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# Sector Diagnostics

# CONFECTIONS

**October 2006**

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## ADDITIONAL REFERENCES

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# **SECTOR DIAGNOSTICS**

# **CONFECTIONS**

**October 2006**

This report has been compiled based on a survey the findings of which may differ from the point of view of BIZPRO or the U.S. Agency for International Development (USAID).

Kiev 2006

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# RESULTS

## THE MARKET

The confections sector in Ukraine grew dynamically in 2000-2004. By 2004, a certain level of market structure had been achieved: leading companies had founded holdings and corporations, gained customer loyalty in their market segments, established proper supply networks both in domestic and global markets, invested in new equipment, increased their focus on quality and product variety, strengthened old brands, and brought innovative products and new trademarks into the market. Most of the changes that took place in the confections sector were due to both domestic and foreign investment.

The confections sector is composed of several major segments, specifically: sugar-based confectionery goods without cocoa powder, baked (flour-based) confections, chocolate, chocolate goods, and products containing cocoa. Each of the aforementioned segments had their own dynamics measured in both monetary and physical units. In general, according to the State Statistics Committee of Ukraine, Ukrainian confectionaries produced 968 thousand tons of products worth 3,876.7 million UAH in 2004 (nondurable confections were not included in this statistic). The largest shares of production volume of the confections sector were held by the flour-based confections segment (in physical terms) and the segment of chocolate and chocolate goods (in monetary terms).

During the 2000-2004 period, a rise in production was observed for flour-based goods (particularly for cookies) and chocolate products (candies and chocolate bars), which coincided with a decrease of sugar-based goods (hard candy) production.

There were up to 833 enterprises working in the confections sector at the time of the survey; for 472 of these, the confectionery industry was their primary activity. Most of the enterprises that listed confections as their secondary production activity were involved in flour-based confections production.

In 2004, sales volumes of sector enterprises comprised 13,215 million UAH; sales have been growing sharply since 2002.

The share of exports in the confectionery goods sector was 23 percent that year, or 309 thousand tons (336 million USD). The majority of Ukrainian exports were products containing cocoa (53 percent), 22 percent of exports were flour-based confections, and 25 percent were sugar-based confectionery goods.

Confection imports into Ukraine are comparatively low. In 2004, the volume of cocoa and chocolate items imported to Ukraine totaled 131 thousand tons worth 180 million USD.

## PRODUCTION

Both the production structures and majority of equipment of Ukrainian enterprises are leftovers from the Soviet era. Leading market players act as universal producers; i.e., they manufacture products of various commodity groups for various market segments. Enterprises develop production plans, but a distinct feature of this sector is sensitivity to changes in patterns of demand and export activity.

As a rule, company development and changes in production patterns are observed among larger enterprises. Leading enterprises in the market – such as Roshen, AVK, Kyiv-Konti, Svitoch, and Kraft Foods Ukraine – are implementing new management techniques and technological developments. They renew their equipment, buy

new technologies, and develop their own innovative products more often than small and medium-sized producers do. Nevertheless, when making an overall assessment of the confections sector, it should be noted that the share of those enterprises that upgraded their production was relatively small (approximately one-fourth of the enterprises surveyed had managed to improve candy production in all of their plants).

The majority of new equipment purchased by enterprises in order to upgrade their manufacturing techniques was from Ukraine.

The political and economic situation in Ukraine forced enterprises to purchase equipment at their own expense (credit and rent-to-own plans were considered unattractive by entrepreneurs).

## RAW MATERIALS AND ENERGY RESOURCES

Both local (flour, sugar, and milk) and imported (cocoa, nuts, and tropical and confectionery oils) raw materials are used in confections production.

Characteristic features of the raw materials market for confections include ongoing declines in the quality of domestic products, inconsistent supplies, and seasonal price fluctuations. A high level of dependency on imported raw materials was reported; since prices for imported products have been rising, producers have been forced to charge higher prices for their products.

As in any other industry, the confections sector depends on energy resources. Electricity is the major energy source in the confections sector. The share of energy in the total cost of production was up to 20 percent during the surveyed period (depending on the company's size and types of goods produced).

Most of the surveyed enterprises were actively looking for ways to save energy, mostly by introducing energy-saving technologies and replacing aging equipment with new machinery.

## SALES

The main sales channels used by confections enterprises were their own retail networks (the majority consisted of small businesses) and

wholesale traders (mostly medium-sized and large enterprises chose this option).

## COMPETITION

Experts reported strong competition in the Ukrainian confections market due to the following factors:

- the (previously intensive) growth of the number of enterprises has slowed considerably;
- creation of a market structure and specializations;
- major market operators were making efforts to boost the quality and variety of their products;
- development and improvement of equipment and technologies;
- product brand development;
- development of the expensive price segment; and

- use of new marketing techniques and aggressive advertising methods.

The main players in the market (with a combined share of 50 percent) are Roshen, AVK, and Kiev-Konti. It should be noted that every sub-segment has its own leaders.

Industry experts pointed to "shadow" production and sales by small businesses (mainly involved in baked confectionery goods) as a common phenomenon. The existence of the shadow sector did not influence the activities of major market players. However, its existence is explained by the state's inability to enforce quality control standards, proper use of raw materials with differing levels of quality (flour, for example), and sales networks. Twenty-two percent of the surveyed enterprises businesses stated that they had not applied for certification of their products.

## FINANCE

The typical confectionery enterprise has the following components in its cost structure: raw materials (the most expensive), energy, packing, logistics, marketing, and equipment amortization; labor costs do not yet compose a large share of the total production cost.

According to the industry experts, the average level of profitability in the confections sector was 10-15 percent. Fifty-one percent of the surveyed CEOs claimed that their enterprise was profitable, thirty-seven percent broke even, and only 12 percent reported suffering losses.

## EXPORTS

Based on the survey results, 21 percent of confectionery businesses exported products to foreign markets. These were mostly the CIS countries (95 percent of the exporters worked in the markets of the former Soviet states) and Europe (57 percent of exporters).

Ukrainian producers most often supply the same products to foreign markets as they do to the

domestic market (only 35 percent made adaptations to existing products or produced specialized products for export purposes). Enterprises mostly used local raw materials, and only used imported raw materials for chocolate products.

Enterprise managers identified tough competition in foreign markets as the main obstacle to increasing their export volumes.

**DEVELOPMENT**

According to confection industry executives, over 60 percent of producers have obtained all necessary certificates and standardized their products. Small enterprises comprised the smallest share of this group.

International certification was not in the process of becoming more common; most of the surveyed enterprises were not even making plans to certify their products according to international standards.

Most companies used their own funds for enterprise development; the majority of this investment was used to purchase new equipment.

Foreign investment was rare; according to the surveyed enterprise CEOs, this was either because they had enough of their own resources or because investors' requirements were too demanding.

**THE REGULATORY ENVIRONMENT**

Government authorities frequently conducted inspections of confectionery enterprises, a practice that disrupted business operations to such an extent that it discouraged the sector's development.

Permit issuance, registration and re-registration, and certification and standardization procedures were the most common reasons for entrepreneurs to be in contact with state authorities.

A low level of collaboration between enterprises and the authorities at different levels of

government was identified as an issue that needed to be resolved in order to improve the regulatory environment.

The problem of illegal payments to officials continued to exist throughout the studied period. Entrepreneurs cited the push to speed up completion of procedures and eliminate barriers to registration as factors that pushed them to bribe officials.

**BUSINESS ASSOCIATIONS**

Confectionery enterprises were rather passive in terms of taking part in business associations. Larger enterprises were much more active than small and medium-sized businesses in this sense.

Of those confectionery companies that were members of business associations, the majority

were members of sector-specific organizations and national-level (less often oblast-level) associations.

Participation in international business associations was more the exception than the rule among Ukrainian confectionery enterprises.

# METHODOLOGY

## THE GOAL OF THE SURVEY

To study the current state and development of the confections sector. This study includes market analysis of chocolate, hard candy, and pastry production.

## OBJECTIVES

This survey intends to:

- analyze the status and dynamics of the confections sector both as an overall market and according to key indicators (including production volumes, imports, exports, and investment);
- describe the structure of production and the level of technical development among sector enterprises, and problems related to and enterprise plans for implementing product standardization and certification;
- describe levels and structures of raw materials supplies to sector enterprises and evaluate the efficiency of energy usage;
- present market leaders and define specifics of the competitive environment;
- describe the financial standing of enterprises in this sector and analyze the average profitability (profit margin) of production by market segment;
- present foreign economic activities of sector enterprises, accomplishments and impediments in the process of entering foreign markets, and predictions regarding Ukraine's potential accession to the WTO, EU, and Common Economic Space (CES);
- describe the regulatory environment for businesses, highlighting problems and ongoing changes; and
- identify levels of enterprise involvement in civic activities, the extent of enterprise membership in business associations, and areas where corruption is common.

## STRUCTURE AND SOURCES OF THE STUDY

This analytical report consists of 10 sections. The study used two types of data:

1. Primary data from a survey of 102 CEOs of confection-producing enterprises of various sizes.

Interviews were also conducted with industry experts (including top managers of large national-level companies and reporters writing for sector publications) in order to confirm information obtained from secondary sources and find answers to some controversial questions.

2. Secondary sources, for example: official statistics for 2000-2004 provided by the State Statistics Committee of Ukraine and the State Customs Service of Ukraine.

The study also used information from other secondary sources that included sector publications, reports by Ukrainian and international analytical centers, and business associations. Secondary data was selected, analyzed, and used in different sections of this report.

## THE SURVEY

**Term:** The all-Ukrainian "Sector Diagnostics" survey was conducted in April 2006.

**Goal of the survey:** To examine internal and external barriers to enterprise operations in the confections sector.

**Survey method:** Face-to-face structured interviews.

**Questionnaire:** This consisted of 11 sections.

Section A. Basic company data

Section B. Exports

Section C. Investment

Section D. Raw materials and other resources

Section E. Sales

Section F. Foreign economic policy

Section G. Standardization and certification

Section H. Competition

Section I. New designs and industrial models

Section J. The regulatory environment

Section K. Levels of enterprise civic involvement

**Respondents:** Top management personnel (CEOs) of confection-producing enterprises of all sizes.

**Sample:** The sample consisted of 102 businesses. Forty-six were small, 29 were medium-sized, and 27 were large. Most of these (81 enterprises) were located in Ukraine's regional capitals.

Participants in the survey were directors and chief accountants of small, medium-sized, and large businesses.

#### **LIST OF TERMS AND ABBREVIATIONS**

WTO: World Trade Organization

EU: European Union

CES: Common Economic Space

CIS: Commonwealth of Independent States

KVED: Economic Activities Classification

UKTZED: Ukrainian Classification of Trade and Foreign Economic Activity. Used by the State

Statistics Committee and State Customs Service of Ukraine.

NPP: Industrial Nomenclature of Goods

SKP: Statistical Classification of Products (used by the State Statistics Committee of Ukraine since January 2004).

ISO: International Organization for Standardization. A union of 156 national standardization institutes with a central secretariat in Geneva. The ISO 9000 set of international standards is applied under Quality Management Systems.

Small enterprise: A business with 1 to 50 employees.

Medium-sized enterprise: A business with 51 to 250 employees.

Large enterprise: A business with more than 250 employees.

# SECTION 1. THE MARKET

## THE STATUS OF THE CONFECTIONS MARKET

Rich domestic sources of raw materials, flour, and sugar prompted the emergence and growth of a strong confections industry in Ukraine in the 20th century.

In the early 1990s, the 200 confections enterprises operating in Ukraine produced 1,111,300 tons of output.

The economic downturn that followed the collapse of the Soviet Union negatively affected the confections industry. A huge wave of imports and growing consumer demand for foreign sweets also contributed to a fall in production. Large enterprises focusing on improvement of product quality and expanding their product ranges by gradually abandoning traditional production methods. This spurred the emergence of a plethora of small businesses in the confections sector.

Positive trends were observed in the confections sector since 1997 (following a decline between 1991 and 1996). Until 2000, annual growth of production in the sector was 23 percent. According to the State Statistics Committee's estimates, the industry contributed 3 percent to the country's GDP.

The expansion and increase in production volumes within the Ukrainian confections sector were caused by several factors:

- restructuring of ownership and consolidation of capital in the confectionery industry;
- significant foreign and domestic investment;

- expansion of companies' product ranges;
- aggressive marketing policies; and
- use of modern packaging materials and new equipment.

Today, the Ukrainian confections market is comparable to that of any other European country in terms of the quantity and quality of available goods. Confectionery goods include up to 1,000 different products, and domestically produced goods account for 90 percent of the Ukrainian confectionery market.

According to the industry experts, the confections market in Ukraine has a number of distinctive features, particularly:

- the confections market is raw materials-intensive, with the cost of raw materials representing the lion's share of the total cost of production;
- the seasonality of raw materials causes fluctuations of prices for sugar, flour, and cocoa beans over the course of the year; and
- dependence of production on seasonal changes manifests itself in the following ways: demand for confectionery products tends to grow in autumn and winter, and production volumes grow during that time as well.

**TABLE 1.1. CONFECTIONERY PRODUCTS BY KVED CODES**

KVED code	Description
15.82	Production of dried bread, biscuits, pies, and pastries with long shelf lives
15.89.9	Production of other confectionery food products
15.84	Production of cocoa products and chocolate

Source: State Statistics Committee of Ukraine.

The following classifications of statistical data were used to analyze the structure of the confections market and break it into segments: codes of the Ukrainian Classification of Trade and Foreign Economic Activity (UKTZED), local codes of the State Statistics Committee of Ukraine (NOM), Statistical Classification of Products (SKP)

codes, and codes according to types of economic activity (KVED).

Table 1.1 (shown above) presents major segments of confections sector by type of economic activity (KVED codes).

Until December 31, 2003, local codes of the State commodity classifications (Table 1.2).  
Statistics Committee of Ukraine were applied to

**TABLE 1.2. CLASSIFICATION OF CONFECTIONERY PRODUCTS BY LOCAL CODES (NOM) OF THE STATE STATISTICS COMMITTEE OF UKRAINE**

<b>NOM code</b>	<b>Description</b>
853000	Confectionery goods
854100	Sugar-based confectionery goods
854105	Hard candy/caramel
854106	Chocolate-glazed hard candy
854113	Dragée (drops)
854122	Soft chocolate-glazed candies
854124	"Assorted" candies
854126	Soft candies without chocolate glaze
854132	Chocolate and chocolate products
854142	Cocoa powder (commodity form)
854152	Toffee
854157	Halvah
854162	Jelly and lozenges
854170	Chocolate beverages
854175	Sweet bars on hardened vegetable oils
854195	Turkish delight and other sugar-based goods
854200	Flour-based confectionery
854212	Biscuits
854225	Low-fat, low-sugar dry biscuits ( <i>zatyazhnoe</i> in Ukrainian)
854231	Hard biscuits and crackers
854235	Cakes and pastries
854236	Muffins and Swiss rolls
854237	Wafers
854242	Gingerbread
854255	Turkish delight and other flour-based confectionery goods
854260	Flour-based goods with lower contents of sugar (share of total flour-based goods production)
854302	Wrapped confectionery goods (share of total confections production)
854306	Pre-packaged confectionery goods
854312	Confectionery goods in boxes
854321	Diet confectionery goods (share of total confections production)
854332	Confectionery goods for diabetics
854350	Chewing gum

Source: State Statistics Committee of Ukraine.

As of January 2004, the industry's nomenclature of goods was changed and a new Statistical

Classification of Products (SKP) was introduced (See Table 1.3).

**TABLE 1.3. CLASSIFICATION OF CONFECTIONERY PRODUCTS BY SKP CODES**

<b>SKP code</b>	<b>Description</b>
15.81.12.010	Cakes
15.81.12.020	Pastries
15.81.12.030	Sweet buns
15.81.12.040	Pies, turnovers, doughnuts
15.81.12.090	Eastern flour-based sweets
15.82.11	Bread with hard crusts, dried bread, toast bread, and similar crunchy products
15.82.11.300	Bread with hard crusts
15.82.11.500	Dried bread, toast, etc.
15.82.11.510	Bread crumbs
15.82.11.700	Bagel-like products with added sweeteners
15.82.12	Gingerbread and similar products; sweet biscuits; wafers
15.82.12.300	Gingerbread and similar products
15.82.12.301	Gingerbread
15.82.12.302	Fruit cakes

SKP code	Description
15.82.12.303	Swiss rolls
15.82.12.304	Rum cake
15.82.12.500	Sweet biscuits and wafers
15.82.12.530	Fully or partially chocolate-covered sweet biscuits and wafers
15.82.12.550	Sweet biscuits without any chocolate coating
15.82.12.551	Sweet biscuits
15.82.12.552	Soft biscuits
15.82.12.553	Flaky biscuits
15.82.12.559	Other biscuits
15.82.12.590	Wafers without any chocolate coatings
15.82.13.100	Non-fermented bread
15.82.13.200	Wafer sheets, waffle cones and cups, rice paper, bread products for religious ceremonies, etc.
15.82.13.300	Wafers with moisture contents of over 10%
15.82.13.400	Dry biscuits (hard biscuits and crackers)
15.82.13.500	Leavened bread (spicy or salty)
15.82.13.900	Bread products without sweeteners
15.82.13.910	Bagel-like goods, excluding pretzel sticks and bread sticks
15.82.13.990	Other bread products without sweeteners
15.84.1	Cocoa
15.84.11.000	Cocoa paste without sugar or sweetening substances
15.84.12.000	Cocoa butter, cocoa-based oil
15.84.13.000	Cocoa powder without sugar or other sweetening substances
15.84.14.000	Cocoa powder with sugar or other sweetening substances
15.84.21	Chocolate and other ready-made food products containing cocoa, packaged, weighing over 2 kg
15.84.22	Chocolate and other ready-made food products containing cocoa, in bricks, sheets, or bars
15.84.22.300	Chocolate and similar products, with or without filling
15.84.22.330	Chocolate and similar products with filling
15.84.22.350	Chocolate and similar products without filling, with addition of cereal grains, fruit, or nuts
15.84.22.390	Chocolate and similar products without filling
15.84.22.400	Chocolate
15.84.22.430	Chocolates containing alcohol
15.84.22.450	Other chocolates
15.84.22.500	Other chocolate goods
15.84.22.530	Other chocolate goods with filling
15.84.22.550	Other chocolate goods without filling
15.84.22.600	Confectionery goods covered with sugar or artificial sweeteners, containing cocoa
15.84.22.700	Paste-like products containing cocoa
15.84.22.800	Products containing cocoa for preparing drinks
15.84.22.900	Other products containing cocoa
15.84.23	Confectionery product made of sugar, including white chocolate, without cocoa
15.84.23.100	Chewing gum, covered with sugar or not
15.84.23.300	White chocolate
15.84.23.500	Confectionery goods in paste form including marzipan, packaged, weighing over 1 kg; throat lozenges and cough drops made of sugar and both natural and artificial flavoring components
15.84.23.600	Sugar-covered goods; confectionery goods made from jelly
15.84.23.630	Sugar-covered goods; "sugar-coated sweets," including sugar-covered almonds
15.84.23.650	Confectionery goods in the form of jelly, including fruit lozenges
15.84.23.700	Hard candy, caramel, toffee, etc.
15.84.23.730	Hard candy, with or without filling
15.84.23.731	Toffee
15.84.23.732	Fudge candies
15.84.23.750	Hard candy, toffee, etc.
15.84.23.800	Dragée

SKP code	Description
15.84.23.900	Other sugar-based confectionery goods
15.84.23.901	Halva
15.84.23.902	Lakoum
15.84.23.903	Turkish delight
15.84.23.909	Sugar-based confectionery goods

Source: State Statistics Committee of Ukraine.

Table 1.4 presents the classification of confectionery goods according to UKTZED codes used by the State Statistics Committee and State Customs Service of Ukraine.

**TABLE 1.4. CLASSIFICATION OF CONFECTIONERY PRODUCTS BY UKTZED CODES**

UKTZED code	Description
1704000000	Sugar-based confectionery goods (including white chocolate) without cocoa
1704100000	- Chewing gum, with or without hard coatings
1704900000	- Other, including:
1704901000	- - Licorice extracts with no less than 10% sucrose and no other substances added
1704903000	- - White chocolate
1704905100	- - - Pastes including marzipan, in original packaging, with net weights of 1 kg or more
1704905500	- - - Throat lozenges or cough drops
1704906100	- - - Dragée and similar sweets in the form of dragée
1704906500	- - - - Confectionery goods in the form of chewing gum and jellies, including fruit paste (marmalade) in the form of sugar-based confectionery products
1704907100	- - - - Hard candy, with or without filling
1704907500	- - - - Hard candy, including:
1704908100	- - - - - Hard candy produced as a result of compression (in pill form)
1704909900	- - - - - Other
1905000000	Various bread products and confectionery goods, containing cocoa or not: wafer sheets, empty capsules suitable for use in pharmaceutical manufacturing, waffle cones and cups, pre-prepared sheets of dough. This category includes:
1905100000	- Bread crisps
1905200000	- Gingerbread
1905300000	- Sweet dry biscuits; wafers and waffle cones
1905400000	- Dried bread, toast, etc.
1905900000	- Other

Source: State Statistics Committee of Ukraine.

A classification based on definitions of the largest segments (Table 1.5) is most commonly used for sector market analysis.

The State Statistics Committee of Ukraine uses this segmentation to present statistical information in external publications.

**TABLE 1.5. CLASSIFICATION OF CONFECTIONERY PRODUCTS BY SEGMENTS**

<b>Sugar-based confectionery goods</b>
- dragée
- fruit hard candy (including chocolate-glazed)
- milk and cream hard candy (including chocolate-glazed)
- toffee
- Turkish delight
<b>Flour-based confectionery goods</b>
- biscuits
- wafers
- gingerbread
- crackers
- Swiss rolls and sponge cakes
- pastries
- cakes

**Chocolate and chocolate goods**

- chocolate in bricks, sheets, or bars
- sculpted chocolate
- chocolates
- chocolate bars

All of the aforementioned classifications will be referred to further in this report as needed. Since the codes were changed in 2004, information in this report may be presented in two formats in

order to achieve the highest possible accuracy of statistical data: in terms of the confections sector in general, and by segments in the years 2000-2003 and 2004.

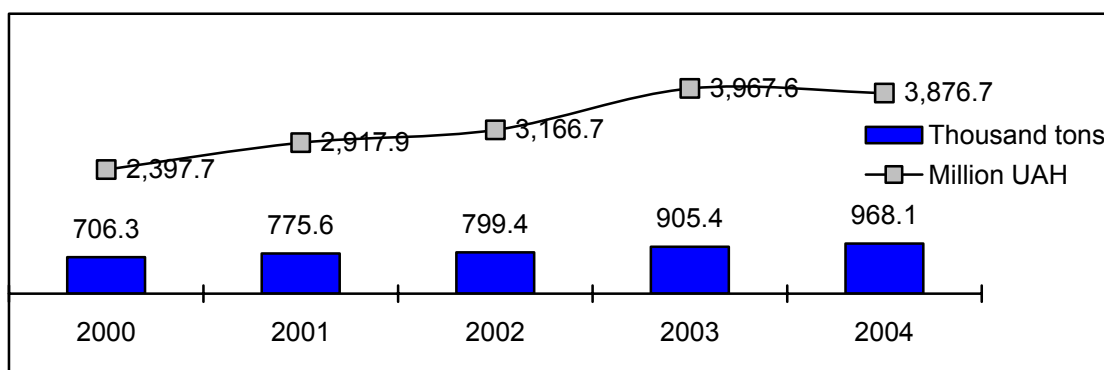
**PRODUCTION**

According to the State Statistics Committee (using KVED codes and excluding confectionery goods with short shelf lives), confectionery production volumes in Ukraine reached 968.1 thousand tons in 2004, a figure that was 6.9 percent more in physical terms and 2.3 percent less in monetary terms than the previous year's figures.

in physical terms and by 25.3 percent in monetary terms; see Chart 1.1). The new State Statistics Committee classifications were used to calculate confectionery production volumes for 2004; thus, product groups may differ from the previous years, changing the overall volume of the segment as a result.

Compared to 2000, confectionery production volumes grew by 9.8 percent in 2001, by 13.2 percent in 2002, and by 28.2 percent in 2003. The highest growth was observed in 2003 (compared to 2002, production volumes grew by 13.3 percent

In the opinion of industry experts, further growth of the Ukrainian confectionery market is still likely since the expensive price segment and Swiss sponge rolls segment still appear to be underdeveloped.

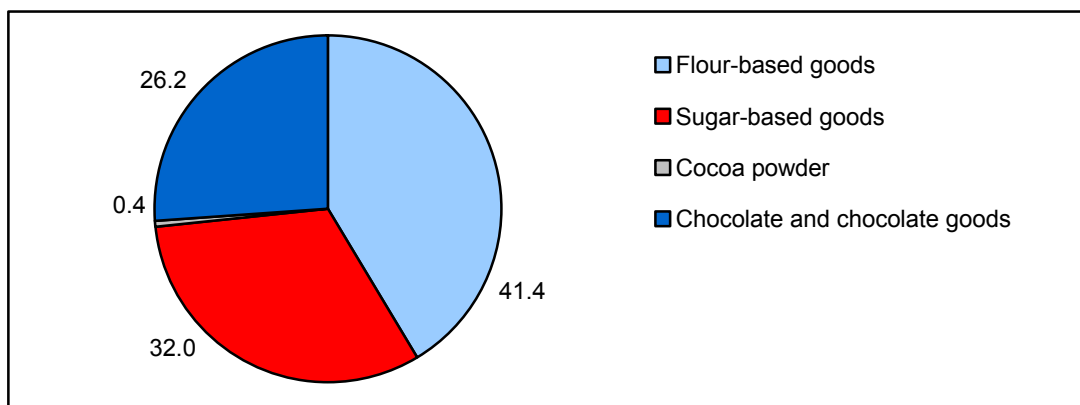
**CHART 1.1. CONFECTIONERY PRODUCTION VOLUMES, 2000-2004**

Source: State Statistics Committee of Ukraine.

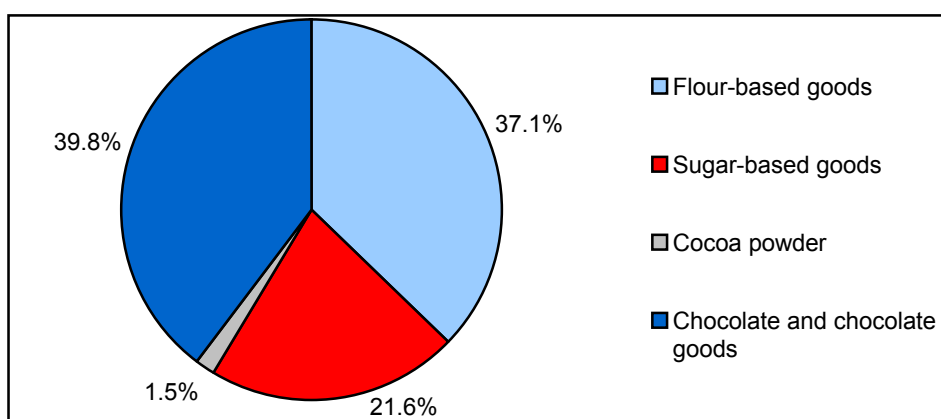
**PRODUCTION VOLUMES BY SEGMENTS**

SKP codes categorized this sector's products in four major segments, in particular: 1) baked (flour-based) confectionery goods (cookies, hard biscuits and crackers, wafers, and gingerbread), accounting for 41.4 percent of overall sector output); 2) sugar-based confectionery goods (hard candy, dragée, sweets not containing cocoa, and Turkish delight) comprising 32.0 percent; 3)

chocolate goods, comprising 26.2 percent; and 4) cocoa powder, accounting for 0.4 percent (Chart 1.2). In monetary terms, the largest share (39.8 percent) belonged to chocolate goods, flour-based goods accounted for 37.1 percent, and sugar-based goods generated 21.6 percent of the sector's revenue (Chart 1.3).

**CHART 1.2. SHARES OF CONFECTIONS SECTOR SEGMENTS IN PHYSICAL TERMS, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

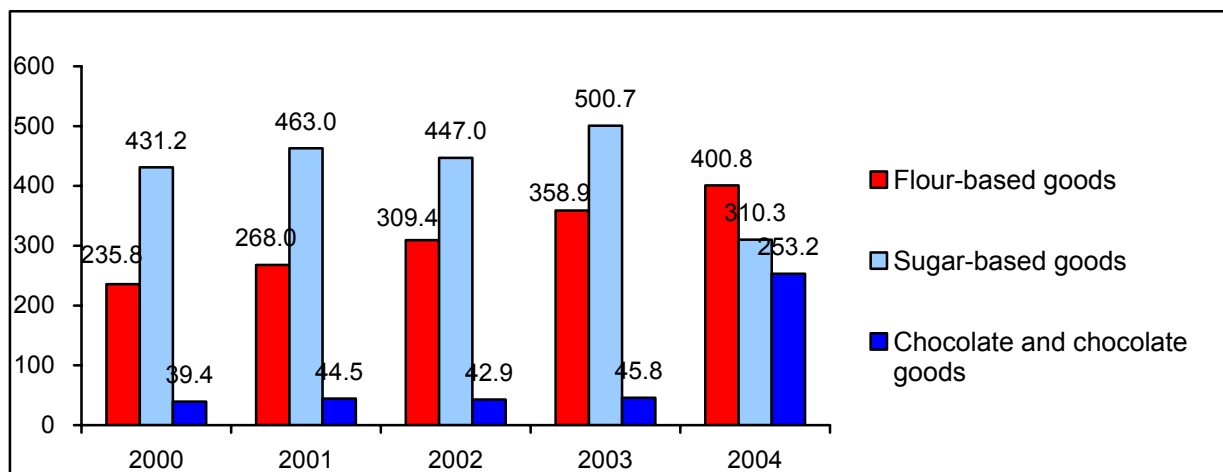
**CHART 1.3. SHARES OF CONFECTIONS SECTOR SEGMENTS IN MONETARY TERMS, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

During the surveyed period, a rise in production was observed in the flour-based and chocolate product segments. The expansion of these segments was offset by instability and a decrease in production within the sugar-based goods segment (a drop of 30.8 percent in 2004; see Chart 1.4). Chocolate production grew by 5.5 times compared to 2003, and output of flour-based goods increased by 11.7 percent.

