales leaders list.

The industry profitability index is up to 11% (for the leader as of 2004, see diagram 6.9.).

Profitability leaders may be split into the three conditional groups:

- 2 - 3.9%;
- 4 - 7.9%;
- 8 - 12%.

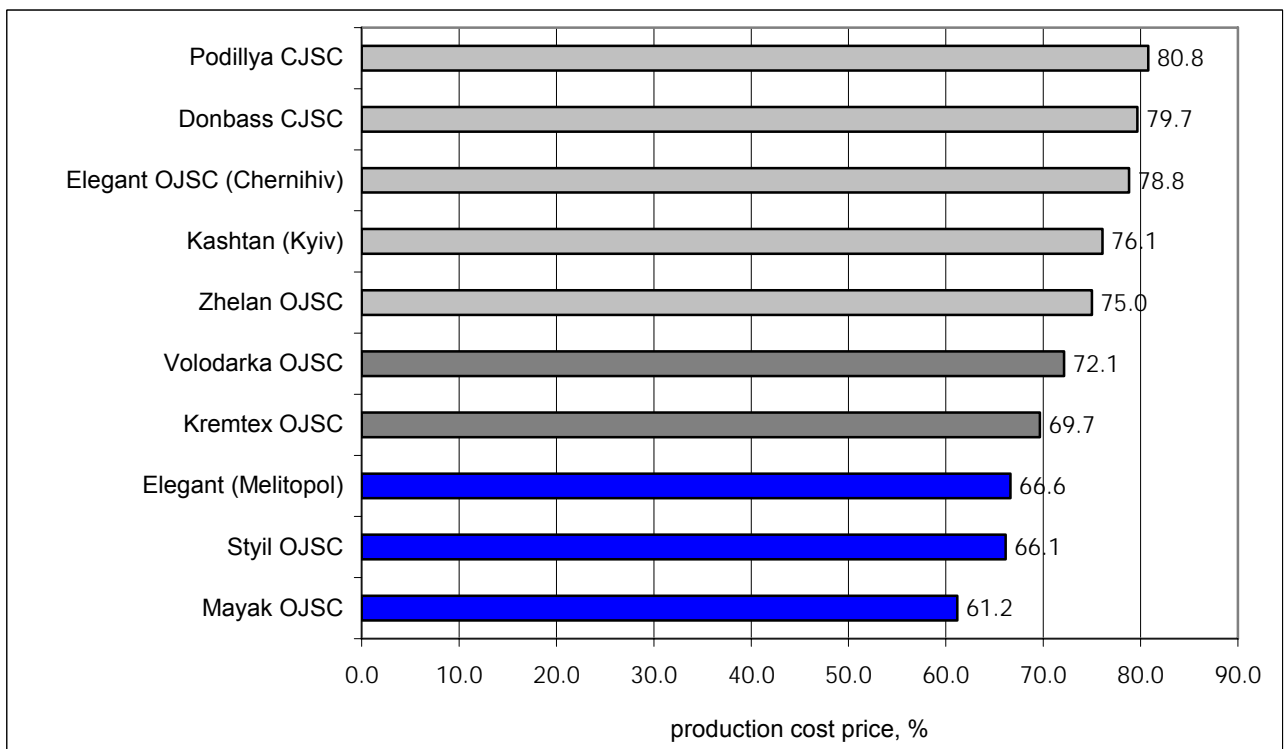
DIAGRAM 6.9. PROFITABILITY LEADERS, %



For profitability leaders of the sector (diagram 6.10.) the corresponding value is between 60 and 80%. Therefore, leaders can be split into groups with the following production cost levels:

- 60 - 66.7%;
- 66.8 - 73.5%;
- 73.6 - 80%.

DIAGRAM 6.10. PRODUCTION COST-SAVING LEADERS, %



Many sector managers mention that insufficiencies of capital financing and circulating assets are a problem. Volodymyr Marchenko, director of the TOV TD Textile Manufactory, believes enterprises could solve this problem using credit lines. The size of loans depends on their term and how much money is needed. Most often, sector companies take out loans using company assets or circulating goods for collateral, and loans are for a 1-year term.

Marchenko noted that the optimum credit conditions in light industry are as follows: credit of up to 10 years at an annual rate of 5% with a minimum pledge. Thus far, no such conditions are available on the market, and will only come into play with the help of government regulations.

Banking sphere experts note that some banks treat lease conditions seriously and offer their key accounts different forms of crediting. We can therefore forecast that when Ukrainian companies get used to operating on credit lines, they will win market space on their own market.

Regression analysis was used to evaluate the influence of:

- labor productiveness on profit increase rates;
- production capacity loads on profit increase rates;
- energy costs on profit increase rates,

See the results of this analysis in the annexes.

CONCLUSIONS

1. Clothing enterprise cost structures are characterized by a high level of labor compensation costs.
2. The cost structure is roughly the same for small, medium and large businesses. Small businesses pay less for social programs.
3. A 2005 profitability rise was mainly due to increased sales.
4. Both methods of regression analysis demonstrated dependence between production

increase and profitability increase. Additionally, the analysis determined the influence on profitability of the following factors:

- investments into equipment,
- changes in production capacity loads;
- the share of energy costs in the cost structure.

5. Sector leaders have a 2-11% profitability rate. The share of production cost for these companies is 60-80% of product price.

SECTION 7. EXPORT ACTIVITIES

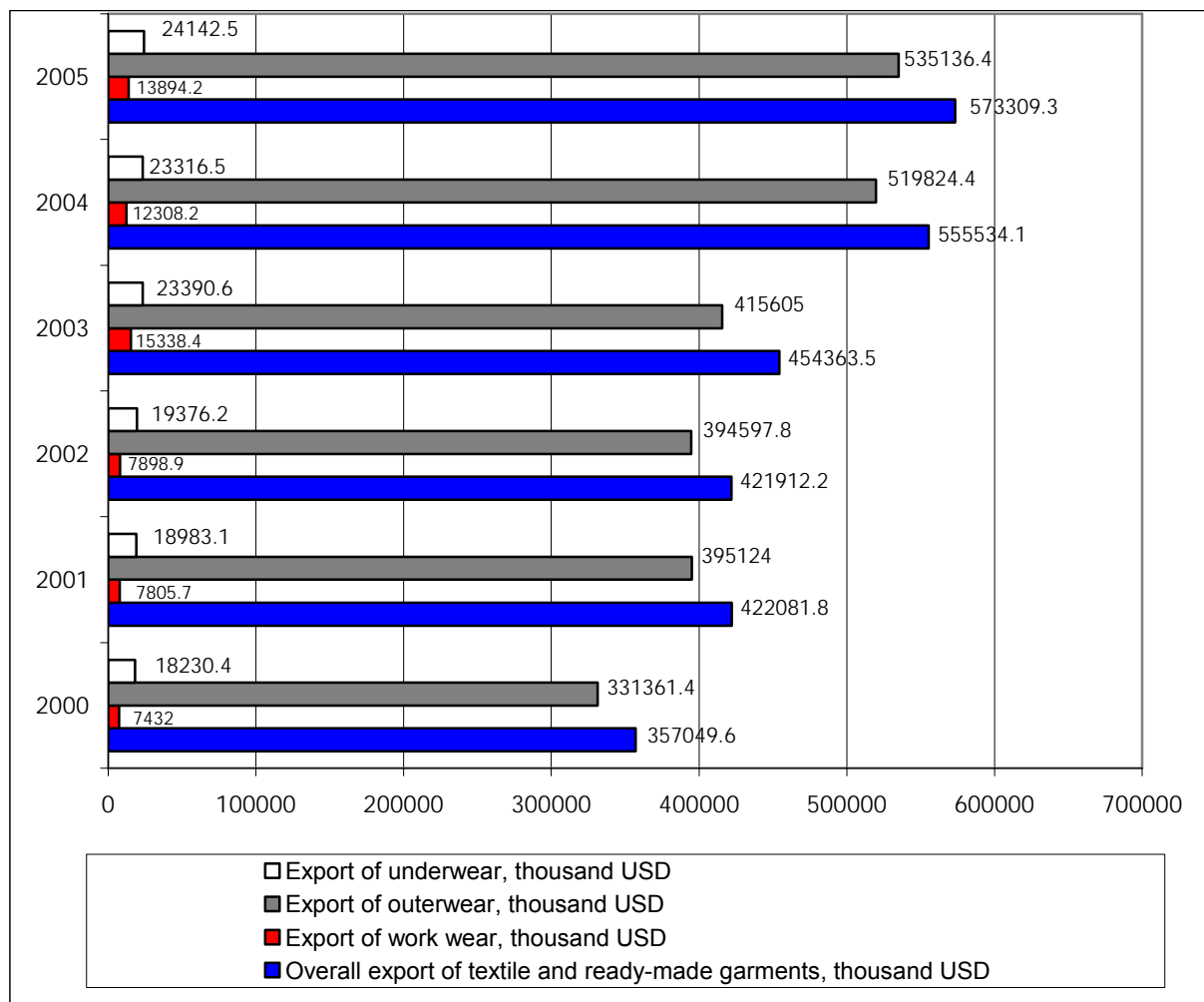
ANALYSIS OF EXPORT ACTIVITIES OF SECTOR'S ENTERPRISES OVER 2000-2004

Export represents 40%-56% of GDP in the structure of Ukraine's economy. But Ukrainian export is poorly diversified.

According to the Ministry of Economy, closed production cycles represent only 17% of GDP

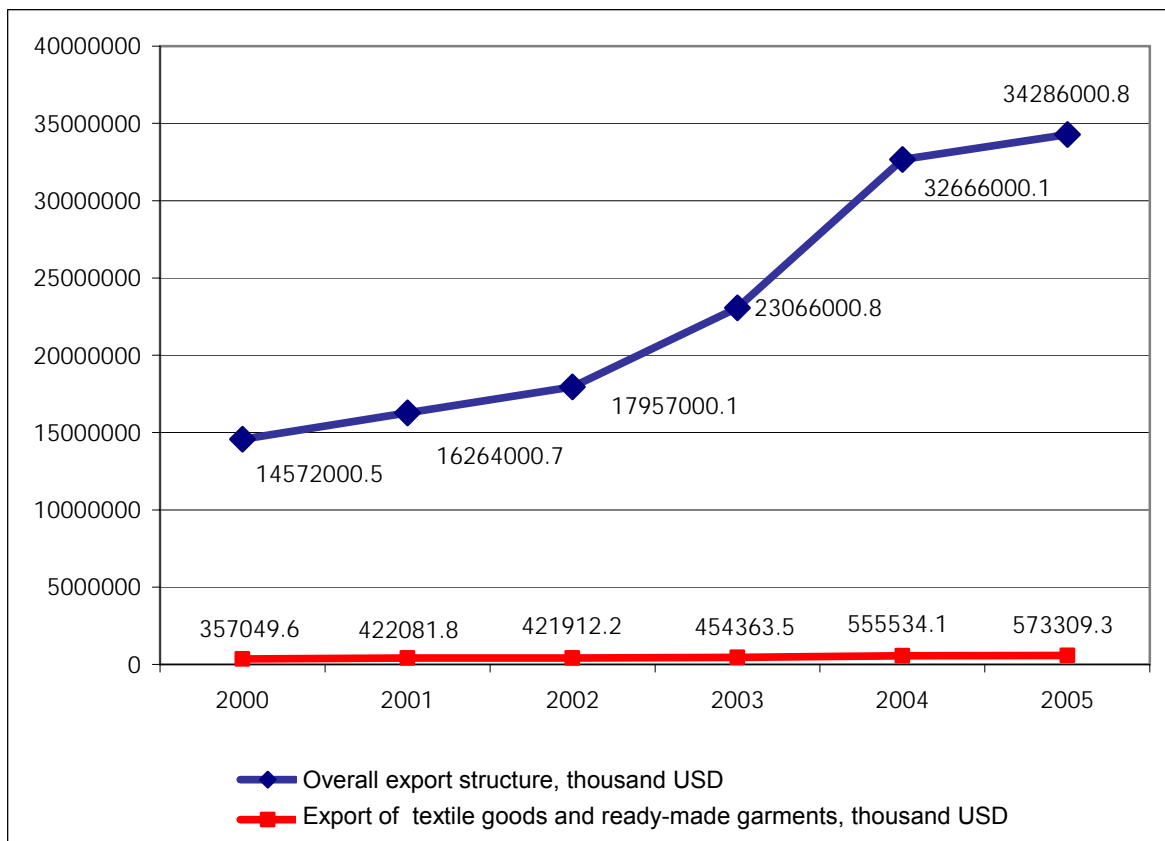
creation. This makes the country dependent on import, to an at least 80% level. Correspondingly, in exported goods, there is a high content of imported raw materials and energy, so competitive ability of import decreases.

DIAGRAM 7.1. STRUCTURE OF EXPORT OF TEXTILE AND CLOTHING ITEMS, THOUSAND USD



In the structure of textile and clothing export, outer clothes export dominates; its share is 92-93%. Underwear export (4.2%-5.2% on average) and

work wear export (from a minimum of 1.9% in 2001 to a maximum of 3.4% in 2003) hold minor shares (see diagram 7.1.).

DIAGRAM 7.2. EXPORT DYNAMICS OF TEXTILE AND CLOTHING PRODUCTS IN THE OVERALL EXPORT STRUCTURE OF UKRAINE, THOUSAND USD

In 2000-2005 the share of textile and clothing items in the overall export structure varied from 1.7% to 2.6%. In relative figures, its changes from year to year were minor (see diagram 7.2.).

What follow are facts about Ukraine's foreign economic activities and about the industry and clothing sector in particular.

2000

- 1) A rise in exports was achieved by improving the range of exported products and devaluing the hryvnia in relation to foreign currencies.
- 2) Export activities became attractive due to high inflation.
- 3) Trade became focused on CIS countries. In January-June 2000, the share of foreign economic trade with CIS countries increased to 45.8%, and the share of overall export increased from 35.2% to 35.9%.
- 4) In 2000, Russia became Ukraine's main trade partner.

2001

- 1) Light industry goods were one export branch in which growth was observed in 2001 (+18.3%).
- 2) The volume of clothes supplied to EU countries increased significantly. This was due to the recognition of Ukrainian clothes' technical

competitive ability on European markets and to the elimination of EU import quotas for such products after March 2001.

- 3) The main share of exported Ukrainian clothes were made on commission for tolling orders from Western companies.
- 4) Europe became the primary market for export of Ukrainian light industry products. Since 2001, export of Ukrainian-made goods to Europe has seen a growth tendency.
- 7) Some 25-30% of Ukrainian light industry export was to the USA.
- 8) Signing of a new agreement with the EU on textile products trade imposed no quantitative limitations on Ukrainian textile import.

2002

- 1) Companies continued to work under tolling schemes.
- 2) Russia remained the major buyer.

2003

- 1) Export of finished products made on commission increased in comparison with 2002 in the overall structure of Ukraine's export.

2) Textile clothes had the biggest share in the overall export structure.

3) According to the United European Portal, textile and clothing export from Ukraine to the EU in 2003 was worth 472 million Euros.

2004

1) Clothing export equaled approximately \$300 million US dollars.

2) The overall investment attractiveness of the industry equaled at least \$40 million US dollars per annum.

3) Ukraine exported \$1 billion USD worth of clothing and knitted wear to the EU. The main share in export of finished products made on commission is held by textile, knitted wear and other clothing.

4) Textile dominated the structure of export to France (its share was 30.6%). The increasing number of orders from France and Germany was due to transportation costs being much lower between those countries and Ukraine, as compared to other countries.

OBSTACLES TO INCREASING EXPORTS

Recent years have seen significant positive shifts in Ukraine's presence on EU markets. According to Ukrainian statistics, in 1996-2002, foreign trade between Ukraine (goods and services) and the EU increased by \$3.5 billion USD, or by 1.7 times. At the same time, export increased by 2.1 times and import by 1.5. EU countries' share in Ukraine's foreign trade also went up quickly. In 1995-2003 it increased from 13 to 25%,

The Ukrainian and EU trade structure indicates that the range of traded goods was extremely narrow. In 2000-2002, light industry's share in overall Ukrainian export to the EU was only 15.1%. This information suggests that Ukrainian export so far has been one-dimensional. The main barriers hindering export potential (according to public polling) are:

1. Administrative and bureaucratic obstacles

These could be due to certain features of Ukrainian legislation. Ukrainian enterprises lose

potential customers due to the peculiarities of the laws they must follow. Let us imagine, for example, that an American company wants to make suits in Ukraine out of Ukrainian fabric and then sell them in the US. The textile enterprise in this case would not be able to get its VAT back. To get around that, it would have to export the fabrics first, selling them to the customer in a tolling scheme, thus wasting time and money. Clients often refuse to work with Ukrainian companies under such conditions.

2. High level of competition

This problem is exacerbated by poor materials and technical conditions at exporters' factories. Many enterprises have no modern IT or even simple communications systems, and so are isolated from world markets.

Only a small percentage of enterprises (15.6%) have encountered no obstacles to participating in European markets.