Changes in the production structure for specific products were caused by the following:

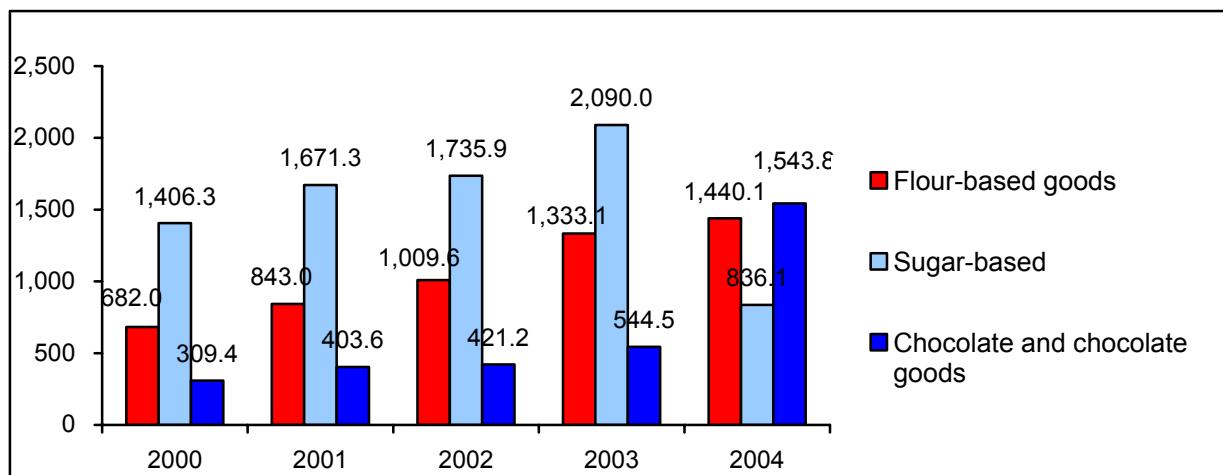
- lower exports of hard candy to Russia (the largest export market for Ukrainian confectioners) resulting from introduction of a special Customs duty by the Russian government that made imports of hard candy to Russia economically unsound;
- growing imports of chocolate goods that made domestic producers struggle to attract Ukrainian consumers, particularly those in the expensive price segment; and
- growth of production volumes in the segment of flour-based goods (the simplest and cheapest in terms of production costs) due to the fact that they could be produced by both large bread factories and small bakeries.

**CHART 1.4. CONFECTIONERY PRODUCTION VOLUMES BY SEGMENTS, 2000-2004 (THOUSAND TONS)**

Source: State Statistics Committee of Ukraine.

Volumes of flour-based goods and chocolate products also grew in monetary terms in the period between 2000 and 2003. The analysis for 2004 also included flour-based goods with short shelf lives (particularly cakes and pastries). This explains a noticeable decrease in production volumes of flour-based goods both in physical and monetary terms.

Production volumes of chocolate and chocolate goods in monetary terms increased by 2.8 times in 2004 compared to 2003 (Chart 1.5). In monetary terms, the volume of sugar-based goods produced in 2004 was 2.5 times smaller than in the previous year.

**CHART 1.5. CONFECTIONERY PRODUCTION VOLUMES BY SEGMENTS, 2000-2004 (MILLION UAH)**

Source: State Statistics Committee of Ukraine.

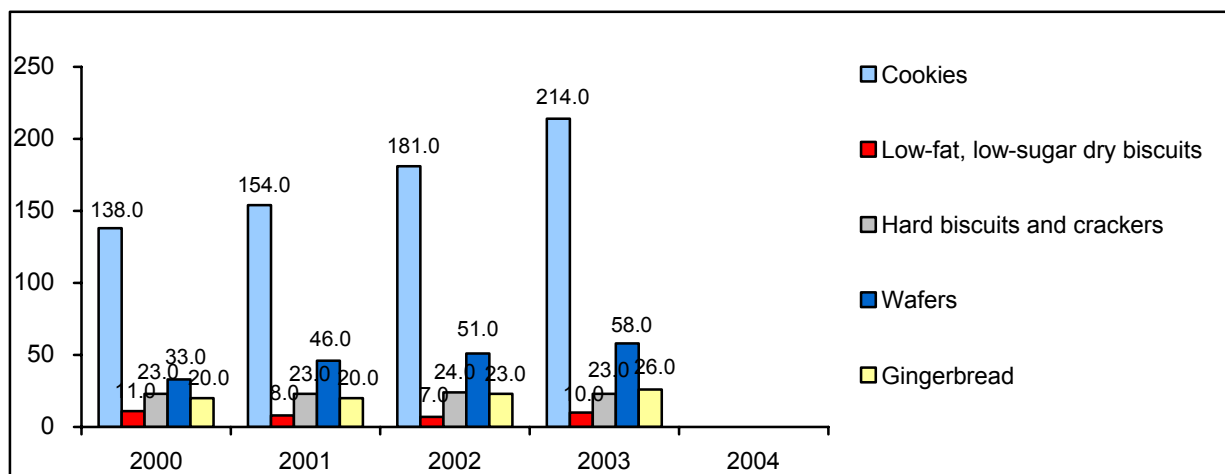
Charts 1.6.-1.11 present changes in production of confectionery goods by commodity groups in the largest segments of the sector. As statistical monitoring of production volumes has been performed since January 2004 according to the new Industrial Nomenclature of Goods (NPP) – a system harmonized with KVED, UKTZED, and other international product classifications – analyses and evaluations of data for different periods may contain significant errors.

The main variation between the NPP system and the old product nomenclature according to local

codes is in terms of product descriptions, because similar product titles can have entirely different definitions under these two systems.

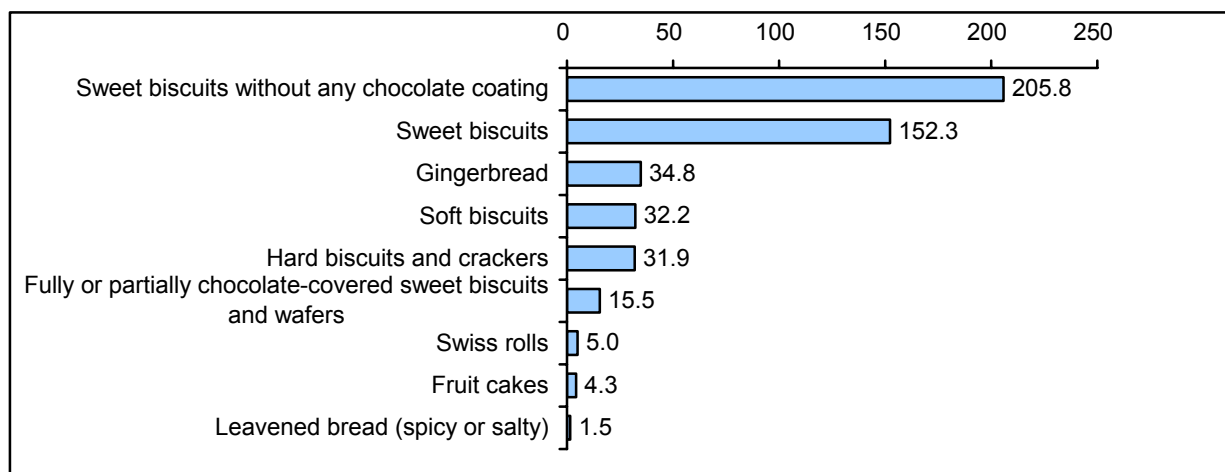
Production volumes of flour-based confectionery goods grew in the period between 2000 and 2003. Biscuits led the segment of flour-based products in terms of production volumes during this time. In 2004 (Chart 1.7), biscuits retained their leading position among flour-based confectionery goods.

**CHART 1.6. FLOUR-BASED CONFECTIONERY PRODUCTION VOLUMES BY COMMODITY GROUPS, 2000-2003 (THOUSAND TONS)**



Source: State Statistics Committee of Ukraine.

**CHART 1.7. FLOUR-BASED CONFECTIONERY PRODUCTION VOLUMES BY COMMODITY GROUPS, 2004 (THOUSAND TONS)**

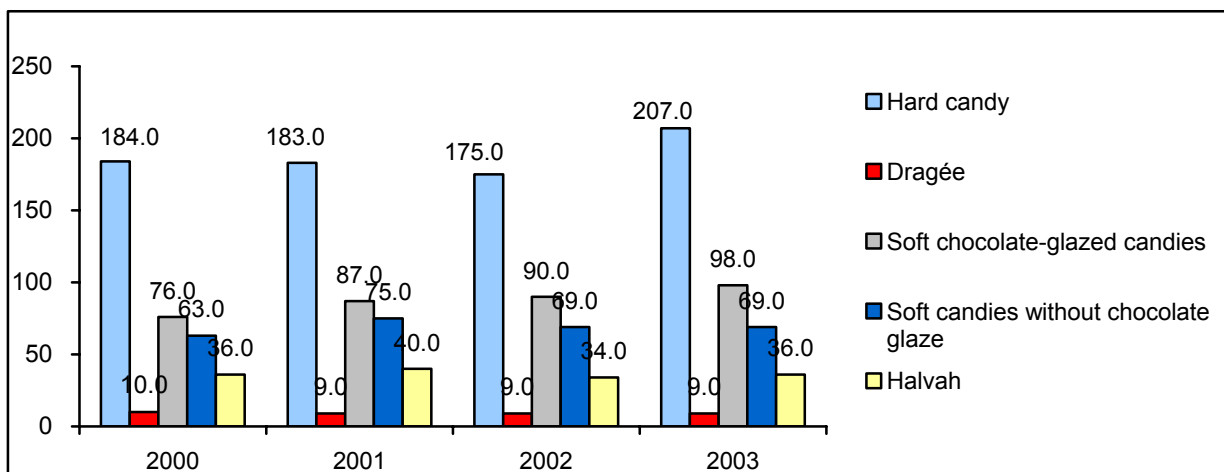


Source: State Statistics Committee of Ukraine.

Hard candy was the top product by volume among sugar-based goods. In 2003, production of hard candy reached 207 thousand tons, or 18.3 percent more than in 2002 (Chart 1.8).

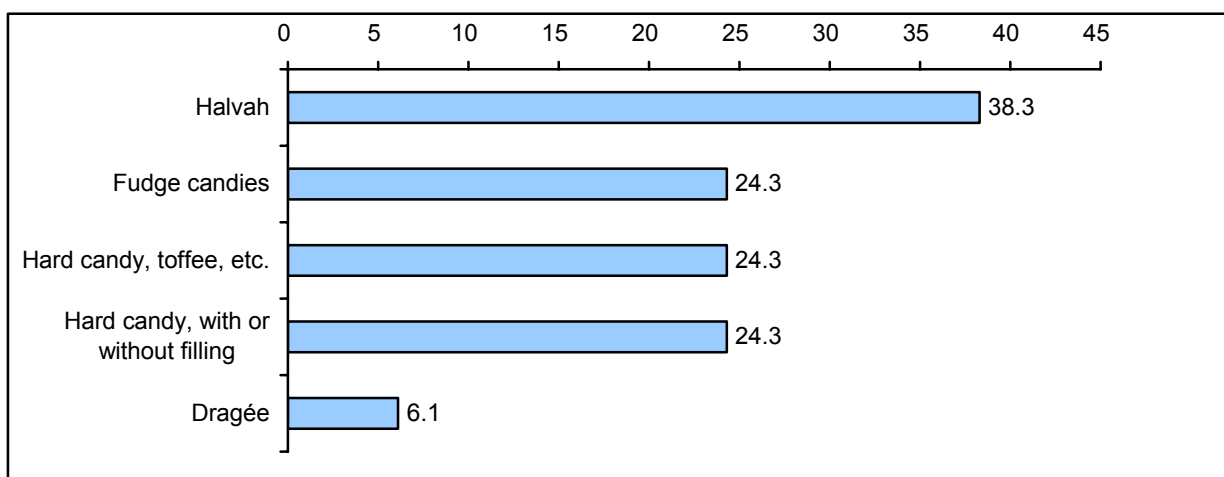
According to the State Statistics Committee of Ukraine, halvah ranked highest in terms of production volumes among sugar-based goods, with 33.8 thousand tons of output (Chart 1.9).

**CHART 1.8. SUGAR-BASED CONFECTIONERY PRODUCTION VOLUMES BY COMMODITY GROUPS, 2000-2003 (THOUSAND TONS)**



Source: State Statistics Committee of Ukraine.

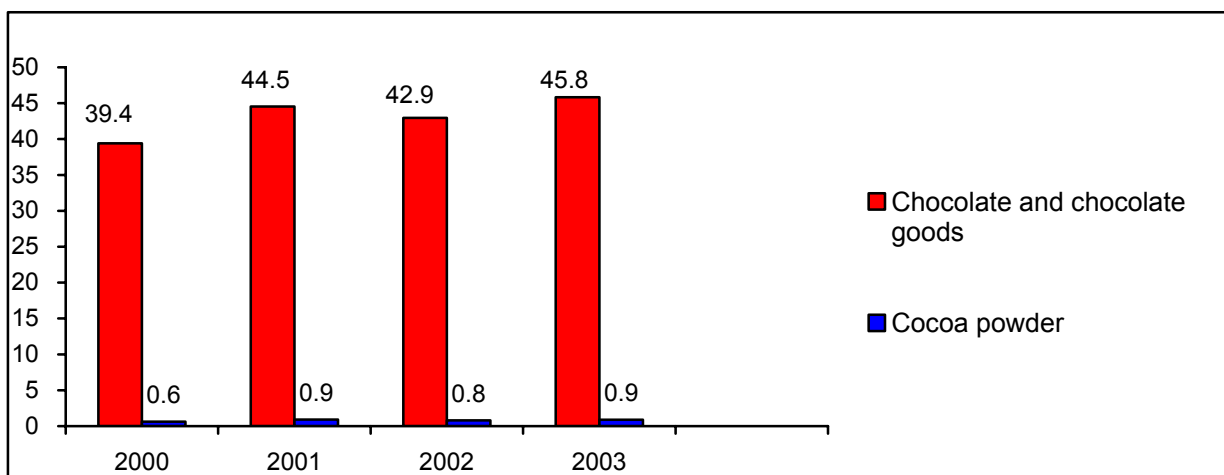
**CHART 1.9. SUGAR-BASED CONFECTIONERY PRODUCTION VOLUMES BY COMMODITY GROUPS, 2004 (THOUSAND TONS)**



Source: State Statistics Committee of Ukraine.

As of 2003, production volumes of chocolate and chocolate goods reached 45.8 thousand tons, a 6.8 percent increase from 2002 (Chart 1.10).

**CHART 1.10. PRODUCTION VOLUMES OF GOODS CONTAINING COCOA BY COMMODITY GROUPS, 2000-2003 (THOUSAND TONS)**



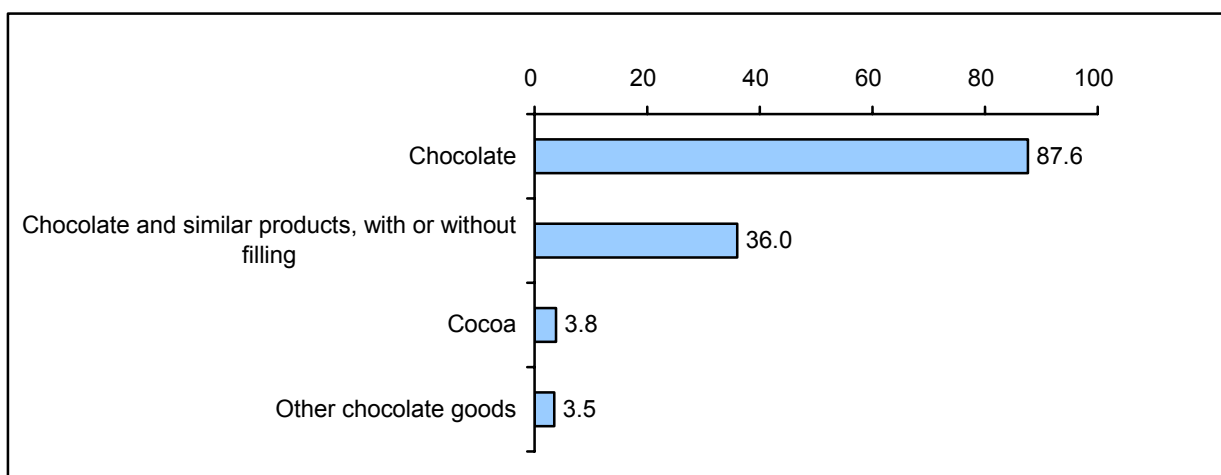
Source: State Statistics Committee of Ukraine.

Chocolate is a confectionery product with only two ingredients: cocoa butter and ground cocoa. Since most chocolate-producing factories were located in Russia during the Soviet era, Ukrainian enterprises inherited a lack of production capacity for manufacturing chocolate. For a few years, this segment was ruled by importers. Domestic production of chocolate received a push toward development only when foreign investors stepped in (e.g., Kraft Foods Ukraine).

Due to the need to survive amid strong competition, Ukrainian chocolate producers implement state-of-the-art production technologies.

In 2004, 87.6 thousand tons of chocolate candies were produced, compared to 36 thousand tons of chocolate and chocolate goods with or without filling (Chart 1.11).

**CHART 1.11. PRODUCTION VOLUMES OF GOODS CONTAINING COCOA BY COMMODITY GROUPS, 2004 (THOUSAND TONS)**



Source: State Statistics Committee of Ukraine.

## SECTOR LEADERS

Almost every oblast of Ukraine has a confectionery plant. Confections manufacturing in Ukraine includes enterprise conglomerations that belong to the State Food Department system: Ukrkonditer, Ukrprodsoyuz, Ukrkhib, and independent private sector companies. Almost one-fourth of all confections are produced by 28 branches of the following types: Ukrkonditer plants, Ukrprodsoyuz foodstuff manufacturing facilities, and the Ukrkhib system's manufacturing and sales locations.

Overall, the number of businesses producing confectionery goods grew from 592 to 833 in the period between 2000 and 2004 (Table 1.6; Chart 1.12). While the number of businesses producing flour-based goods increased, the number of chocolate factories decreased during that time.

Of enterprises operating in this market, 68.4 percent were engaged in flour-based confectionery production, only 22.9 percent produced chocolate and sugar-based confectionery goods, and the remaining 8.7 percent covered all other products in this sector.

In the process of market structuring and share distribution, a few powerful concerns have come to the forefront of this sector:

- Roshen (the Karl Marx factory in Kyiv, and factories in Vinnytsya, Kremenchuk, and Mariupol);
- AVK (this concern incorporates factories in Donetsk, Luhansk, and Mukacheve, as well as the Pchela and Mart plants); and
- Kiev-Konti (includes the Donetsk Chocolate Factory, as well as the Horlivka and Konstantinivka Confectionery Factories).

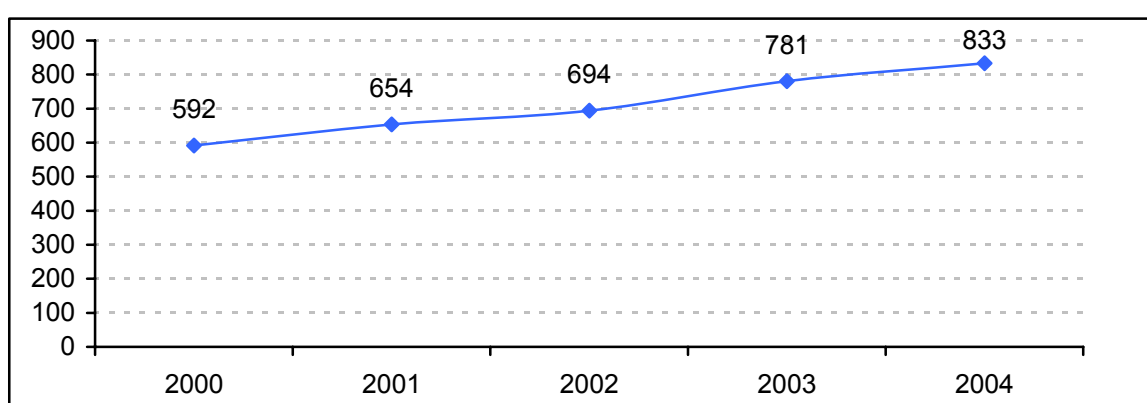
These domestic concerns are powerful enough to supply products to both regional and national markets while targeting export markets. While some businesses worked in oblast and regional markets, some only operated within the boundaries of their rayons or cities.

In the regional context, the largest production volumes were recorded in the Donetsk Oblast, while the Poltava Oblast ranked second and Kyiv City placed third. The Dnipropetrovsk and Odessa Oblasts rounded out the "top five" Ukrainian oblasts in terms of confectionery goods production.

**TABLE 1.6. THE NUMBER OF CONFECTIONERY ENTERPRISES, 2000-2004**

KVED code	Description	2000	2001	2002	2003	2004
15.82	Production of dried bread, biscuits, pies, and pastries with long shelf lives	317	375	420	507	570
15.89.9	Production of other food products	57	63	69	74	72
15.84	Production of cocoa powder and chocolate	218	216	205	200	191
Total		592	654	694	781	833

Source: State Statistics Committee of Ukraine.

**CHART 1.12. THE NUMBER OF CONFECTIONERY ENTERPRISES, 2000-2004**

Source: State Statistics Committee of Ukraine.

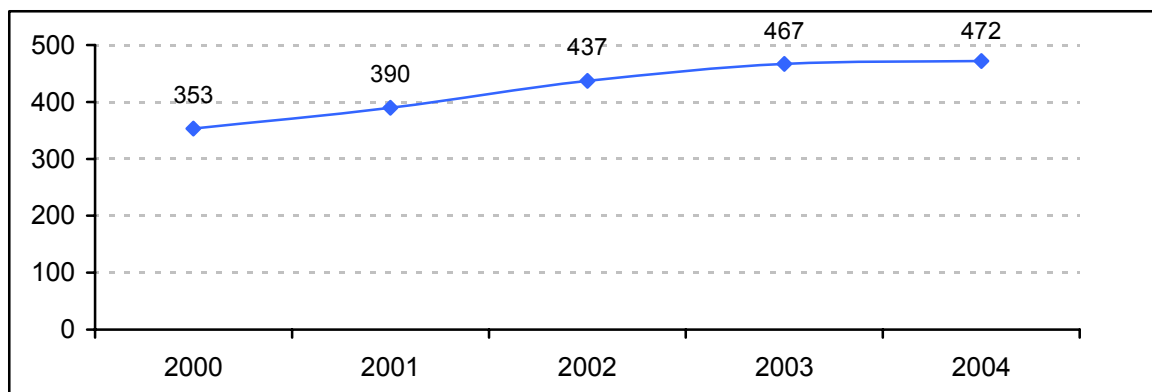
As of December 31, 2004, 472 enterprises listed production of confectionery goods as their primary activity; of these, 124 produced cocoa powder and chocolate (Table 1.7; Chart 1.13).

From 2000 onward, there has been a clear trend of growth in the number of confectionery goods producers.

**TABLE 1.7. THE NUMBER OF CONFECTIONERY ENTERPRISES BY PRIMARY TYPES OF ACTIVITY, 2000-2004**

KVED code	Description	2000	2001	2002	2003	2004
15.82	Production of dried bread, biscuits, pies, and pastries with long shelf lives	194	210	246	269	276
15.89.9	Production of other food products	57	63	69	74	72
15.84	Production of cocoa powder and chocolate	102	117	122	124	124
Total		353	390	437	467	472

Source: State Statistics Committee of Ukraine.

**CHART 1.13. THE NUMBER OF ENTERPRISES ENGAGED IN CONFECTIONS AS A PRIMARY ACTIVITY, 2000-2004**

Source: State Statistics Committee of Ukraine.

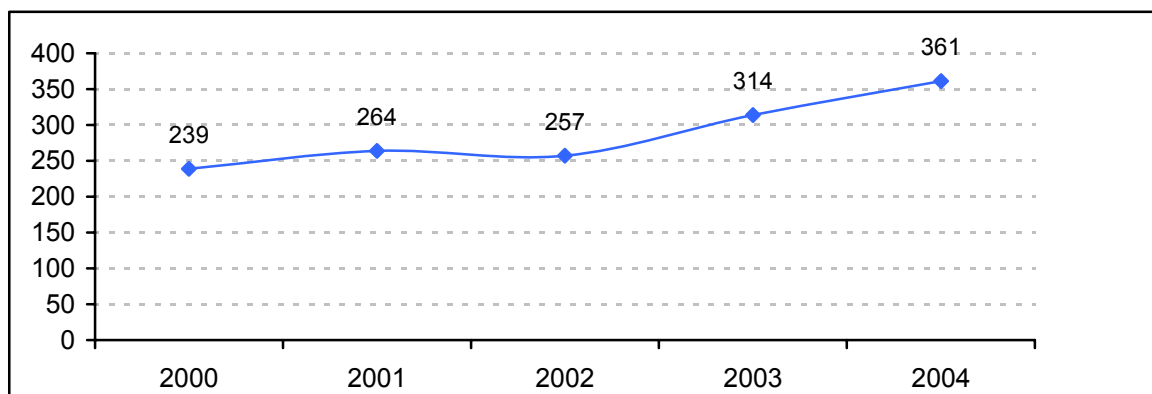
In addition to the aforementioned enterprises, the confections sector also included businesses for which confectionery goods was a non-primary activity (Table 1.8). In 2004, there were 361 such enterprises, the overwhelming majority of which (294) produced flour-based confectionery goods.

The number of enterprises producing cocoa powder and chocolate as a non-primary activity was falling, which may be evidence of high competition in this segment and an increase in the share of enterprises engaging in production of flour-based goods as a non-primary activity.

**TABLE 1.8. THE NUMBER OF ENTERPRISES PRODUCING CONFECTIONERY GOODS AS A NON-PRIMARY ACTIVITY, 2000-2004**

KVED code	Description	2000	2001	2002	2003	2004
15.82	Production of dried bread, biscuits, pies, and pastries with long shelf lives	123	165	174	238	294
15.89.9	Production of other food products	-	-	-	-	-
15.84	Production of cocoa powder and chocolate	116	99	83	76	67
Total		239	264	257	314	361

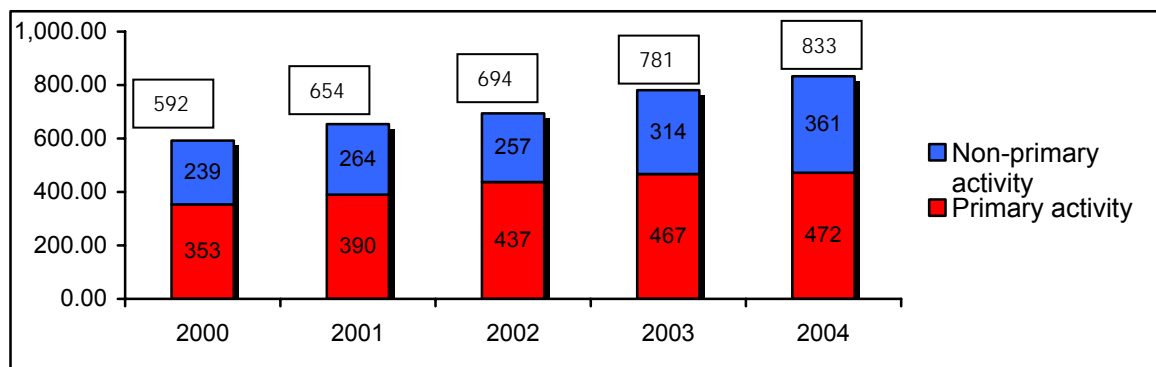
Source: State Statistics Committee of Ukraine.

**CHART 1.14. THE NUMBER OF ENTERPRISES ENGAGED IN CONFECTIONS AS A NON-PRIMARY ACTIVITY, 2000-2004**

Source: State Statistics Committee of Ukraine.

Businesses for which confectionery production was a non-primary activity accounted for 43 percent of confectionery enterprises in 2004.

Their share constituted 40 percent on average in the years covered by the survey.

**CHART 1.15. THE NUMBER OF CONFECTIONS SECTOR ENTERPRISES BY PRIMARY ACTIVITIES, 2000-2004**

Source: State Statistics Committee of Ukraine.

It has been noted that the overall number of enterprises operating in the confectionery industry has been growing annually and reached 833 as of early 2004.

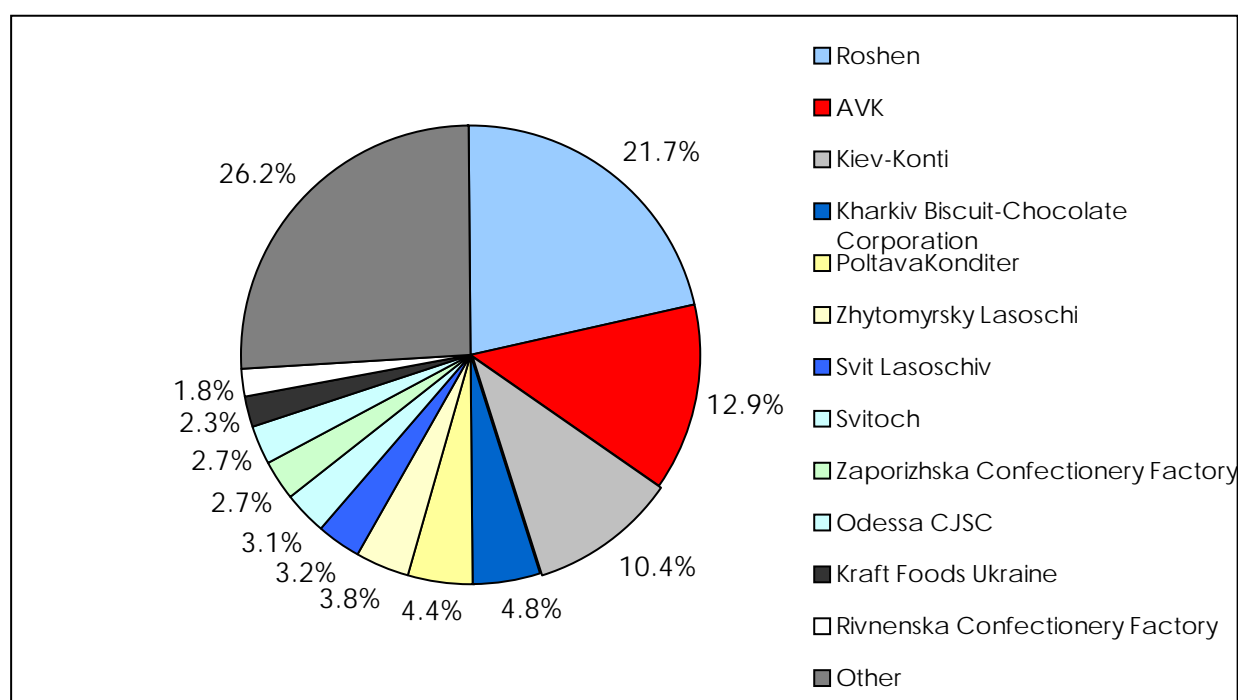
The total potential production capacity of confectionery factories in Ukraine is estimated at 1 million tons. According to Ukrkonditer, half of confectionery production volume in 2004 was accounted for by three major market players: Roshen, AVK, and Kiev-Konti.

The “top ten” industry leaders (enterprises that contributed over 1 percent to total confectionery output) included the Kharkiv Biscuit-Chocolate Corporation, Svitoch, Svit Lasoschiv, PoltavaKonditer, Zhytomyrsky Lasoschi, Odessa CJSC, Zaporizhska Confectionery Factory, Kraft Foods Ukraine, and Rivnenska Confectionery Factory (Table 1.9 and Chart 1.16).