DIAGRAM 7.3. MAIN PROBLEMS IN ENTERING FOREIGN MARKETS, %

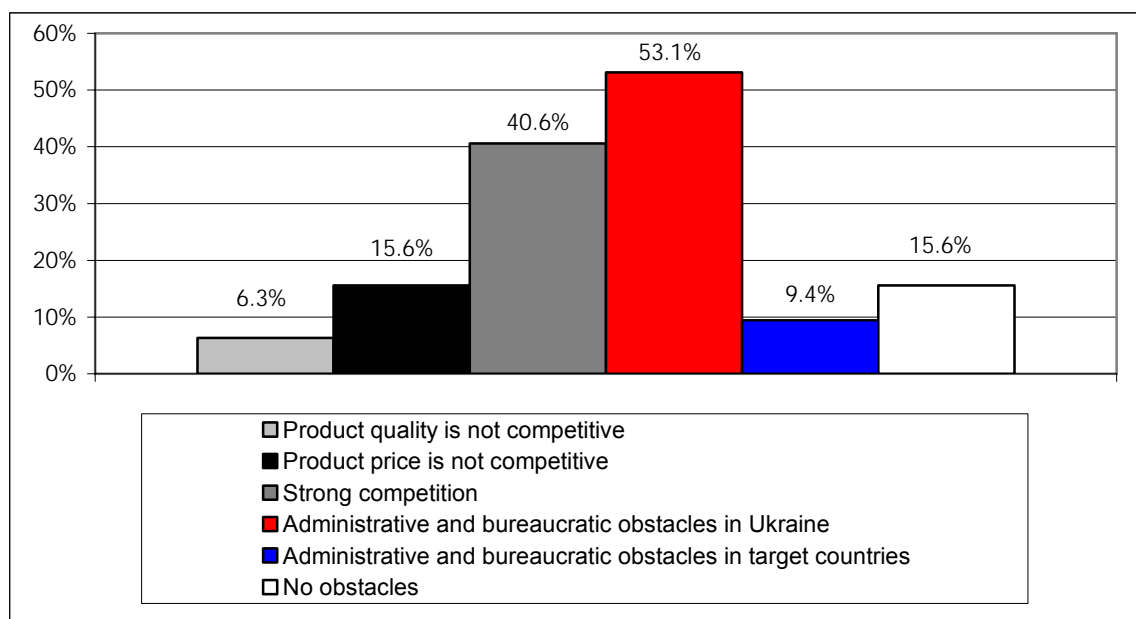
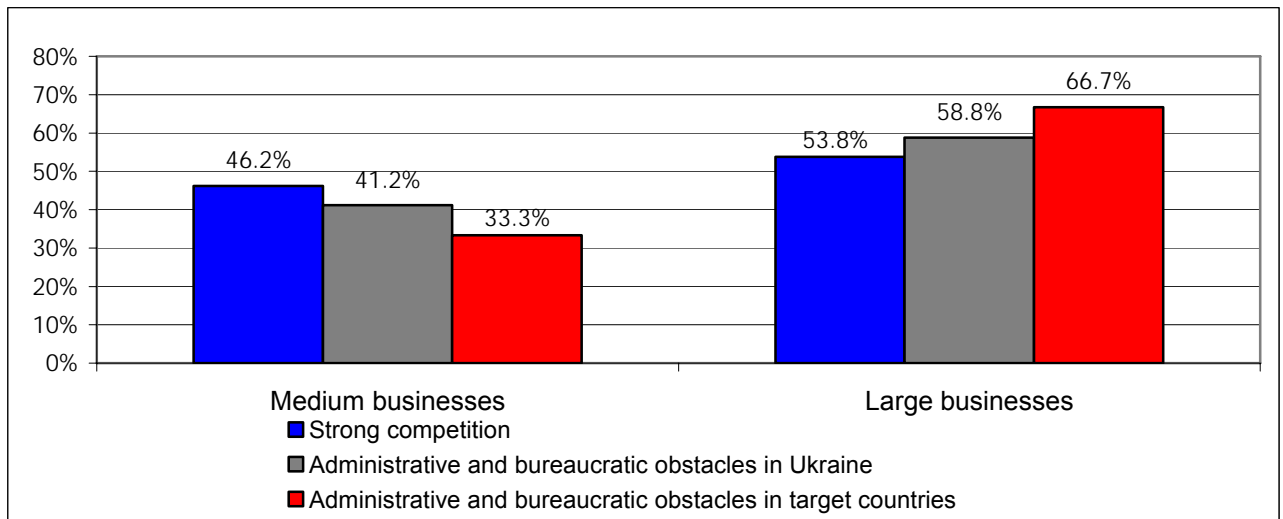


DIAGRAM 7.4. MAIN PROBLEMS FOR MEDIUM AND LARGE ENTERPRISES IN ENTERING FOREIGN MARKETS, %

Interviews indicate that the main problems for large enterprises that want to enter European markets are administrative and bureaucratic obstacles in the target countries and administrative obstacles in Ukraine.

This underscores that Ukrainian legislation and regulations fail to adequately support national exporters, and subsequently generate negative European attitudes towards Ukrainian exporters.

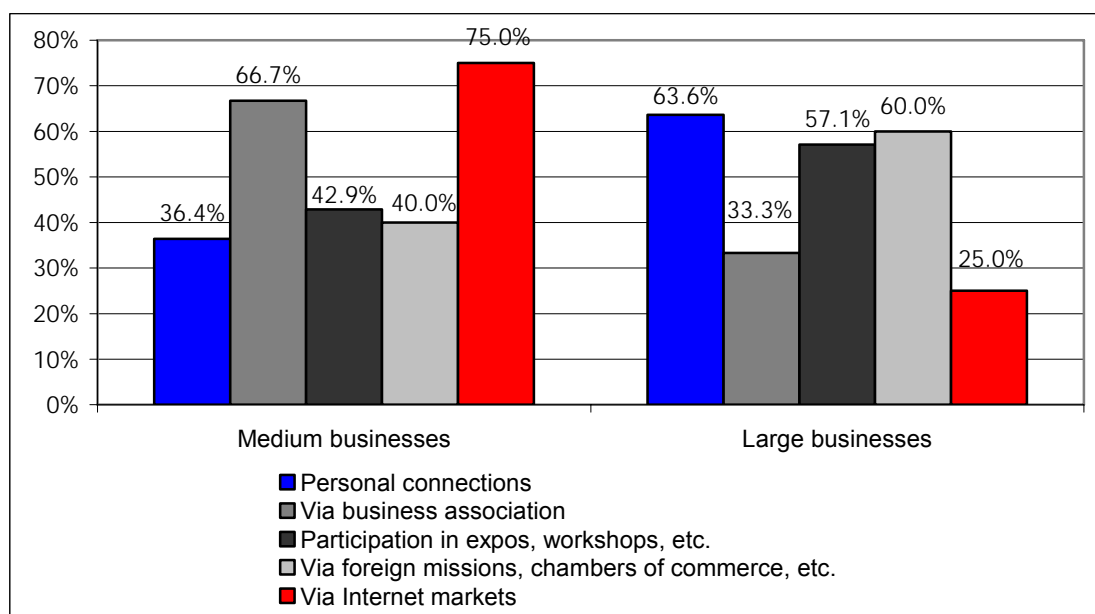
TABLE 7.1. WAYS OF ENTERING FOREIGN MARKETS

Ways of entering foreign markets	Companies, %
Foreign partners contacted the company	62.5
Through personal connections	34.4
Through participation in workshops, exhibitions, etc.	21.9
Through foreign missions, chambers of commerce, embassies	15.6
Through the Internet	12.5
Through business associations	9.4

For medium-sized business, the main obstacle to entering European markets is strong competition. This testifies to business associations' and the state's insufficient support for medium enterprises' export activities.

Most companies use personal liaisons and contacts to get access to European markets, since support from business associations is insignificant. Only 9.4% of companies entered

European markets as a result of such assistance. Participation in expos, workshops and other specialized events is, however, efficient. Support from chambers of commerce, missions and embassies is minor, which testifies to a lack of contacts and a poor level of development of foreign economic relationships. The share of companies that achieved participation on European markets via the Internet is rather high, at 12.5%.

DIAGRAM 7.5. WAYS OF ENTERING FOREIGN MARKETS, MEDIUM AND LARGE ENTERPRISES, %

It is interesting that Internet communications are the main method for medium businesses (75%), while large companies choose that method in only 25% of cases. They tend, rather, to rely on personal contacts. Medium companies clearly

receive less support than they need. Also, medium companies tend to use the assistance of business associations, while large enterprises prefer participation in expos, workshops, etc.

ANALYSIS OF LEVEL OF SUPPORT AND CONSEQUENCES OF UKRAINE'S POTENTIALLY JOINING THE WTO, EU AND COMMON ECONOMIC SPACE

Low rates of economic development had a negative influence on Ukraine's foreign trade development in 2000-2004. Given strong competition on the world markets, Ukraine fell farther behind the leading countries and stronger competitors gradually pushed it into the Third World zone.

The anti-dumping code ratified by the Parliament was a positive development in the regulatory environment. The code's adoption is consistent with Ukraine's international obligations and better protects Ukrainian exporters.

National legislation and regulations are gradually coming into compliance with international law. In certain areas, regulation of foreign economic activities is becoming more liberal. The list of goods that can be exported without strict state control has become much shorter.

Poor integration into international economic structures limits Ukraine's presence on priority markets. Since Ukraine is not a WTO member, it cannot use international regulatory mechanisms for trade, including for commercial disputes. The rules are in fact used against Ukraine when conditions for anti-dumping investigations are devised.

On February 1, 2006, the USA officially recognized Ukraine as a market economy. Market economy status allows Ukrainian companies to compete on the US market on a parity basis with companies from other countries. At the same time, market status gives Ukraine the chance to stimulate investment.

In 2000, Ukrainian textile manufacturers were allowed to increase export to EU by 30-50% (depending on the category). Ukraine subsequently increased exports by \$140-145 million.

Ukraine - EU

Ukraine borders several EU countries. Textile products form the basis of Ukraine's light industry export to the EU. Experts believe that Ukraine could realize the following advantages by strengthening its ties with the EU:

1. Overall benefits. If Ukraine embraces European values and principles, it will improve its reputation and become an integral part of a huge economic, cultural and informational space.

2. Economic benefits. Ukraine could expand its companies' presence in Europe. Getting closer to the EU, even before Ukraine becomes a formal member, could help lift trade barriers and lead to more free trade.

3. Integration into the world economy. Ukraine could become a link between the EU and China. Strategically, this could help integrate the Ukrainian, Chinese and EU textile industries into the world economy.

According to interviews with company managers, large and small businesses believe that EU membership would be the most advantageous

development for them. Medium companies tend to think the situation will not change much. This is because the state does not properly support their activities (diagram 7.6.). Exporters tend to support EU membership for Ukraine. Non-exporters, meanwhile, tend to think EU membership will not change much. We already mentioned that exporters see new foreign market opportunities if Ukraine joins the EU (diagram 7.7.).

DIAGRAM 7.6. CONSEQUENCES OF UKRAINE'S MEMBERSHIP IN EU FOR DIFFERENT SIZE COMPANIES, %

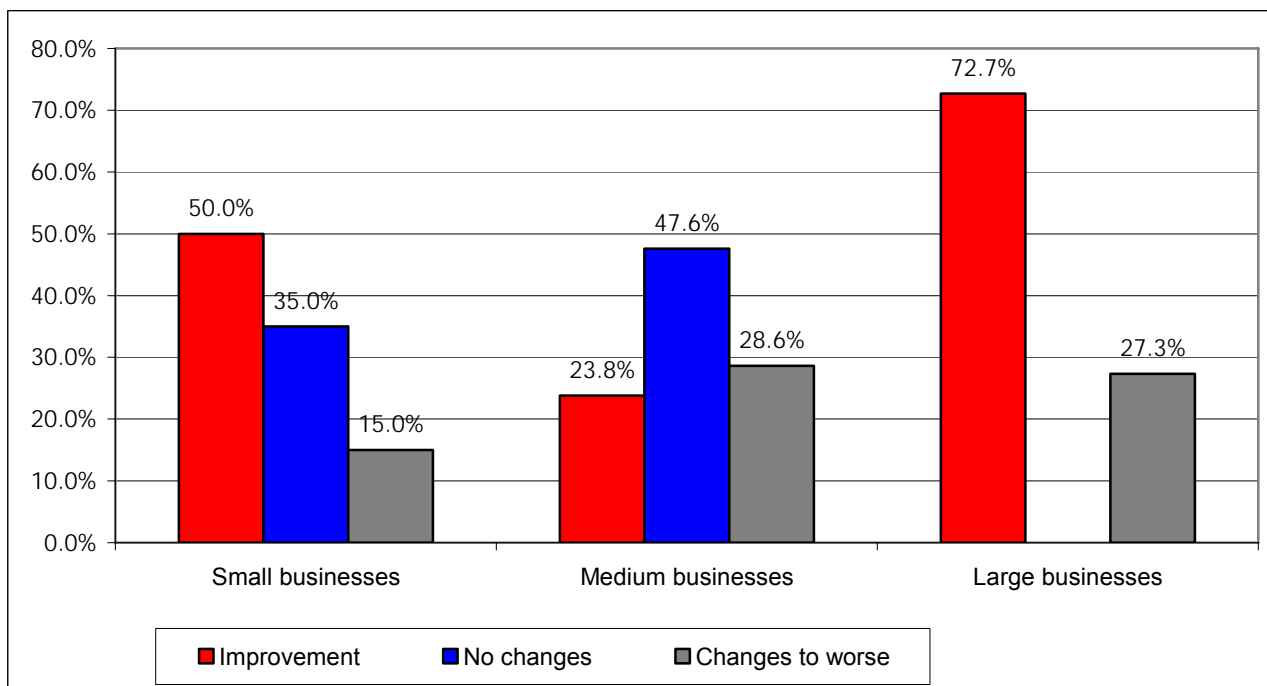
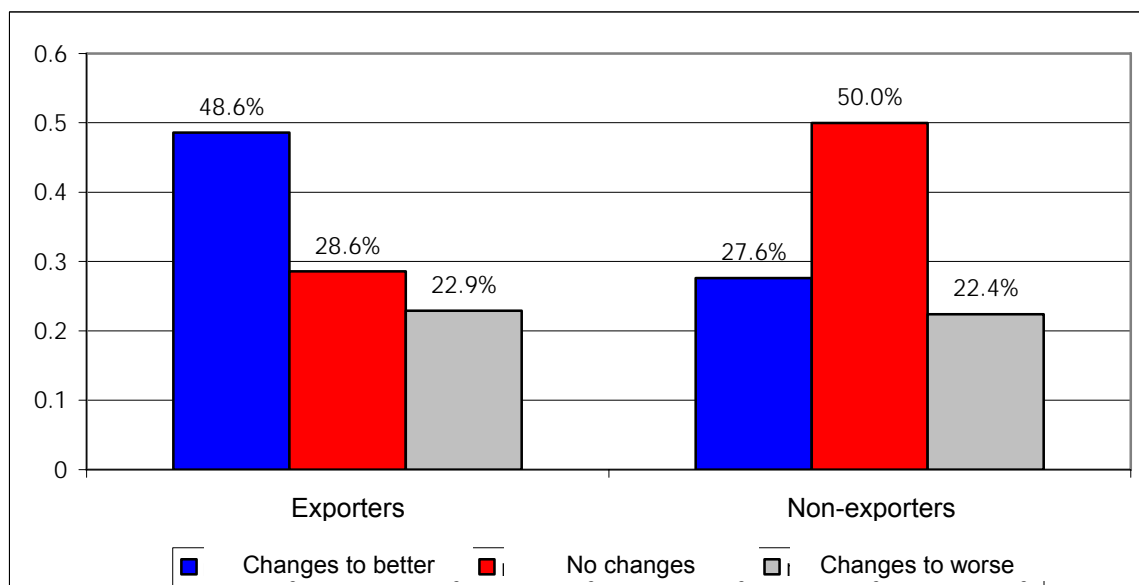


DIAGRAM 7.7. CONSEQUENCES OF UKRAINE'S MEMBERSHIP IN EU FOR EXPORTERS AND NON-EXPORTERS, %



Ukraine - CES

The Common Economic Space (CES) is considered a purely economic project aimed at developing CIS countries' economies.

Creating a free trade zone is a priority for Ukraine as regards the CES. Trade among CES members would be unlimited.

One benefit would be simplification of border-crossing procedures for citizens of CES member countries.

The first of the four agreements that form the basis for CES creation concerns establishment of a customs treaty. (The others involve movement of goods and services, of labor, and of capital). The

customs treaty agreement involves a package of 38 agreements. There should be no internal borders for customs treaty members, and determining customs tariffs should be the province only of the CES Commission.

Most companies (63%-70% according to polling) think their prospects will improve when Ukraine achieves CES membership. This is because CES membership is an opportunity to supply Ukrainian-made products to the CES markets using balanced production schemes and stable connections. Most companies that do not support CES membership are small (diagram 7.8).

Exporters and non-exporters alike tend to support CES membership. Membership would help boost sales and production volumes (diagram 7.9).

DIAGRAM 7.8. CONSEQUENCES OF UKRAINE'S MEMBERSHIP IN CES, %

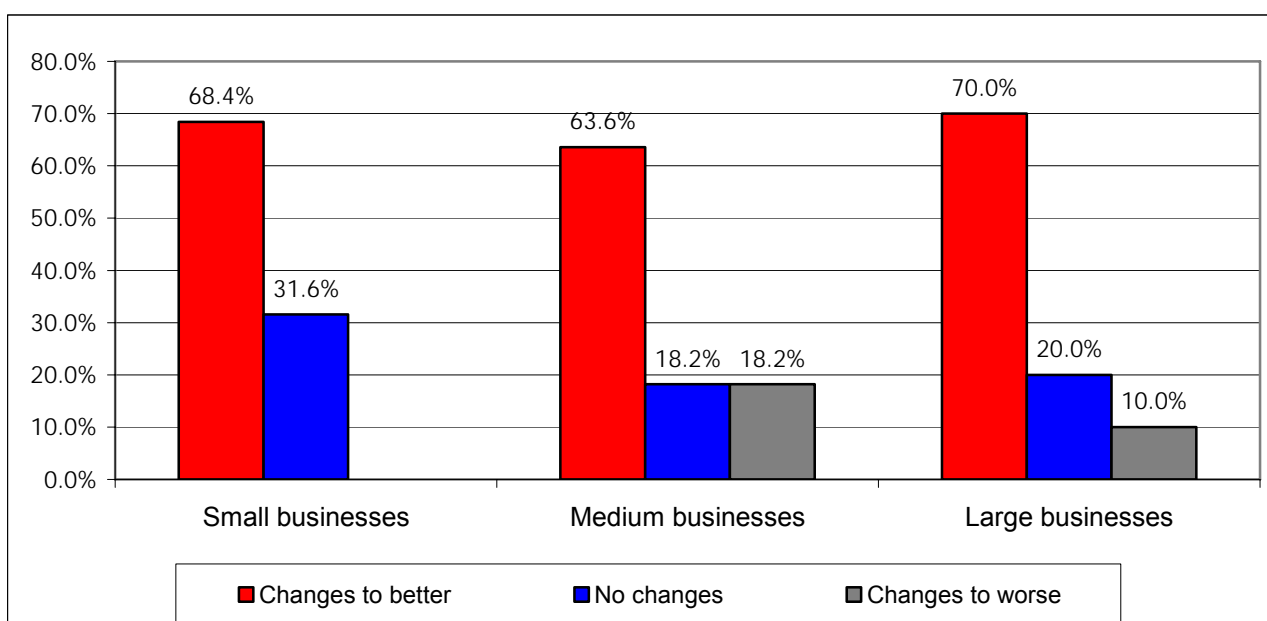
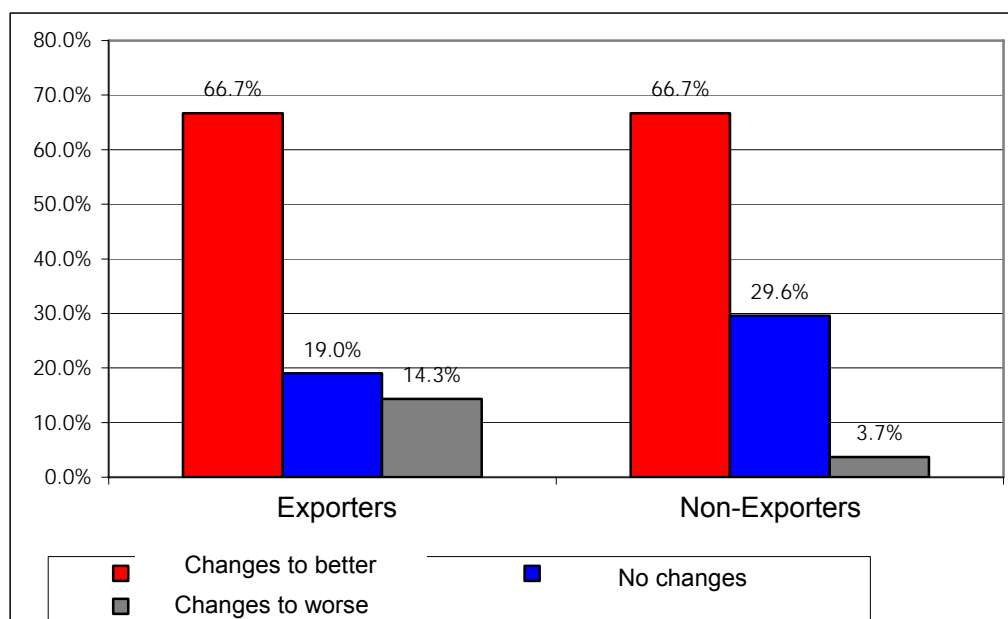


DIAGRAM 7.9. CONSEQUENCES OF UKRAINE'S MEMBERSHIP IN CES, %



Ukraine - WTO

Experts believe WTO membership guarantees clothing companies access to world markets for goods, services, technology and capital. It lessens commercial risks by fostering more stable trade modes and intensifying export production.