**TABLE 1.9. LEADING SECTOR ENTERPRISES, 2004**

Company	Confectionery goods production volume, thousand tons	Share in overall production volume, %
Roshen	202.0	21.7
AVK	121.0	12.9
Kiev-Konti	97.0	10.4
Kharkiv Biscuit-Chocolate Corporation	45.0	4.8
PoltavaKonditer	41.0	4.4
Zhytomyrsky Lasoschi	35.0	3.8
Svit Lasoschiv	30.0	3.2
Svitoch	28.0	3.1
Zaporizhska Confectionery Factory	26.0	2.7
Odessa CJSC	25.0	2.7
Kraft Foods Ukraine	21.0	2.3
Rivnenska Confectionery Factory	15.0	1.8
Other	244.0	26.2

Source: State Statistics Committee of Ukraine.

**CHART 1.16. MARKET SHARES OF LEADING ENTERPRISES, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

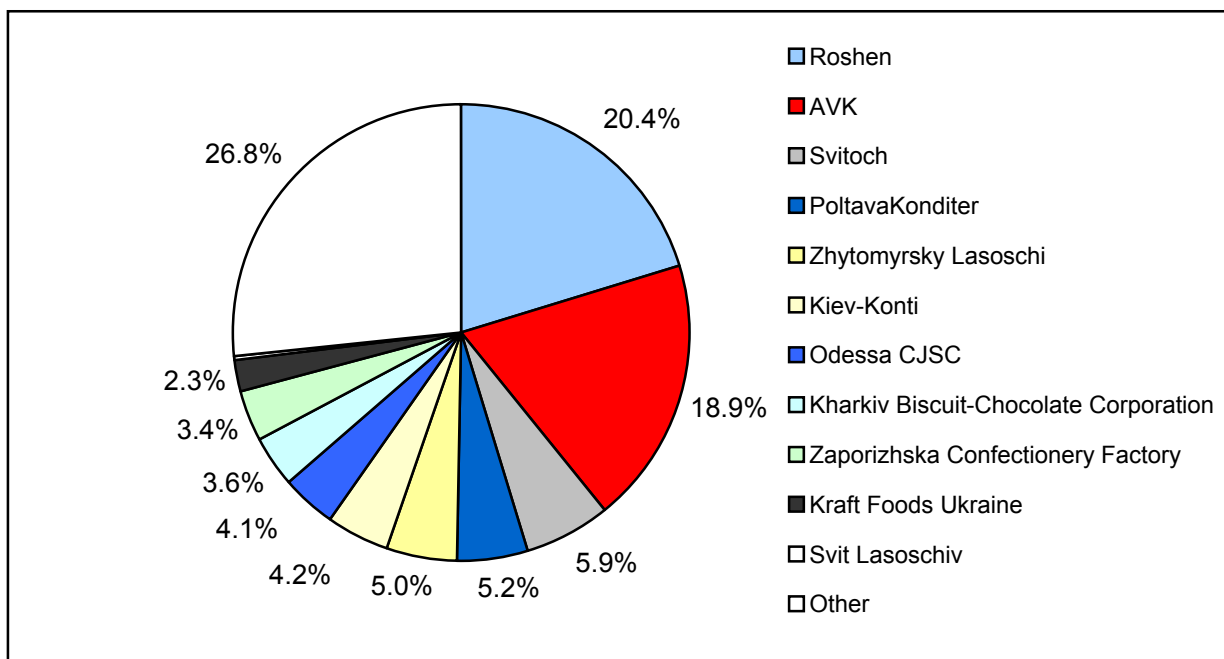
Groups of leaders existed in every segment of the confectionery market. The leaders in the sugar-based goods segment included Roshen (20.4 percent of output), AVK (18.9 percent), Svitoch

(5.9 percent), PoltavaKonditer (5.2 percent), and Zhytomyrsky Lasoschi with 5.0 percent (Table 1.10 and Chart 1.17).

**TABLE 1.10. LEADING ENTERPRISES IN THE SUGAR-BASED PRODUCTS SEGMENT, 2004**

Company	Production volume (thousand tons)	Percentage of total production volume
Roshen	49.5	20.4
AVK	45.6	18.9
Svitoch	14.4	5.9
PoltavaKonditer	12.6	5.2
Zhytomyrsky Lasoschi	12.0	5.0
Kiev-Konti	10.2	4.2
Odessa CJSC	9.9	4.1
Kharkiv Biscuit-Chocolate Corporation	8.7	3.6
Zaporizhska Confectionery Factory	8.2	3.4
Kraft Foods Ukraine	5.6	2.3
Svit Lasoschiv	0.4	0.2
Other	64.9	26.8

Source: State Statistics Committee of Ukraine.

**CHART 1.17. MARKET SHARES OF LEADING ENTERPRISES IN THE SUGAR-BASED PRODUCTS SEGMENT, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

Leaders in the segment of flour-based confectionery goods were Kiev-Konti (14.7 percent), Roshen (12.4 percent), Svit Lasoschiv

(8.2 percent), AVK (6.3 percent), and the Kharkiv Biscuit-Chocolate Corporation with 5.7 percent (Table 1.11, Chart 1.18).

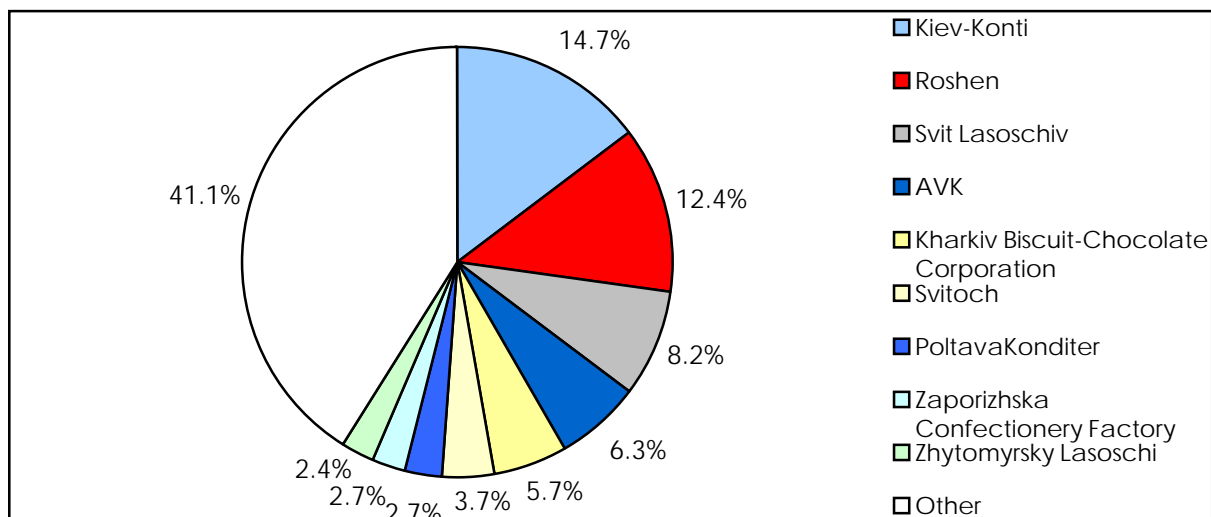
**TABLE 1.11. LEADING ENTERPRISES IN THE FLOUR-BASED PRODUCTS SEGMENT, 2004**

Company	Production volume (thousand tons)	Percentage of total production volume
Kiev-Konti	56.4	14.7%
Roshen	47.7	12.4%
Svit Lasoschiv	31.3	8.2%
AVK	24.1	6.3%
Kharkiv Biscuit-Chocolate Corporation	21.9	5.7%
Svitoch	14.2	3.7%
PoltavaKonditer	10.5	2.7%
Zaporizhska Confectionery Factory	10.2	2.7%
Zhytomyrsky Lasoschi	9.4	2.4%
Other	157.4	41.1%

Source: State Statistics Committee of Ukraine.

One unusual aspect of the flour-based goods segment was the fact that domestic giant Roshen was not its leader. Furthermore, nine large companies (with market shares of over 2 percent) operated actively in this segment.

Thus, this segment was the most diverse due to a combination of relatively simple production and stable demand throughout the year.

**CHART 1.18. MARKET SHARES OF LEADING ENTERPRISES IN THE FLOUR-BASED PRODUCTS SEGMENT, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

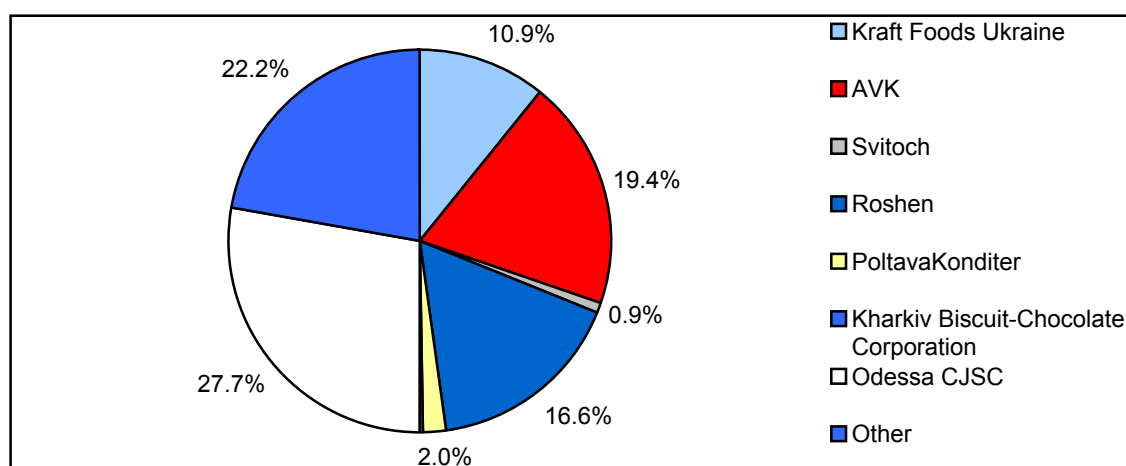
**TABLE 1.12. LEADING ENTERPRISES IN THE SEGMENT OF PRODUCTS CONTAINING COCOA, 2004**

Company	Production volume (thousand tons)	Percentage of total production volume
Kraft Foods Ukraine	14.4	27.7
AVK	10.1	19.4
Svitoch	8.6	16.6
Roshen	5.7	10.9
PoltavaKonditer	1.1	2.0
Kharkiv Biscuit-Chocolate Corporation	0.5	0.9
Odessa CJSC	0.2	0.3
Other	11.5	22.2

Source: State Statistics Committee of Ukraine.

The cocoa-containing goods segment was dominated by Kraft Foods Ukraine (27.7 percent), AVK (19.4 percent), Svitoch (16.6 percent), and

Roshen with 10.9 percent (Table 1.12, Chart 1.19).

**CHART 1.19. MARKET SHARES OF LEADING ENTERPRISES IN THE SEGMENT OF PRODUCTS CONTAINING COCOA, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

### SALES VOLUMES BY SEGMENTS, 2000-2004

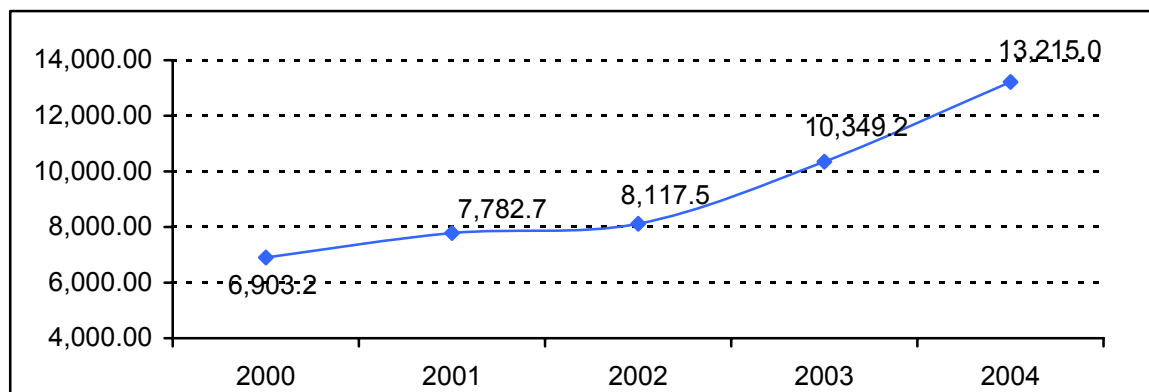
In 2000, total confectionery output was worth 6,903.2 million UAH; this figure grew steadily in the years analyzed in this report. In 2001, it grew by 12.7 percent compared to 2000 to reach 7,782.7 million UAH.

The slowest growth (only 4.3 percent) was observed in 2002. This low figure was explained

by the fact that domestic producers were adapting in order to compete with foreign producers and adjust to changes in national legislation adopted that year.

In 2004, businesses that produced confectionery goods earned a total of 13,215 million UAH, or 27.7 percent more than in 2003.

**CHART 1.20. CONFECTIONERY SALES VOLUMES, 2000-2004 (MILLION UAH)**

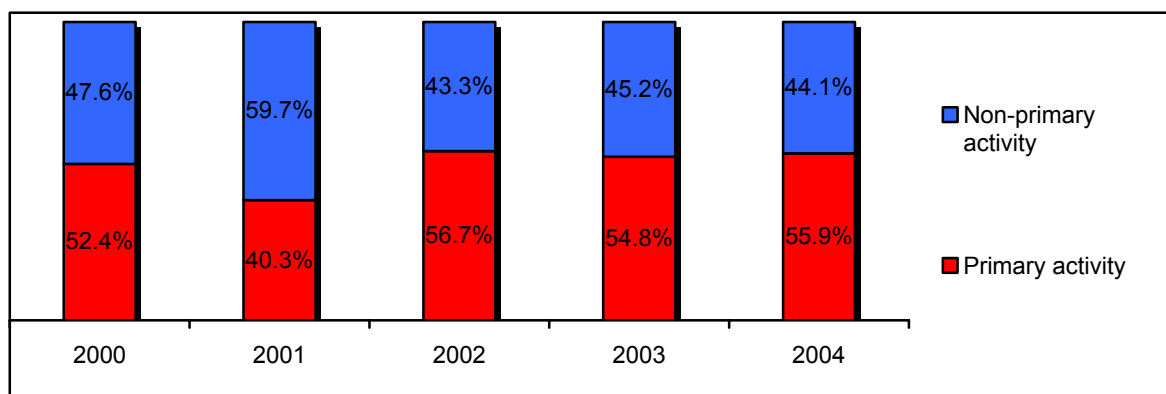


Source: State Statistics Committee of Ukraine.

It is important to note that in the period between 2002 and 2004, 56-57 percent of output was sold by producers engaged in confections as their

primary business, while 43-35 percent of goods were sold by enterprises for which the confections sector was a non-primary activity (Chart 1.21).

**CHART 1.21. ENTERPRISE CONTRIBUTIONS TO THE TOTAL SALES VOLUME OF CONFECTIONERY PRODUCTS BY PRIMARY ACTIVITIES, 2000-2004 (IN %)**



Source: State Statistics Committee of Ukraine.

### VOLUMES AND STRUCTURES OF CONFECTIONS SECTOR EXPORTS, 2000-2004

In 2000-2003, the yearly share of exports in total sector sales was 31 percent on average.

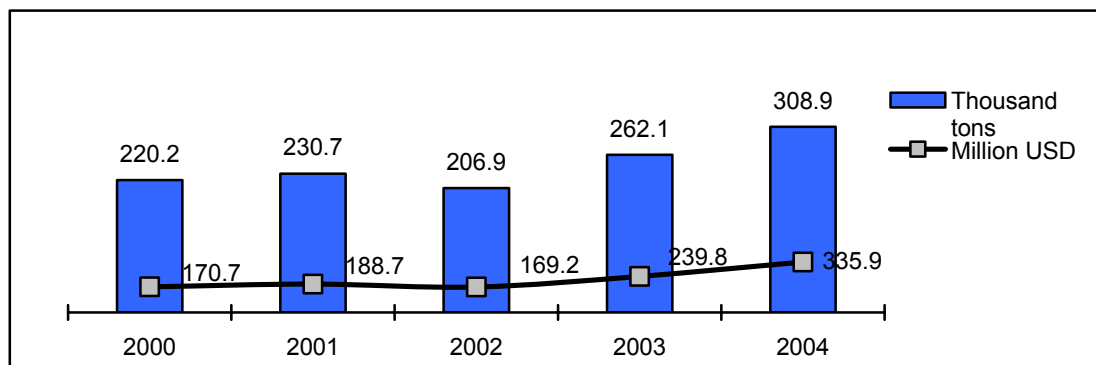
In 2004, Ukrainian producers exported 40 percent of their goods. Nearly 309 thousand tons of goods were exported, or 17.9 percent more than in 2003 (Chart 1.22).

Lower export volumes in 2002 were caused by measures taken by the Russian government to protect their own domestic confectionery producers (hard-boiled candy producers in particular). After the Government of the Russian Federation introduced an additional duty on

imports of sugar-based goods and other confectionery goods not containing cocoa in May 2001, products made by the majority of Ukrainian producers were no longer competitive. Medium-sized confectionery factories were hit hardest because they had no facilities for producing hard candy containing cocoa and could not afford to reduce their profitability or re-target exports toward other CIS countries.

These decisions by the Russian government forced Ukrainian producers to take a number of steps in order to remain competitive, particularly:

- changing the ingredients and packaging of products exported to Russia;
- acquiring confectionery factories in Russia (this was done by the largest exporters, such as Roshen and Kiev-Konti); and
- searching for and expanding into new external markets (exports to Western European countries grew by 20 percent, while those to CIS countries grew by 10 percent).

**CHART 1.22. CONFECTIONERY EXPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004**

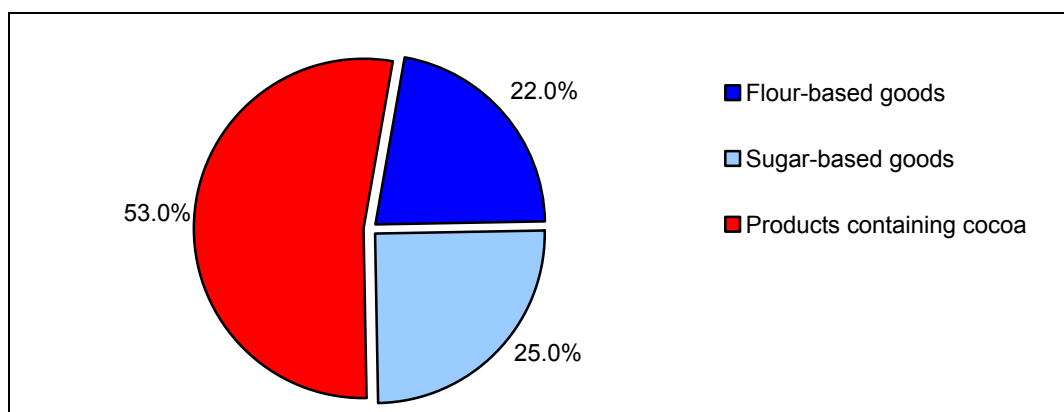
Source: State Statistics Committee of Ukraine.

Russia was the main consumer of Ukrainian confectionery goods in 2000-2003, buying 70 percent of Ukrainian exports. During that time, Ukrainian confectionery goods represented 30 percent of the Russian market. The main products exported to Russia were sugar-based goods.

In August 2004, Russia reduced duties on food products imported from Ukraine. This facilitated expansion of Ukrainian hard candy into the

Russian market and supported overall production of sweets in Ukraine.

Shares of confections sector segments in exports were distributed in the following way: products containing cocoa represented the largest share with 53.0 percent (Chart 1.23), while flour-based and sugar-based goods occupied approximately equal shares with 22.0 percent and 25.0 percent, respectively (Chart 1.23).

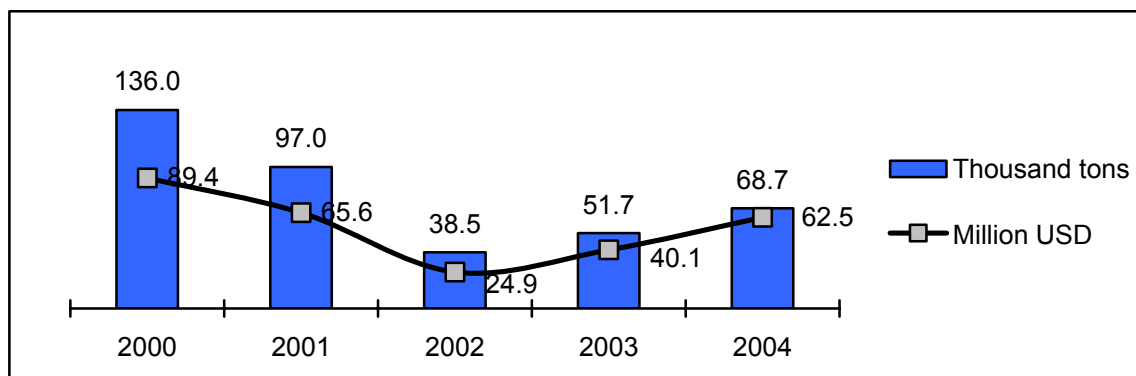
**CHART 1.23. THE STRUCTURE OF CONFECTIONERY EXPORTS, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

### EXPORTS BY MARKET SEGMENTS

Between 2000 and 2004, exports of flour-based confectionery goods fell by almost half. A record drop was observed in 2002, when the lowest volumes of biscuits, wafers, and pastries were exported.

Since 2002, export volumes of flour-based confections have grown annually by 34 percent (Chart 1.24).

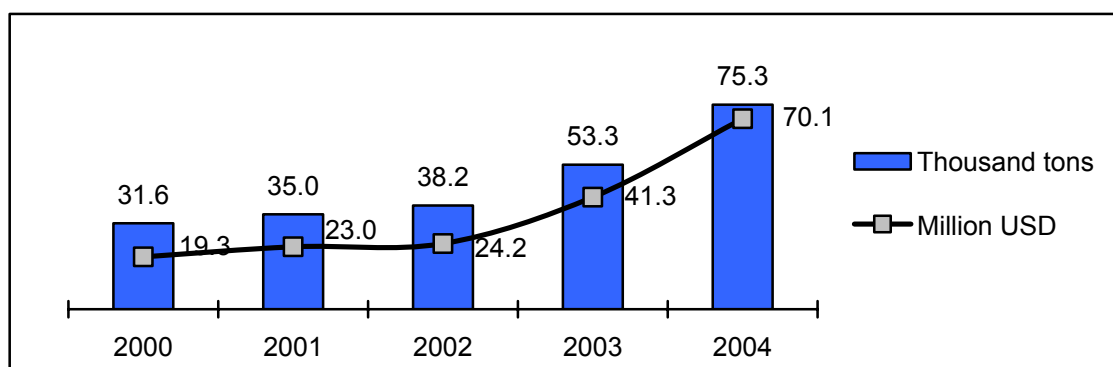
**CHART 1.24. FLOUR-BASED CONFECTIONERY EXPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004**

Source: State Statistics Committee of Ukraine.

Exports of sugar-based confectionery goods (primarily hard candy) have had a distinctive upward tendency. In 2004, exports grew by 41.3 percent compared to 2003 (Chart 1.25).

Export growth was noted only in the latter years of the survey period. From 2000 to 2002, exports of

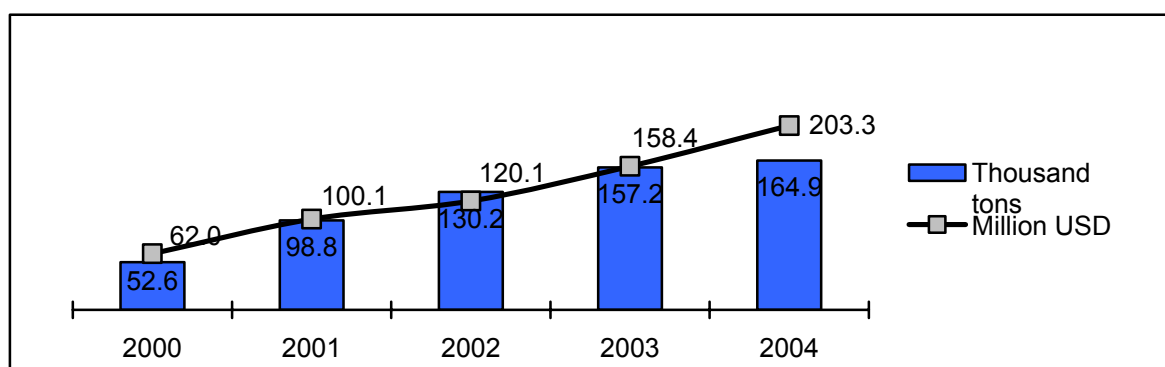
confectionery goods slowed. A somewhat slow increase in export volumes of hard candy in 2001 and 2002 was caused by reorientation of production toward cocoa-containing sweets. These products were not subject to Customs duties upon entry into Russia, and could thus be exported at almost producers' prices.

**CHART 1.25. SUGAR-BASED CONFECTIONERY EXPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004**

Source: State Statistics Committee of Ukraine.

Exports of confectionery goods containing cocoa (with largest share occupied by ready-made chocolate and chocolate goods) also demonstrated a trend of growth (Chart 1.26). In

2004, Ukrainian producers exported a total of 203 million USD worth of goods, or 28.3 percent more than the year before (although this growth in physical terms represented only 4.8 percent).

**CHART 1.26. EXPORTS OF PRODUCTS CONTAINING COCOA IN PHYSICAL AND MONETARY TERMS, 2000-2004**

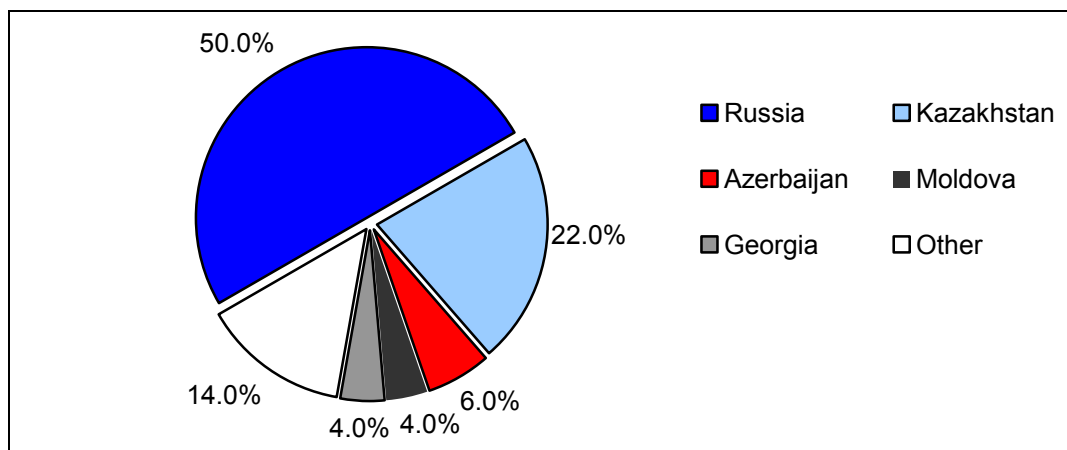
Source: State Statistics Committee of Ukraine.

## MAJOR EXPORTERS

Roshen, AVK, Kiev-Konti, Kharkiv Biscuit-Chocolate Corporation, Odessa CJSC, and Zhytomyrsky Lasoschi accounted for over 70 percent of exports of confectionery goods in 2004. The main target markets for exports of Ukrainian

confectionery goods in 2004 were Russia (50 percent), Kazakhstan (22 percent), Azerbaijan (6 percent), Moldova (4 percent), and Georgia with 4 percent (Chart 1.27).

CHART 1.27. EXPORT DESTINATION COUNTRIES, 2004 (IN %)



Source: Interviews with industry experts.

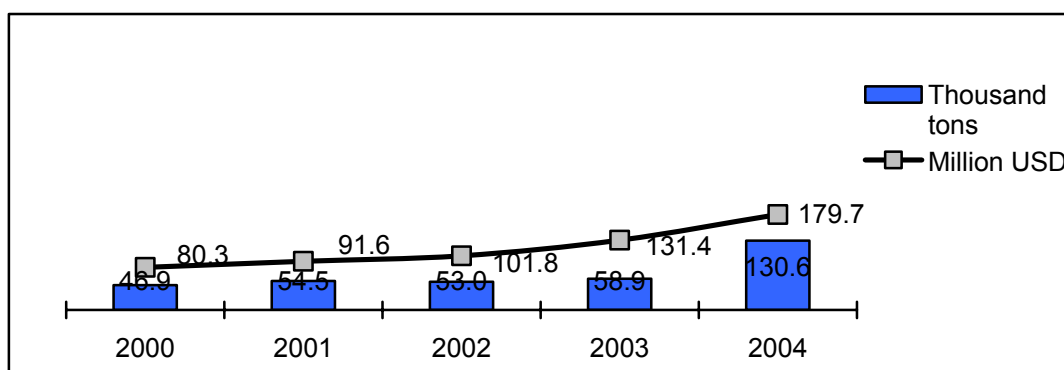
## VOLUMES AND STRUCTURES OF CONFECTIONS SECTOR IMPORTS, 2000-2004

The volume of imports of confectionery goods into Ukraine was quite low compared to exports. Import volumes reached only 42.2 percent of export volumes during this period.

Import volumes began growing in 2001. The main reason for this increase in imports was a

stabilization of the economic situation in Ukraine and higher living standards for average Ukrainians (the population's purchasing power increased, which in turn facilitated sales of imported goods). Economic stability encouraged international producers to spend more money on promotion of their brands in the Ukrainian market.

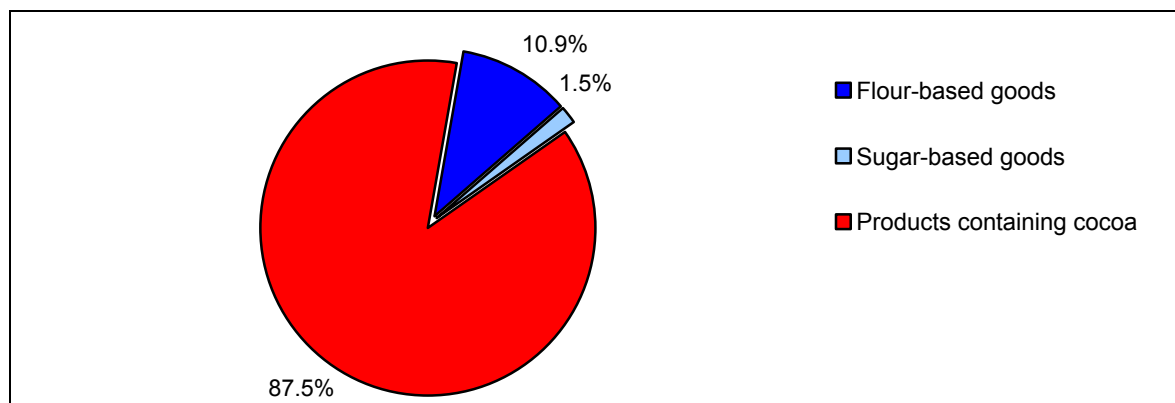
CHART 1.28. CONFECTIONERY IMPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004



Source: State Statistics Committee of Ukraine.