Experts forecast a fall in the costs Ukrainian exporters now face due to discrimination. There will be a reduction of transportation costs due to free transit through WTO countries, intensification of structural reforms and new incentives to improve competitiveness. Costs will also fall after double standards for domestic and foreign market end.

Some experts think that lower import tariffs would lead to stronger competition on the domestic market between Ukrainian and foreign manufacturers. In theory, it should stimulate modernization of production and renovation of outdated equipment. Technical levels and the quality of Ukrainian goods would increase significantly. But this is only going to happen if companies can compete with foreign companies at all. Any increase of import would result in a corresponding decrease in production by local companies. Some of them would leave the market. This is in fact the opinion of Lyudmila Zubko, dean of the Light Industry Department at the Kyiv National Technology and Design University.

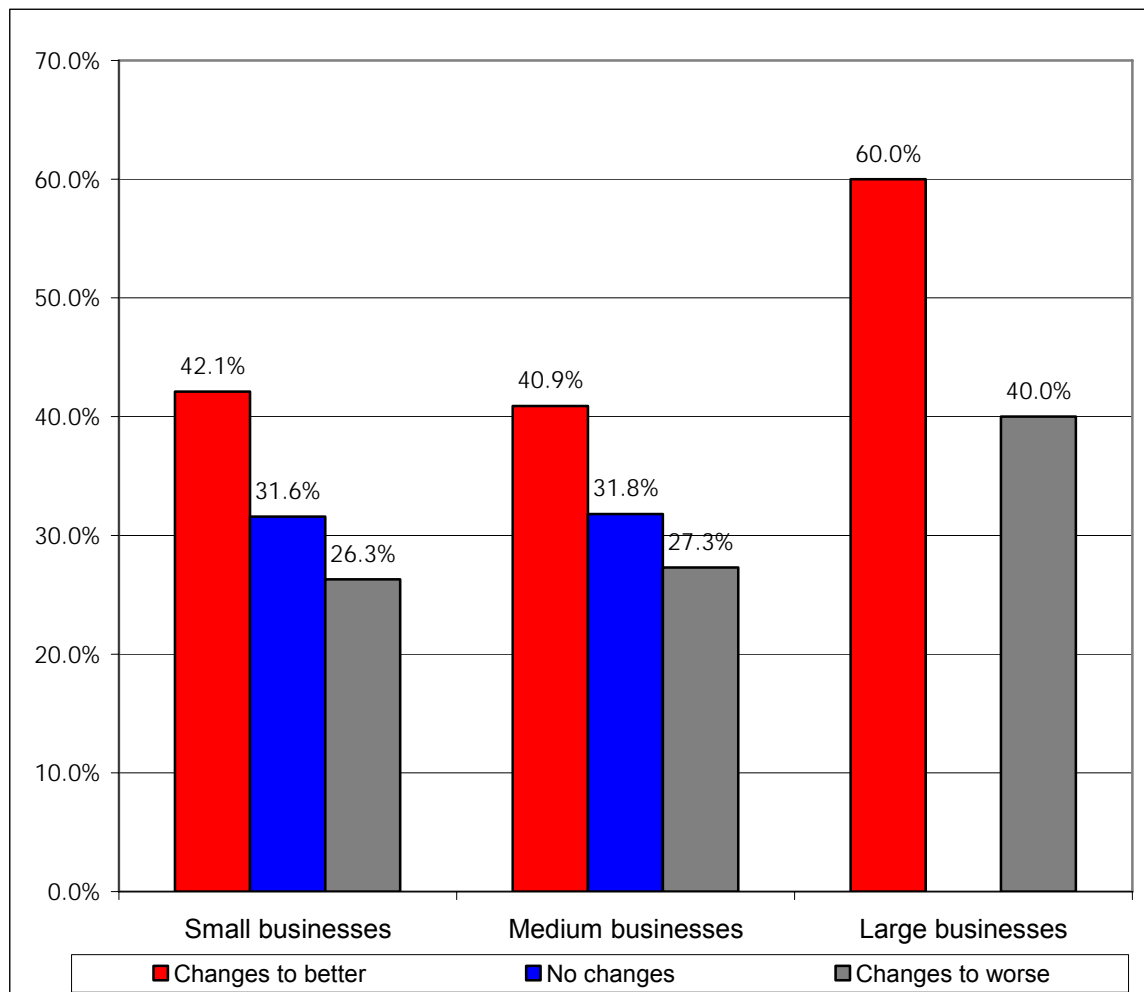
At the same time, our experts tend to think that cooperation between Ukraine and WTO would

make the clothing import into Ukraine more transparent. Since gray import would be replaced by white import, its overall volume is likely to decrease, with positive consequences for Ukrainian manufacturers. So says Yuri Cherniy, of the Ministry of Industrial Policy.

The light industry and the clothing sector are industries that would benefit from Ukraine's WTO membership. Membership would provide:

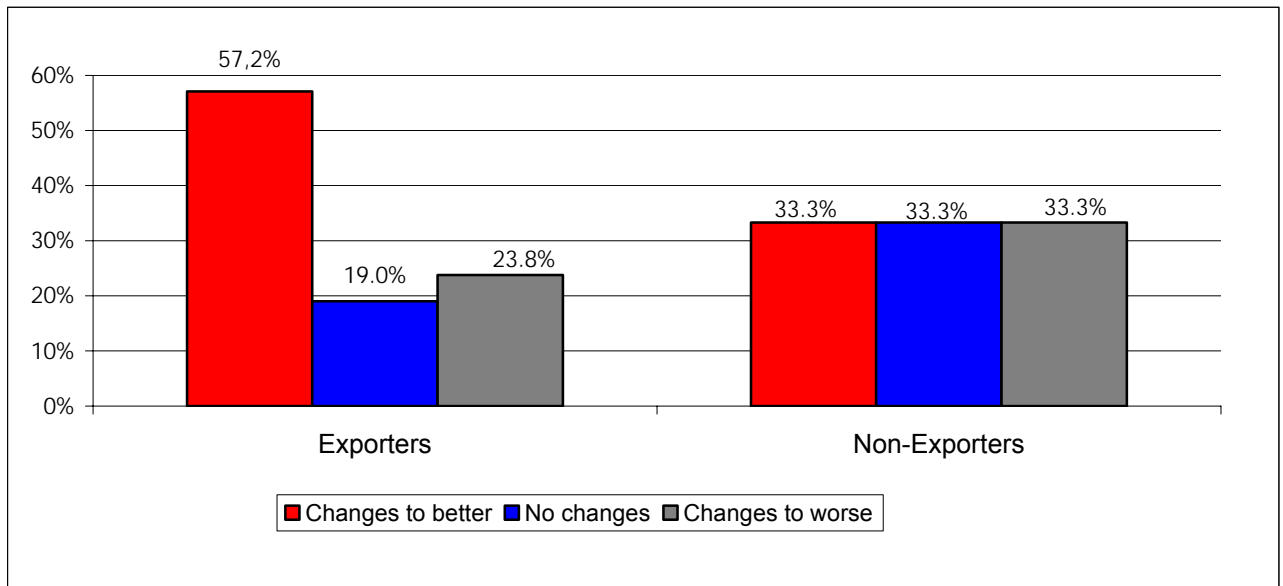
- a decrease in tariff limitations and other limitations on Ukrainian goods' access to practically all key world markets;
- increase of foreign investments into the industry, allowing the renovation of equipment and upgrade of technologies in light industry production.

Light industry and clothing companies today use 40-50% of their production capacities and are prepared to increase production volume. As of now, Ukrainian companies have to focus on foreign markets, where high-quality clothing and knitted wear made in Ukraine enjoy significant demand. At the same time, most goods on the domestic market are represented by low-quality illegally imported non-certified goods, creating serious competition to national manufacturers. Enforcement of standardization and certification rules mandated by WTO regulations would help increase national production.

DIAGRAM 7.10. CONSEQUENCES OF UKRAINE'S WTO MEMBERSHIP, %

Interviews indicate that large companies tend most to think that Ukraine's WTO membership would improve their situation. At the same time, most companies that think the situation is going to deteriorate also belong to the large businesses category, because in the event of WTO membership, they would have to observe higher quality standards. Medium and small companies tend to think that the situation either would improve

(due to access to markets with higher technology levels and new work schemes) or that the situation is not going to change (diagram 7.10.). Exporters think the situation will improve. Non-exporters think the situation will improve or stay the same. This is additional evidence that they lack state support and have no clear idea how Ukraine's WTO membership might influence their situation. (diagram 7.11.).

DIAGRAM 7.11. LEVEL OF SUPPORT FOR UKRAINE'S WTO MEMBERSHIP, %

CONCLUSIONS

1. Some 40%-56% of Ukraine's GDP is represented by export. However, this export is poorly diversified. Outer clothes export dominates in the textile and clothing export structure.

2. In recent, Ukraine's presence on European markets has improved. However, there is still work to be done on the main barriers to boosting export potential, namely administrative and bureaucratic obstacles and strong competition.

3. At this time, Ukraine is considering joining the EU, the CES and the WTO.

4. In contrast to companies focused on the domestic market, exporters see new international market opportunities if Ukraine joins the EU.

5. Most enterprises regardless of size and export orientation support Ukraine's joining the CES.

6. Most industry experts and large businesses think Ukraine's WTO membership will improve the situation in the industry.

SECTION 8. DEVELOPMENT

This section analyzes the following aspects of clothing sector development:

1. Balancing production capacities with sales volumes, organizational structure and a weakened marketing component;

2. Contracting designers to develop trademarks;

3. Increasing certification and standardization;

4. Boosting investment into sector companies.

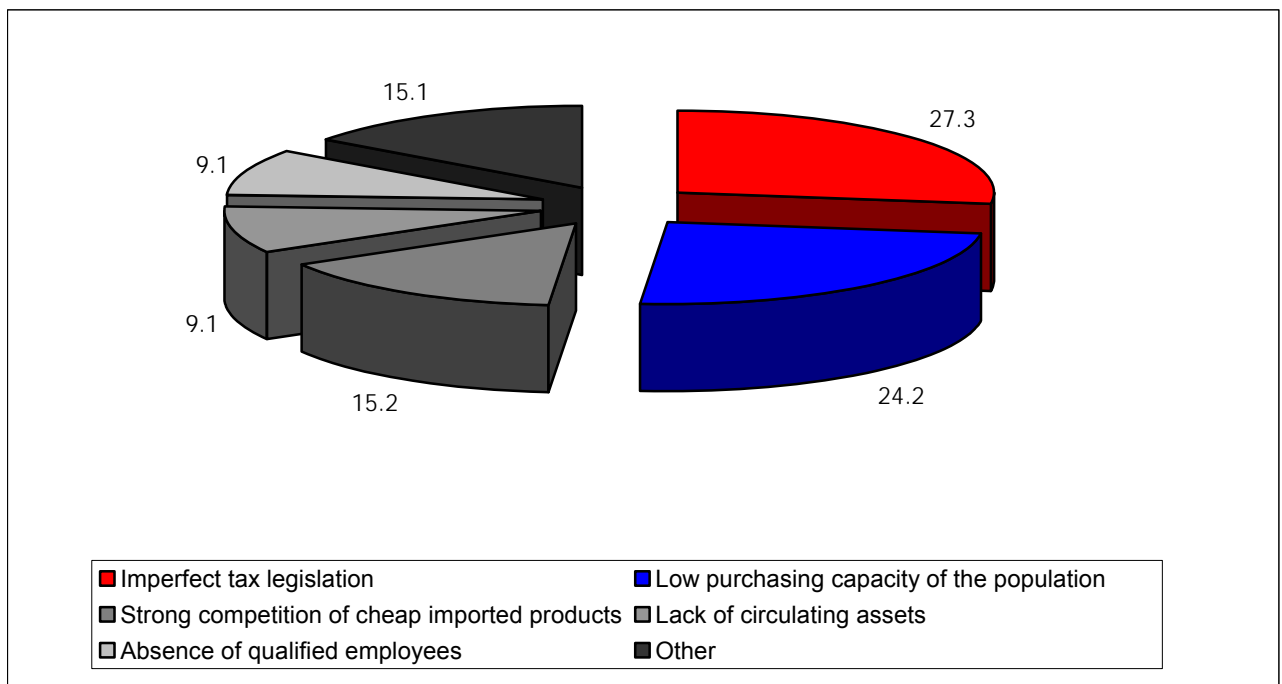
SECTOR DEVELOPMENT MAIN DIRECTIONS

The situation in the clothing sector has improved, but there are problems that need to be resolved soon.

industry's unsatisfactory situation are imperfect tax legislation, low purchasing capacity on the part of the population and the domination of cheap imported goods, primarily from Asia and Turkey (diagram 8.1).

According to annual reports of 33 joint-stock companies in 2004, the main reasons for the

DIAGRAM 8.1. MOST CRUCIAL ISSUES IMPACTING CLOTHING SECTOR'S ACTIVITIES, 2005 %



Based on the data, many Ukrainian companies are just not ready to operate and compete under market conditions. They have serious management problems. Most companies in the sector have unbalanced production capacities in relation to sales volume. Their production and sales orientation are unstable, and their marketing is weak. They make mistakes defining segments and target markets, their knowledge of potential buyers is insufficient and their structural elements are inefficient.

Another issue is that there are few local manufacturers with their own trademarks, and no designers participate in the production process.

The list could also include high continuous costs, low financial management efficiency, the absence of costs management, etc. Without improving the entire management system, successful competition is impossible.

In Ukraine, light industry companies produce more than 70% of their products on tolling orders. As a result, clothing factories mastered production that complies with the requirements of developed markets. However, when working on tolling orders, enterprises omit several links in the Ukrainian business chain. For example, the work of local designers, textile maker and accessory makers is unneeded. Also, labor costs are always rising, and it is less profitable to place tolling orders here. To maintain profitability, the next level has to be reached. That is, local specialists have to be hired, and brand clothes have to be

designed and domestically sold. This is impossible without designers creating fashionable clothes that people want.

Today, clothes by local designers are popular among only a narrow consumer segment. Designer clothes collections are small and expensive. Ukrainian designer clothes never become mass production clothes, although in the near future they could.

Another important issue in Ukraine is the absence of wholesale customers who order clothes

collections after fashion shows. Stores now usually accept such collections for sale on commission. Given the situation, it is difficult to survive not only for independent designers but also for clothing factories, which have to have large circulating assets reserves.

Another problem is a lack of specialists, especially in the middle link: process engineers, mechanics, masters, etc.

STANDARDIZATION IMPLEMENTATION LEVEL

As of the end of 2005, one of the most serious problems facing Ukrainian clothing factory management was outdated work standards. Quality management is performed based on standards developed in 1972.

They are therefore obviously out of date, and of course were designed for a completely different production ideology. Ukrainian manufacturers, therefore, try to get international certificates.

According to Yuri Cherniy, deputy director of the department for the light, furniture and woodworking industries in the Ministry of Industrial Policy, it is difficult for Ukrainian companies to adjust and regulate their activities according to the standards that currently apply.

If Western companies certify their products from the point of view of ecological safety, Ukrainian companies work to standards indicating the number of stitches used on products.

The existing standards apply to clothes made for the physiques of the 1970s, while the average body has by now changed.

Implementation of ISO standardization is performed primarily to achieve a certain production management scheme (quality management system).

Procedural standardization leads to much higher-quality management.

Exporters tend to implement certification more than other companies.

This is a function of stricter quality requirements on foreign markets. Most exporters have implemented ISO certification. The majority of the companies that have quality management systems have never exported products. Few of these operate ISO, though ISO is the most popular QMS in Europe.

A certain portion of European products is exported to markets that apply no certification requirements (among exporters there are companies with no certificates whatsoever) (diagram 8.2. and diagram 8.3.)

DIAGRAM 8.2. LEVEL OF PRODUCT CERTIFICATION OF COMPANIES, DEPENDING ON THE LEVEL OF THEIR EXPORT ORIENTATION, 2005 %

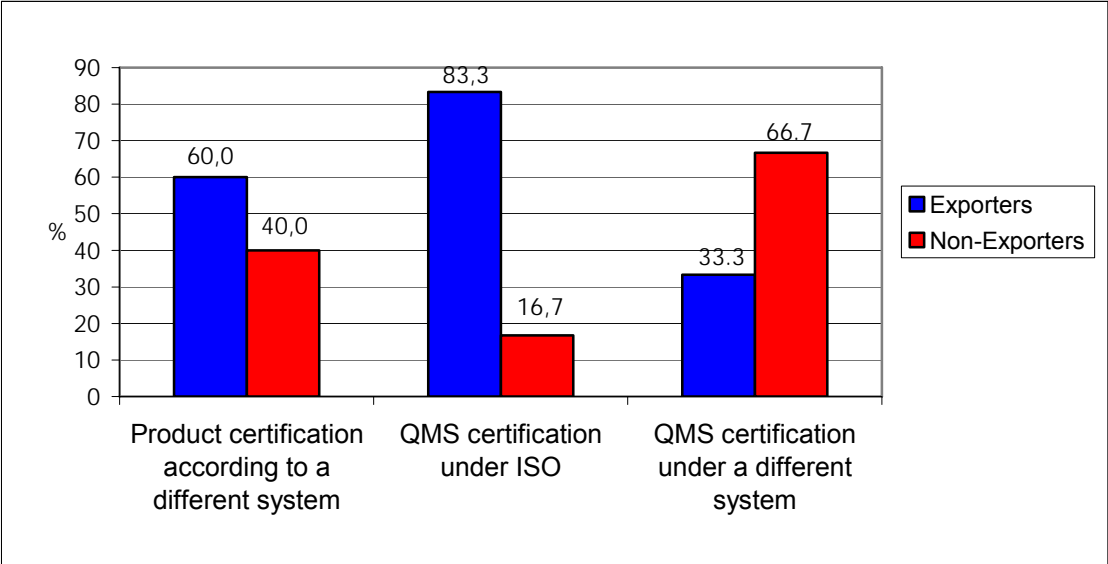
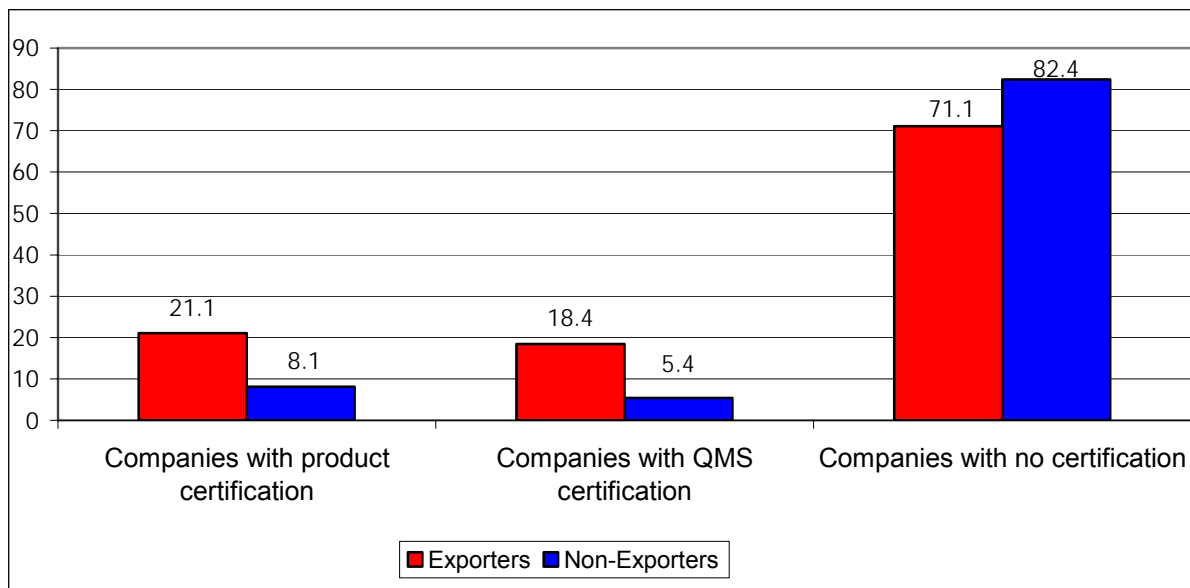


DIAGRAM 8.3. LEVEL OF CERTIFICATION UNDER DIFFERENT SYSTEMS, DEPENDING ON THEIR EXPORT ORIENTATION, 2005, %*



* The total amount may exceed 100% because some respondents chose several answer options.

It is clear from diagrams 8.4 and 8.5 that the certification level is different for differently-sized companies. For instance, large businesses evince the highest certification levels. That's because they have more spare funds for bringing their

production and QMS in compliance with certification requirements. The most widespread type of certification is product certification, because it requires less capital investment than QMS certification does.

DIAGRAM 8.4. SHARE OF CERTIFIED COMPANIES, DEPENDING ON THEIR SIZE, 2005, %

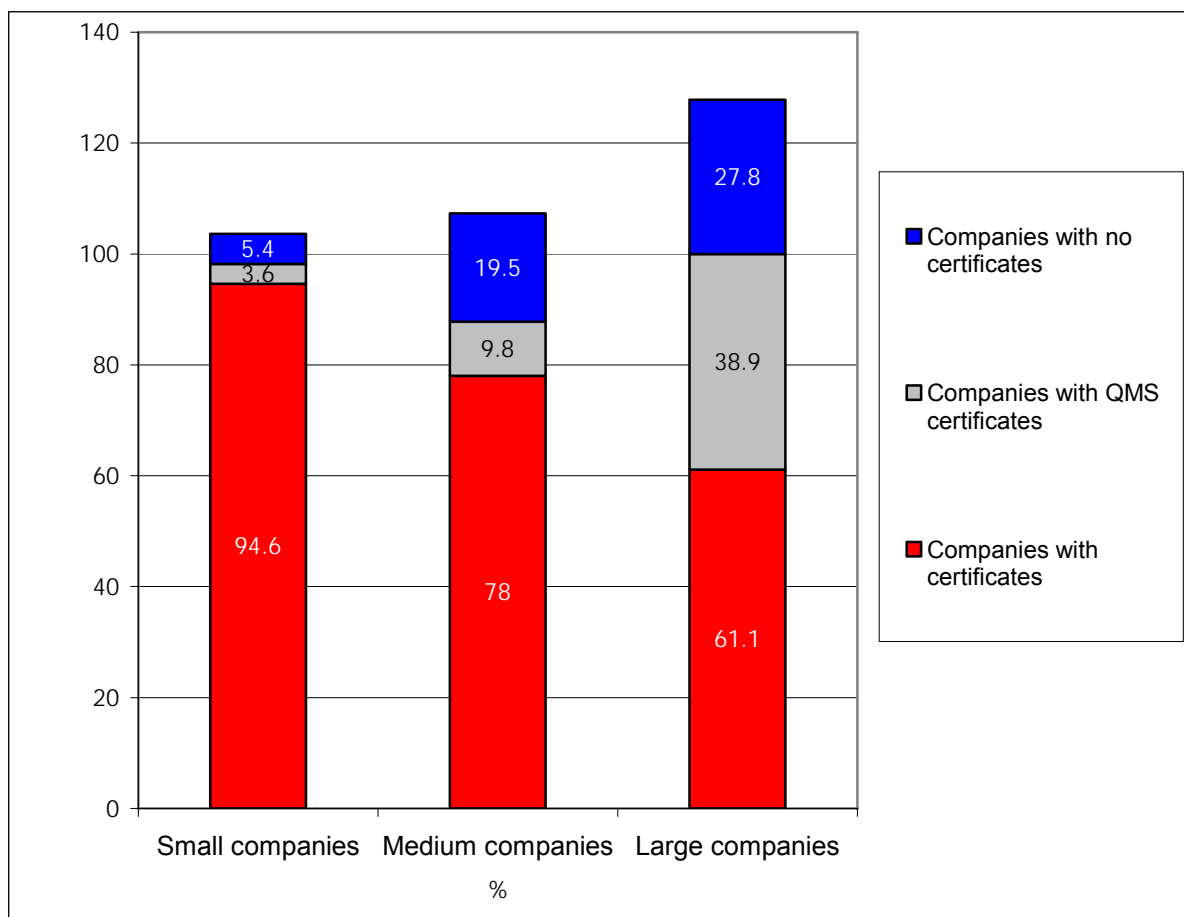
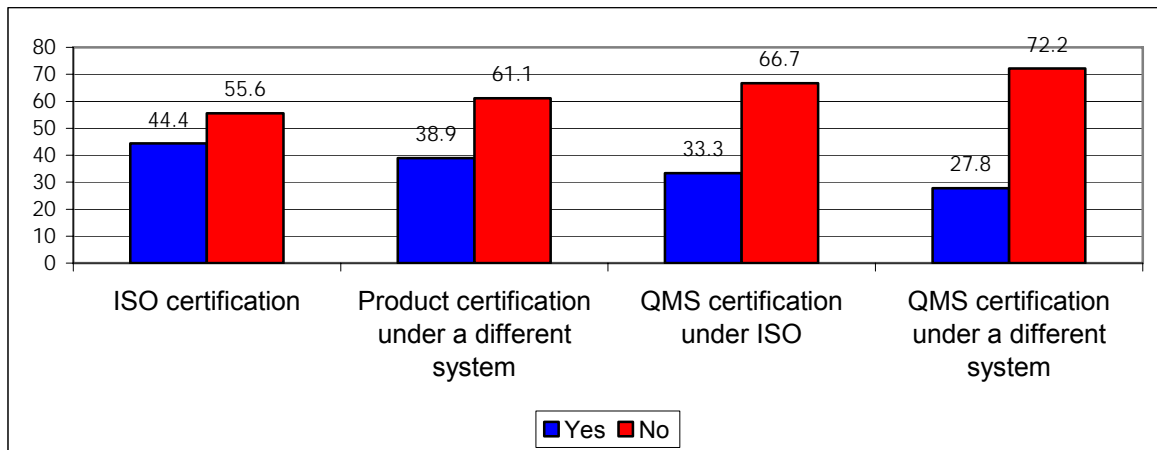


DIAGRAM 8.5. LEVEL OF CERTIFICATION OF ALL ENTERPRISES, UNDER DIFFERENT SYSTEMS, 2005, %



Only few companies have begun certifying products and QMS (diagram 8.6, diagram 8.7.).

About 20% of the sector's companies have plans for such certification.

DIAGRAM 8.6. COMPANIES' PLANS FOR PRODUCT CERTIFICATION, 2005, %

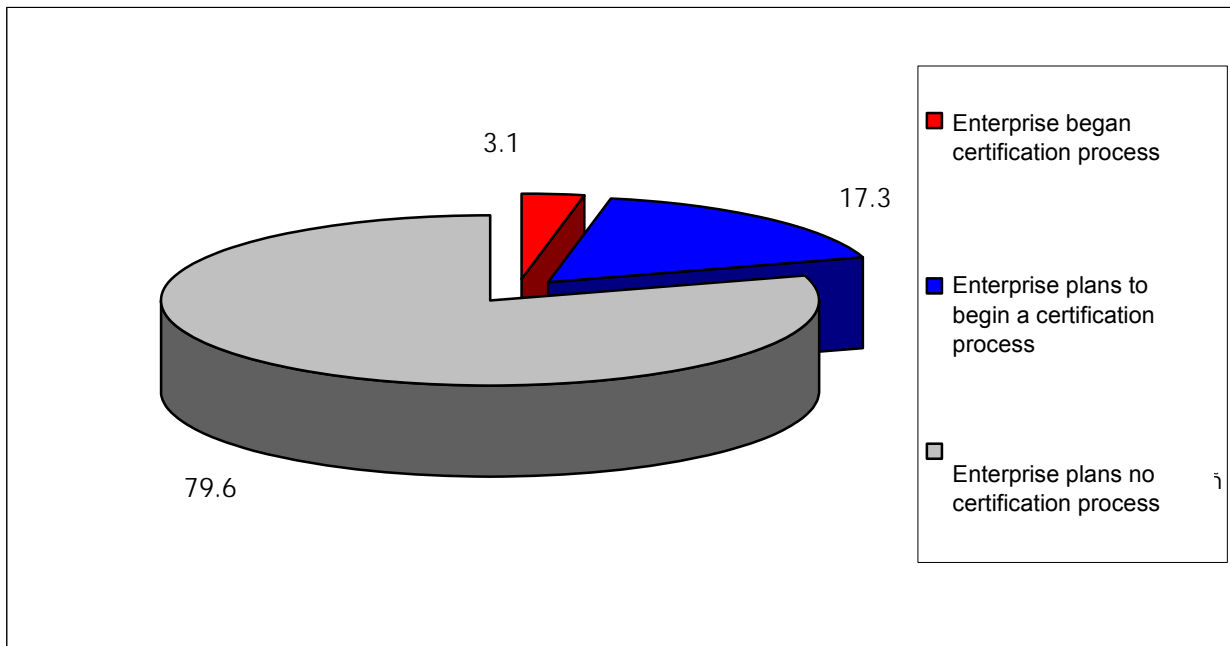
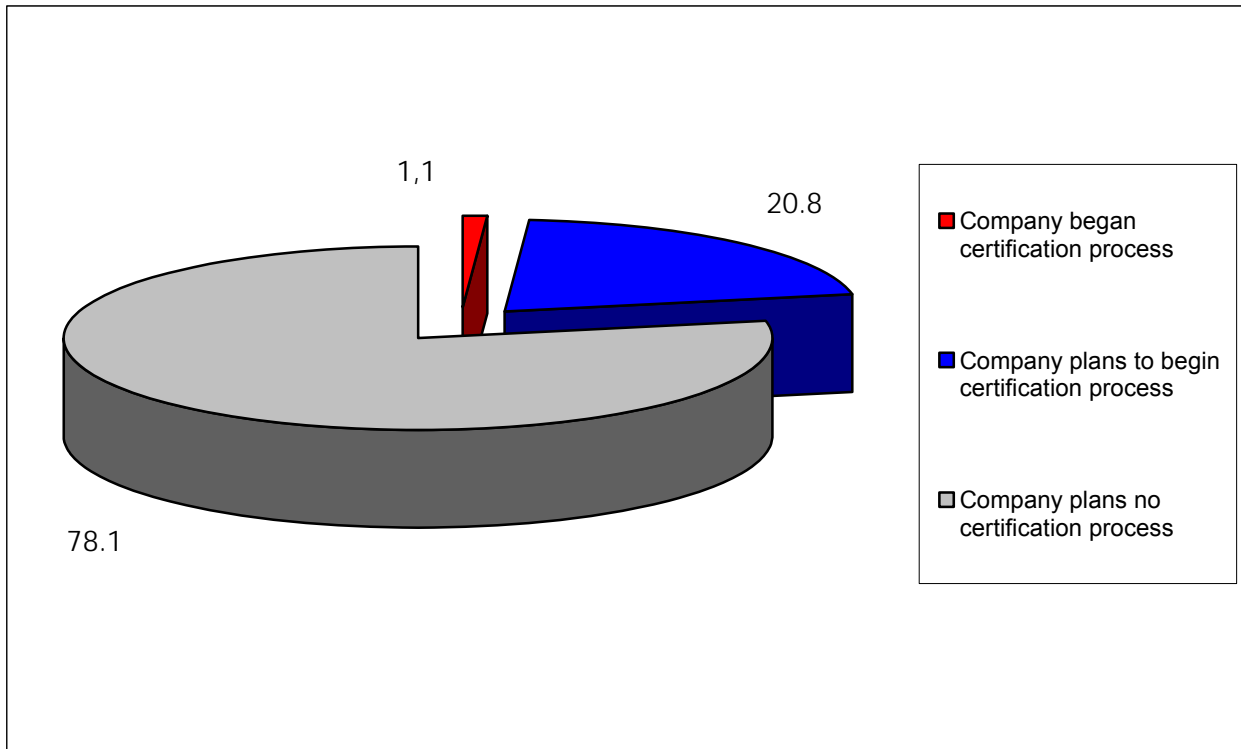


DIAGRAM 8.7. COMPANIES' PLANS FOR CERTIFICATION OF QMS UNDER ISO, 2005, %



Approximately 25% of all clothing companies in Ukraine are subject to mandatory certification. Plus, an additional 16% of the companies' portion of the products complies with standards (diagram 8.8.). Manufacturers focused on the domestic

market are more interested in making products complying with national standards (diagram 8.9). Enterprises exporting their products are primarily interested in compliance with international standards.

DIAGRAM 8.8. LEVEL OF PRODUCT STANDARDIZATION IN 2005, %

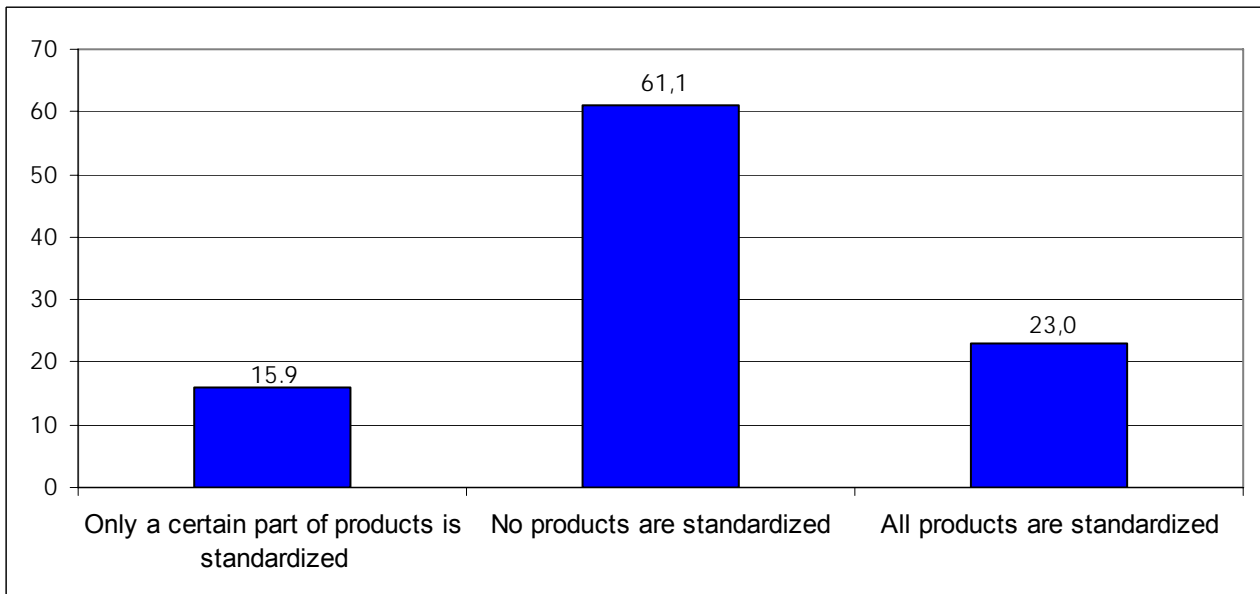
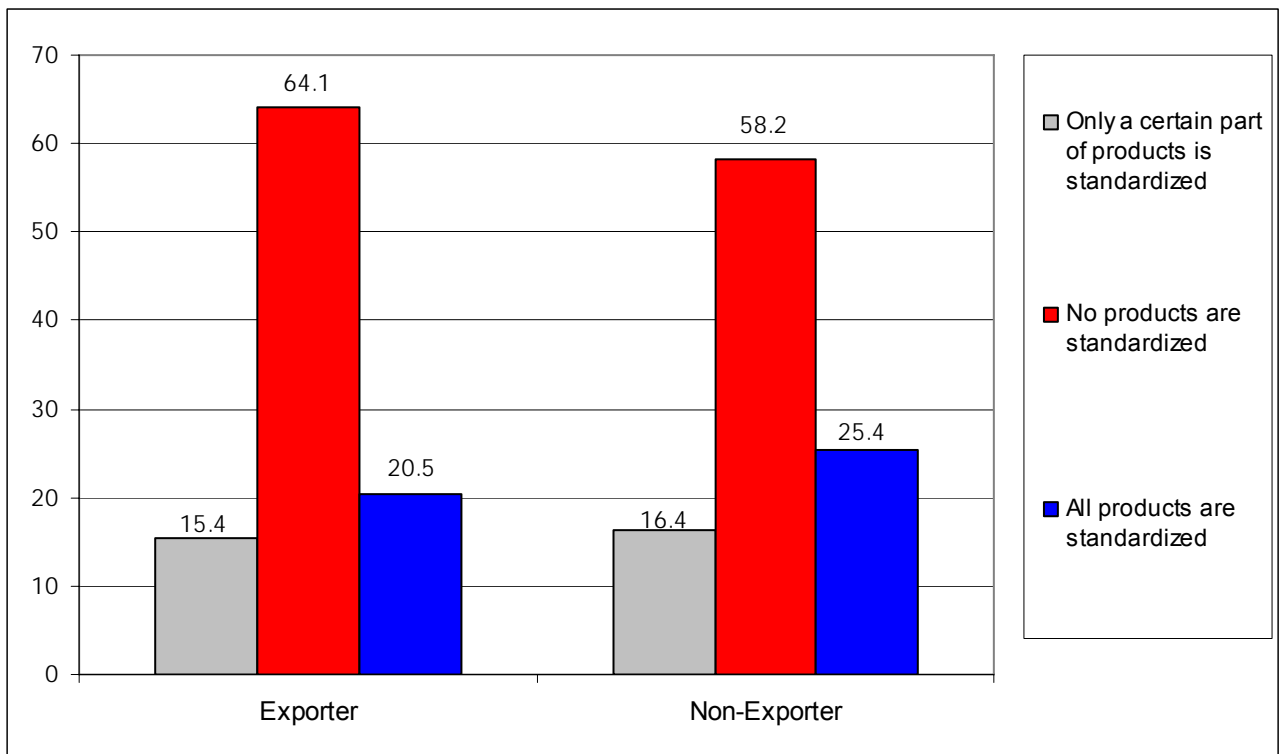