In 2004, over 130.6 thousand tons of confectionery goods worth 179.7 million USD were imported into Ukraine (Chart 1.30). In 2004, the share of imports grew considerably compared to previous years.

Growing import volumes during this period were encouraged by a new resolution of the Ukrainian government on reduced rates of import duties for ready-made confectionery goods.

**CHART 1.29. THE STRUCTURE OF CONFECTIONERY IMPORTS, 2004 (IN %)**

Source: State Statistics Committee of Ukraine.

### IMPORTS BY SEGMENTS

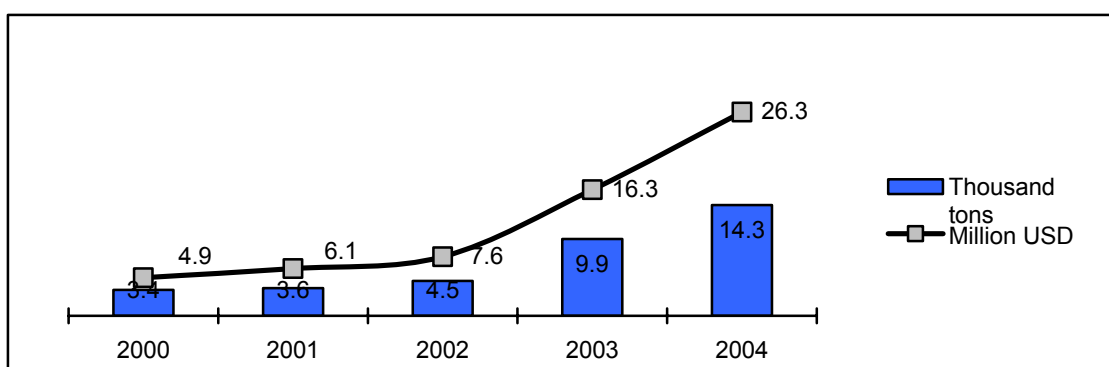
Imports of flour-based confectionery goods grew in the period between 2000 and 2004 (Chart 1.30). In 2003, a dramatic increase of import volumes was noted in this segment: by 2.2 times in physical terms, and 2.1 times in monetary terms. This growth was due to imports of Russian products, the share of which in total imports was 80 percent.

According to Ukrainian producers, imported cookies did not present significant competition to

local products because imports were mostly expensive goods that were not yet produced by Ukrainian factories. Cookies were the only type of confection brought in from Russia without Customs restrictions.

In 2004, imports totaled 14.3 thousand tons, 44 percent higher than import levels in 2003. In monetary terms, imports of flour-based confectionery goods grew by 61.3 percent in 2004.

**CHART 1.30. FLOUR-BASED CONFECTIONERY IMPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004**



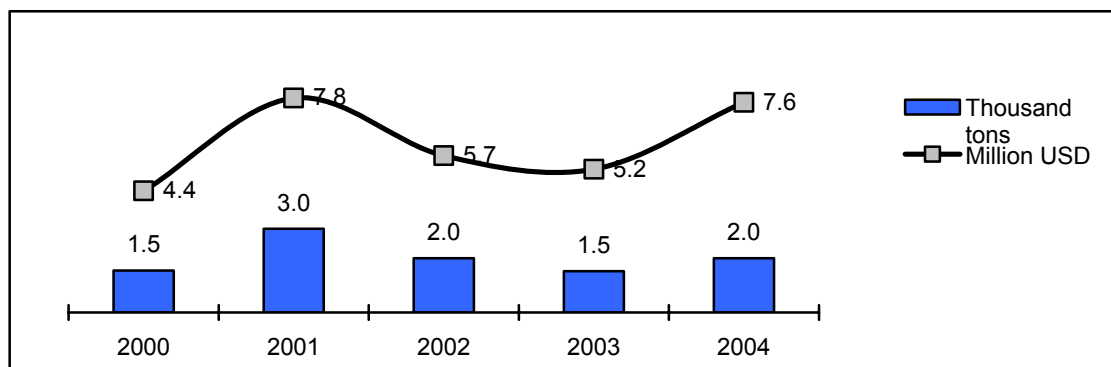
Source: State Statistics Committee of Ukraine.

Imports of sugar-based confectionery products to Ukraine were characterized by instability (Chart 1.31). The largest amount of confectionery goods made from sugar without cocoa (3 thousand tons) was imported in 2002.

In 2002-2003, imports from this product category fell due to restored production capacities and adaptation to new conditions on the part of domestic producers. Imports in the hard candy market were present in the form of products for

which there were no equivalents in Ukraine (for example, Kislrot (Netherlands) as well as with Figaro and Verbena (Slovakia).

Foreign brands in the market serve more as "demonstrations" of potential future product lines than as actual competitors. Hence, Ukrainian producers may evaluate foreign products without leaving the country and make appropriate changes to their own production plans.

**CHART 1.31. SUGAR-BASED CONFECTIONERY IMPORTS IN PHYSICAL AND MONETARY TERMS, 2000-2004**

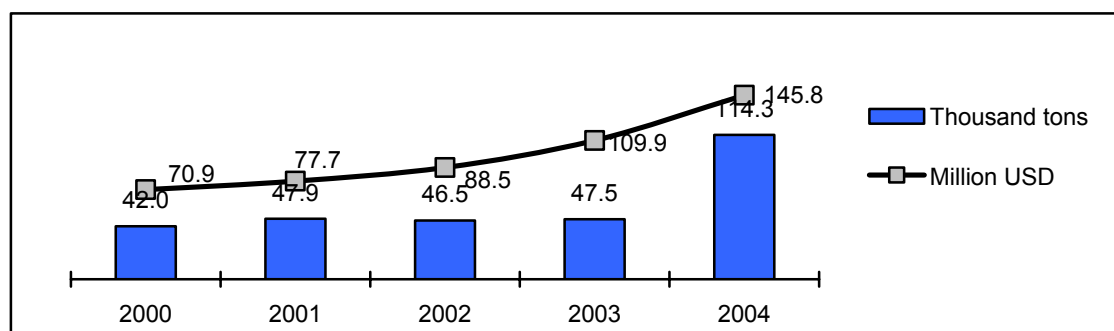
Source: State Statistics Committee of Ukraine.

The largest share of imports into Ukraine belonged to confectionery goods containing cocoa (ready-made chocolates and cocoa powder). In 2004, 114.3 thousand tons of these products worth 146 million USD were imported into Ukraine (Chart 1.32). This is 2.4 times more in physical terms and 32.7 percent more in monetary terms than the import figures for 2003.

It is important to note that in 2003, imports of chocolate dropped in physical terms compared to

2002 (Chart 1.32). This is explained by the fact that Ukrainian confectioners expanded their chocolate product ranges in the expensive price segment and started to squeeze importers out of the market.

In 2003, Ukrainian producers began entering market segments previously dominated by importers. A few large companies (including AVK and Roshen) simultaneously launched production of expensive chocolates.

**CHART 1.32. IMPORTS OF PRODUCTS CONTAINING COCOA IN PHYSICAL AND MONETARY TERMS, 2000-2004**

Source: State Statistics Committee of Ukraine.

### MAJOR IMPORTERS

Main importers of confectionery goods into Ukraine in 2004 included:

- Ferrero Rocher (chocolates);
- Kraft Foods (porous chocolate);
- Mars (Russia; chocolate bars);
- Chipita Saint Petersburg (Russia; croissants, Swiss rolls, chocolate spreads);
- Konditer-Kursk (Russia; biscuits);
- Mantinga (Lithuania; pre-prepared items for baking);
- Kamska Confectionery Factory (Russia; chocolate wafers);

- Harris CIS (Russia; Swiss rolls); and
- Meridian Plus (Russia; dried bread).

Statistical data demonstrated that Russia had been the major importer of confectionery goods into Ukraine during the studied period. Products containing cocoa accounted for the largest share of imports. Sugar-based confectionery goods contributed the smallest share.

Ukrainian producers were severely challenged by competitors in the chocolate goods segment

because foreign companies offered a much wider variety of product flavors and types.

### CONFECTIONS MARKET SIZE, 2004

In 2004, the confections market was worth 3,045.7 million UAH (Chart 1.33). In calculations for this survey, the standard formula was applied:

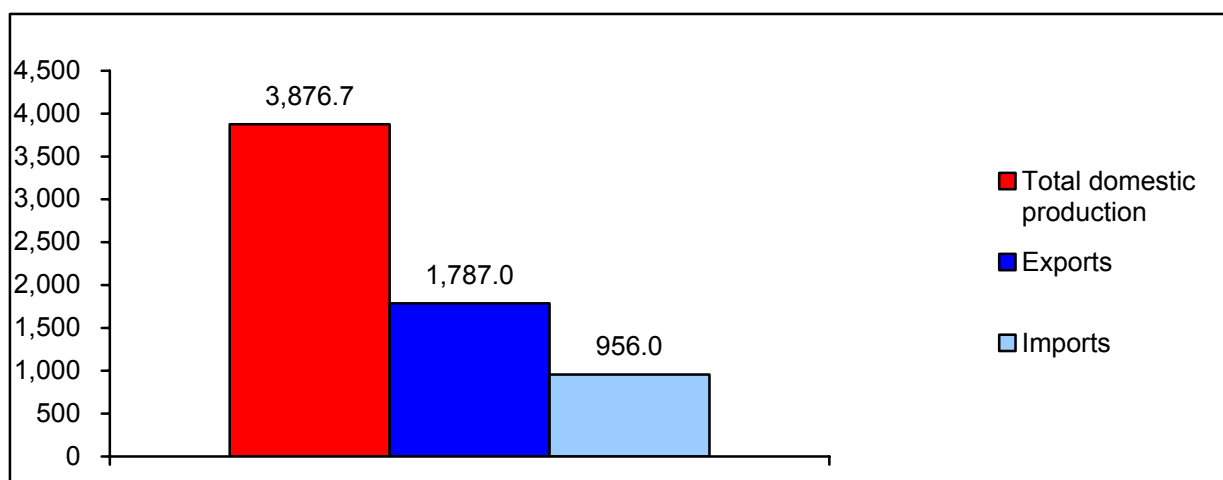
(domestic production + imports) – exports

Domestic production in Ukraine was calculated using official data of the State Statistics of Ukraine within the framework of SKP classifications. The value of imports of confectionery goods in monetary terms was calculated based on official

statistical data of the State Statistics Committee of Ukraine and using UKTZED classifications.

The value of exports was calculated based on official data from the State Statistics Committee of Ukraine regarding exports, and within the framework of UKTZED classifications. All calculations used the average foreign exchange rate of the National Bank of Ukraine for the year 2004: 1 USD = 5.32 UAH.

**CHART 1.33. THE SIZE OF THE CONFECTIONS MARKET IN 2004 (MILLION UAH)**



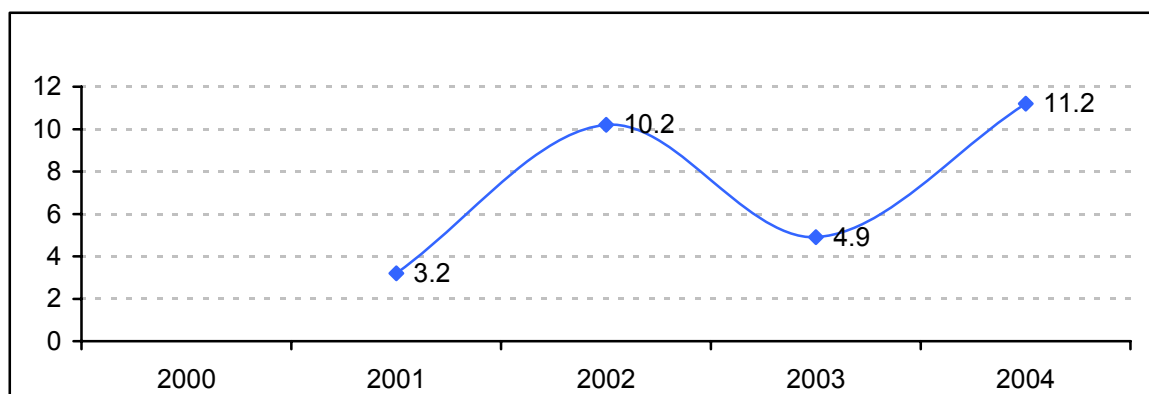
Source: State Statistics Committee of Ukraine.

### FOREIGN DIRECT INVESTMENT, 2001-2004

In the period between 2001 and 2004, the level of FDI in the confections sector was unstable (Chart 1.34). In 2001 and 2003, the level of investment was lowest, while in 2001 and 2004, investment grew noticeably.

In 2004, the largest share of investment was channeled toward production of confectionery goods containing cocoa.

**CHART 1.34. ANNUAL FOREIGN DIRECT INVESTMENT IN THE CONFECTIONS SECTOR, 2001-2004 (MILLION USD)**



Source: State Statistics Committee of Ukraine.

In the midst of rigorous competition in the Ukrainian confections market, new companies continued to appear, smaller companies expanded their product ranges, companies focused more on specific market segments, and enterprises continued to attract foreign investors. A few large international investors stepped in to support domestic production facilities: Nestlé (Svitoch), Kraft Foods Ukraine (Ukraina Factory), Cobisco Union (Zhytomyrsky Lasoschi), SigmaBleyzer (PoltavaKonditer), and the Western NIS Enterprise Fund (AVK).

The rapid development of the market, sustainable growth of demand, and high returns in the confectionery business have all led companies from other sectors to consider investing in confections. For example, Continium (known both for its oil business activities and for large dairy operations) purchased the Bukovinka Confectionery Factory in Chernivtsi and a confectionery production facility in Lutsk.

**TABLE 1.13. TOTAL FOREIGN DIRECT INVESTMENT IN THE CONFECTIONS SECTOR, 2001-2004 (MILLION USD)\***

	2001	2002	2003	2004
Beginning of the year	61.1	64.2	74.4	79.3
Annual increase	3.2	10.2	4.9	11.2
End of the year	64.2	74.4	79.3	90.5

Source: State Statistics Committee of Ukraine.

\* Figures for enterprises with sales volumes over 0 in the list of KVED product codes.

Other operations were mostly either owned by employees or domestic investors, or were divided between both employees and domestic investors. Apart from Roshen, local investors worth noting are Technocenter (Ivano-Frankivsk Confectionery Factory), Top-trans (Cherkasy Biscuit Factory), and the Zaporizhzhya Regional Bank (Zaporizhska Confectionery Factory).

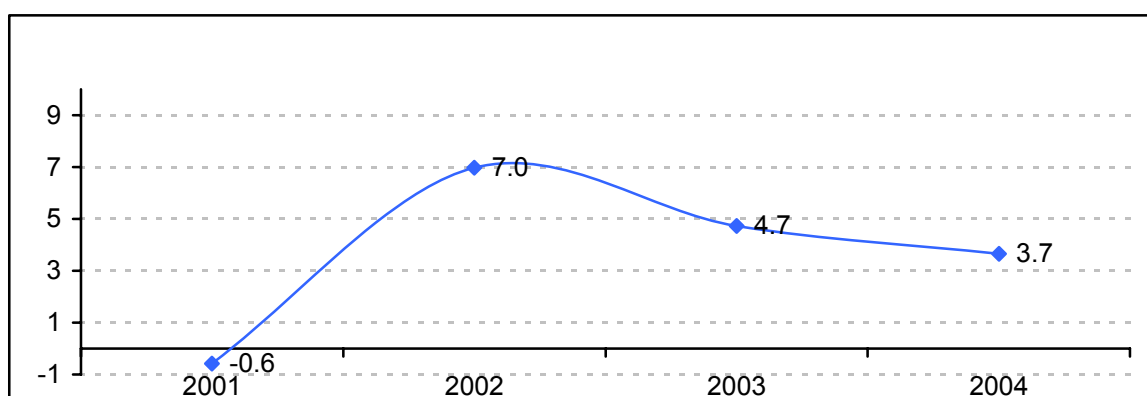
These investments gave the confections sector a new chance at survival, enabling many

enterprises to replace outdated equipment, purchase new assembly line complexes for confectionery goods production and packaging, and buy high quality raw materials.

Because of investments and aggressive marketing policies, Ukrainian confectioners not only recaptured the domestic market (having pushed out Polish and Turkish products), but also gained a strong foothold in Russia and other markets.

## FOREIGN DIRECT INVESTMENT IN MARKET SEGMENTS

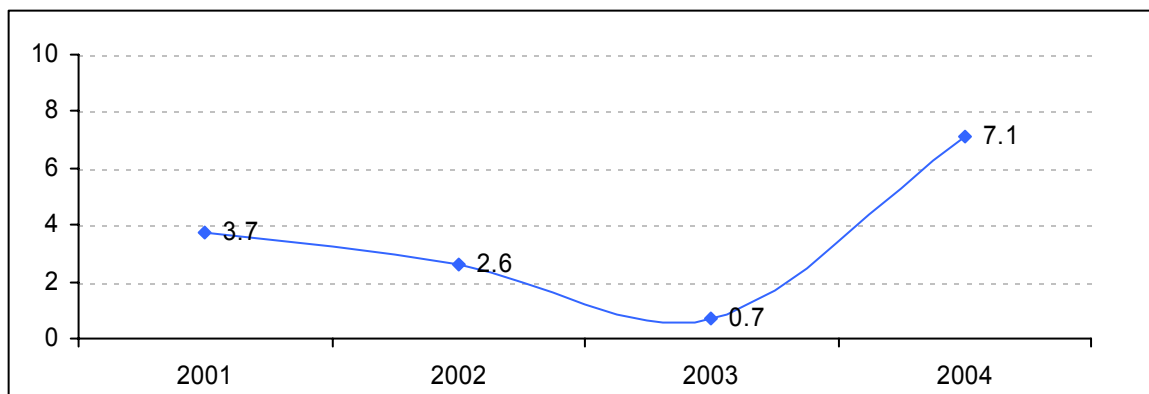
**CHART 1.35. ANNUAL FOREIGN DIRECT INVESTMENT IN PRODUCTION OF FLOUR-BASED CONFECTIONERY GOODS, 2001-2004 (MILLION USD)**



Source: State Statistics Committee of Ukraine.

In 2000, volumes of FDI in production of goods containing cocoa were low. In 2003, the Government of Ukraine attempted to levy an

excise duty on chocolate that caused an outflow of investment from this segment.

**CHART 1.36. ANNUAL FOREIGN DIRECT INVESTMENT IN PRODUCTION OF GOODS CONTAINING COCOA, 2001-2004 (MILLION USD)**

Source: State Statistics Committee of Ukraine.

# SECTION 2. PRODUCTION

## ORGANIZATION AND STRUCTURE OF PRODUCTION

According to industry experts, the organization of production that confectionery enterprises inherited from the Soviet era resembles old equipment; preserving it will only further thwart enterprise development. In order to compete, most market leaders set up new production divisions in order to ensure stable development and a place in the market, and apply new high-tech approaches to organizing their production facilities.

Technical operations are conducted in strict compliance with instructions that have the force of law for production staff. Round-the-clock mass assembly line production is ensured by specialized logistics, mechanics, and technological departments. Moreover, a factory's central laboratory guarantees proper compliance with rules governing technological processes. The staff of these enterprises must include divisions assigned to developing and including new products via mass production. The contents and sequence of activities of these divisions comply with old design and engineering regulations from the Soviet era.

As for the structure of production, this analysis will show that in addition to maintaining Soviet-era frameworks for production activities, the largest enterprises in the sector:

- act as universal producers, but consistently expand their presence in one selected market segment;
- follow monthly or quarterly work plans (some larger producers also use annual programs drafted on the basis of predictions for the market); and
- acknowledge the possibility of introducing structural changes to their operations in order to respond to challenges in the market; for example, some companies (AVK, Roshen, and Kraft Foods Ukraine) are building new production facilities in order to adapt to changes in demand and export potential.

Preservation of a wide product range allows companies to maintain their position in the market, since production diversity is important for sales.

The confectionery market is rapidly reaching a point of saturation; the level of investment in this sector has been limited so far, and it is safe to assume that enterprises will turn to specialization

in certain market segments and concentrate more on quality and diversity within the boundaries of those segments as time goes on. The experience of the following companies with investment in Ukraine is proof of these tendencies: Kraft Foods, Nestlé, and Rainford.

**Roshen** (in the cities of Kyiv, Vinnytsya, Mariupol, and Kremenchuk in Ukraine, and Lipetsk in Russia). In terms of structure, this corporation is a conglomeration of businesses, each of which works in its own market segment. This corporation ranks first in production of sugar-based goods and hard candy (the Kremenchuk factory specializes in this particular segment), and holds – according to different estimates – 45 percent of the domestic market. The Mariupol Confectionery Factory specializes in flour-based confectionery goods. Since Roshen lags behind Kraft Foods Ukraine in the chocolate segment, one of its development areas is creation and production of new types of chocolate. As for chocolate candies (particularly packaged candies), Roshen competes successfully with AVK and Svitoch.

**AVK CJSC** (in the cities of Donetsk, Dnipropetrovsk, Luhansk, and Mukacheve). AVK's operations target various segments of the confectionery market. Sweet biscuits and wafers (15.5 percent) and hard candy (11 percent) combine to form a quarter of AVK's total production volume.

However, the largest share of the company's products in physical terms is represented by the most profitable segments: goods containing cocoa (31.2 percent) and chocolate candies (29 percent). According to company management, production of chocolate and chocolate goods grew by 20.2 percent in 2004, making AVK the overall leader of the chocolate segment.

In 2004, AVK's market share in the chocolate segment increased to 28.3 percent (from 26.9 percent in 2003). The market share of the chocolate segment belonging to AVK's closest rival, Roshen, was 22 percent. AVK intends to continue increasing chocolate production volumes.

**Kraft Foods Ukraine** (Trostyanets). This company differs from its closest competitors in terms of its production structure since it holds only a small share of total Ukrainian confections sector production. However, the company has been

successful in the most profitable market segment: chocolate.

**Svitoch** (Lviv). This company positions itself in the market as a producer of chocolate and chocolate candies (with a share of 17.4 percent in this segment). An important element of the company's production structure is biscuits (with a share of 15 percent).

**Kiev-Konti** (in the cities of Donetsk, Konstantinivka, and Horlivka in Ukraine, and Kursk in Russia). This company's production structure is dominated by flour-based confectionery goods (i.e., biscuits and crackers). Kiev-Konti holds first place in Ukraine's biscuit and cracker segment with 24.3 percent. This company is responsible for 18 percent of total domestic production of dragée, 10.5 percent of wafers, 10 percent of hard candy, and 8 percent of other sweets.

**Kharkiv Biscuit-Chocolate Corporation** (Kharkiv). This enterprise was created when the following two companies united: (1) the Kharkiv Biscuit Factory, producing over 100 brands of flour-based confectionery goods, and (2) the Kharkiv Confectionery Factory, specializing in production of hard and glazed candies, marmalade, and marshmallows. This company comprises almost 6.3 percent of total Ukrainian production volume in the flour-based goods segment, namely: biscuits, crackers, wafers, sponge cakes, Swiss rolls, and cakes.

**PoltavaKonditer OJSC** (Poltava). This confectionery factory produces a wide range of products within four production lines: hard candy, sugar-based products, chocolates, and flour-based products. Preserving the production

structure inherited from the Soviet times, this enterprise's management selected production of chocolate and hard candy as main areas for development (the company's shares of these segments of the Ukrainian confections market are 2 percent and 5.2 percent, respectively).

**Zhytomyrsky Lasoschi** (Zhytomyr). Hard candy and other sugar-based goods make up an essential share of the output of this confectionery factory. The factory has also made efforts to increase production volumes of the following flour-based goods: biscuits, wafers, and products geared toward consumers with diabetes.

**Rainford** (Dnipropetrovsk). This company's factory was built in Dnipropetrovsk in 1999, and was immediately positioned as a chocolate producer. Having launched production activities by following recipes of famous European chocolatiers, Rainford switched to chocolates created according to their own recipes in 2001. This enterprise specializes in production of chocolate in the medium-priced and expensive segments.

A hallmark of the confections sector is seasonal fluctuation of demand for products from various segments. In terms of supply, the peak of production of sugar-based and chocolate goods is in spring, late autumn, and early winter. The only possibility to avoid overloading production facilities before crucial periods is create modern warehouse facilities in order to store products for extended periods of time.

According to the industry experts, however, seasonal fluctuations are typically more common for medium-sized and small businesses, whereas large companies are less affected by it.

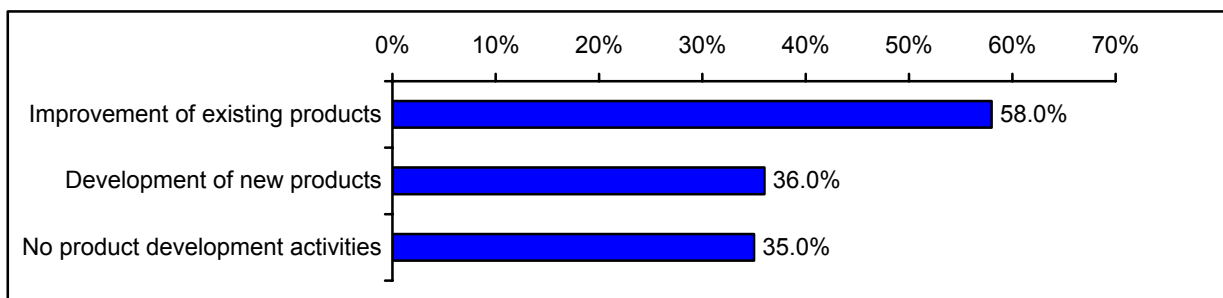
## TECHNOLOGY AND INNOVATION

Over half of the enterprises taking part in the survey (regardless of size) were implementing new developments to improve their products.

Of the surveyed enterprises, 36.0 percent (mostly large businesses) engaged in development activities with the aim of creating new products. The largest share of confectionery producers that did not engage in development activities was found among small businesses (Chart 2.1).

This situation may be explained by the level of competition and consumer specifics. While the market shares of small businesses are acceptable and stable now, larger enterprises are making active efforts to increase their market presence. In the current environment, enterprises can only attract new customers with product ranges that continuously improve and higher product quality.

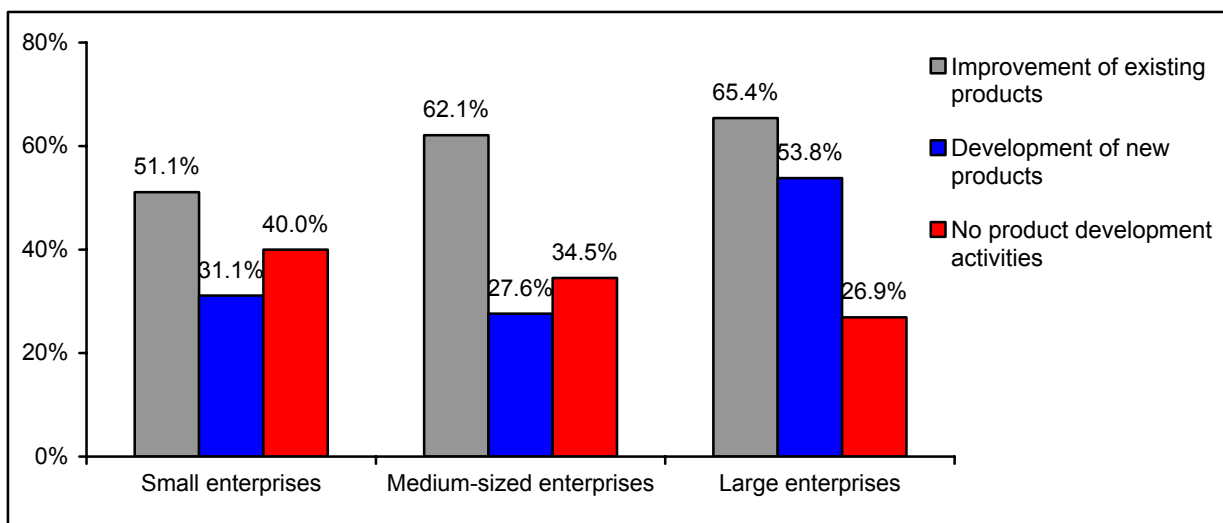
**CHART 2.1. IMPLEMENTATION OF PRODUCT DEVELOPMENT ACTIVITIES AMONG SECTOR ENTERPRISES\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 2.2. IMPLEMENTATION OF PRODUCT DEVELOPMENT ACTIVITIES AMONG SECTOR ENTERPRISES (BY ENTERPRISE SIZE)\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

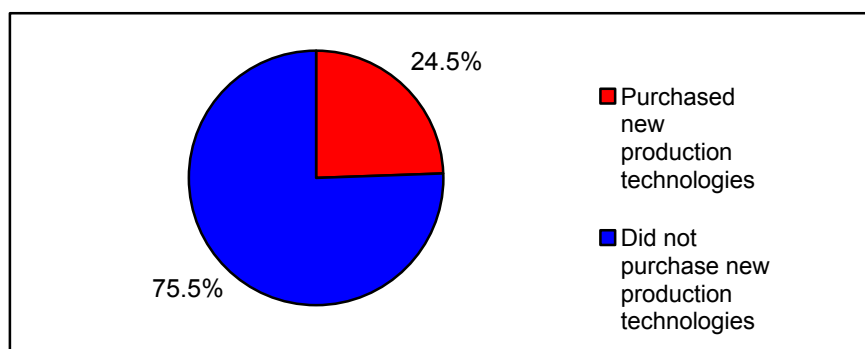
Of the surveyed enterprises, 24.5 percent acquired new production technologies in the period between 2003 and 2005.