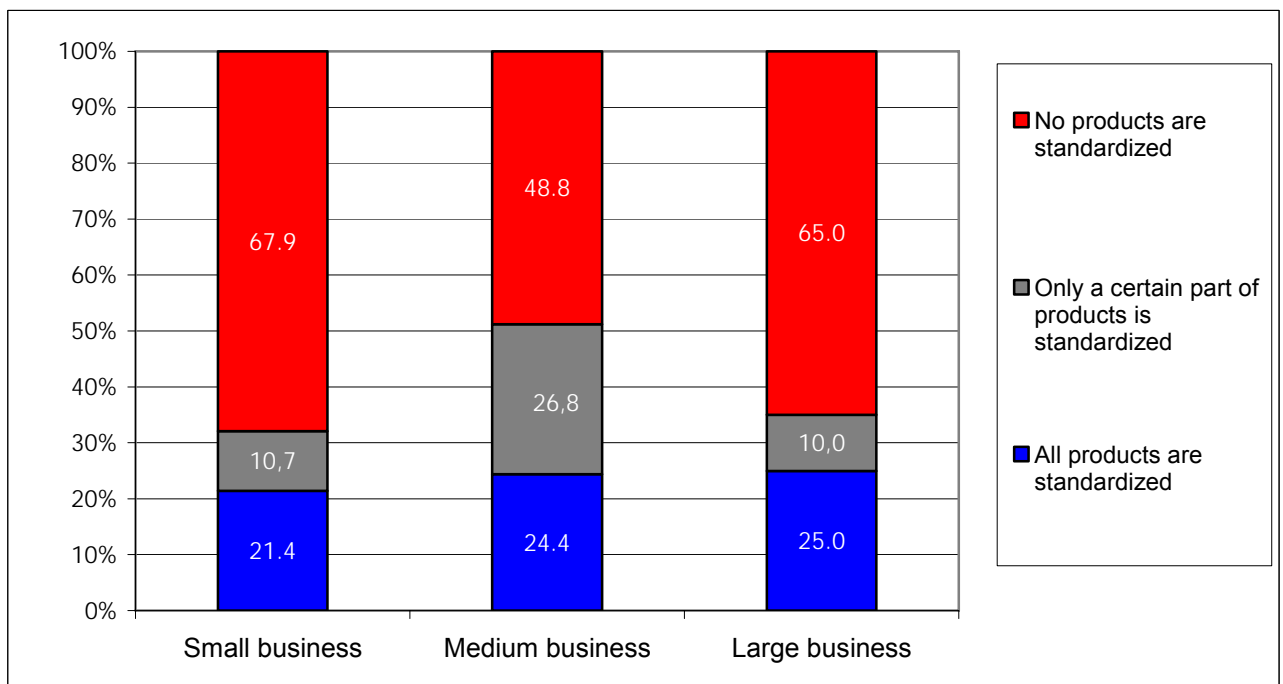
DIAGRAM 8.9. LEVEL OF STANDARDIZATION OF COMPANIES, DEPENDING ON THEIR EXPORT ORIENTATION, %



It is obvious from the following diagram (8.10.) that mandatory standardization requirements apply to different sized companies in practically the same way. For medium companies there is a more or less even distribution between companies all or a part of whose products are subject to

standardization, and companies whose products are not standardized. As regards small and large businesses, however, two-thirds of companies make products that are not subject to standardization.

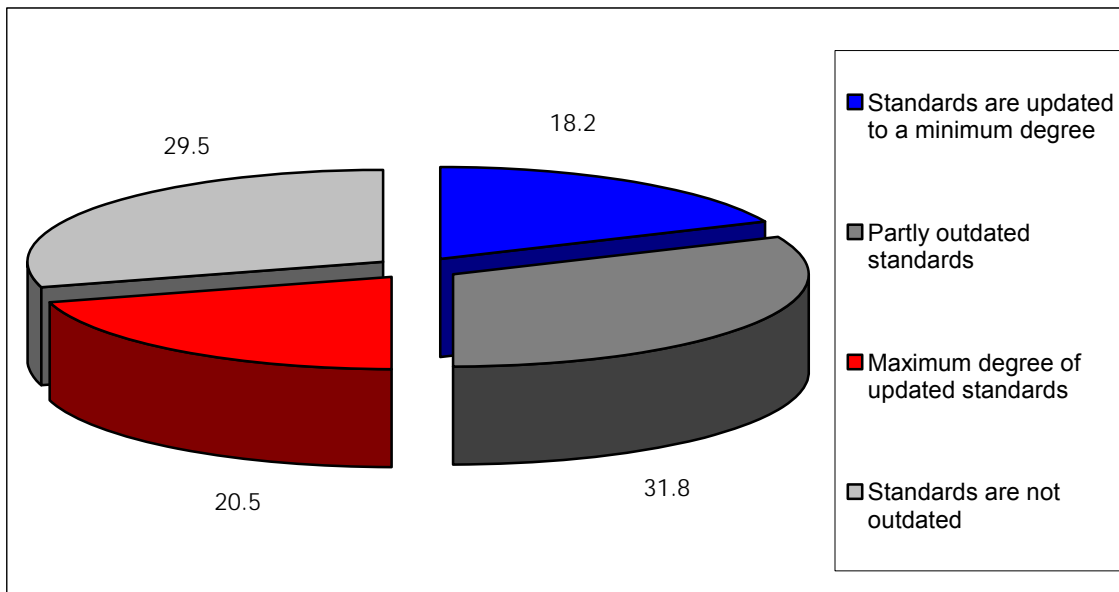
DIAGRAM 8.10. LEVEL OF PRODUCT STANDARDIZATION, DEPENDING ON THE SIZE OF ENTERPRISES, 2005, %



The questionnaires show that only one-third of the companies subject to mandatory standardization

in Ukraine use standards other than outdated ones (Diagram 8.11.).

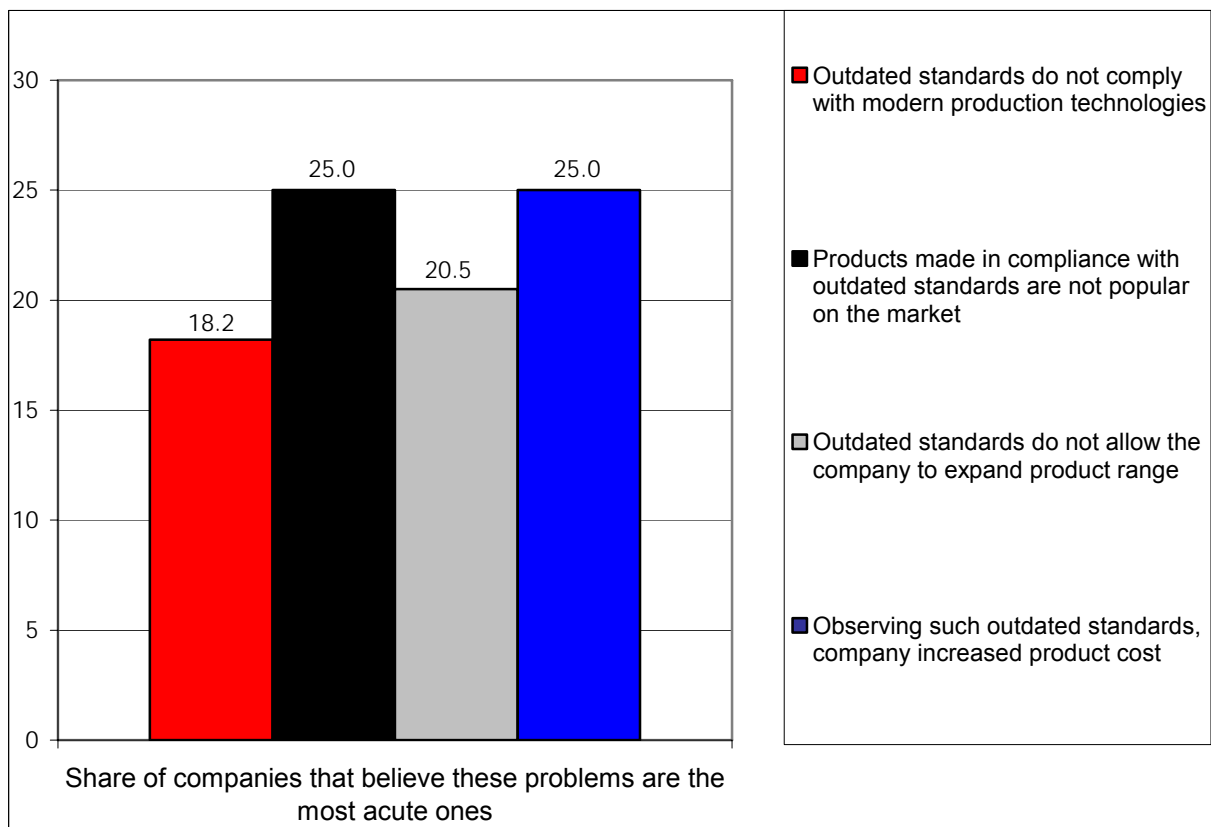
DIAGRAM 8.11. SHARE OF OUTDATED STANDARDS FOR COMPANIES SUBJECT TO MANDATORY STANDARDIZATION IN UKRAINE, IN 2005 P, %



The worst problems arising due to outdated national standards are as follows: products made according to such standards are not in demand;

products cost more due to the necessity of compliance (diagram 8.12.).

DIAGRAM 8.12. THE MOST ACUTE ISSUES FOR COMPANIES CAUSED BY OUTDATED STANDARDS, 2005, %



ANALYSIS OF THE LEVEL, STRUCTURE AND ORIGIN OF INVESTMENT INTO SECTOR'S ENTERPRISES

Both national and foreign investors are so far cautious about investing in the clothing industry. When tax benefits were effective, businessmen invested in clothing factories. Now they have left the industry. However, by the standard of rate of fund circulation, the clothing industry is second only to the food industry. It is, therefore, surely attractive for investors.

Investments in the clothing sector are insignificant (statistics data is analyzed below). However, experts say many Ukrainian clothing companies have renewed their equipment lately. It is possible, therefore, that investments into the sector are in the shadows (just as are company profits and foreign clothes import levels).

An anonymous expert says customs authorities register import of clothing production equipment

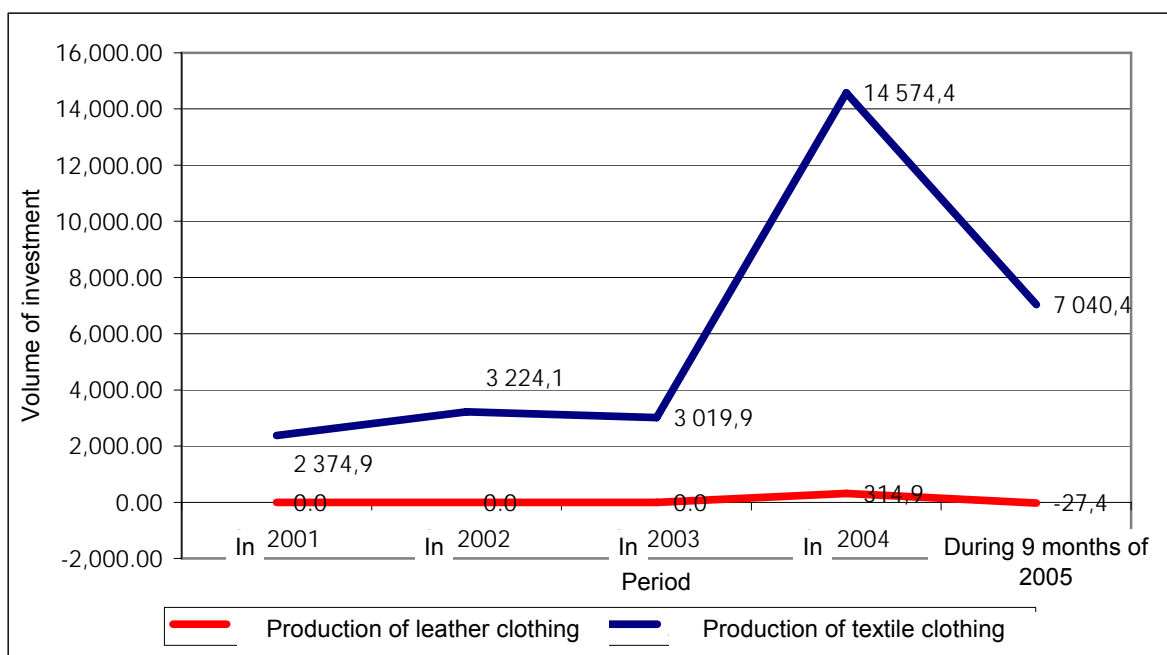
for significant amounts of money, though Ukrainian companies seldom report purchases of such equipment.

Experts evaluate the investment attractiveness of Ukrainian clothing industry as at least \$40 million US dollars per annum.

One sector expert states: "Over the past few years, the clothing industry exported to the EU and the USA. Companies waited for investments and got them. Clothing giants like Dana and Chernigiv CF Elegant received money from foreign investors and work on tolling schemes".

What follows is State Statistics Committee information on registered investment volumes.

DIAGRAM 8.13. DYNAMICS OF CHANGE IN INVESTMENT VOLUMES IN 2001 – QIII, 2005, THOUSAND HRYVNIAS



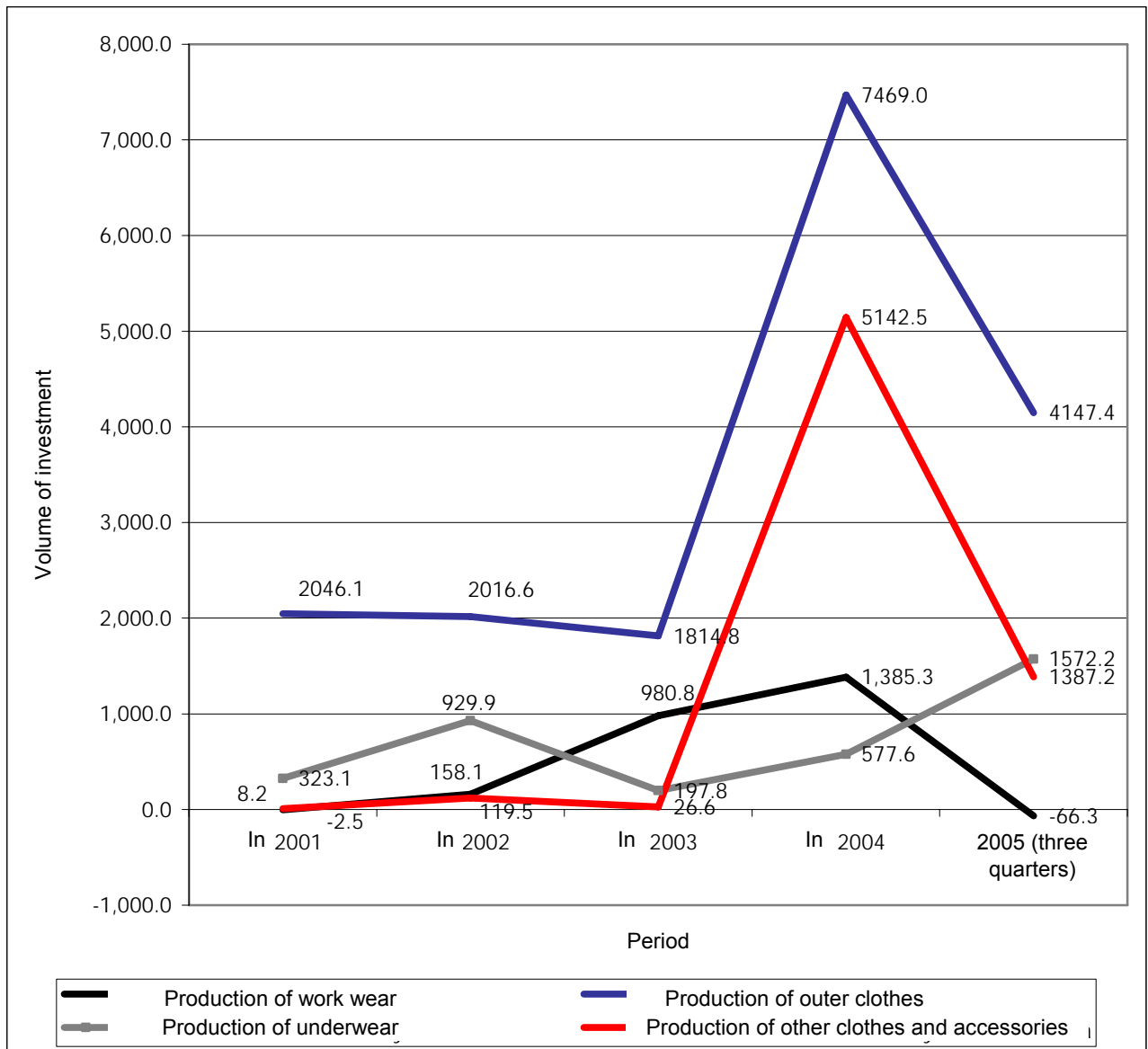
The most attractive companies for investment are those that make clothes, outer clothes in particular. In the analyzed year, 30294.6 thousand hryvnias were invested into outer clothes production, and the overall funds spent on clothes production for 5 years was 45179.9 thousand hryvnias. Note that most of these companies work on tolling schemes and funnel their profits into business development.

In 2004, investment activities in the sector increased (diagram 8.13). Thus 14574.4 thousand

hryvnias were allocated to textile clothes production, as compared to 3019.9 thousand hryvnias in 2003. This was first of all due to the fact that a major part of the equipment was outdated and required immediate renovation.

In 2004, the amount of investment for companies engaged in production of accessories was 5142.5 thousand hryvnias, against 26.6 thousand hryvnias in 2003. This was due to rising demand for accessories.

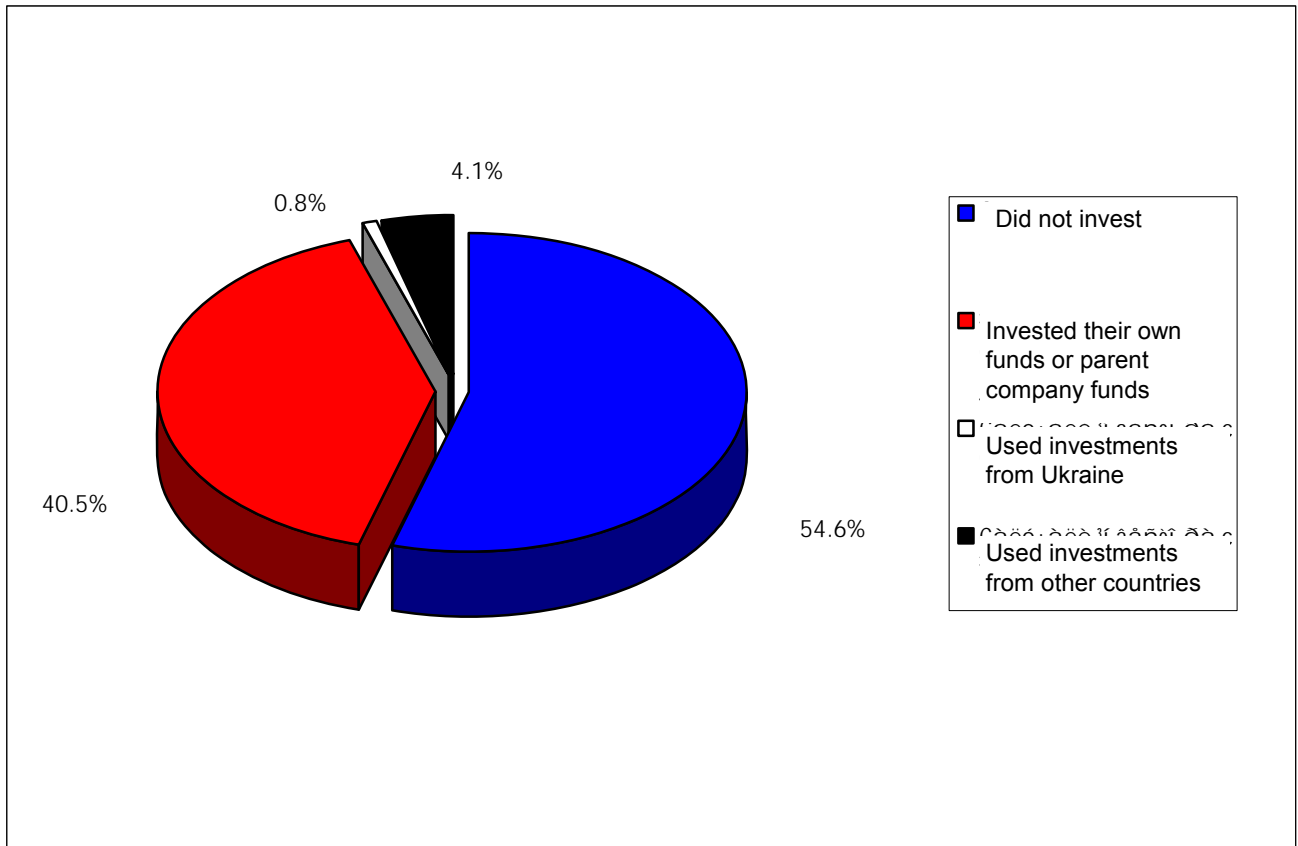
DIAGRAM 8.14. DYNAMICS OF INVESTMENT VOLUME CHANGE, FOR TEXTILE CLOTHES PRODUCTION, IN 2001 – QIII 2005, THOUSAND HRYVNIAS



Another piece of evidence for the sector's development is that most invested funds are the companies' own money (diagram 8.15.). This

means that company owners are not interested in finding outside investors.

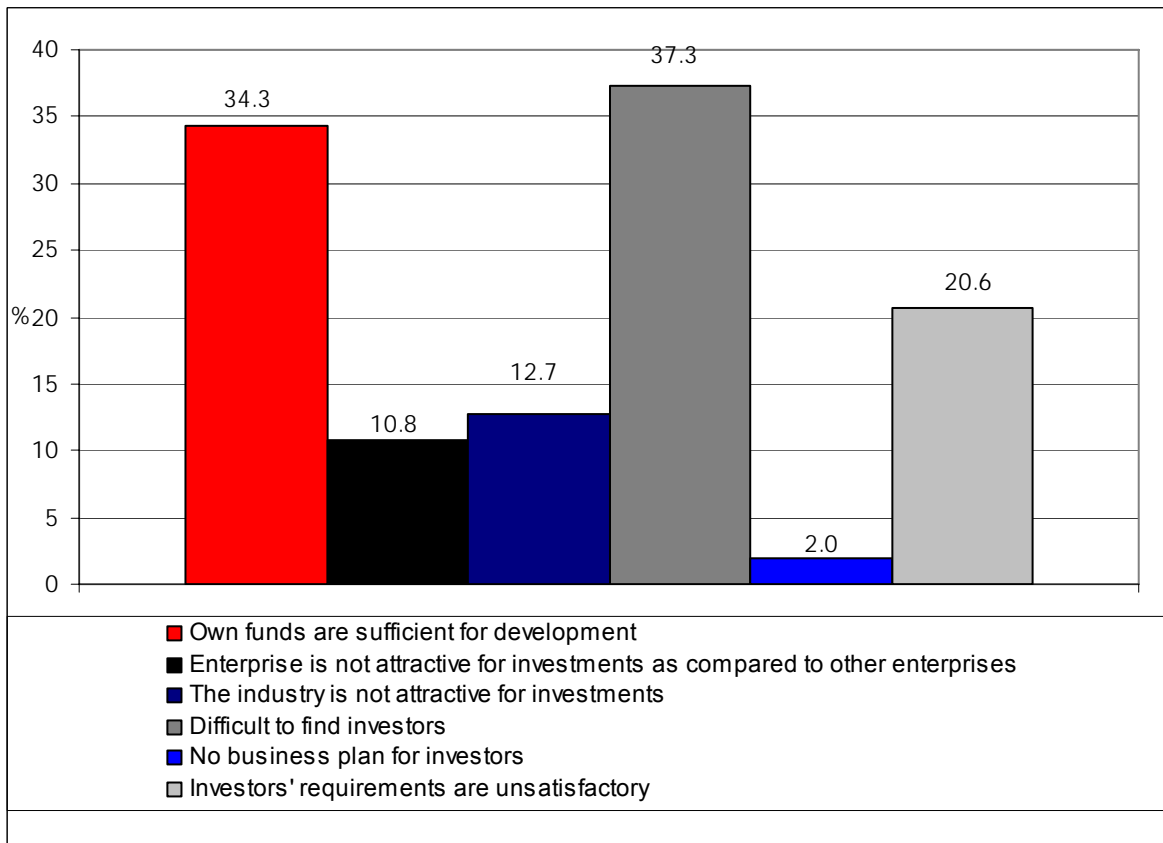
DIAGRAM 8.15. COMPANIES' INVESTMENT IN THEIR OWN DEVELOPMENT, 2005, %



The main reasons for not receiving investments were as follows: the sufficiency of companies'

own funds or difficulties in finding investors (diagram 8.16.).

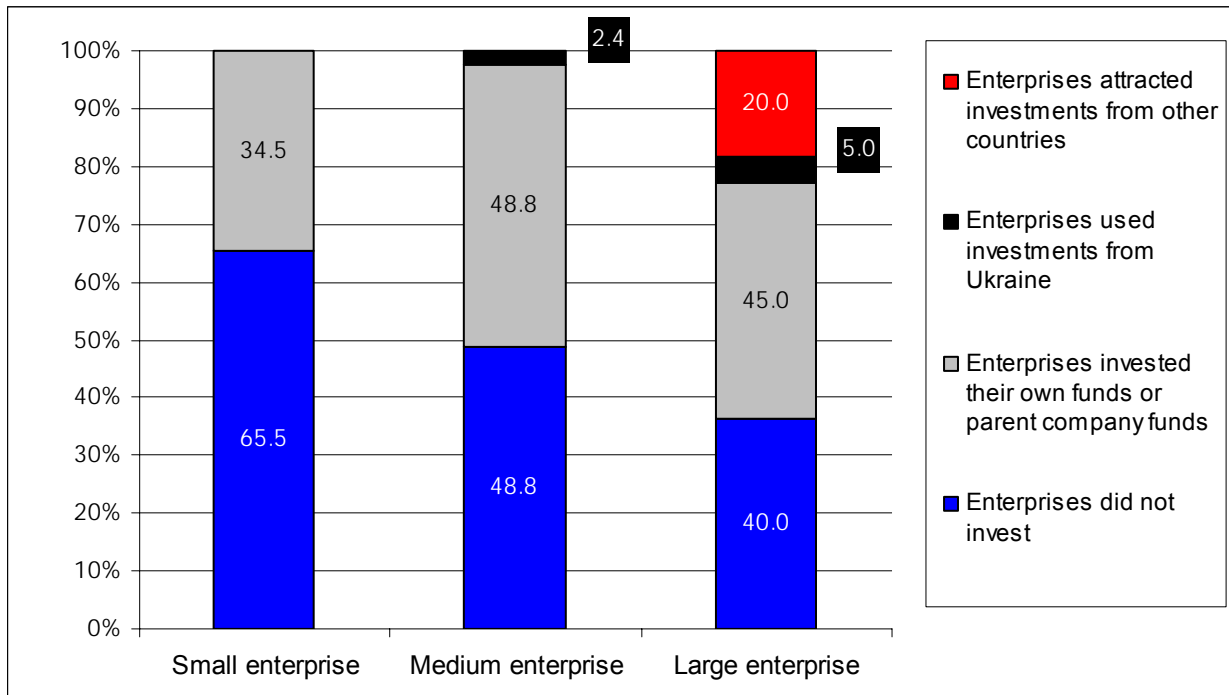
DIAGRAM. 8.16. CLOTHING COMPANY'S REASONS FOR NOT GETTING INVESTMENTS, 2005, %



In describing sources of investment into the sector, it is worth noticing that large and medium businesses have more resources. They are also more attractive for other investors. This is

especially true of large enterprises, 20% of which received funds from foreign investors in 2005. At this time, the only engine of development for small companies is their own funds (diagram 8.17.).

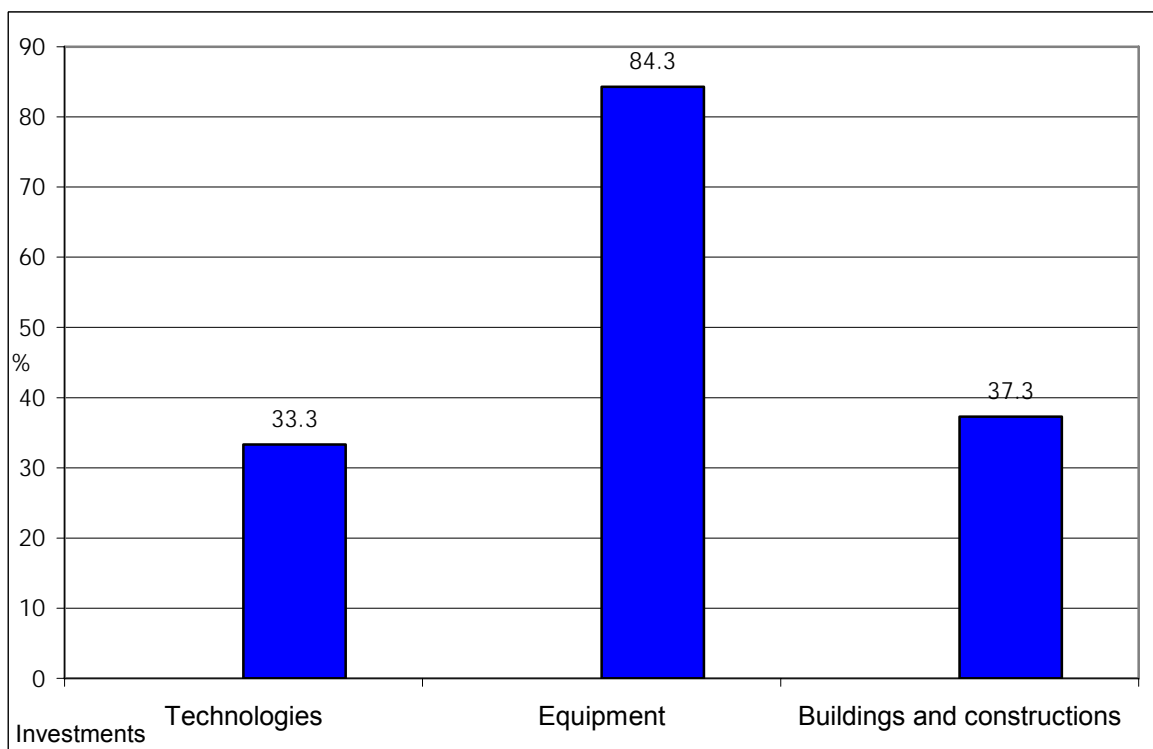
DIAGRAM 8.17. SOURCES OF INVESTMENT DEPENDING ON COMPANY SIZE, 2005, %



Questionnaires show that enterprises invest their funds mostly in renovation of fixed assets, in particular into equipment (diagram 8.18).

This is a stable tendency that does not depend on company size.

DIAGRAM 8.18. STRUCTURE OF INVESTMENTS IN THE SECTOR, 2005, %

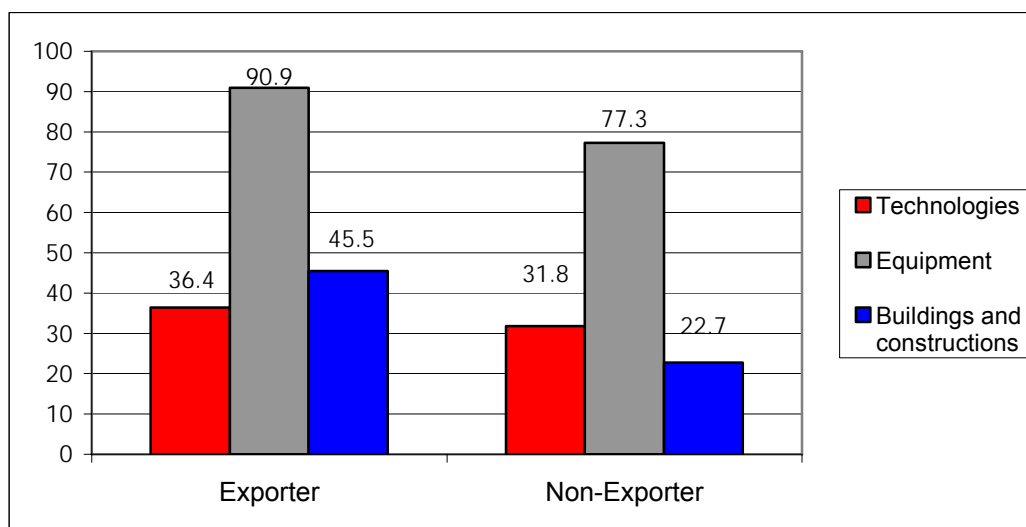


* The total may exceed 100 % because respondents may choose several options.

Companies with significant export shares tend to invest more in equipment, because they have to keep improving the quality of their products to stay competitive on foreign markets. But significant

investment into equipment by non-exporters witnesses to increasing competition on the domestic market. This obliges manufacturers to maintain high levels of quality (diagram 8.19).