These were mainly medium-sized and large enterprises, since they tended to have enough

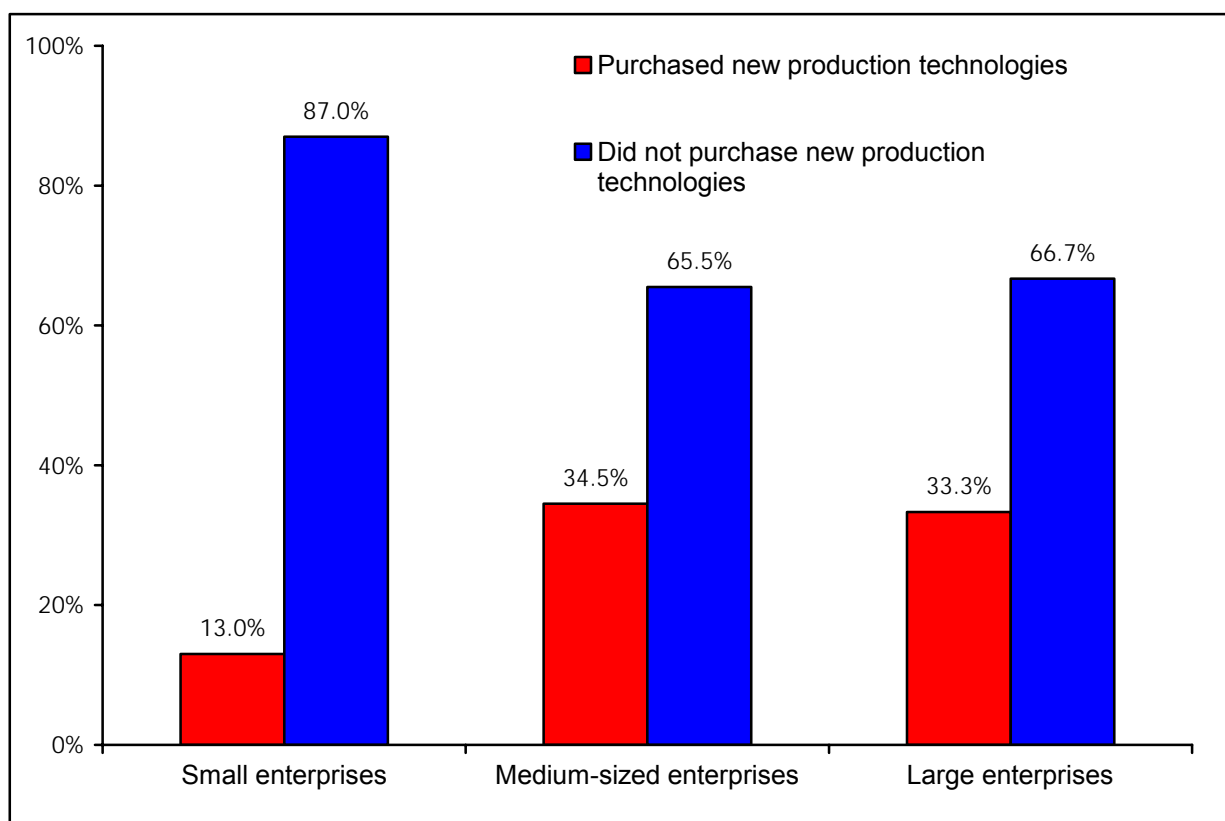
money and professional expertise in order to implement upgrades of production technologies.

Among small businesses, 13 percent reported that they were able to purchase new production technologies (Chart 2.3 and 2.4).

**CHART 2.3. PURCHASES OF NEW PRODUCTION TECHNOLOGIES, 2003-2005**



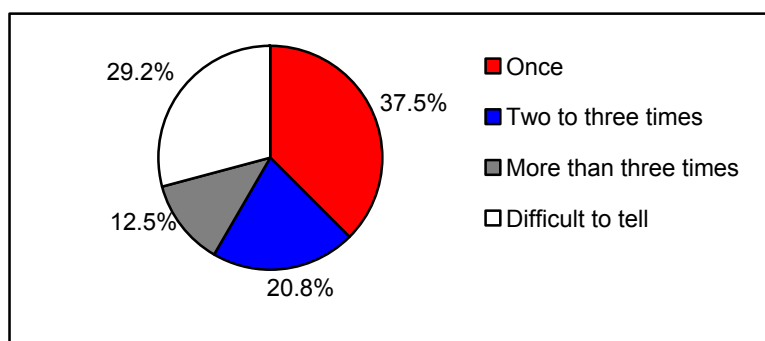
Source: Survey of 102 confectionery enterprise CEOs.

**CHART 2.4. PURCHASES OF NEW PRODUCTION TECHNOLOGIES, 2003-2005 (BY ENTERPRISE SIZE)**

Source: Survey of 102 confectionery enterprise CEOs.

Ukrainian confectionery enterprises generally did not invest money in new production technologies because of high costs (75.5 percent). Over half of those enterprises that did purchase new

technologies from 2003 to 2005 (24.5 percent) did so less than two times over the surveyed period (Chart 2.5).

**CHART 2.5. FREQUENCY OF NEW PRODUCTION TECHNOLOGY PURCHASES, 2003-2005**

Source: Survey of 102 confectionery enterprise CEOs. Number of respondents to this question in particular: 24.

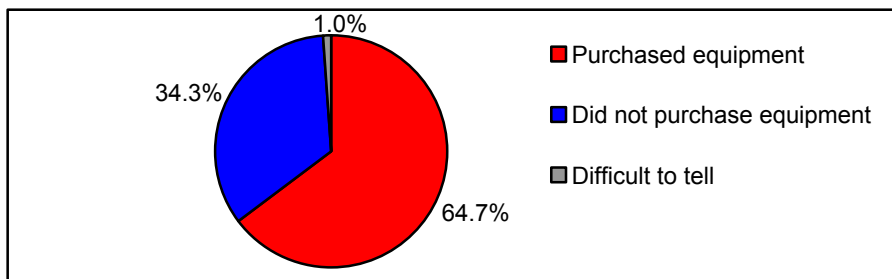
Purchasing equipment is an important step toward better quality and higher demand for one's products; however, it is financially risky at the same time. Moreover, new equipment is one of the most significant expenses for companies.

Over the course of 2005, 64.7 percent of businesses that participated in the survey

purchased new equipment. These were mainly large and medium-sized businesses (77.8 percent and 72.4 percent, respectively; see Charts 2.6 and 2.7).

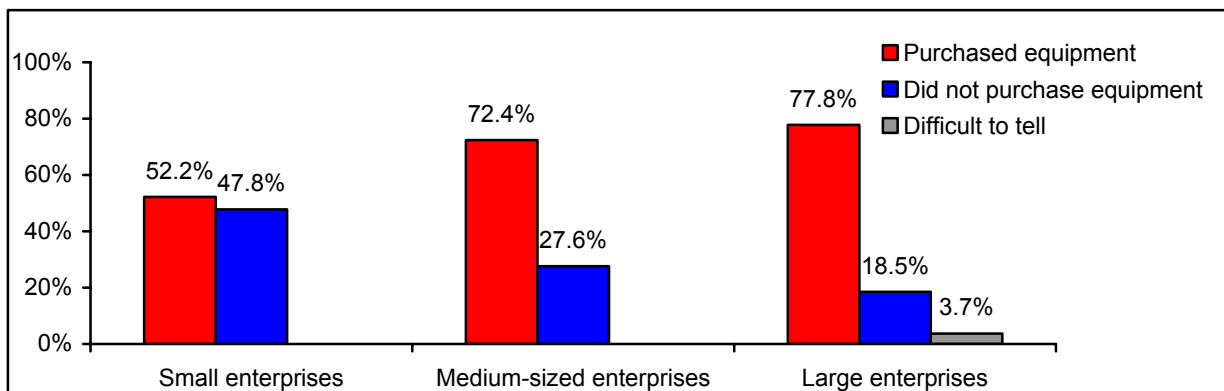
In contrast, only half of small enterprises could afford to purchase new equipment.

**CHART 2.6. EQUIPMENT PURCHASES IN 2005**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 2.7. EQUIPMENT PURCHASES IN 2005 (BY ENTERPRISE SIZE)**



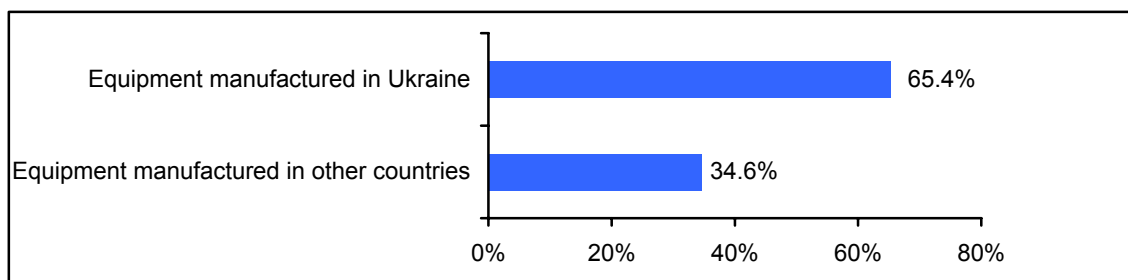
Source: Survey of 102 confectionery enterprise CEOs.

According to the results of the poll, 65.4 percent of businesses purchased new equipment manufactured in Ukraine. In terms of the origin of new foreign-made equipment, Germany, Italy, and Russia were mentioned the most often (Chart 2.8). While businesses generally purchased new

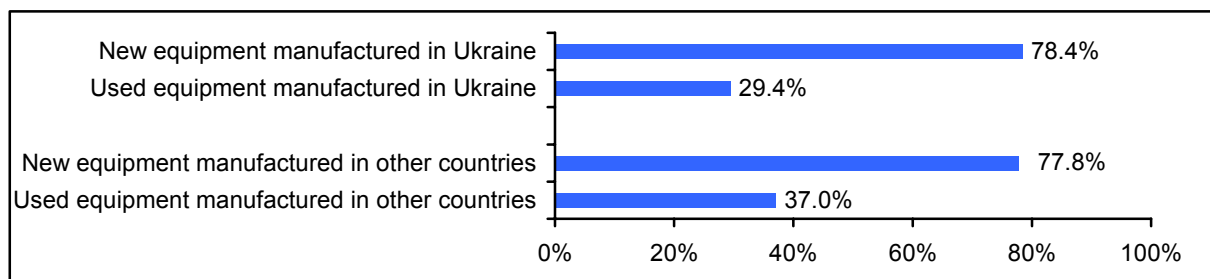
equipment (both Ukrainian- and foreign-made), sometimes they bought second-hand machinery.

Second-hand equipment of foreign origin was purchased more frequently than used models made in Ukraine (37.0 percent compared to 29.4 percent, respectively; see Chart 2.9).

**CHART 2.8. ORIGINS OF PRODUCTION EQUIPMENT**



Source: Survey of 102 confectionery enterprise CEOs. Number of respondents to this question in particular: 65.

**CHART 2.9. EQUIPMENT CHARACTERISTICS\***

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 65.

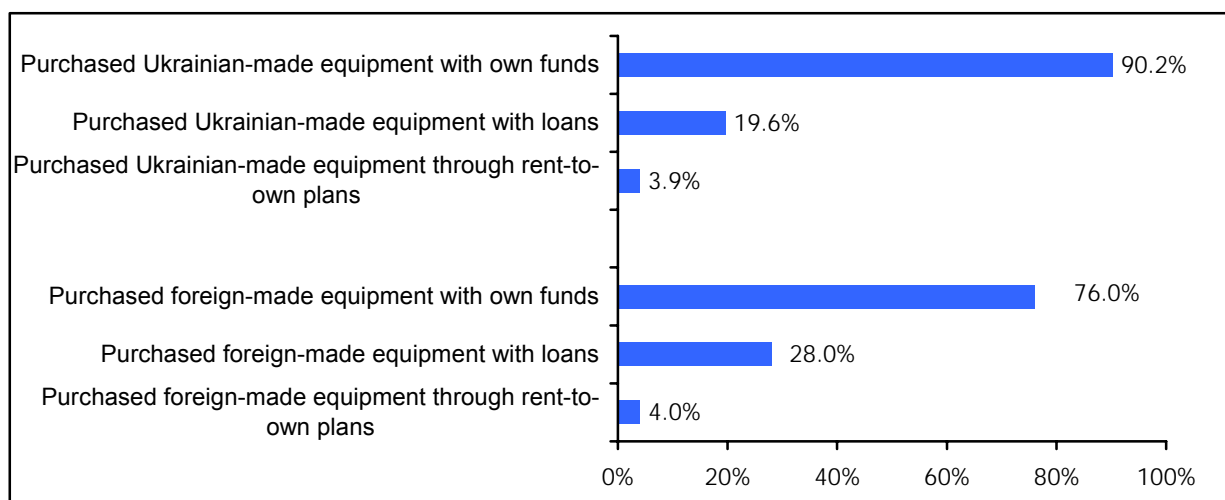
\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

Enterprises mostly paid for equipment using their own funds. While this stands as evidence of enterprises' high profits, it also confirms the immaturity of the Ukrainian banking sector (and the underdeveloped nature of credit and rent-to-own systems in particular).

Demands by potential lenders were unsuitable because collateral requirements exceeded the size of loans considerably. As noted by the industry experts, only projects with short

reimbursement periods attracted investors, and rapid growth was not typical for the Ukrainian confections market.

Purchases of equipment via rent-to-own plans were not attractive for enterprises, either. First, it would be necessary to make regular payments for use; second, the rapid technological development of the market could lead to equipment becoming obsolete before enterprises had finished paying for it (Chart 2.10).

**CHART 2.10. FINANCING EQUIPMENT PURCHASES\***

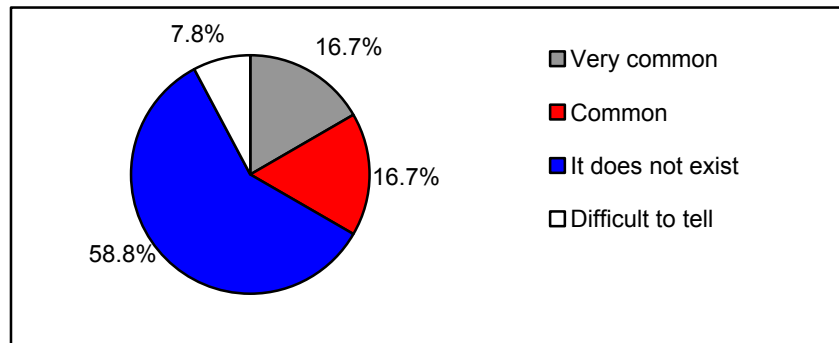
Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 65.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

## RESEARCH AND DEVELOPMENT ACTIVITIES AND COPYRIGHT ISSUES

Of the surveyed enterprise CEOs, 33.4 percent stated that illegal copying was either "very common" or "common" in the confections sector. The situation in the market pressured enterprises

to outdo their competitors, which sometimes resulted in plagiarism of ideas, flavors, and packaging designs.

**CHART 2.11. HOW COMMON IS ILLEGAL COPYING IN THE SECTOR?**

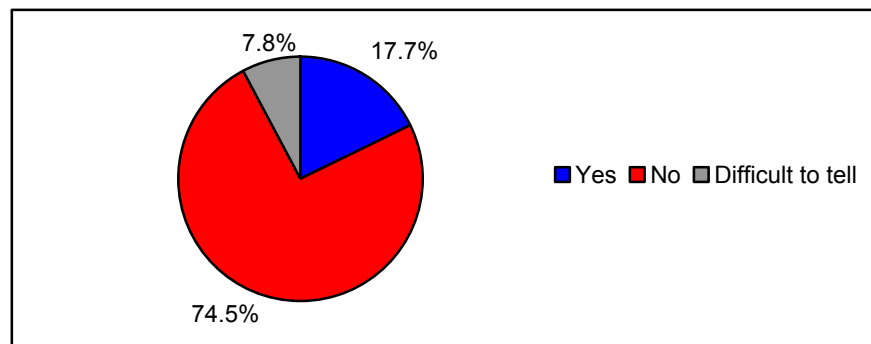
Source: Survey of 102 confectionery enterprise CEOs.

Despite the fact that a significant share of the respondents acknowledged that illegal copying was a common practice, 74.5 percent did not believe that it caused problems for their enterprises.

Heads of large enterprises were more likely to state that illegal copying presented problems for their operations (33.3 percent) than their counterparts among medium-sized and small enterprises (6.9 percent and 15.2 percent, respectively).

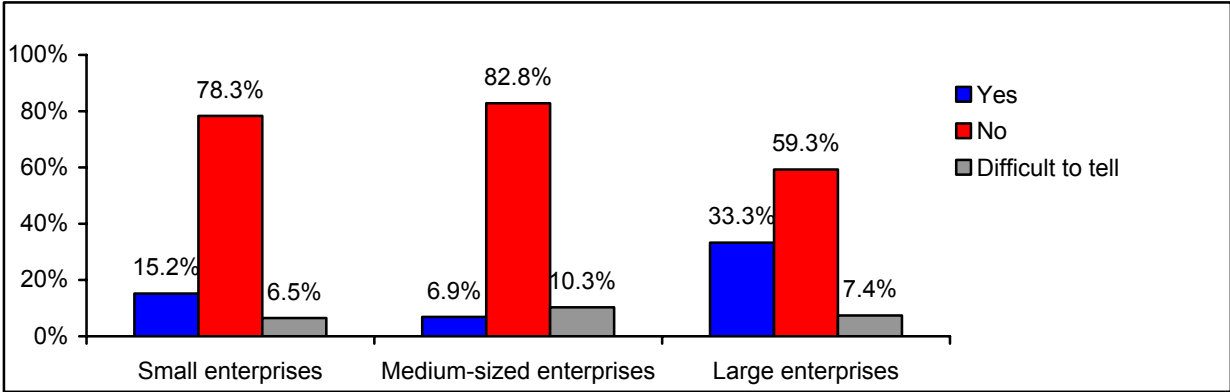
This serves as proof that either industrial espionage was not viewed as a serious problem, or companies' intellectual property was sufficiently protected.

On the other hand, some industrial models were so sophisticated and technology-intensive that for small and medium-sized enterprises (which usually lacked the necessary equipment), copying was either impossible or just impractical.

**CHART 2.12. IS ILLEGAL COPYING A PROBLEM FOR YOUR ENTERPRISE?**

Source: Survey of 102 confectionery enterprise CEOs.

**CHART 2.13. IS ILLEGAL COPYING A PROBLEM FOR YOUR ENTERPRISE? (BY ENTERPRISE SIZE)**



Source: Survey of 102 confectionery enterprise CEOs.

# SECTION 3. RAW MATERIALS AND ENERGY RESOURCES

## OVERVIEW OF THE RAW MATERIALS MARKET

Confections production is considered material-intensive: according to the industry experts, the cost of raw materials represented from 60 to 75 percent of total production costs. The share of imported raw materials in the cost of production sometimes reached 60 percent among enterprises specializing in chocolate and chocolate goods.

The confections industry mainly uses domestic raw materials: flour, sugar, milk, and butter. The only imports are ingredients that are unavailable domestically: cocoa beans, hazelnuts, peanuts, and tropical oils and mixes (such as coconut and peanut oils). However, in the event of a crisis in the flour and sugar markets in Ukraine (as in 2003), confectioners are forced to purchase imported raw materials at particularly high prices.

At present, confectioners still face the following problems:

- The inadequate (and declining) quality of domestic raw materials falls short of standards set by confectionery producers.
- Prices for raw materials in the Ukrainian market are unstable (most producers voiced displeasure regarding the need to raise prices for their products because of rising raw materials costs).

The higher price of imported raw materials (particularly cocoa as an essential component of chocolate and chocolate goods) contributed to uncertainty about the future of the chocolate segment. Confectioners were doubtful that the domestic market could accept expensive chocolate. However, factories will not be able to work with losses for much longer. Ukrainian confectioners have been waiting for domestic “chocolate giants” to influence changes in raw materials supply prices, but industry experts stated that leading companies have already protected their own companies from risks associated with obtaining raw materials by purchasing yearly supplies of cocoa in advance.

As noted earlier, most large businesses specialize in several different segments of the confectionery market. This leads to a “product range problem” (sometimes producers have over 200 brands of goods) wherein a company is unable to improve any production segment because their resources are stretched to the limit. This makes procurement of raw materials, packaging, and equipment extremely difficult; moreover, it increases production costs and may lead to losing customers in certain consumer market segments.

## MAIN SUPPLIERS OF RAW MATERIALS

### Domestic suppliers

#### Sugar

Ukrainian confection enterprises consume about 300 thousand tons of sugar annually. The main issues of these enterprises include:

- Seasonal volatility of sugar prices. Prices are lowest in September and October after each year’s harvest, and rise in summer. In order to accommodate demand throughout the year, producers are forced to find ways to purchase this raw material at the lowest price possible. One solution is to sign supply agreements for sugar with fixed prices for the year. However, only large companies can afford to do so. Medium-sized and small businesses in particular have to purchase sugar at prices that fluctuate constantly.

- Sugar quality. Production of some sorts of confectionery goods requires sugar that domestic manufacturers cannot supply (e.g., sugar for household use with crystals 300-500 microns in size; this can also be used for chocolate production).

As one of the major generators of revenues for the government budget, the sugar industry in Ukraine enjoys legislative support. The government protects sugar producers’ interests. Government support of high sugar prices has an adverse effect that extends beyond the confectionery goods sector.

Sugar prices were particularly unstable in 2002. Supplies of sugar in the domestic market were insufficient, and exports of sugar out of Ukraine only exacerbated the problem.

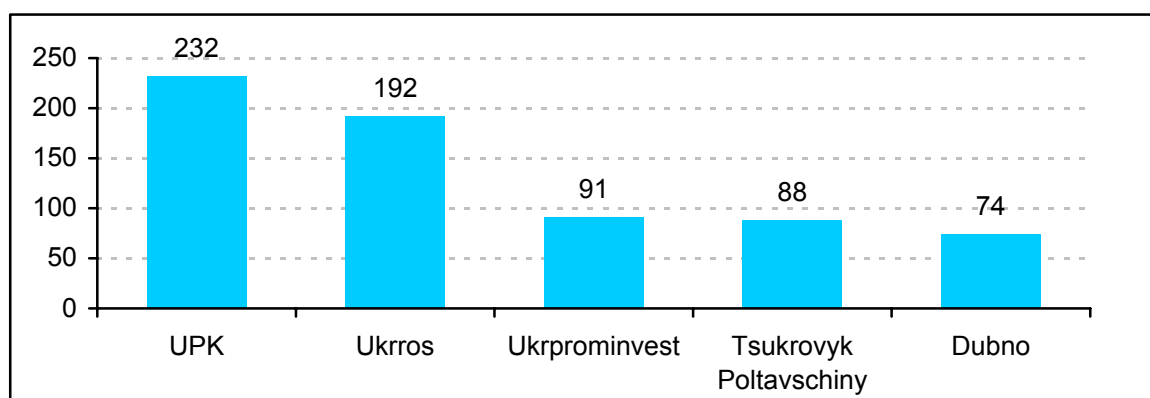
In 2003-2004, adequate supplies of domestic sugar were produced, and a share was exported. As a result, domestic prices were stable.

According to the Ukrsugar Association, 192 sugar factories were operating in Ukraine with a total production capacity of 5 million tons per year until very recently. At the time of the survey, nearly 30 had been shut down. This fate was imminent for another 40 operations. Market participants believed that processing capacities of 60 to 80 Ukrainian factories were sufficient to handle the quantity of sugar beets harvested domestically (even more so if these 60 to 80 plants were to undergo a technical upgrade).

At the time of the survey, the most powerful sugar producers in Ukraine included:

- UPK (14 factories), producing a total of 232 thousand tons per year;
- Ukrros (6 plants), producing a total of 192 thousand tons per year;
- Ukrprominvest (2 plants), producing a total of 91 thousand tons per year;
- Tsukrovyk Poltavshchiny (5 plants), producing a total of 88 thousand tons per year; and
- Dubno (6 plants), producing a total of 74 thousand tons per year.

**CHART 3.1. SUGAR PRODUCTION BY LEADING ENTERPRISES, 2004 (THOUSAND TONS)**



Source: State Statistics Committee of Ukraine.

### Flour

The years 2000 and 2002 were favorable for grain crops, which positively influenced the confections industry. Flour production dropped in 2003 due to a poor grain harvest and adversary weather conditions. As a result, Ukraine was forced to import grain. Higher prices for flour caused a 6-percent increase in prices for baked confectionery goods. A good harvest in 2004 stabilized prices for raw materials – and confections prices as a result.

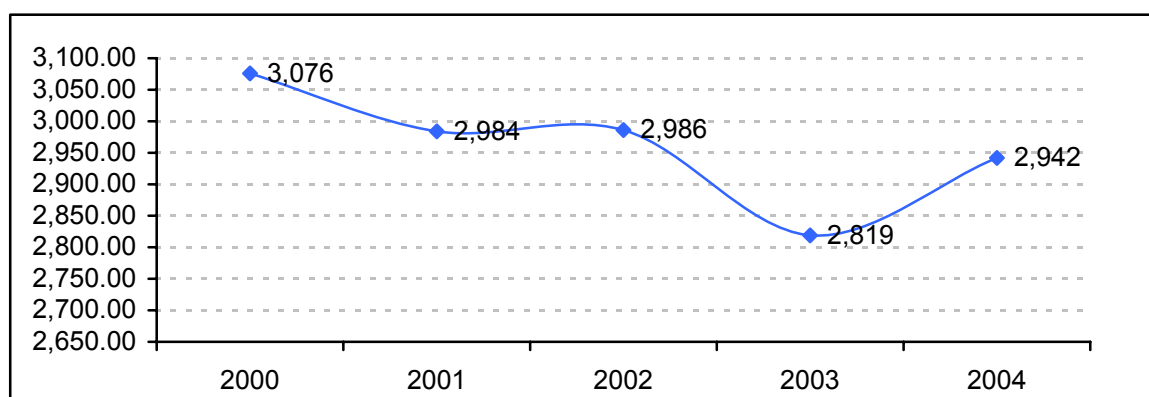
According to industry experts, the situation with flour is one of the most critical problems for the flour-based confectionery segment for the following reasons:

- The flour production market operates within the framework of outdated standards that apply to only four main components.

- No system for producing special-purpose flour for confectionery goods exists in Ukraine (in contrast, Denmark's confections industry uses nearly 80 different varieties of flour for confectionery production alone).

In Ukraine, 60 percent of flour production is controlled by the following state-owned entities: Khlib Ukrainy State-Run Joint-Stock Company, the State Reserve, and Kyivmlyn CJSC. Other companies are under private ownership. In addition, there are nearly 3,000 small flour mills.

Use of low quality flour purchased at low prices enabled small and medium-sized enterprises to maintain profitability of their operations, but product quality suffered.

**CHART 3.2. FLOUR PRODUCTION VOLUMES, 2001-2004 (THOUSAND TONS)**

Source: State Statistics Committee of Ukraine.

### Milk

Local producers use domestically produced milk powder in production of some types of confectionery goods (particularly chocolate), but face similar issues with quality to those encountered with sugar and flour.

### Imported raw materials

#### Cocoa beans

Due to worsening weather conditions in major producer countries and a growing number of diseases striking cacao plantations, growth of global production of cocoa has slowed. At the same time, however, global consumption of goods containing cocoa has been growing steadily.

A *coup d'état* in Côte d'Ivoire (the leading producer of cocoa beans) led to a sharp drop in harvesting and sales of raw cocoa beans. This resulted in skyrocketing cocoa prices in the New York Commodities Exchange in 2002 (that eventually reached a 17-year high). The undersupply of raw cocoa to the market for that year was estimated at 94 thousand tons; in the following season, it reached 120 thousand tons.

In the 2003-2004 season, the situation changed radically: high world prices resulted in producers setting high purchase prices, which then encouraged farmers in many countries to enlarge the share of farmland used to grow cocoa beans and invest in cultivation of this product. According to the latest data, global production of cocoa in the 2003-2004 season reached 3,423 million tons, which represents an increase of 10 percent compared to the previous year.

West Africa is the principal region for cocoa bean cultivation. Two leading countries in the cocoa

market are located here: Côte d'Ivoire, the world's number one producer of cocoa beans (with 40 percent of global output, or 1.3 million tons) and Ghana (350-400 thousand tons annually). These countries have been producing cocoa for many years and therefore have a well-managed system of cultivation and marketing. In this region, cocoa beans are harvested twice a year: in October-January (the main harvest), and in April (the interim harvest). As a rule, Ukrainian confectioners purchase cocoa beans from Côte d'Ivoire; political instability there has adversely affected prices of inputs in Ukraine.

#### Hazelnuts

In 2004, a poor harvest in Turkey (the main importer) caused a twofold increase in prices for hazelnuts, an essential ingredient of a large number of sweet goods (specifically in promising segments for Ukrainian producers). This mostly concerns expensive products that are found in the chocolate segment. As a result, prices for confectionery goods containing hazelnuts rose by 6 to 8 percent. Drastic growth of prices for nuts (hazelnuts and almonds) affected prices of chocolate candies in the expensive and medium-priced segments.

#### Confectionery oils and additives (fermented components, fragrances, and acids)

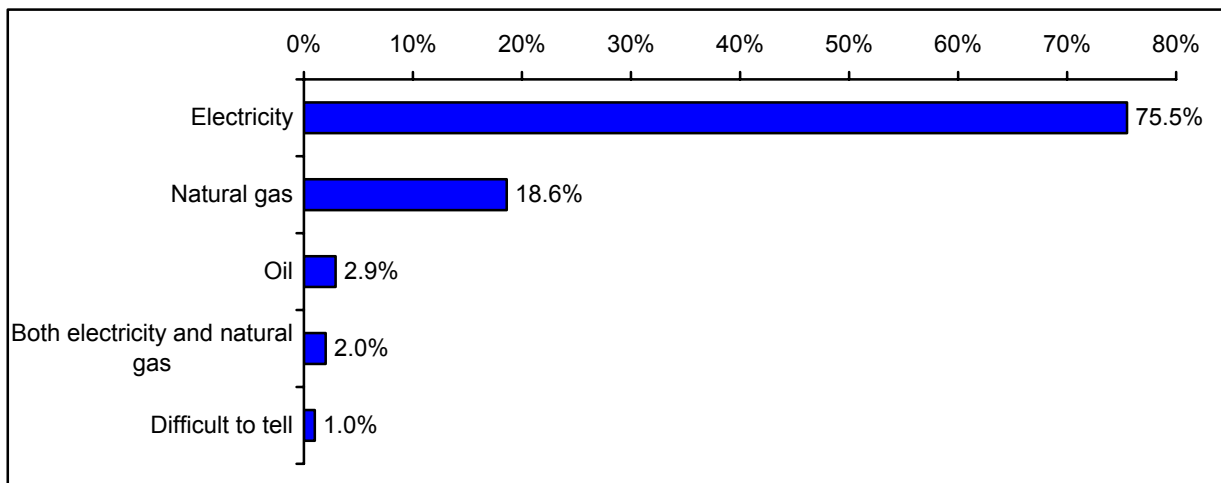
These are imported from Switzerland, Germany, Denmark, Belgium, and Japan. Some confectionery oils (e.g., palm oil) for the medium-priced and inexpensive segments are of domestic origin (produced in Ukraine by the Odessa, Kirovohrad, and Zaporizhzhya cooking oil factories).