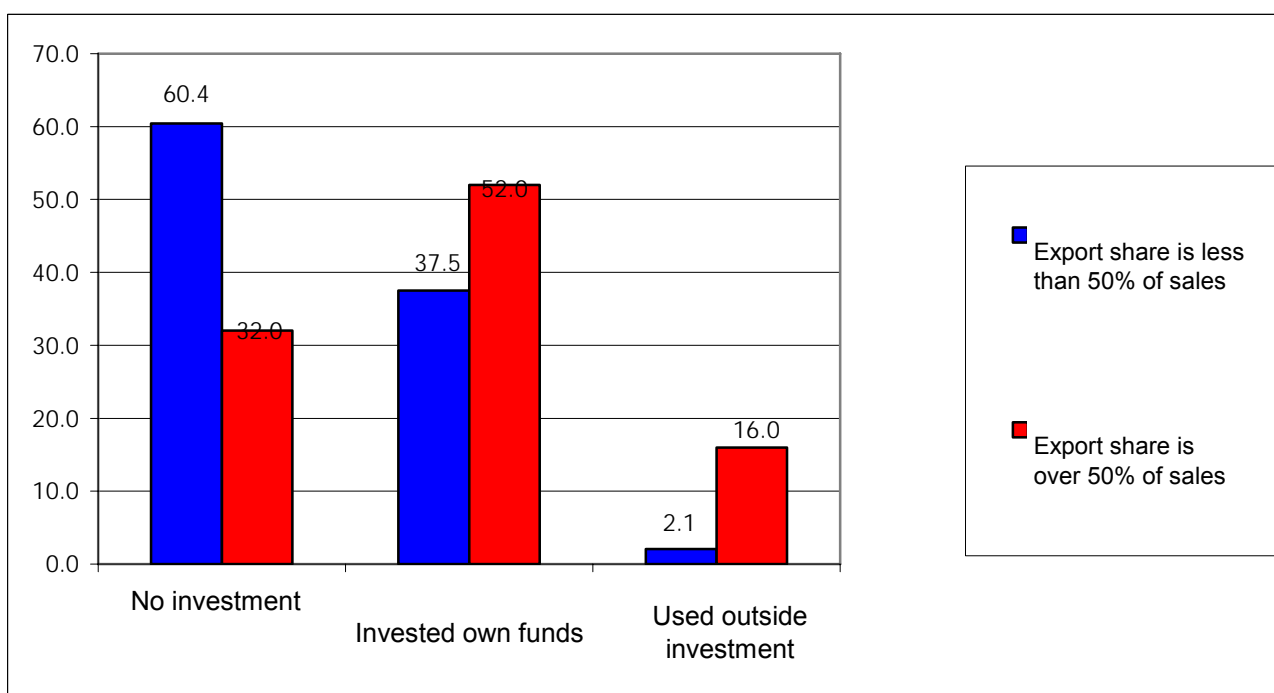
DIAGRAM 8.19. STRUCTURE OF INVESTMENT, DEPENDING ON EXPORT ORIENTATION, 2005, %



Companies with export shares in excess of 50% of overall sales volume have more opportunities to invest their own funds into production development

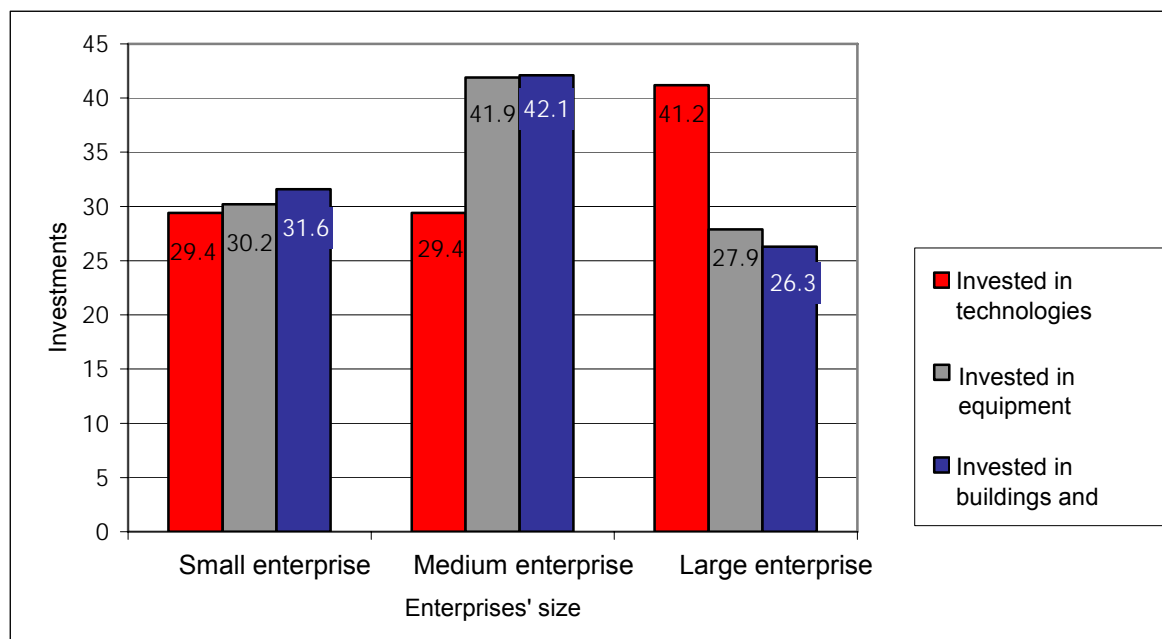
and they receive more investment, both Ukrainian and foreign, than do non-exporting companies (diagram 8.20).

DIAGRAM 8.20. INVESTMENT INTO DEVELOPMENT, DEPENDING ON COMPANIES' EXPORT ORIENTATION, 2002, %



The most active investors are medium businesses. Almost 50% of them invest in equipment and structures, and one-third invest in technologies. Large companies occupy a different stage of

modernization, so most of them invest in technologies: energy-saving, recycling, closed cycle, etc. (diagram 8.21).

DIAGRAM 8.21. STRUCTURE OF INVESTMENTS, DEPENDING ON THE SIZE OF COMPANY, 2005, %

The intensity of capital investment by sector companies confirms the clothing sector's development. This development is driven by large/medium and small companies.

Expert comments:

1. "Today's investors are much more interested in factory buildings, either in leasing them or using them as business centers" - Sergey Mina, commercial director of ZAT PTSF Dana.
2. "There are many designers in Ukraine today, but none of them have brands or are supported by production" - Olga Mudrenko, designer, Olga Style Company.

Many experts associate the sector's problems with the undevelopment of Ukraine's fashion industry.

Operating on Ukraine's domestic market takes more effort and money than does exporting. A lack of Ukrainian popular brands leads enterprises to focus on foreign markets almost completely (through tolling orders, rather than through export of finished products).

Only manufacturers with popular brands enjoy high profitability levels.

For instance, the SELA brand chain bought the Zimaletto trademark from the producers of a popular soap opera, thus acquiring a positive brand image and mass brand awareness.

Bertrand Costes, CEO of the British investment fund QES Investment Limited, who has invested in CF Yunist, says: "We have improved the factory management structure significantly, and established new marketing and sales departments. We will study the market and the tastes of consumers so that we understand what kind of clothes they need. We will also expand our distribution network and search for new clients in Kyiv and Ukraine in general. It is very important to break Ukrainians' stereotypes about Ukrainian clothes."

Indeed, one development priority should be to increase awareness about the clothing sector and its adjacent sectors, and about new designer solutions and clothing product promotions and sales. Management qualification should be improved, and cooperation should be expanded with adjacent sectors of Ukraine's economy.

CONCLUSIONS

1. The clothing sector's most typical problems include a lack of balance between production capacities on the one hand and sales volumes, production and sales orientation on the other. Weak marketing is also a problem. To overcome such problems, companies have to improve management.
2. Companies must find efficient sales markets. This requires proper financing and capable managers.
3. At this stage of development, companies must work with designers to create their own trademarks and brands.
4. Exporters tend to use certification more than do other companies.
5. Only one-third of enterprises use modern standards.
6. Investments into the clothing sector are gradually increasing. The main source for such

investment is the companies' own funds. This witnesses to the fact that many companies have enough money, and do not need outside investors. Export-oriented companies are more active in investment because they make higher profits on foreign markets. At the same time, most investments into the clothing sector are made in the shadows. Ukraine's customs service registers

imports of clothing production equipment, though that equipment is not always declared in companies' financial accounts.

7. The vast majority of companies have invested in renovating fixed assets. Only large companies invested in technology. This puts such companies on a different level of development.

SECTION 9. REGULATORY ENVIRONMENT

Tax policy as regards sector companies and investment into the sector damages profitability and impedes renovation of production equipment.

The main features of the regulatory environment are as follows:

- general laws and rules of entrepreneurship;
- tax rules and regulations;;
- regulation of raw material and spare parts import;
- regulation of finished products export;
- quality standards and product certification.

The regulatory environment is characterized by legislative difficulties and inconsistencies, and unnecessary bureaucracy. Negative factors include the following:

- VAT return, taxes;
- customs procedures;
- imperfect legislation, legislative barriers, frequent changes in legislation;
- bureaucracy, too many procedures/permits; too much time is lost on export registration of product;
- currency regulation of export activities and collateral securities;
- unstable currency exchange rate;
- certification, standardization, technical specifications of products;
- political factors, government activities;
- corruption;
- large number of transportation cycles, inspections, administrative barriers.

Special attention should be paid to the tolling schemes used in the sector, because companies are able to load their production capacities to make goods on commission for foreign clients. Such activity is regulated by the Law of Ukraine "On Tolling Schemes in Foreign Economic Relationships" and the legislation on VAT. The most important issues are customs registration through collateral securities and bills of exchange, the issue of the zero VAT rate, etc.

Another important issue that influences competitive ability on the domestic market of is

government policy regarding customs tariffs for different groups of raw materials, light industry products in general, and clothing sector goods in particular. There are low customs duties on imported finished products and high duties on the raw materials (fabrics, parts, accessories) from which Ukrainian manufacturers make finished products for sale in Ukraine. So Ukrainian products become more expensive than imported products are. This creates unfavorable conditions for development of local manufacturer.

The same problem can be seen in the context of secondhand clothes sales in Ukraine. It has increased significantly in past years. There is a strict sanitary-hygienic control process for goods made by Ukrainian companies, including raw materials control, analysis of used chemicals, dyes, accessories, etc. But there is no control for secondhand clothes. According to the Health Ministry, this could pose a threat to people's health. Also, this deteriorates conditions for national manufacturers.

Sanitary legislation prohibits import of goods without proper sanitary control and requires that imported goods undergo the same control procedures as Ukrainian products (According to the Ministry of Industrial Policy).

Both government organizations (Ministry of Industrial Policy) and professional associations (Ukrlegprom) work on regulatory policy issues. The government tasked the Department of Light Industry of the Ministry of Industrial Policy with developing a Program for Development of Light Industry in 2005-2011. The purpose was to stock Ukraine's market with high-quality competitive goods made by Ukrainian light industry enterprises, toward development all types of native enterprises.

Ukrlegprom proposed that, until 2009, companies use the VAT and profit tax moneys they would normally pay into the budget for reconstruction and modernization of production. This is provided for by the draft law "On Conditions of Development of Ukrainian Textile Enterprises," approved on February 17, 2004 at the meeting of

Ukrlegprom's board. According to the press-release of the Ukrainian Union of Industrialists and Entrepreneurs (UUIE), the draft law also proposed that, until 2009, VAT and customs

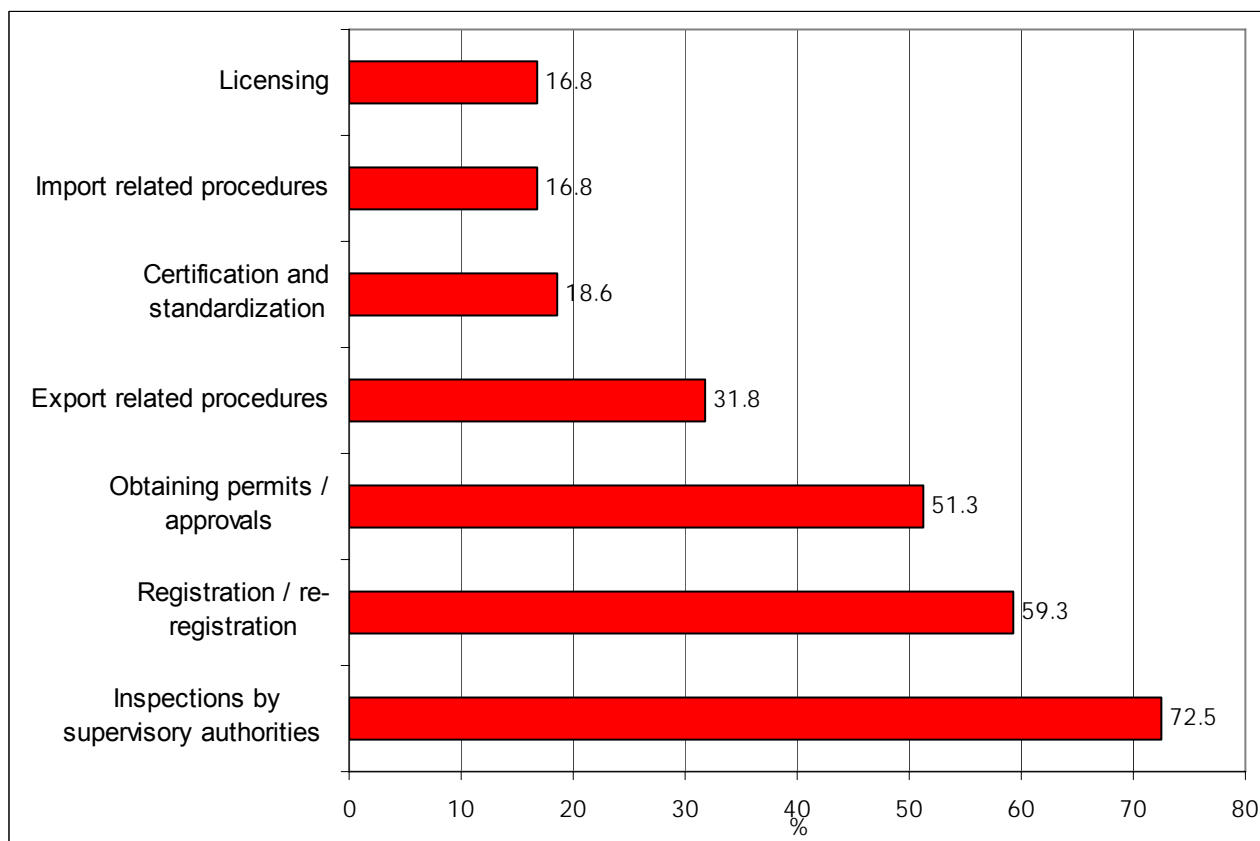
duties not be levied on raw materials, equipment, etc., imported by enterprises for purposes of their own production.

ADMINISTRATIVE BARRIERS TO ECONOMIC ACTIVITIES IN THE SECTOR

Ukrainian legislation is enhanced by various administrative and bureaucratic barriers. Sector enterprise managers claim the most serious

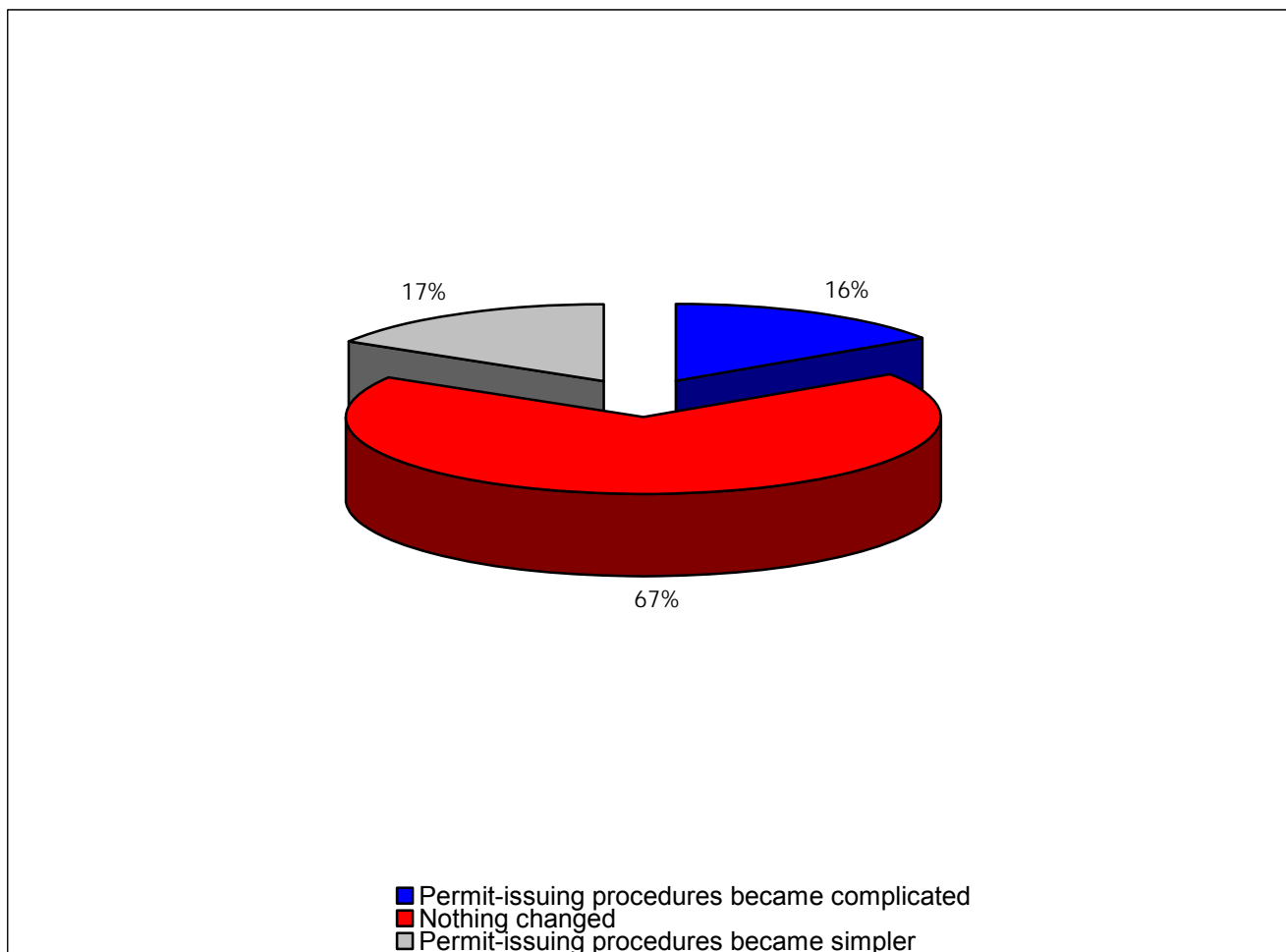
problems are: inspections by regulatory authorities, and registration and re-registration toward obtaining permits and licenses.

DIAGRAM 9.1. ADMINISTRATIVE ISSUES INFLUENCING ENTERPRISES' ACTIVITIES, %



The key factors are the time and money that enterprises have to spend overcoming barriers. Despite that government agencies have tried to simplify some procedures (e.g. "one window registration") and regulate inspections, progress

remains slow. Most companies (67%) think nothing has changed as regards obtaining permits. Only 17% think the procedures have become simpler (Diagram 9.2.).

DIAGRAM 9.2. OPINIONS ABOUT CHANGES TO PERMITTING PROCEDURES, %

Experts note that since 2005 Ukraine's light industry has been experiencing many problems, the worst of which were a result of changes to the 2005 budget. One consequence of these changes is the use of collateral securities for customs clearance of raw materials. Banks have to pay for these out of their own funds. This also complicates customs procedures and makes them more expensive. VAT charged on raw materials processing on tolling orders also hinders production. Due to high VAT on imported raw materials, companies decide it is not worth working, because their profitability is minimal in any event: 0.5-1%. There have been serious fines, terminated agreements with foreign partners, and the loss of significant portions of the EU and US markets. The social consequences of such government policy become clear if we consider that almost 80% of Ukrainian companies and more than 100 thousand employees work with raw materials received under tolling schemes.

According to sector experts, the fall in the currency exchange rate has lowered income for companies working on tolling schemes by 10-11%. Add in higher transportation, fuel and other

component costs and profits decrease by another 8-10%. Profitable companies are becoming unprofitable.

The existing tax system for imported equipment (VAT and customs duties) dissuades investment in technical re-equipment of production.

In China, India and Turkey, there is a system of government sponsorship for textile companies that want to improve their equipment (the government covers 70-100% of equipment costs). Even Russia has eliminated customs duty and VAT on technical equipment for textile industry.

Legislation on clothing import into Ukraine, however, is more mild. The average customs fee for imported clothing is 5.5%. In EU countries it is 9%.

The minimum customs value for imported goods is dozens of times lower than manufacturer prices.

According to Lyudmila Zubko, dean of the Light Industry Department at Kyiv National Technology and Design University, the main problem for light industry enterprises is a lack of state attention and support.

IMPACT OF ECONOMIC ENTITIES ON REGULATORY ENVIRONMENT

The regulatory environment can be influenced in the following ways:

- lobbying in the Parliament and Cabinet of Ministers;
- developing professional associations that can, in turn, develop standards in the sector.

We have mentioned that the government pays minimal attention to development of light industry. It has adopted development programs, but also to a certain extent impedes their implementation. Despite local manufacturers' doubts about Ukraine's WTO membership, decisions are made on the intergovernmental level that comply with WTO principles and allow Ukrainian

manufacturers to increase export. For instance, one important development was the conclusion in 2000 of a new agreement between Ukraine and the EU on textile products trade. It eliminated quantitative limitations on import of Ukrainian textile products into EU countries as of March 1, 2002.

There are also examples of cooperation between professional associations and government agencies. For instance, the Ukrainian Association of Light Industry Enterprises signed a memorandum of cooperation with the State Customs Service to overcome shadow mechanisms in light industry goods import and to create a reliable barriers against illegal import.

CONCLUSIONS

1. Questionnaires indicate that regardless of their size and import orientation, enterprises tend to think that the main barriers to export are external, not internal.

2. The main barriers to export are:

- inspections by regulatory organizations;
- registration and re-registration;
- procedures for obtaining permits/licenses;
- export procedures;
- certification and standardization.

3. Internal issues (such as outdated and outmoded equipment, lack of production facilities and problems with contracting professional designers) usually occupy second place after external problems.

4. As for the changes to export permit procedures, questionnaires show that most companies see no significant changes in the situation (67%). Other opinions split equally. Some 17% think it has become simpler to get export permission, while 16% think the situation is just the opposite.

5. Government agencies and industrial associations understand the importance boosting the clothing sector's export potential. This is witnessed to by the 2002 agreement between EU and Ukraine on eliminating limitations on Ukrainian textile product import to European markets; and by the memorandum of cooperation between the Ukrainian Association of Light Industry Enterprises and the State Customs Service on combating shadow import.

6. Tax policy regarding operations and investment in the sector decreases profitability and impedes renovation of equipment.

SECTION 10. BUSINESS ASSOCIATIONS

PARTICIPATION OF SECTOR ENTERPRISES IN BUSINESS UNIONS AND ASSOCIATIONS

International experience shows that when manufacturers unite, prospects improve.

system of support for national manufacturers and exporters is poorly organized.

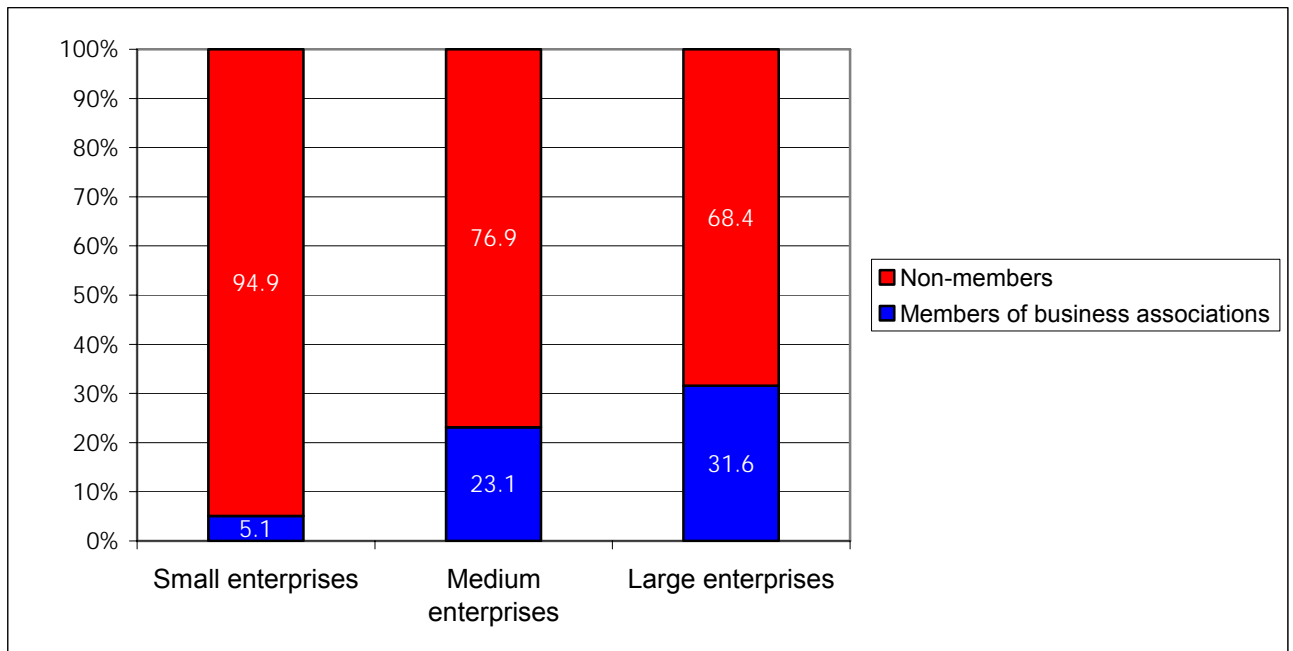
In Ukraine, the tendency toward association is weak, which is another sign that the national

That main active associations in Ukraine are the following:

TABLE 10.1. BUSINESS ASSOCIATIONS IN UKRAINE

Organization name	Territory	Organizational form	Number of members	Mission and goal
Ukrlegprom - Ukrainian Association of Light Industry Enterprises	Ukraine	Government association	31 enterprises	Protection and lobbying of manufacturers' interests on the government level Fighting unfair quotas Lobbying Ukraine's interests when Ukraine joins the WTO. Participating in preparation of draft laws
National Leather-Shoes Union of Ukraine	Ukraine	National union	Kyiv – 10	Providiung assistance to manufacturers
Textile-Contact Association	Ukraine	Trade and production concern	11 enterprises	Developing new directions and investments in light industry

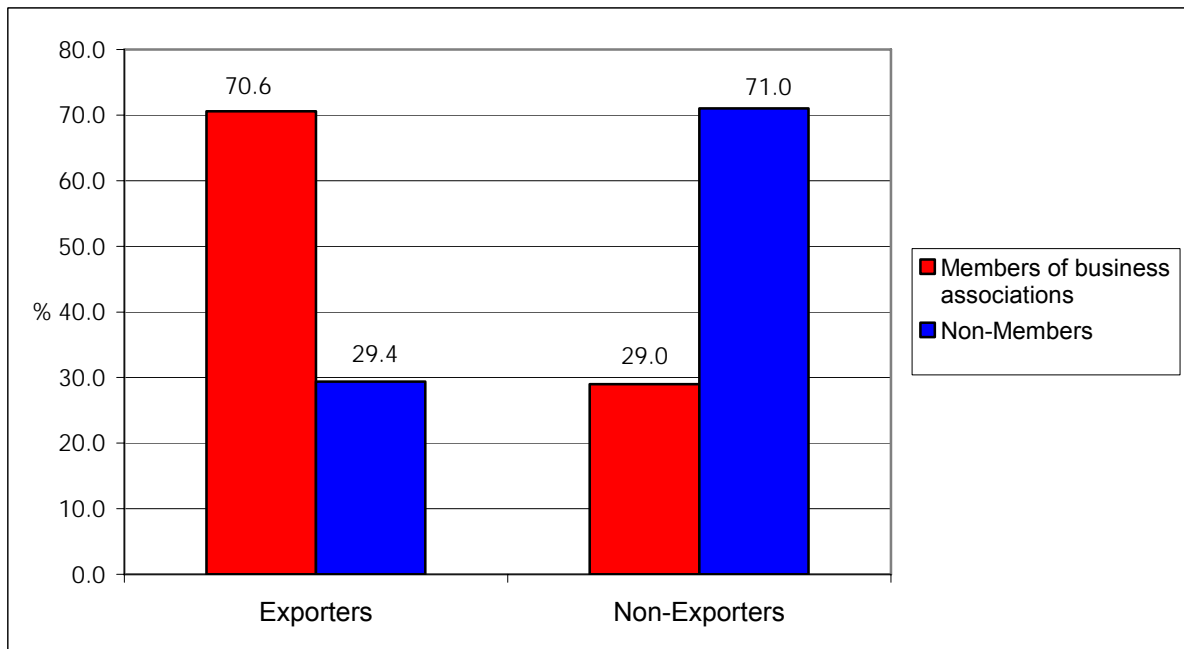
DIAGRAM 10.1. DYNAMICS OF PARTICIPATION IN BUSINESS ASSOCIATIONS, BY COMPANY SIZE, %



One-third of all associated companies are large businesses, which may be because large businesses tend to establish associations, to

prevent other players from entering the market. Another important factor is membership fees, which smaller businesses might not want to pay.

DIAGRAM 10.2. RELATIONSHIP BETWEEN LIGHT INDUSTRY PRODUCTS EXPORT AND BUSINESS ASSOCIATION MEMBERSHIP, %



The highest percentage of members of business associations is observed among light industry exporters (70.6%). The opposite tendency is observed among the non-members - 68% of them are non-exporters. This witnesses the fact that there is a tendency for joining business associations among exporters and that the existing business associations do not provide

adequate attitude to non-exporters and do not lobby their interests. It is also possible that non-exporters don't want to join business associations for some other reasons. At the same time, experts note that existing business associations do not correspond to their direct purpose. Deputy Director of the Department in charge of development of light, furniture and

woodworking industry of the Ministry of Industrial Policy of Ukraine Yuri Cherniy noted that activities of business associations in light industry do not comply with the provisions of their Articles of Association. Expert notes that sometimes associations lobby decisions that are beneficial for

a certain group of influential persons, which often causes problems to other enterprises. Therefore, existing business associations do not create unity among the sector's enterprises the way they should do it.

CONCLUSIONS

1. There are three major business associations in Ukraine capable of influencing the activities of the sector's companies.

This is state association Ukrlegprom, National Leather-Shoes Association of Ukraine and trade and production concern Textile-Contact.

2. Most of the enterprises of the sector, regardless of their size, are not members of business associations.

3. Most of the members of associations are exporters. There are much less members of business associations among non-exporters.

4. Experts note that business associations do not fully comply with their declared purpose.

ANNEXES

REGRESSION ANALYSIS OF FACTORS INFLUENCING PROFITABILITY

METHODOLOGY AND DATA

Data generated by interviewing the sector's enterprises was used as the basis for our model. The data relates to the following groups: resources, sales channels, new developments

and industrial samples, the regulatory environment and basic information on companies. Several variables from the 2005 questionnaire that could explain changes in profitability were included in each group.

TABLE 1. DESCRIPTION OF DATA

Change	Number of observations	Average	Stat. deviation	Min. value	Max. value
Change of profitability, %	123	3.96764	22.4605	-60	100
Labor productivity increase, yes/no	123	0.422764	0.496019	0	1
Investment into construction, yes/no	123	0.154472	0.362878	0	1
Investment into equipment, yes/no	123	0.349594	0.478792	0	1
Export, % of sales	123	20.93496	37.62536	0	100
Saving energy resources, yes/no	123	0.593496	0.49319	0	1
Competitive environment, yes/no	123	0.601626	0.491566	0	1
Innovations, yes/no	123	0.634146	0.483639	0	1
Difficulties with inspections, yes/no	123	0.292683	0.456855	0	1
Difficulties with registration, yes/no	123	0.186992	0.3915	0	1
Difficulties with permits, yes/no	123	0.154472	0.362878	0	1
Ability to lobby, yes/no	123	0.211382	0.409959	0	1
Unofficial payments, % of net profit	123	1.739837	6.360531	0	50
Changes in loading production facilities, %	116	4.258621	28.07107	-70	104
Change of product range, %	115	9.078261	21.07428	-60	115
Change of average salary, %	116	14.38793	21.55267	-24	125
Sales channels	123	55.0813	43.57481	0	100
Technologies purchased in 2003-2005, yes/no	123	0.186992	0.3915	0	1
Borrowing credit funds for investment, yes/no	123	0.089431	0.286532	0	1
Investment of own funds, yes/no	123	0.447155	0.499233	0	1
Share of energy carriers in overall cost, %	90	13.8	15.96288	1	90

Dependent variable

Change of profitability, %. Data was taken from question 11, where respondents were asked to indicate the percentage of their company's profitability change.

Independent variables

1) Increase in labor productivity, dichotomized variable taken from question 11. If labor productivity increased, the variable is assumed to be 1; if the productivity did not change or decreased, the variable is assumed to be 0. Percent variable was not used because

respondents were not advised about labor productivity.

2) Investments in construction. Dichotomized variable was taken directly from the questionnaire and assumed to be 1, if the enterprise invested in construction (question 25).

3) Investment in equipment. Dichotomized variable taken from the questionnaire is assumed to be 1, if the company invested into equipment (question 25).

4) Export, % of made products. This variable shows share of export in overall quantity of variable should increase profitability because export has a positive influence on sales, because a company opens new markets.

5) Energy resources savings. Dichotomized variable is taken from question 36 and is assumed to be 1, if the company made steps towards energy conservation. Affirmative answer was deemed to be either one of the first two options: "Yes, the enterprise works actively on this," and "Yes, something is being done" .

6) Competitive environment. Dichotomized variable, answers taken from question 53. The variable equals 1 if the respondents answered "High level" or "Very high level"

7) Innovations, dichotomized variable, based on question 55. Variable becomes 1 if the enterprise performed any innovations in 2003-2005.

8) "Difficulties" group, dichotomized variable, based on question 61. This variable is assumed to be 1 if the respondents graded problems as 3 points and higher. Only problems most typical for enterprises were taken into the model (based on question 60): difficulties with inspections, registrations or permits.

9) Ability to lobby. Dichotomized variable, based on question 67. This variable is 1 if the respondents answered yes to at least one question.

10) Unofficial payments. This variable is based on question 71; it shows what percent of annual net profit was spent on unofficial payments to different officials.

11) Change of production facilities load, %. This variable is based on question 11. It shows by what percent production facilities loading changed. This variable directly influences profitability.

12) Change in product range, %. This variable is based on question 11 and shows the percentage of change of the product range.

13) Change in average salary, %. This variable is based on question 11. It shows by what percent average salary changed.

14) Sales channel. This variable is based on question 42 and shows what percent of a company's products is sold via wholesale

production, in natural form (question 17). This

traders and via direct sales to end users (out of warehouses, individual orders, etc.). The sum of percentages for both questions was taken. It is expected that this would be a negative influence, because such channels presuppose lower sales prices.

15) Acquired technologies, 2003-2005. Dichotomized variable, based on question 56. It is assumed to be 1 if the company acquired new technologies in 2003-2005 for satisfaction of market needs. It is expected to have positive influence on profitability.

16) Borrowing credit funds for investment. Dichotomized variable, assumed as 1, if the company bought new equipment (local or imported) with credit funds. It is expected to have a negative impact on profitability because crediting is the most expensive type of financing. Unfortunately this variable covers only a certain part of investment, namely investment into equipment.

17) Investing own funds. Dichotomized variable, assumed to equal 1 if the company bought new equipment (local or imported) with own funds. It is expected to have a negative impact on profitability because crediting is the most expensive type of financing. Unfortunately, this variable covers only a certain part of investment, namely investment into equipment.

18) The share of energy carriers in product cost, %. This variable is taken as is, from question 35.

The OLS Model (least-squares method) and the logistic model for dichotomized dependent value were used for the regression. Regression was tested for heteroscedastic dependencies (not normally distributed excess), for multicollinearity (independent values correlate with each other) and for omitted variables. The testing revealed heteroscedastic properties (we made proper corrections) and the presence of omitted variables. Such omitted variables distort the derived coefficients. Unfortunately, the problem of omitted variables can be resolved only by adding new variables or by building panel ones, which is impossible in this selection. That is why, when considering the results, it is necessary to take into account the effect of omitted variables. Other problems associated with regressions composition include insufficient selection of enterprises and deficit of retrospective data. All this renders the end results not very reliable.

TABLE 2 LINEAR REGRESSION RESULTS (OLS)

Linear regression Number of obs = 85

F (20, 64) = 3.34

Prob > F = 0.0001

R-squared = 0.4703

Root MSE = 20.496

Change of profitability, %	Coef.	t	P> t
Labor productivity increase, yes/no	12.03439	2.17	0.034
Investment into construction, yes/no	3.609687	0.49	0.626
Investment into equipment, yes/no	11.29094	1.62	0.109
Export, % of sales	-0.19302	-2.22	0.03
Saving energy resources, yes/no	-2.82178	-0.7	0.489
Competitive environment, yes/no	-6.44292	-1.33	0.188
Innovations, yes/no	7.589359	1.19	0.237
Difficulties with inspections, yes/no	-2.66383	-0.55	0.583
Difficulties with registration, yes/no	6.973365	0.96	0.34
Difficulties with permits, yes/no	0.439829	0.07	0.947
Ability to lobby, yes/no	-1.8903	-0.36	0.718
Unofficial payments, % of net profit	0.448074	0.89	0.379
Changes in loading production facilities, %	0.433132	3.21	0.002
Change of product range, %	-0.11074	-0.75	0.454
Change of average salary, %	-0.10287	-0.73	0.466
Sales channels	-0.02009	-0.33	0.744
Technologies purchased in 2003-2005, yes/no	1.300929	0.22	0.83
Borrowing credit funds for investment, yes/no	-3.48782	-0.32	0.747
Investment of own funds, yes/no	-7.39277	-1.27	0.207
Share of energy carriers in overall cost, %	-0.18358	-1.94	0.057
Constant	7.847254	1.08	0.282

In addition to the OLS model, used to determine factors impacting the increase of profitability, a logistic model was used to find dependencies

between the same independent variable and the fact of profitability increase.

TABLE 3 LOGISTIC REGRESSION RESULTS

Change of profitability, %	dy/dx	z	P> z
Labor productivity increase, yes/no	0.311861	2.32	0.02
Investment into construction, yes/no	0.003595	0.02	0.988
Investment into equipment, yes/no	0.190717	-1.29	0.198
Export, % of sales	-0.00303	-0.79	0.427
Saving energy resources, yes/no	0.019692	0.15	0.878
Competitive environment, yes/no	0.188963	-1.14	0.255
Innovations, yes/no	0.016007	-0.09	0.931
Difficulties with inspections, yes/no	0.134727	0.56	0.578
Difficulties with registration, yes/no	0.052924	-0.28	0.779
Difficulties with permits, yes/no	0.166738	-1.51	0.132
Ability to lobby, yes/no	0.01712	1.42	0.155
Unofficial payments, % of net profit	0.000727	0.23	0.821
Changes in loading production facilities, %	0.00088	0.3	0.765
Change of product range, %	0.002611	-0.77	0.44
Change of average salary, %	0.000895	0.6	0.549
Sales channels	0.117098	0.56	0.573
Technologies purchased in 2003-2005, yes/no	0.093416	0.25	0.802
Borrowing credit funds for investment, yes/no	0.072301	0.4	0.689
Investment of own funds, yes/no	0.003703	0.81	0.42

SOURCES OF INFORMATION

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