### STRUCTURE AND EFFICIENCY OF ENERGY CONSUMPTION

Confections factories that participated in the survey cited both electricity and natural gas as the main energy resources used in operations. Meanwhile, most enterprises (75.5 percent) stated

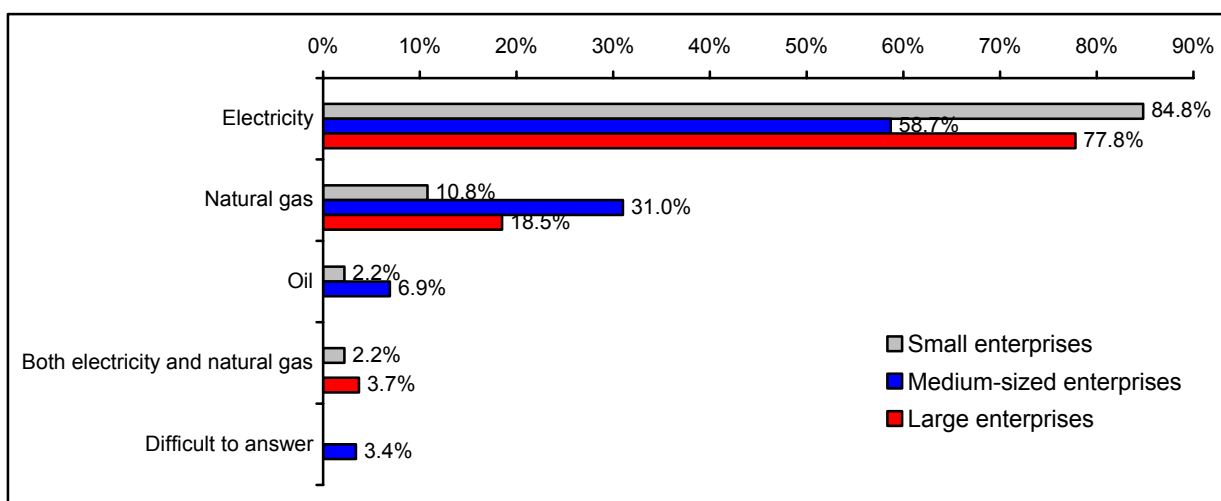
that electricity was their main energy resource. A relatively large share of medium-sized enterprises (compared to small and large operations) used natural gas (Charts 3.3 and 3.4).

**CHART 3.3. MAIN TYPES OF ENERGY RESOURCES USED BY ENTERPRISES**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 3.4. MAIN TYPES OF ENERGY RESOURCES USED (BY ENTERPRISE SIZE)**



Source: Survey of 102 confectionery enterprise CEOs.

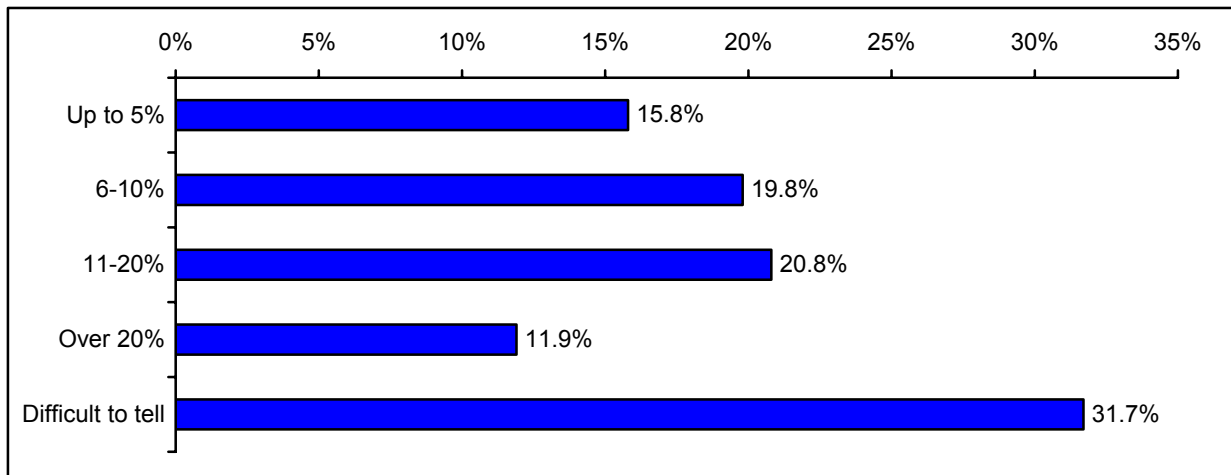
Energy costs represented up to 20 percent of total production costs. Only 11.9 percent of businesses reported that the share of energy in their production costs exceeded 20 percent.

However, 31.7 percent of business managers did not give a clear answer, i.e., they were unable to estimate the share of energy costs in the cost of production. This may serve as evidence that the enterprises did not monitor their energy usage because either it was low, or energy was too cheap for enterprises to bother with monitoring consumption.

For 24.4 percent of medium-sized businesses, the share of energy costs in the cost of production did not exceed 5 percent.

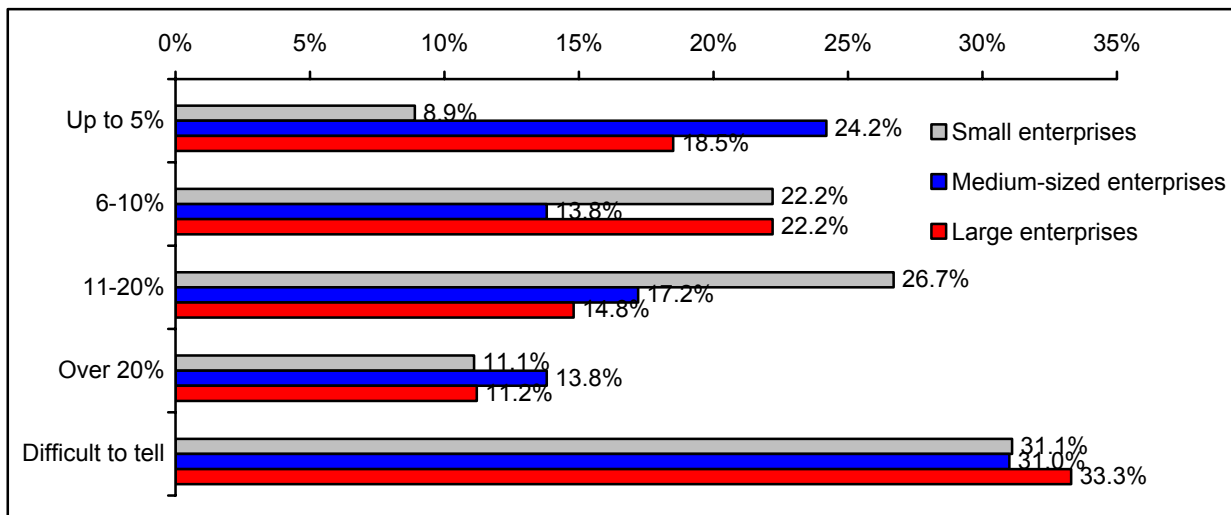
According to 26.7 percent of small businesses, the cost of energy amounted to 20 percent of the cost of production, which may demonstrate the energy-intensive nature of their operations and – presumably – the obsolete nature of equipment used there (Chart 3.5). Clearly, one of the strengths of new equipment is efficient use of energy.

**CHART 3.5. SHARES OF ENERGY EXPENDITURES IN PRODUCTION COSTS**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 3.6. SHARES OF ENERGY EXPENDITURES IN PRODUCTION COSTS (BY ENTERPRISE SIZE)**

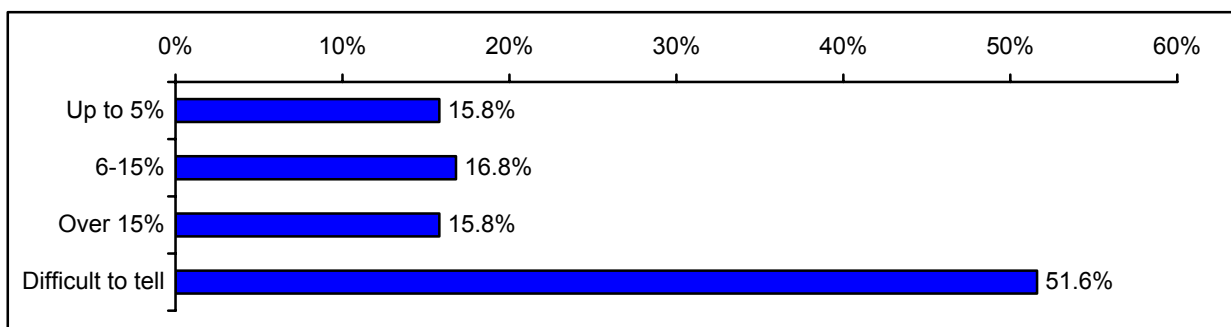


Source: Survey of 102 confectionery enterprise CEOs.

Approximately half of the surveyed enterprise CEOs failed to estimate how much of an increase in the share of energy resources – as a percentage of the total production cost – would affect the competitiveness of their products (Chart

3.7). Other respondents believed that the impact on competitiveness would be significant if the cost of energy resources rose beyond 15 percent of production costs (16.8 percent of respondents).

**CHART 3.7. AT WHAT POINT WILL ENERGY COSTS AFFECT THE COST OF PRODUCTION?**

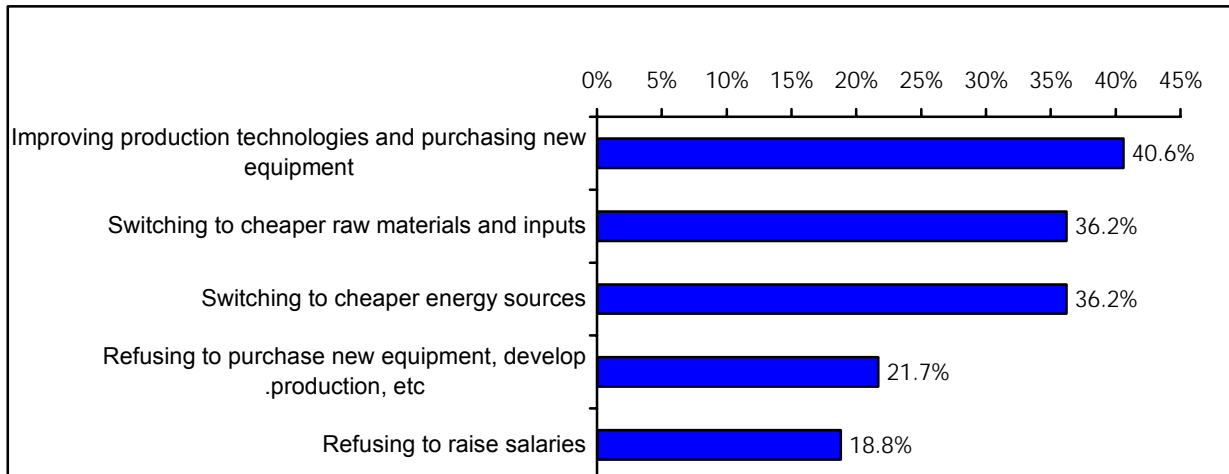


Source: Survey of 102 confectionery enterprise CEOs.

If the cost of energy resources were to go up, entrepreneurs stated that they would attempt to reduce production costs by using improved production technologies and new equipment (40.6 percent) and switching to cheaper energy sources (36.2 percent; see Chart 3.8). In other words, most businesses would combat higher prices through intensive production development.

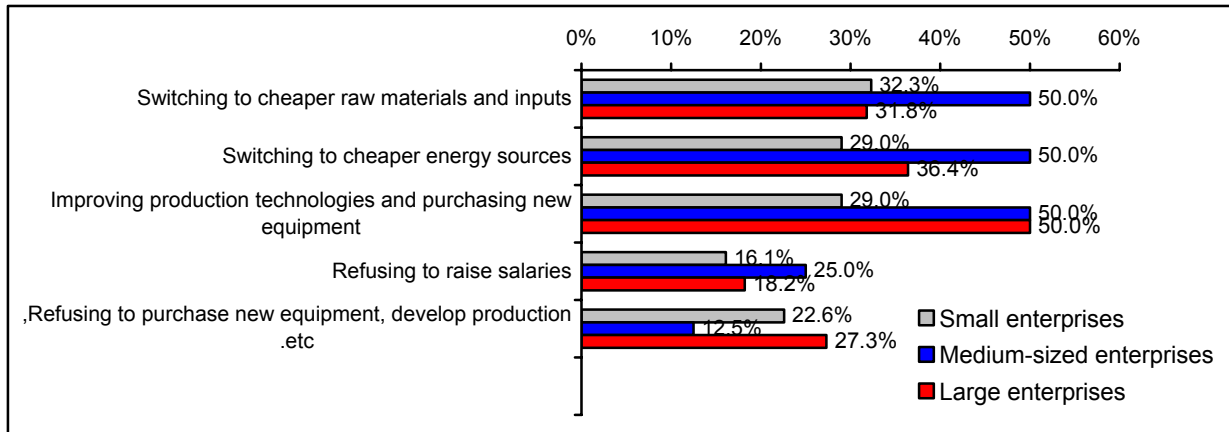
However, 36.2 percent of businesses stated that they would try to reduce the cost of production by using cheaper raw materials and inputs. As can be noted in Chart 3.8, these were mostly medium-sized businesses. If we consider that the quality of raw materials was generally considered low, use of even cheaper raw materials would result in even worse end product quality.

**CHART 3.8. METHODS OF REDUCING PRODUCTION COSTS IN THE EVENT OF AN ENERGY PRICE INCREASE**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 3.9. METHODS OF REDUCING PRODUCTION COSTS IN THE EVENT OF AN ENERGY PRICE INCREASE (BY ENTERPRISE SIZE)**

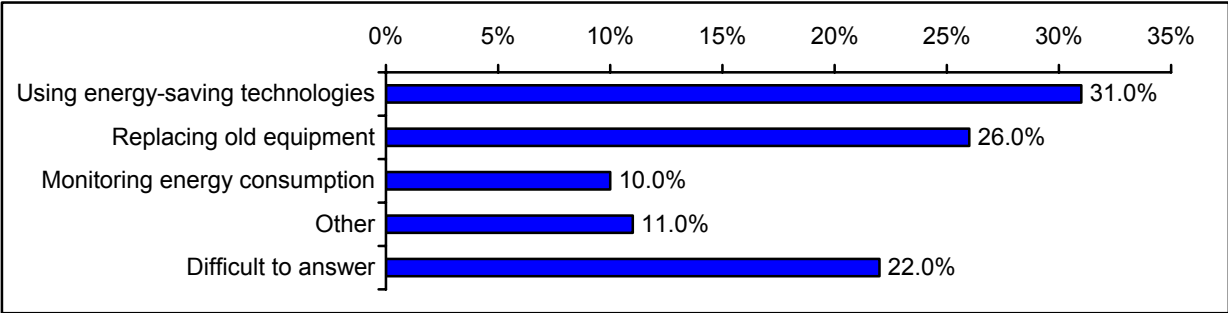


Source: Survey of 102 confectionery enterprise CEOs.

All businesses participating in the survey reported active efforts to conserve energy. Thirty-one percent of businesses used energy-saving technologies, while another 26.0 percent replaced old equipment. This demonstrates a high level of awareness of the effect of energy costs on the total cost of production.

Energy-saving techniques were not used as often as would be required in order to save money on energy costs. It is important to note that 22.0 percent of businesses were unable to answer this question (Chart 3.10).

**CHART 3.10. ENERGY CONSERVATION MEASURES**



Source: Survey of 102 confectionery enterprise CEOs.

# SECTION 4. SALES

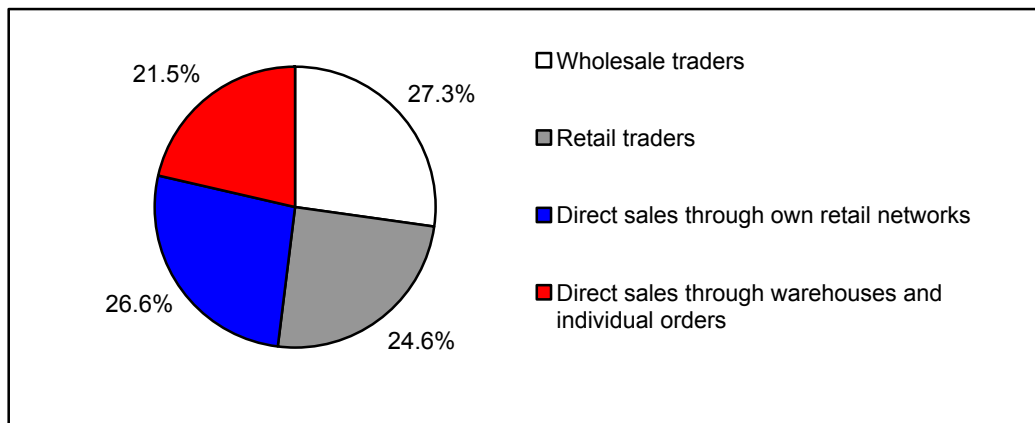
## ANALYSIS OF DISTRIBUTION CHANNELS FOR SECTOR PRODUCTS

In terms of distribution channels, 26.6 percent of businesses that participated in the survey sold their products through their own retail networks and 27.3 percent sold their products through wholesale traders (Chart 4.1).

Direct sales to end consumers were cited by 21.5 percent of respondents (this group was dominated by small and medium-sized businesses that had a convincing presence in regional markets).

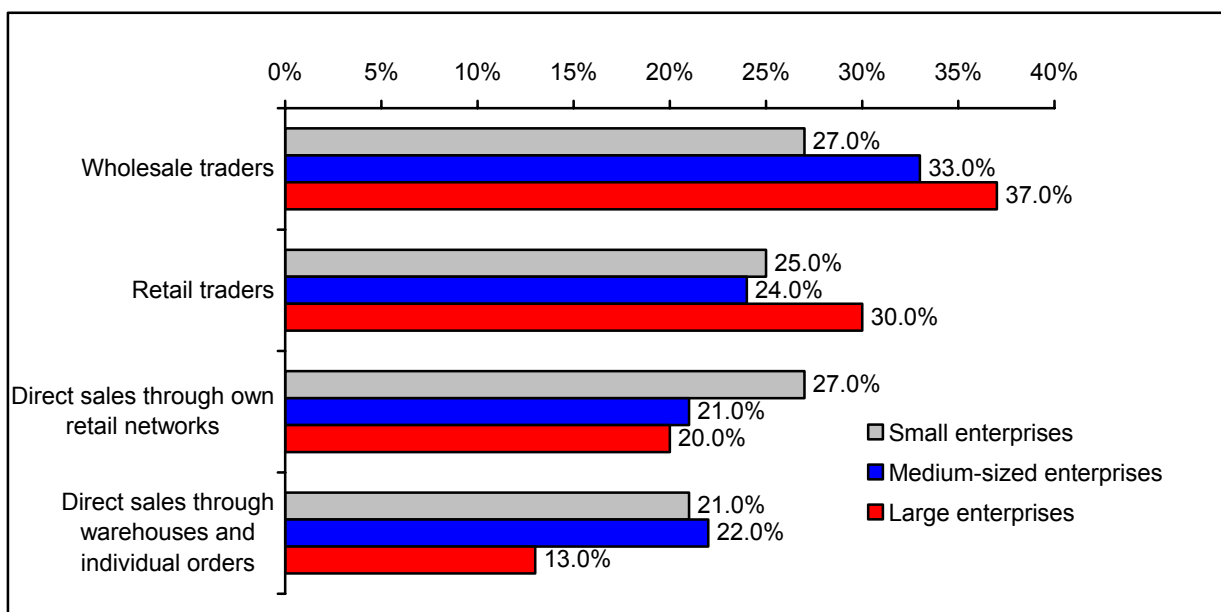
Large and medium-sized businesses usually sold their products through wholesale traders (37.0 percent and 33.0 percent, respectively). Companies of all sizes had their own distribution networks, but this channel was used more often by small businesses (27.0 percent) than by medium-sized and large businesses (21.0 percent and 20.0 percent, respectively). Small businesses were equally represented in all distribution channels (Chart 4.2).

**CHART 4.1. PRODUCT DISTRIBUTION CHANNELS**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 4.2. PRODUCT DISTRIBUTION CHANNELS (BY ENTERPRISE SIZE)**



Source: Survey of 102 confectionery enterprise CEOs.

# SECTION 5. COMPETITION

## REGIONAL DISTRIBUTION

Confectionery factories can now be found now in almost every Ukrainian oblast.

Confections producers may be divided into the following three groups according to production volumes, methods of market entry and influence in the sector, and geographic location:

- The most successful group in terms of production volumes – but smallest in terms of the number of enterprises involved – consisted of Roshen (consisting of 5 factories, one of which is in Russia), Kiev-Konti (consists of three Ukrainian operations and one Russian factory), and AVK (composed of five Ukrainian factories).
- The second most powerful group consisted of enterprises confined to specific regions of Ukraine. These enterprises had sufficient capacities to enter the all-Ukrainian market.
- The third group included small enterprises (often producing other goods in addition to confections) that operated in their own towns or rayons.

In terms of methods of market entry, Ukrainian confectionery factories may be divided into three categories:

- enterprises that developed through foreign investment (Kraft Foods Ukraine, Svitoch);
- enterprises that attracted domestic investors (AVK, Roshen); and
- enterprises that focused on development using their own funding (Kharkiv Biscuit-Chocolate Corporation, Odessa CJSC, and others).

As for small confectionery enterprises, their success will be dependent on two factors: unique products and low selling prices.

In terms of regional distribution, the largest share of production volume was observed in the Donetsk Oblast. Poltava Oblast ranked second, and the city of Kyiv ranked third. The Dnipropetrovsk and Odessa Oblasts rounded out the “top five.” The smallest shares of confectionery goods were produced in the city of Sevastopol and the Kirovohrad and Ivano-Frankivsk Oblasts.

**TABLE 5.1. REGIONAL DISTRIBUTION OF CONFECTIONERY PRODUCTION, 2003 (THOUSAND TONS)**

Region	2003 Production
Donetsk Oblast	159.6
Poltava Oblast	96.4
Kyiv City	67.4
Vinnytsya Oblast	62.6
Dnipropetrovsk Oblast	57.1
Odessa Oblast	48.2
Kharkiv Oblast	43.1
Lviv Oblast	41.0
Cherkasy Oblast	35.5
Luhansk Oblast	33.9
Kyiv Oblast	31.5
Zhytomyr Oblast	29.5
Sumy Oblast	26.5
Zaporizhzhya Oblast	24.5
Rivne Oblast	18.4
Chernihiv Oblast	13.4
Kherson Oblast	10.6
Zakarpattia Oblast	8.7
Volyn Oblast	8.0
Khmelnitsky Oblast	7.5
Chernivtsi Oblast	6.0

Mykolayiv Oblast	4.3
A.R. of Crimea	2.8
Ternopil Oblast	2.8
Ivano-Frankivsk Oblast	2.4
Kirovohrad Oblast	1.7
Sevastopol City	0.4

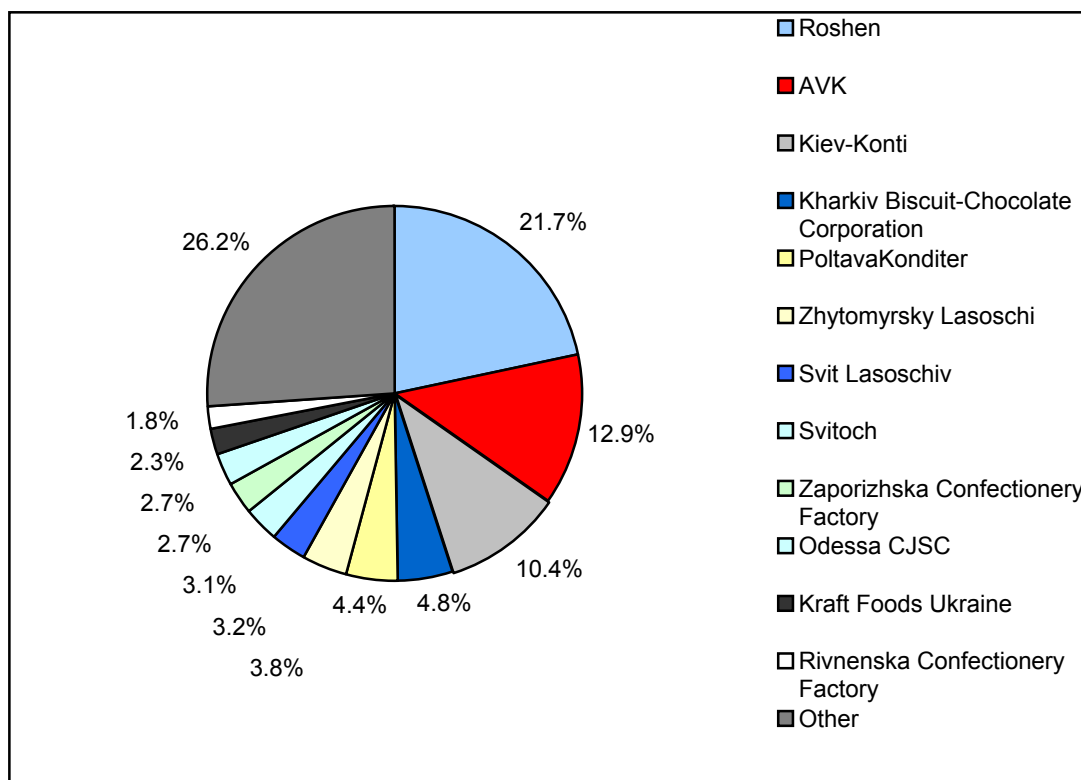
Source: State Statistics Committee of Ukraine.

### MARKET SHARES OF LEADING ENTERPRISES

As noted before, the overall number of businesses operating in the confections sector is growing

annually. As of the beginning of 2004, there were 761 such enterprises.

**CHART 5.1. MARKET SHARES OF LEADING ENTERPRISES, 2004 (IN %)**



Source: Interviews with industry experts.

### ANALYSIS OF LEADING ENTERPRISES' OPERATIONS

Company	Roshen
<b>Background</b>	A confections corporation, Roshen is the largest Ukrainian producer of confectionery goods. Roshen's facilities in Ukraine consist of confectionery factories in Kyiv, Vinnytsya, Mariupol, and Kremenchuk. From 2001 onward, this concern has also incorporated the Liconf Confectionery Factory in Lipetsk, Russia, a factor that has enabled this concern to enter the Russian market without having to cross the Customs border.
<b>Specialization</b>	Producing confections in all segments. The leader in the sugar-based confectionery goods segment. Roshen manufacturing facilities contribute nearly 22% (202 thousand tons) of total domestic sweets production.
<b>Export markets</b>	Russia, Kazakhstan, Moldova, Estonia, Lithuania, the U.S., Canada, Germany, Israel

<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Consumer trust and loyalty</li> <li>▪ Recognized brands</li> <li>▪ High product quality</li> <li>▪ Investment in equipment</li> <li>▪ Own innovation strategies and highly skilled personnel</li> <li>▪ Modern marketing technologies</li> <li>▪ Aggressive advertising methods</li> <li>▪ A presence in the regions, headquarters in the country's capital</li> <li>▪ Maintains good relationships with the Ukrainian government</li> <li>▪ Effective distribution systems and export experience</li> <li>▪ ISO-certified</li> <li>▪ A factory purchased abroad (Russia) increases their presence in external markets</li> </ul>
<b>Company</b>	<b>AVK</b>
<b>Background</b>	Founded in 1991. The title consists of the two founders' initials. AVK started operating as a fully-fledged concern in 1996 when the company purchased five factories in rapid succession (in the cities of Donetsk, Dnipropetrovsk, Luhansk, and Mukacheve). The Western NIS Enterprise Fund (an American equity fund operating under U.S. government supervision) owns a 25% stake in AVK.
<b>Specialization</b>	Focuses on production of high quality goods in the medium-priced and expensive price segments and development of new brands.
<b>Export markets</b>	Exported products comprise over 30% of output and are shipped to 15 countries worldwide. Most exports go to Russia and Kazakhstan. After introduction of a new Customs duty by Russia in 2001, AVK began searching for new markets for its products. These new markets now include Germany, Mongolia, and the U.S.
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Ukrainian and foreign investors</li> <li>▪ Investment in new products for the Ukrainian market</li> <li>▪ Regional traditions of confections production</li> <li>▪ High product quality</li> <li>▪ Modern marketing and advertising</li> <li>▪ Innovative production activities</li> <li>▪ Highly trained personnel</li> <li>▪ Access to foreign markets</li> </ul>
<b>Company</b>	<b>PoltavaKonditer OJSC</b>
<b>Background</b>	In 2000, American investment fund SigmaBleyzer began working closely with the PoltavaKonditer company; by the end of 2003, PoltavaKonditer had joined the "top five" confectionery operations with the largest production volumes in Ukraine.
<b>Specialization</b>	Produces highly competitive cookies and chocolate. "Dominique" cookies in particular are rising in the market.
<b>Export markets</b>	Russia, Kazakhstan, Lithuania, Azerbaijan, Moldova, Georgia
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Foreign investment</li> <li>▪ Investment in development of new products for the Ukrainian market</li> <li>▪ High product quality</li> <li>▪ Modern marketing and advertising</li> <li>▪ Creation of new brands</li> <li>▪ Highly trained personnel</li> </ul>
<b>Company</b>	<b>Kiev-Konti</b>
<b>Background</b>	Founded in 1996. "Konti" is an abbreviation of "Confectionery Technologies and Investment" in Ukrainian. Comprises four factories (in Donetsk, Konstantinivka, and Horlivka in Ukraine, as well as the Russian city of Kursk). In early 2004, Kiev-Konti purchased the Konditer-Kursk confectionery factory (Kursk, Russia).
<b>Specialization</b>	Production of goods in all confectionery segments. Production focuses on flour-based confectionery goods in particular (up to 70% of output).
<b>Export markets</b>	Russia (2/3 of exports), Kazakhstan, Azerbaijan, Kyrgyzstan, Moldova, Baltic States

<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Internal investment</li> <li>▪ Progressive management</li> <li>▪ Clear positioning in the market</li> <li>▪ Currently modernizing production facilities</li> <li>▪ ISO-certified</li> <li>▪ A production facility abroad (Russia)</li> </ul>
<b>Company</b>	<b>Kharkiv Biscuit-Chocolate Corporation</b>
<b>Background</b>	The Kharkiv Biscuit Factory was privatized in 1995, and joined the Kharkiv Confectionery Factory in 1999 to form the Kharkiv Biscuit-Chocolate Corporation.
<b>Specialization</b>	Specializes in production of flour-based and sugar-based goods.
<b>Export markets</b>	The share of exports in total production exceeds 30%. Destination countries include Russia, Kazakhstan, Azerbaijan, Kyrgyzstan, Moldova, Georgia, Lithuania, Latvia, Estonia, Mongolia, the U.S., Canada, and Israel.
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Recognizable brands</li> <li>▪ Clear positioning in the market</li> <li>▪ Traditional recipes of flour-based products</li> <li>▪ Strong customer loyalty</li> <li>▪ Employees are also company shareholders (an incentive for productivity)</li> <li>▪ High product quality, expanding range of flavors</li> <li>▪ ISO-certified</li> <li>▪ Experience in external markets</li> </ul>
<b>Company</b>	<b>Svitoch</b>
<b>Background</b>	In 1998, the Swiss company Nestlé purchased the Svitoch Factory in Lviv. Its entry into the local market involved marketing techniques and new approaches to advertising and packaging that had previously been unheard of in Ukraine.
<b>Specialization</b>	Produces over 100 brands of confectionery goods, including 17 varieties of chocolate. Upgrades production facilities and takes regular steps to increase production volumes.
<b>Export markets</b>	Russia, Kazakhstan, Lithuania, Belarus, Georgia
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Recognized brand</li> <li>▪ Strong customer loyalty</li> <li>▪ Foreign investment</li> <li>▪ Western management and marketing</li> <li>▪ Western equipment and production technologies</li> <li>▪ High product quality</li> </ul>
<b>Company</b>	<b>Kraft Foods Ukraine</b>
<b>Background</b>	The international food giant Kraft Foods purchased a confectionery factory in Trostyanets in 1994 and launched production of chocolate under the "Korona" trademark in 1995. To date, 75 million USD has been invested in the factory. Its production volumes have increased fourfold. Capital investment and marketing expenses have totaled 200 million USD so far.
<b>Specialization</b>	Production of chocolate (over 32% of the total Ukrainian chocolate market). It has developed a new product category for Ukraine: milk chocolate and black chocolate of the highest possible quality.
<b>Export markets</b>	Europe and CIS
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ Foreign investment</li> <li>▪ Aggressive advertising methods</li> <li>▪ Modern marketing techniques</li> <li>▪ Clearly defined market segment</li> <li>▪ Good business practices</li> <li>▪ Parent company support</li> </ul>

Company	Rainford
<b>Background</b>	Factory was built in Dnipropetrovsk in 1999. In 1998, due to growing demand for high quality chocolate, the Rainford trade and industrial group made a decision to build a confectionery factory in Ukraine that would suit the highest European standards and quality criteria. The German company Bindler was chosen to set up manufacturing facilities with the best equipment and terms.
<b>Specialization</b>	Chocolate production
<b>Export markets</b>	Russia, Western Europe, Central Asia, Middle East
<b>Competitive advantages</b>	<ul style="list-style-type: none"> <li>▪ High-tech equipment</li> <li>▪ Organic ingredients</li> <li>▪ Western investment</li> <li>▪ Good business practices</li> <li>▪ Parent company support</li> </ul>

### CONTRIBUTING FACTORS

**Structure of the market.** According to experts, the confectionery market of Ukraine is rather structured and is characterized by a high level of competition.

**Positioning in the market.** The time of strategic positioning is over. Today, there are only small niches of the market where impressive novelty products and wise marketing strategies may nudge competitors aside to a small degree.

**Comparative quality.** The Ukrainian confections market is no longer dictated by setting low prices. Consumers now have higher requirements for sweet products; therefore, product quality has become the deciding factor when purchasing confections. This explains why consumption of high quality products created through complex production cycles has been growing lately, whereas sweets from conventional recipes have become less popular. To be competitive, producers need to work hard on improving quality and expanding their product ranges.

**Potential competitors.** In the context of slow market growth, competition becomes more intense. This is caused by growing production capacities, entry of new companies into the

market, and retail networks selling their own products.

**Bargaining power of suppliers.** Chocolate producers depend heavily on a very small number of cocoa bean suppliers.

**Introduction of new technologies to reduce production costs; investment in equipment.** New competitive products may be manufactured on modern equipment with the usage of advanced technologies. This is why confectionery enterprises invest heavily in purchases of machinery and equipment, and building new production facilities.

**Formation of brand image.** Today, many confectioners are reevaluating their product ranges. They are replacing unpopular products by experimenting with new ones. Product specialization is evolving, and businesses strive to build their image and play a significant (if not leading) role in their segment.

**Paying attention to the expensive segment.** Most producers have launched manufacturing of expensive confectionery goods, because consumption of products from this segment is growing.

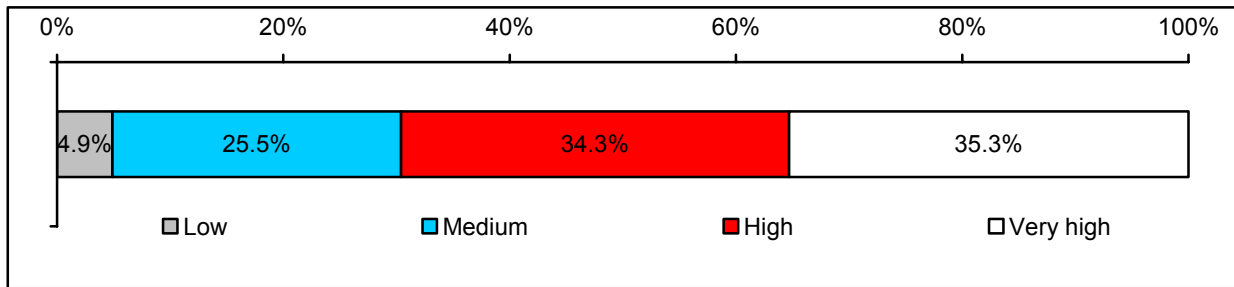
### THE COMPETITIVE ENVIRONMENT AND COMPETITIVE ADVANTAGES OF CONFECTIONERY ENTERPRISES

The majority of survey participants assessed the level of competition in the confections sector as "high" (34.3 percent) or "very high" (35.3 percent); see Chart 5.2.

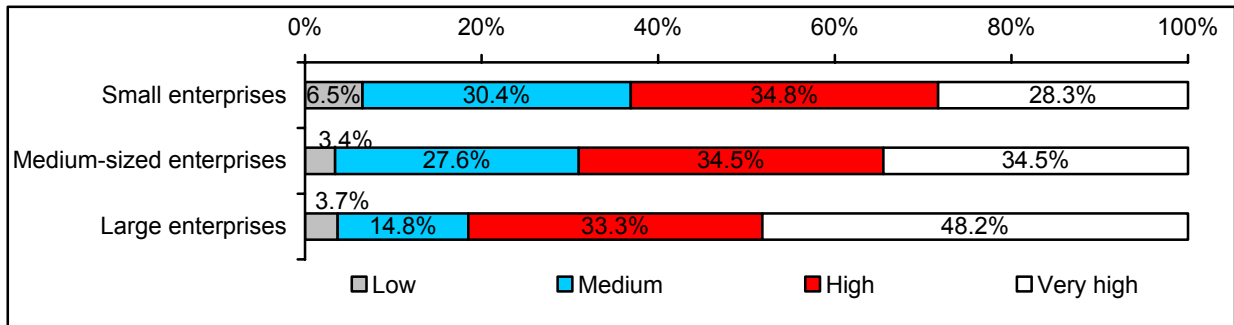
Large businesses were more likely than companies of other sizes to characterize the level of competition as high. This may be explained by pressure on large enterprises from both domestic competitors and international companies with

production capacities large enough to capture significant shares of the Ukrainian market (Chart 3.5).

Medium-sized and small businesses (which mostly held niches in regional markets) also reported "high" or "very high" levels of competition: 69.0 percent and 63.1 percent, respectively.

**CHART 5.2. ASSESSMENT OF THE LEVEL OF COMPETITION**

Source: Survey of 102 confectionery enterprise CEOs.

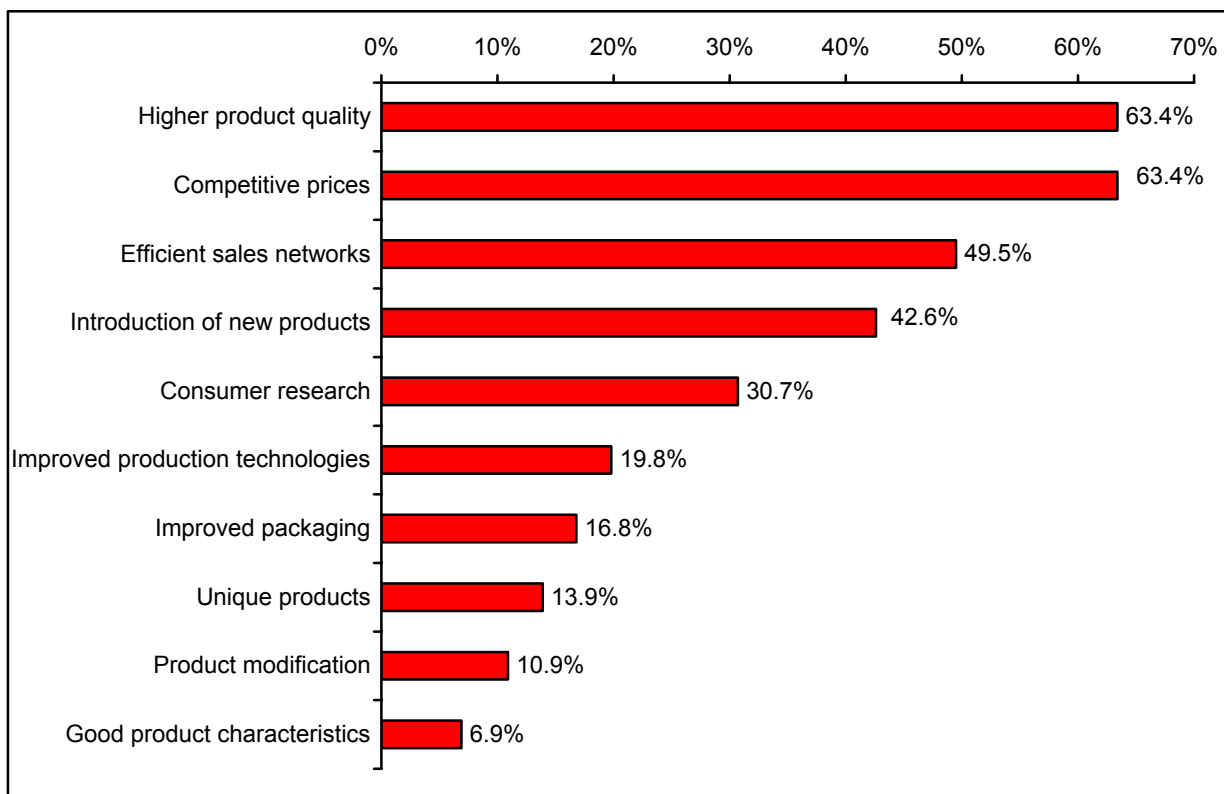
**CHART 5.3. ASSESSMENT OF THE LEVEL OF COMPETITION (BY ENTERPRISE SIZE)**

Source: Survey of 102 confectionery enterprise CEOs.

When asked about their own competitive advantages in the domestic market, the surveyed businesses cited product quality (63.4 percent), prices (63.4 percent), and efficient sales networks (49.5 percent).

The share of importers that worked in the Ukrainian market was not very large; according to

the industry experts, this was caused by specifics of the Ukrainian market and customer preferences. Importers were often unable to increase sales of their products due to their ignorance of the Ukrainian market.

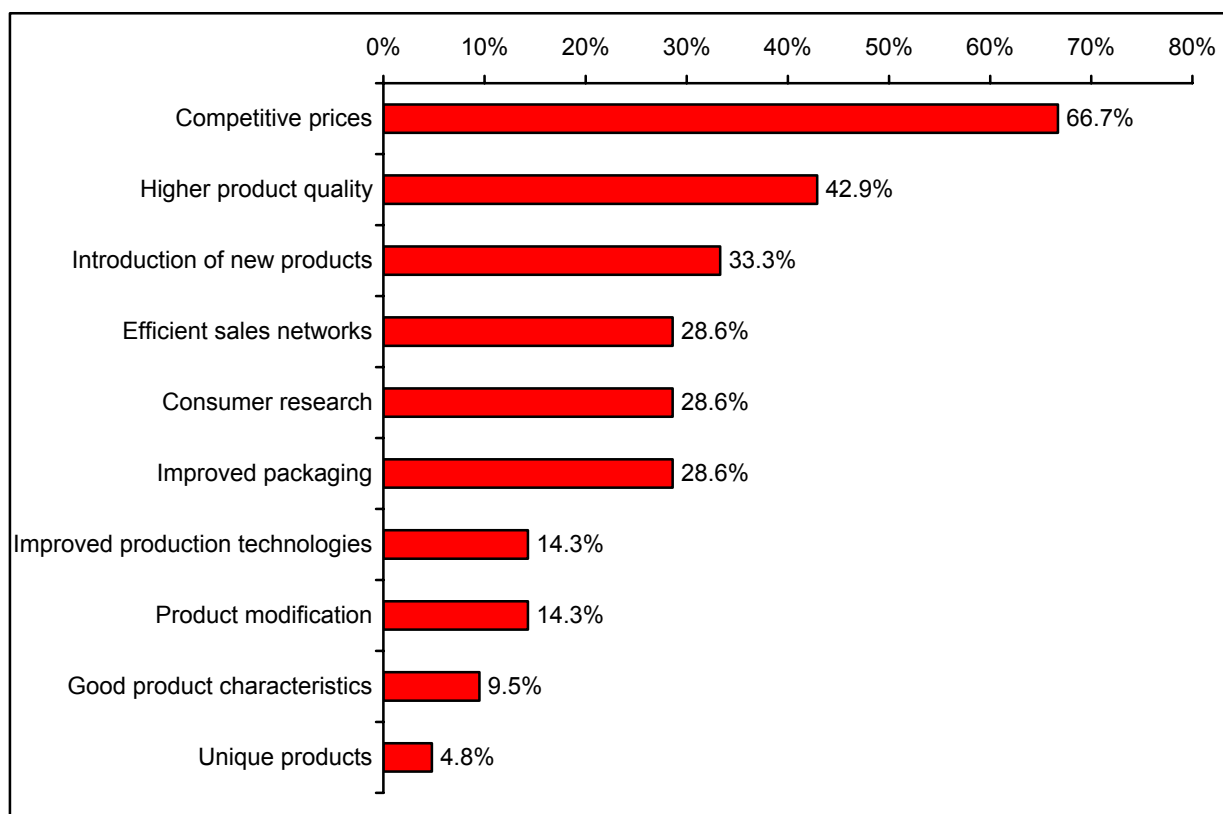
**CHART 5.4. COMPETITIVE ADVANTAGES OF CONFECTIONERY PRODUCERS IN THE DOMESTIC MARKET**

Source: Survey of 102 confectionery enterprise CEOs.

In the external market, the main competitive advantage of Ukrainian producers was mostly low product prices (this was reported by 66.7 percent of respondents). This was also supported by real-life experience (e.g., Ukrainian hard candies in the Russian market are more competitive than Russian products thanks to their lower prices, despite Russia's introduction of a new Customs duty on imports of sugar-based confectionery goods).

In the opinion of the survey participants, their businesses' strengths also included product quality (42.9 percent), introduction of new products (33.3 percent), research of demand in foreign markets (28.6 percent), and improved product appearance (28.6 percent); see Chart 5.4.

Small and medium-sized businesses cited pricing as their main competitive advantage; medium-sized businesses also cited product quality.

**CHART 5.5. COMPETITIVE ADVANTAGES OF CONFECTIONERY PRODUCERS IN EXTERNAL MARKETS**

Source: Survey of 102 confectionery enterprise CEOs.

### THE SHADOW MARKET

According to various expert estimates, shadow production and distribution of confections were mostly conducted by small businesses working in the flour-based goods segment. Reasons for engaging in shadow market activities included:

- simple production processes (especially for such categories as muffins, rum cakes, pies with filling, and some varieties of cookies);
- plenty of domestically produced raw materials, (in particular, flour of various quality levels and prices);
- no need to follow rigid standards or exercise quality control measures; and
- wide distribution networks that were not always officially reported and taxed.

According to the industry experts, it was impossible to estimate the shadow market in either monetary or physical terms. However, there was a great amount of indirect evidence of this market's activities:

- a growing number of enterprises for which the confectionery business was not a primary activity were operating in the flour-based goods segment;
- growing production volumes combined with notably low profitability in the confections sector; and
- high volumes and availability of flour-based goods with short shelf lives in virtually every retail outlet – particularly in open-air markets.

Quite a number of small businesses worked in the “gray market” and reduced the prices of their own end products in order to survive. Production volumes of “clandestine confectioners” had such a huge impact on the flour-based confectionery goods market that in 2003, an attempt was made to resolve this problem through legislation that suggested imposing mandatory licenses for flour-based goods producers. However, the bill was eventually turned down.

# SECTION 6. FINANCE

## COST STRUCTURE

The cost structure of the confectionery industry consists of the cost of raw materials, energy resources, packaging, wages, logistics, marketing and promotion (advertising campaigns), and equipment amortization.

The hallmark of the sector's cost structure was the fact that material and equipment costs consumed the largest share of expenses. The cost of raw

materials in production of some types of products reached 70-75 percent of the total production cost; for this reason, fluctuating prices for raw materials were a very significant factor in the confections sector.

The table below presents the sector cost structure as described by the industry experts.

Expense	Percentage of the total production cost
Raw materials and packaging	75.0%
Energy	8%
Payroll	8.0%
Sales, logistics, and distribution	7.0%
Equipment amortization	0.5%
Other costs	1.5%

## FACTORS INFLUENCING COSTS

Industry experts stated that the cost structure pictured above is quite generalized, and would be different for each product type in reality. In addition, any changes in raw materials or energy markets may influence the cost structure.

Major factors influencing the sector were as follows:

- changes in raw materials prices;
- changes in energy prices (energy costs did not yet represent a critical share of large enterprises' cost structures);
- changes in packaging material prices;
- changes in tax and Customs regulations; and
- stability of the banking system and changes in interest rates.

## AVERAGE PROFITABILITY OF MARKET SEGMENTS

According to the confections enterprise CEOs, the sector's profit margin was 10-15 percent on average during the surveyed period; however, they also noted that in order for an enterprise to survive, profits could not be lower than interest rates offered by Ukrainian banks. They also stated that each segment of the confections sector was sensitive to ups and downs in terms of prices for both raw materials and energy (in addition to Customs duty rates to some extent).

### Flour-based goods

Two main factors defining total production costs were the costs of flour and sugar. For example, rapid growth of prices for raw materials in 2002 led producers to make a tough choice between either raising prices for consumers or reducing the profit margin of production. This was because increases in the price of raw materials resulted in

higher production costs (by almost 10 percent). In 2003, an increase in the price of flour raised production costs by 6 percent throughout the sector.

Flour prices fell in 2004, a factor that positively affected the flour-based goods segment and allowed producers to increase their profit margins.

Medium-sized enterprises appeared to be the most sensitive to increases in raw materials prices because their products looked similar to those made by small businesses but were more expensive. Medium-sized companies tended to incur higher production costs than small enterprises.

Large enterprises seemed to be the most fortunate because they always had enough working capital and raw material reserves in order

to maneuver in the market. The largest share in large businesses' cost structures was occupied by equipment and packaging costs.

The wide product ranges typical among large businesses encouraged them to use new types of equipment and packaging. As a result, these businesses were the most interested in the development of the domestic manufacturing sector.

### **Chocolate**

Essential factors for chocolate producers were fluctuations of Customs duties on imports of cocoa beans, and dependence on reliable delivery of other types of raw materials and additives used in chocolate production. For example, higher prices for hazelnuts (due to a poor harvest in Turkey in 2004) resulted in a 6-8 percent rise in prices of expensive chocolate products.

Despite these complications, high profitability (potentially over 50 percent) makes the chocolate segment an attractive sphere for confections enterprises. When analyzing reasons for why the sugar-based goods sector lagged behind the chocolate sector, analysts cited high profit margins enjoyed by chocolate production. This

means that companies that produce chocolate goods have much larger budgets for promotion than other market participants, which in turn explains why other groups of products (sugar-based confectionery goods in particular) are not as popular as chocolate.

### **Sugar-based confectionery goods**

The profitability of production of traditional hard candy and other sugar-based candies was rather low: no more than 8-12 percent. The main factors influencing the cost and profit margin of products are prices for sugar and syrup. Exporters of hard candy are also affected by changes in Customs regulations.

Hard candies are made from two components: syrups and sugar. In Russia and Ukraine, two factories monopolize corn syrup production. For a very long time, corn syrup was not subject to Customs duties and could freely cross borders of these two countries. In April 2004, the Cabinet of Ministers of Ukraine excluded corn syrup from the list of free-trade products. On the Russian side, a planned Customs duty of 600 EUR per ton of products containing cocoa may cause a 30-100 percent price increase, making Ukrainian candies uncompetitive in the Russian market.

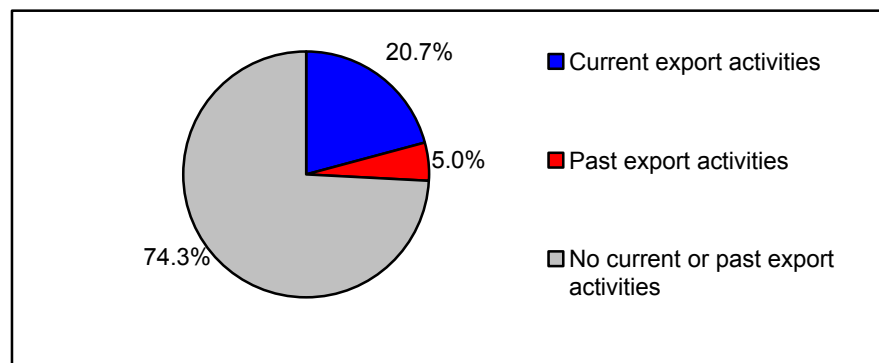
# SECTION 7. EXPORTS

## ANALYSIS OF EXPORT ACTIVITIES

In 2005, 20.7 percent of the surveyed enterprises exported their products to other countries, while 5.0 percent of entrepreneurs stated that they had engaged in export activities in the past (Chart 7.1). Large enterprises had the largest share of

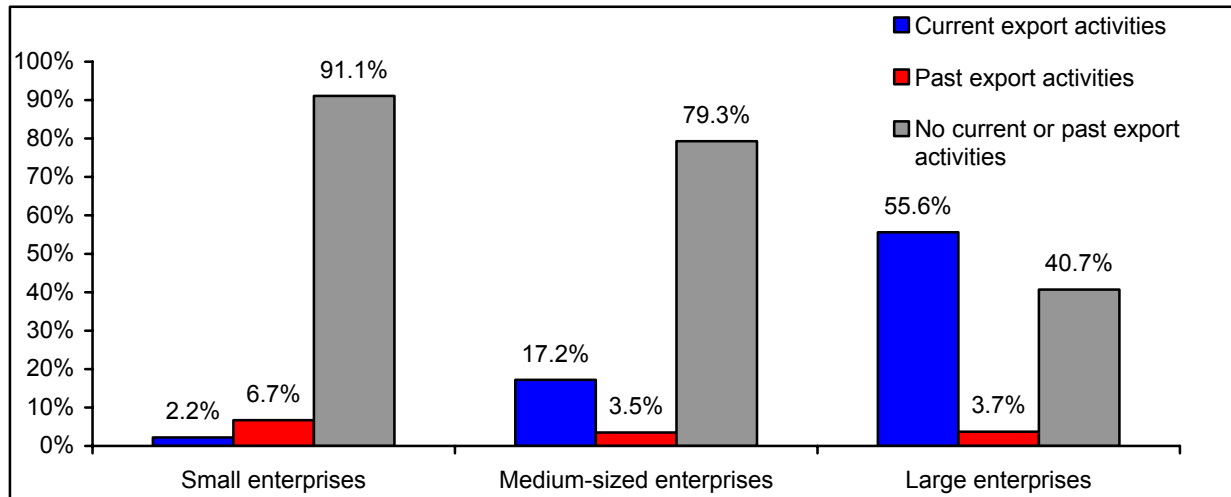
exporters in the sample (55.6 percent, or 15 enterprises). Medium-sized enterprises (17.2 percent, or 5 enterprises) exported their products abroad, while only one of the small enterprises engaged in export activity (Chart 7.2).

**CHART 7.1. PRESENT AND FORMER EXPORT ACTIVITIES**



Source: Survey of 102 confectionery enterprise CEOs.

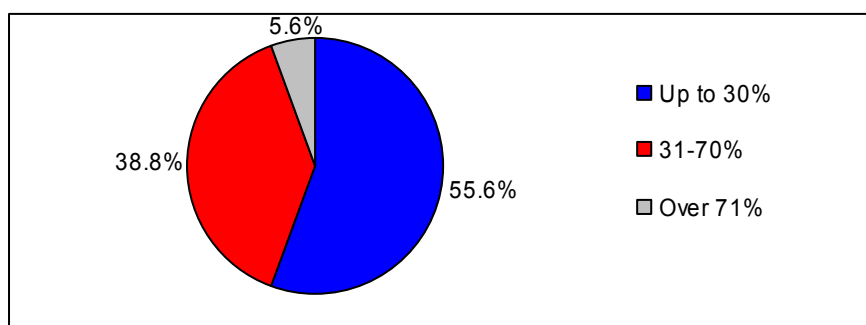
**CHART 7.2. PRESENT AND FORMER EXPORT ACTIVITIES (BY ENTERPRISE SIZE)**



**SOURCE: SURVEY OF 102 CONFECTIONERY ENTERPRISE CEOS.**

Among exporters, 55.6 percent exported up to 30 percent of their products, while 38.8 percent exported from 30 to 70 percent of their products.

A small number of businesses stated that over 71 percent of their products were exported abroad (Chart 7.3).

**CHART 7.3. EXPORTS AS A SHARE OF TOTAL ENTERPRISE PRODUCTION ACTIVITIES**

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

When discussing export volumes, 100 percent of those small businesses that exported products noted that their export volumes were worth at least 50 thousand UAH in monetary terms in 2005. Half of medium-sized businesses estimated that their export volumes ranged from 1 to 2.5

million UAH. Among large businesses, 23 percent stated that their export volumes were worth from 0.5 to 1 million UAH, and another 23 percent reported that their export volumes were worth from 5 to 10 million UAH.

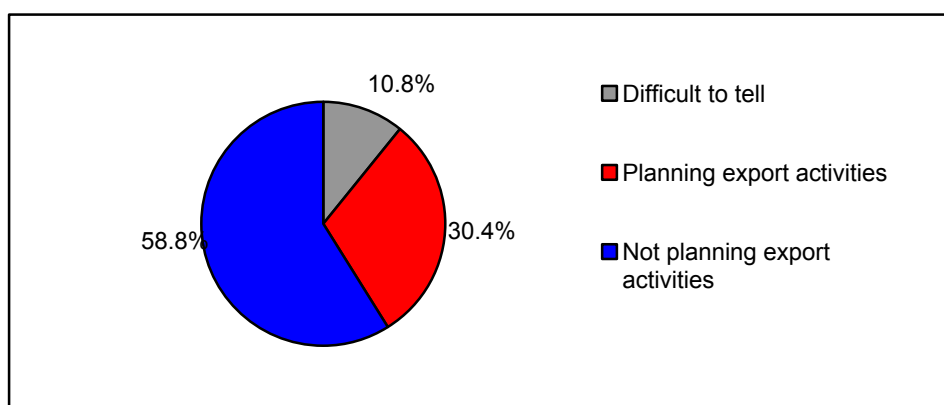
**TABLE 7.1. EXPORT VOLUMES IN 2005 (BY ENTERPRISE SIZE)**

Export volume in 2005	Enterprise size		
	Small enterprises	Medium-sized enterprises	Large enterprises
Up to UAH 50,000	100.0%		7.7%
From UAH 50,000 to 1,000,000		25.0%	38.5%
From UAH 1,000,000 to 25,000,000		50.0%	38.5%
Difficult to tell		25.0%	15.4%

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

The survey results demonstrated that 30.4 percent of the surveyed businesses planned to export their products. If this were to occur, the share of exporters would rise from 21 percent in

2005 to 30 percent. However, more than 58.8 percent of confectionery businesses did not have any plans for entering external markets in 2007 (Chart 7.4).

**CHART 7.4. EXPORT PLANS FOR 2007**

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

## EXPORT DESTINATION COUNTRIES

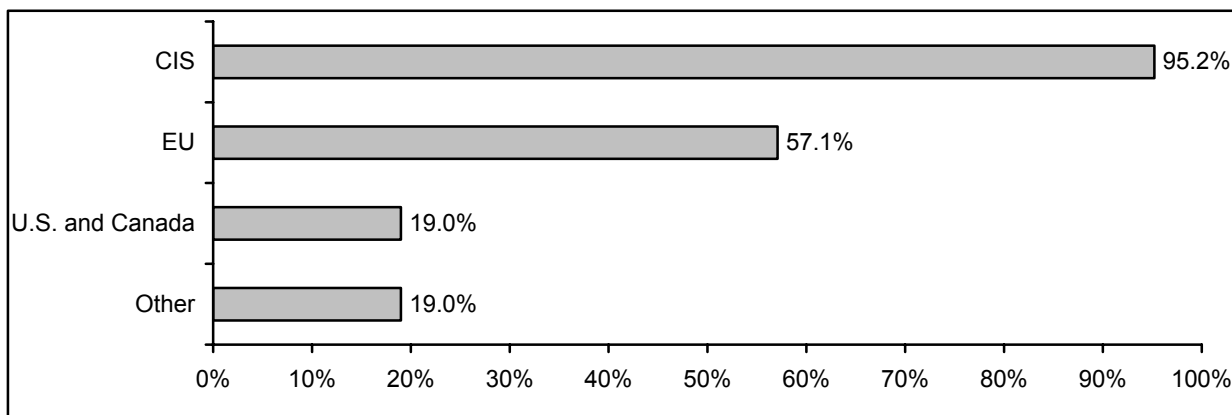
The largest shares of Ukrainian confectionery exports (irrespective of enterprise size) were destined for CIS countries, their most familiar and well-established export partners.

Over half of businesses engaged in exports (large companies in particular) exported their products to

EU countries. This proves that Ukrainian sweets can compete in these markets in terms of quality.

Only 27 percent of large producers exported their candies to the U.S. and Canada.

**CHART 7.5. EXPORT DESTINATIONS\***

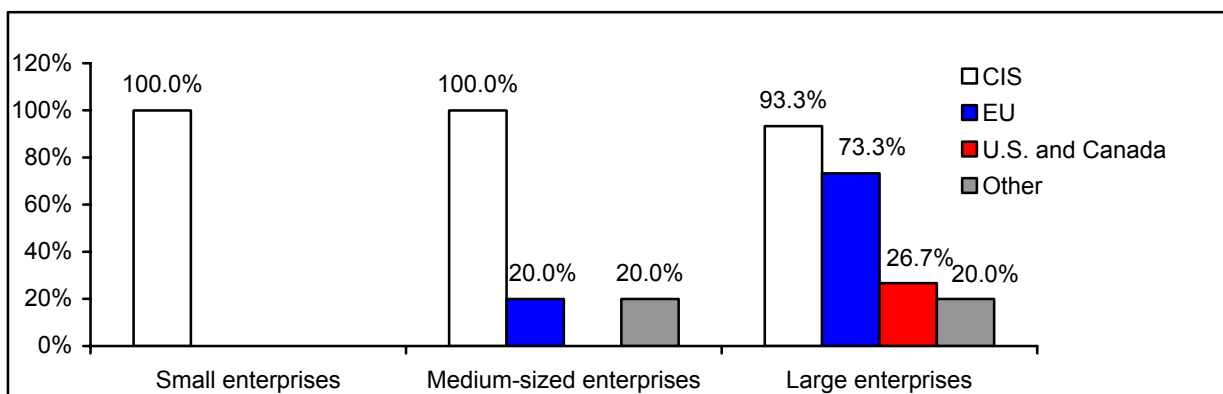


Source: Survey of 102 confectionery enterprise CEOs.

Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 7.6. EXPORT DESTINATIONS (BY ENTERPRISE SIZE)\***



Source: Survey of 102 confectionery enterprise CEOs.

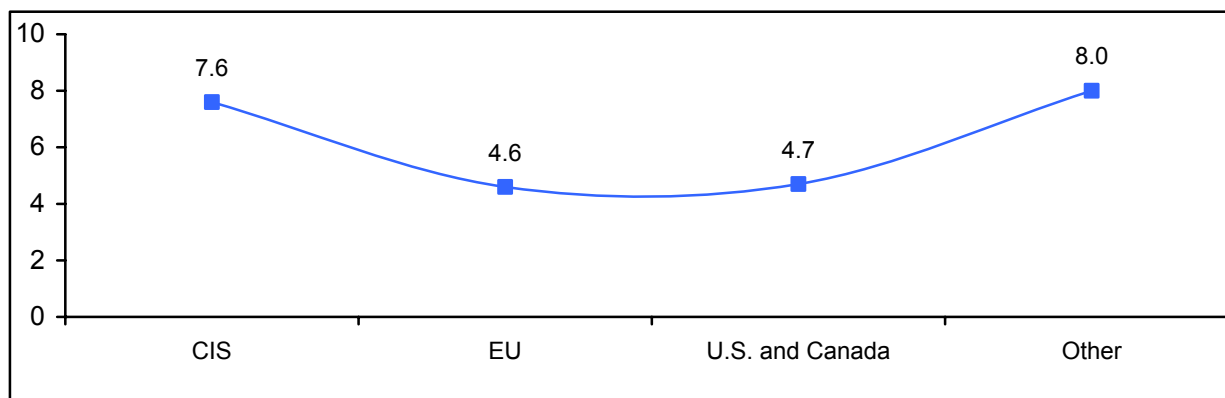
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

A significant percentage of the surveyed enterprises had a long history of exporting to CIS countries (39 percent of respondents had been exporting to CIS markets for over 10 years).

Among businesses exporting confectionery goods to European countries, only 9 percent (one company) had been doing so for 10 years (Chart 7.7).

Most confectioners who exported sweets to the EU and U.S. entered these markets in the late 1990s, when the confectionery industry in Ukraine was not as strong as it is now. Although export volumes to Western markets are relatively low, Ukrainian confectioners are worthy of recognition as suppliers of sweets to global markets.

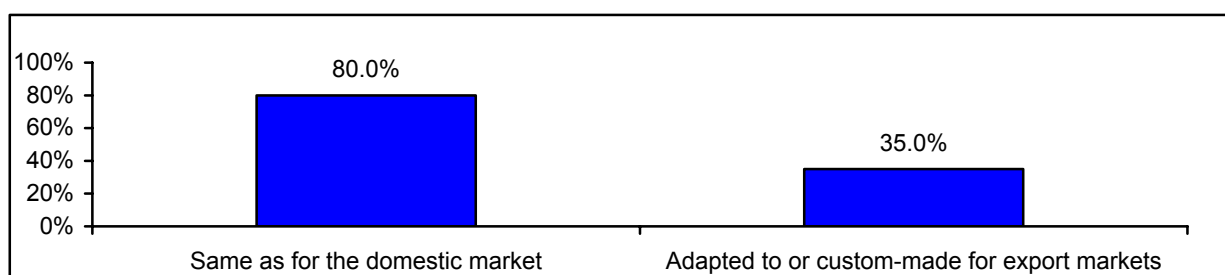
**CHART 7.7. AVERAGE EXPORT EXPERIENCE (IN YEARS)**

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

### TYPES OF EXPORTED PRODUCTS

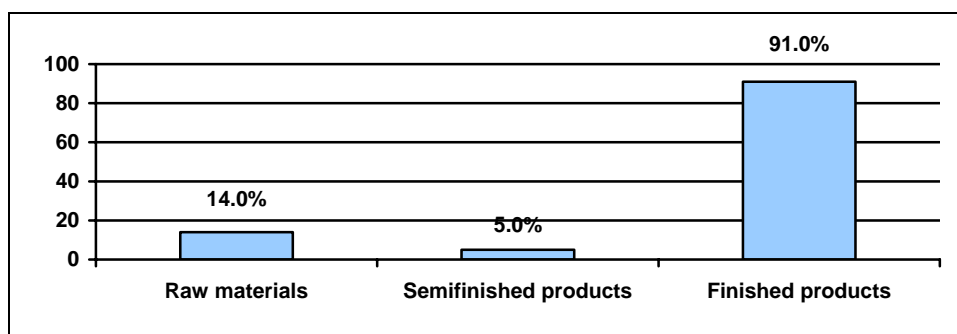
According to the survey findings, 80 percent of businesses exported the same products as those supplied to the domestic market. Thirty-five percent of businesses exported custom-made goods or products adapted for export markets (Chart 7.8).

The survey also revealed that 91 percent of exporters sold finished products to foreign markets. The shares of raw materials and semifinished products out of total exports were comparatively low (14 percent and 5 percent, respectively; see Chart 7.9).

**CHART 7.8. PRODUCTS FOR EXPORT, 2005\***

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 7.9. TYPES OF EXPORTS, 2005\***

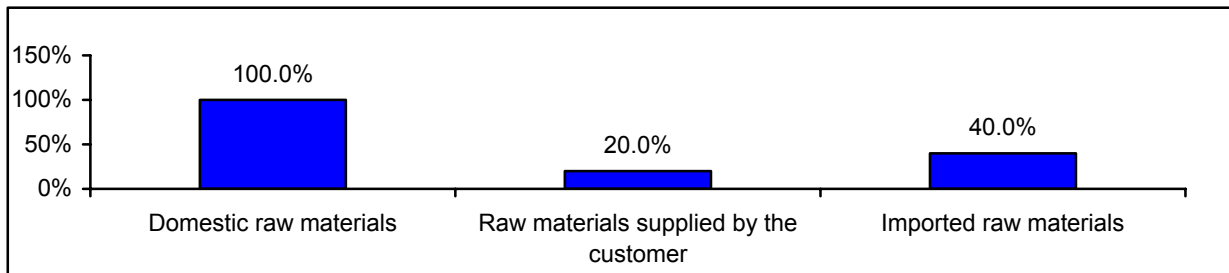
Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

Producers used raw materials of various origins for export-oriented products; however, the largest share was produced domestically.

manufactured products using raw materials supplied by other companies and sold finished goods back to those companies (Chart 7.10).

Forty percent of businesses stated that they also used imported raw materials, while 20 percent

**CHART 7.10. RAW MATERIALS USED TO MAKE PRODUCTS FOR EXPORT, 2005\***

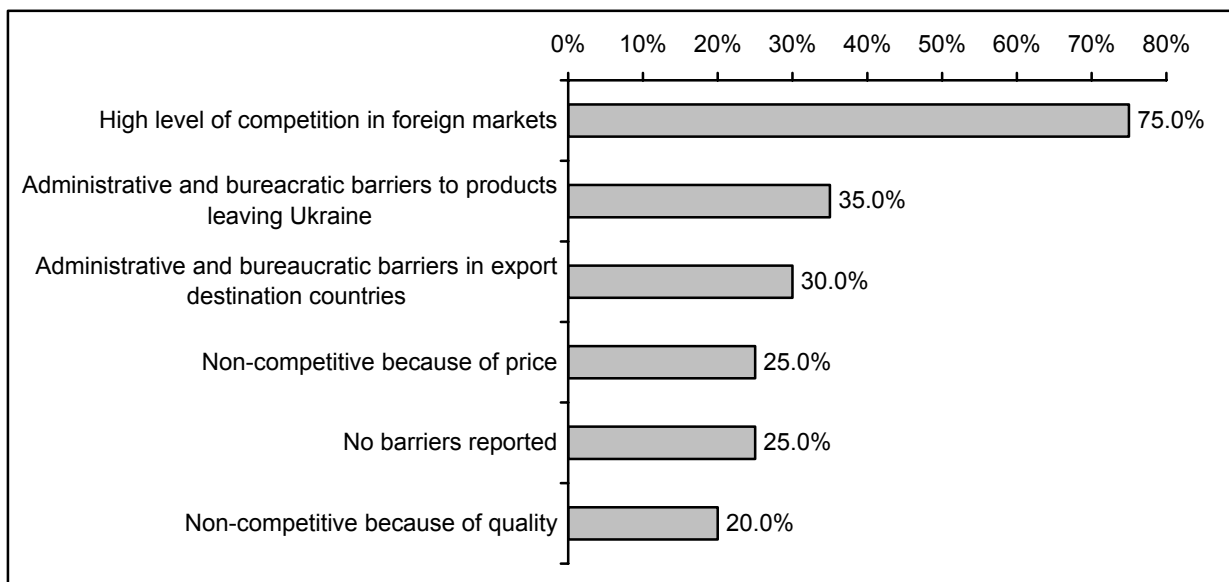
Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

### BARRIERS TO EXPORT GROWTH

A high level of competition in foreign markets appeared to be the most significant barrier to exports of Ukrainian sweets (Chart 7.11). The surveyed businesses ranked the CIS market as the most competitive because most of them had experience operating in that particular market.

The European market was rated as less competitive than the U.S. and Canadian markets. It should be noted that mostly large businesses exported to Europe and North America.

**CHART 7.11. BARRIERS TO EXPORT GROWTH\***

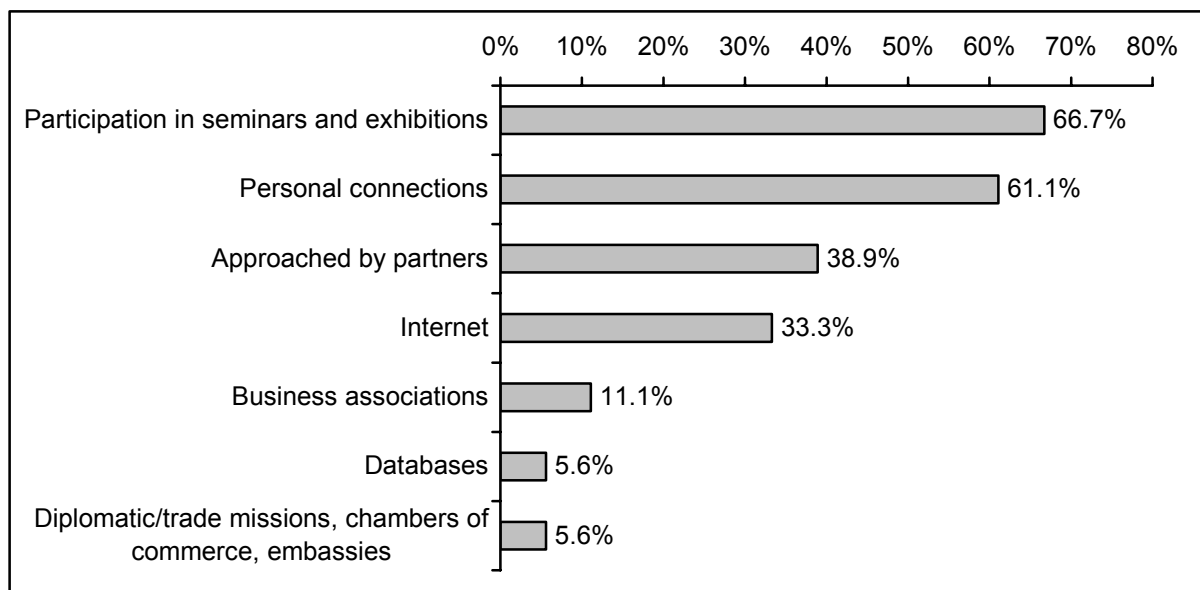
Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

One of the most common ways of finding partners in external markets was participation in seminars, fairs, etc. The U.S. and Canada could also be accessed through business associations.

Potential partners quite often approached Ukrainian businesses on their own, proof of the Ukrainian confectionery sector's appeal (Chart 7.12).

The second most common way of searching for business partners was personal contacts.

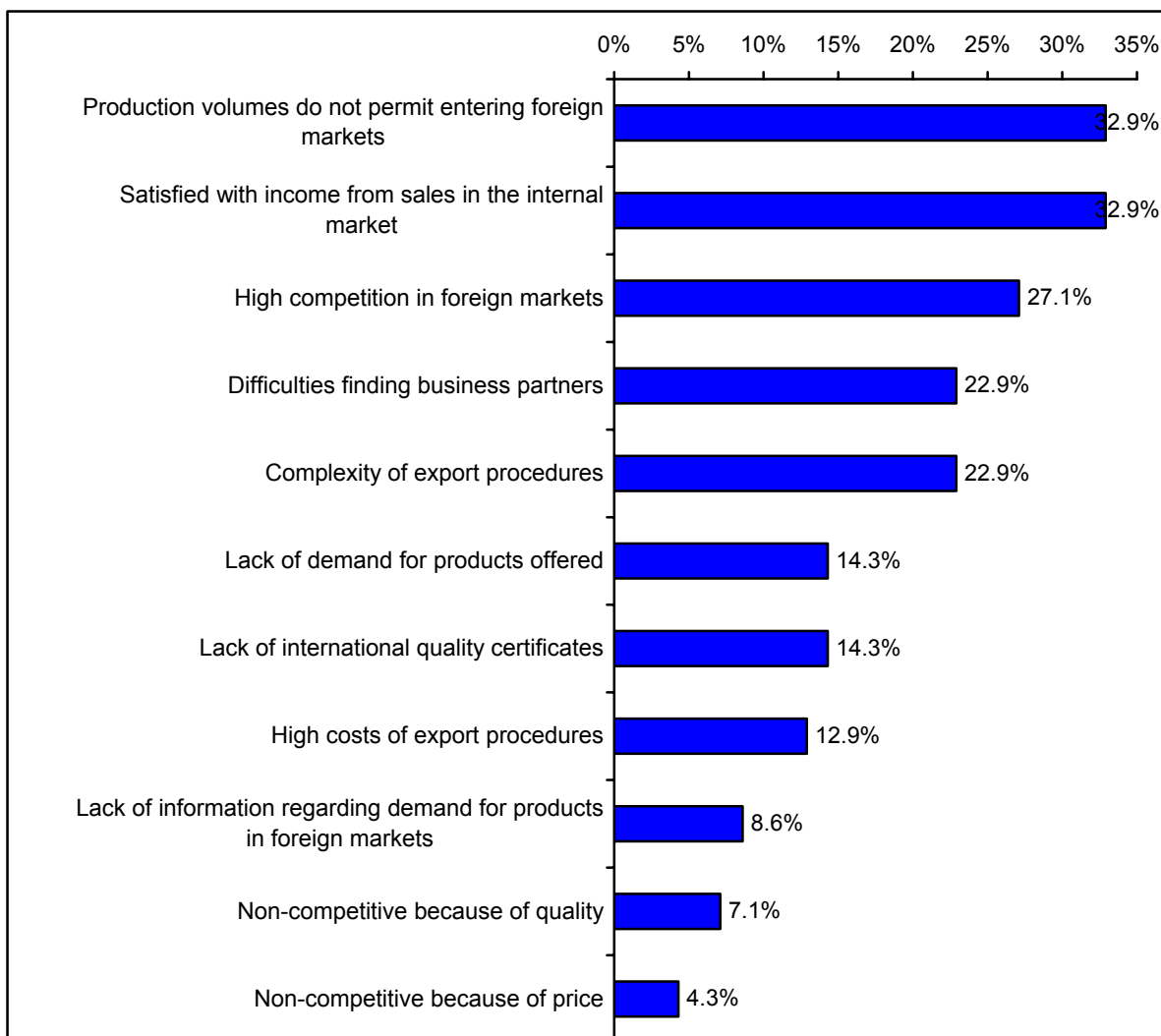
**CHART 7.12. METHODS OF LOCATING PARTNERS IN FOREIGN MARKETS\***

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

According to the confectionery enterprise CEOs, enterprises that could not or refused to engage in export activities fell into the following three categories:

- The first group was composed of businesses with production volumes that were not large enough to enable them to target export markets, and those exclusively oriented toward the domestic market.
- The second was comprised of enterprises concerned about the level of competition in external markets (most likely because of the low competitiveness of their own products).
- The third group consisted of businesses that encountered difficulties in searching for potential partners and completing export paperwork (Chart 7.13).

**CHART 7.13. BARRIERS TO EXPORT ACTIVITIES\***

Source: Survey of 102 confectionery enterprise CEOs.  
Number of respondents to this question in particular: 20.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

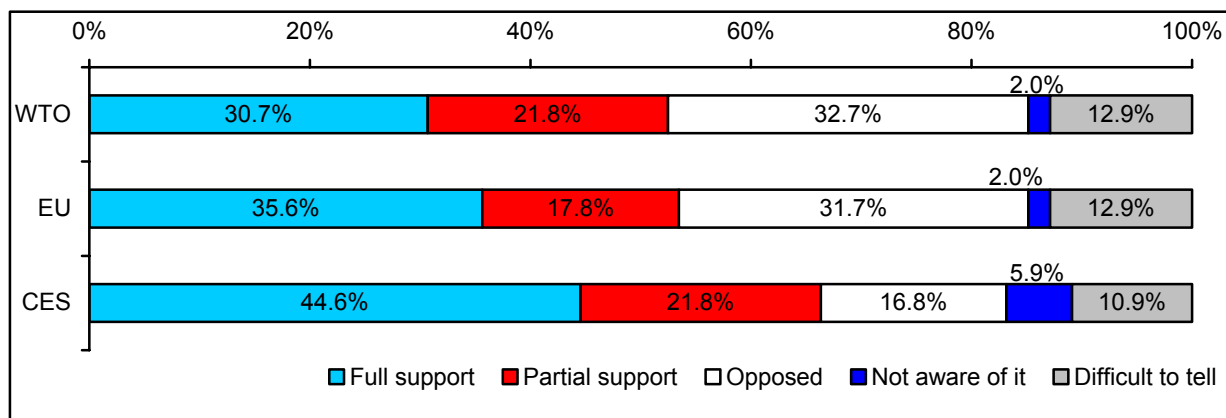
### SUPPORT FOR UKRAINE'S ACCESSION TO INTERNATIONAL ORGANIZATIONS

Most confections enterprise managers supported the idea of Ukraine's accession to international organizations to a certain degree. More respondents (44.6 percent) supported Ukraine's membership in the Common Economic Space (Chart 7.14) than Ukraine's potential membership in the World Trade Organization or European Union (30.7 percent for the WTO and 35.6 percent for the EU). Around 2 to 6 percent of the respondents were not aware that these organizations existed at all.

Accession to the CES would give enterprises free access to markets in Russia, Belarus, and

Kazakhstan (where a huge share of Ukraine's most popular sweets already go).

According to the survey participants, European and world markets were less appealing than the CIS markets. As noted earlier, reluctance to expand into the EU may have been caused by insufficient production capacities, a high level of competition in foreign markets, and a lack of enthusiasm toward meeting the challenge of working in a more structured and developed market than that of the CIS.

**CHART 7.14. SUPPORT FOR UKRAINE'S ACCESSION TO INTERNATIONAL ORGANIZATIONS**

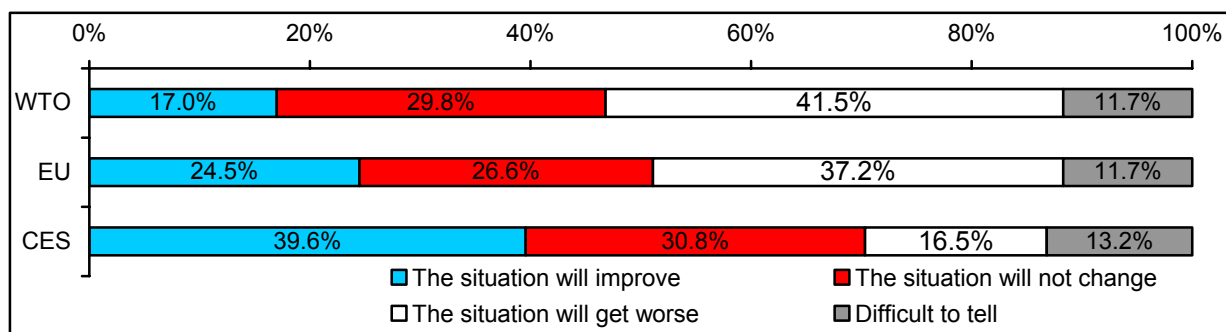
Source: Survey of 102 confectionery enterprise CEOs.

Respondents noted that entry into the CES could positively affect confection enterprises' operations. However, respondents forecast lower business performances in the event that Ukraine entered the EU or WTO (37.2 percent and 41.5 percent, respectively; see Chart 7.15).

Ukraine's accession to international organizations would inevitably influence the structure of exports. According to 45 percent of the respondents, Ukraine's entry into the CES would enable Ukrainian producers to expand their export operations (regardless of business size). In contrast, only 16.7 percent of respondents forecast that EU accession would positively affect

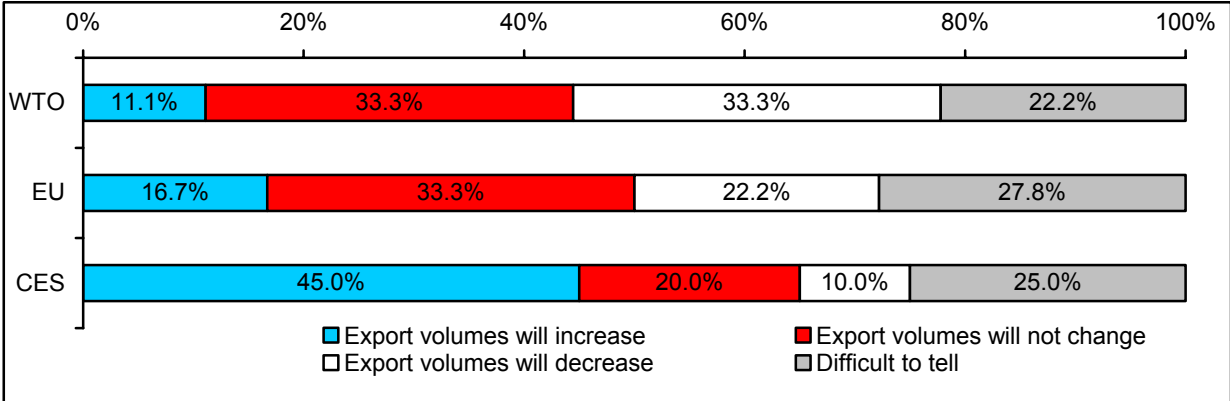
exports. Respondents were even less enthusiastic about the prospects of the Ukrainian export market if Ukraine were to accede to the WTO (11.1 percent of respondents forecast an increase in exports, while 33.3 percent of respondents forecast a decrease; see Chart 7.16).

It is interesting to note that a very large percentage of respondents (22-28 percent) could not evaluate the potential impact of Ukraine joining international organizations at all. This is evidence of both a lack of export experience and the low level of respondents' awareness regarding export activities in general.

**CHART 7.15. THE POTENTIAL IMPACT OF UKRAINE'S ACCESSION TO INTERNATIONAL ORGANIZATIONS**

Source: Survey of 102 confectionery enterprise CEOs.

**CHART 7.16. THE POTENTIAL IMPACT OF UKRAINE'S ACCESSION TO INTERNATIONAL ORGANIZATIONS (ON EXPORT VOLUMES)**



Source: Survey of 102 confectionery enterprise CEOs.

# SECTION 8. DEVELOPMENT

## MAIN DIRECTIONS OF SECTOR DEVELOPMENT

According to sector enterprise managers, the main performance indicators for their operations in 2005 remained at 2004 levels or improved slightly (only a small share of respondents reported worsening performance figures).

Dynamics of performance indicators for enterprises of various sizes supported the argument that large enterprises were the most organized. Large enterprises demonstrated

growth in terms of indicators directly related to intensification of production, such as rising potential production capacity, percentages of potential production capacity, higher profitability of production activities, and improved labor productivity. Most small and medium-sized businesses demonstrated that these indicators remained at the same levels as in 2004 (Table 8.1).

**TABLE 8.1. DYNAMICS OF ENTERPRISE PERFORMANCE INDICATORS IN 2005**

Performance indicators for 2005 compared to 2004		Enterprise size		
		Small enterprises	Medium-sized enterprises	Large enterprises
Production volume (in physical terms)	Difficult to answer	6.7%	3.4%	7.4%
	<b>Increased</b>	<b>46.7%</b>	<b>51.7%</b>	<b>63.0%</b>
	Decreased	13.3%	20.7%	18.5%
	Did not change	33.3%	24.1%	11.1%
Percentage of potential production capacity	Difficult to answer	8.9%	3.4%	7.4%
	Increased	35.6%	31.0%	<b>51.9%</b>
	Decreased	11.1%	17.2%	14.8%
	Did not change	<b>44.4%</b>	<b>48.3%</b>	25.9%
Potential production capacity	Difficult to answer	11.1%	10.3%	11.1%
	Increased	28.9%	27.6%	<b>44.4%</b>
	Decreased	6.7%	10.3%	7.4%
	Did not change	<b>53.3%</b>	<b>51.7%</b>	37.0%
Product range	Difficult to answer	6.7%	3.4%	3.7%
	Increased	<b>53.3%</b>	<b>72.4%</b>	<b>70.4%</b>
	Decreased	4.4%		
	Did not change	35.6%	24.1%	25.9%
Sales volume (in monetary terms)	Difficult to answer	11.1%	6.9%	7.4%
	<b>Increased</b>	<b>48.9%</b>	<b>48.3%</b>	<b>63.0%</b>
	Decreased	15.6%	13.8%	11.1%
	Did not change	24.4%	31.0%	18.5%
Production costs	Difficult to answer	8.9%	14.3%	3.8%
	Increased	<b>71.1%</b>	<b>53.6%</b>	<b>65.4%</b>
	Decreased	2.2%	10.7%	7.7%
	Did not change	17.8%	21.4%	23.1%

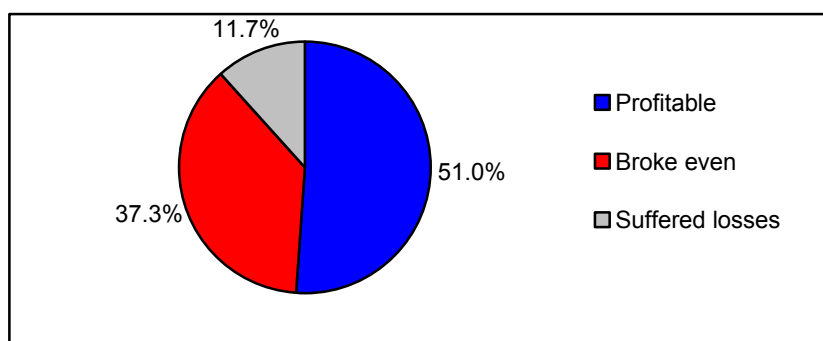
Profits from sales activities	Difficult to answer	8.9%	7.4%	11.5%
	<b>Increased</b>	<b>44.4%</b>	<b>44.4%</b>	<b>65.4%</b>
	Decreased	22.2%	22.2%	3.8%
	Did not change	24.4%	25.9%	19.2%
Profitability of production activities	Difficult to answer	13.3%	13.8%	8.0%
	<b>Increased</b>	<b>35.6%</b>	24.1%	<b>48.0%</b>
	Decreased	15.6%	17.2%	4.0%
	Did not change	<b>35.6%</b>	<b>44.8%</b>	40.0%
Average employee salary	Difficult to answer	8.9%	3.7%	3.8%
	<b>Increased</b>	<b>66.7%</b>	<b>85.2%</b>	<b>84.6%</b>
	Decreased	2.2%		
	Did not change	22.2%	11.1%	11.5%
Labor productivity	Difficult to answer	13.3%		11.1%
	<b>Increased</b>	<b>37.8%</b>	<b>44.8%</b>	<b>59.3%</b>
	Decreased	6.7%	6.9%	3.7%
	Did not change	<b>42.2%</b>	<b>48.3%</b>	25.9%
Number of employees	Difficult to answer	4.4%		7.7%
	<b>Increased</b>	20.0%	<b>34.5%</b>	<b>38.5%</b>
	Decreased	13.3%	17.2%	19.2%
	Did not change	<b>62.2%</b>	<b>48.3%</b>	<b>34.6%</b>

Source: Survey of 102 confectionery enterprise CEOs.

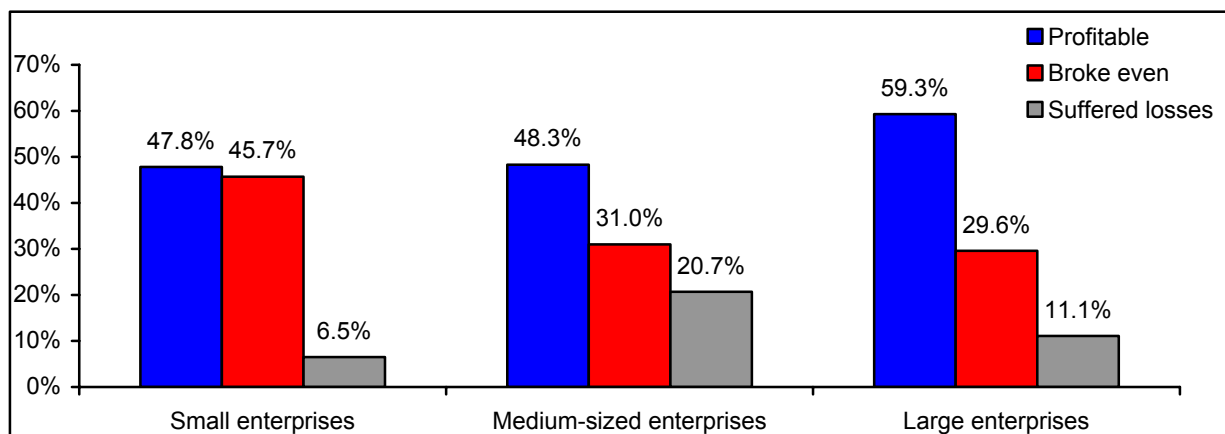
Large businesses were more likely to report positive performance indicators (nearly 60 percent of the surveyed entrepreneurs reported that their business operations were profitable in 2005; see Chart 8.1). In terms of profitability, the worst situation was observed among medium-sized

businesses: more medium-sized enterprises (20.7 percent) reported they incurred financial losses, while the share of those that suffered losses among small enterprises was only 6.5 percent (Chart 8.2).

**CHART 8.1. FINANCIAL PERFORMANCE RESULTS FOR 2005**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 8.2. FINANCIAL PERFORMANCE RESULTS FOR 2005 (BY ENTERPRISE SIZE)**

Source: Survey of 102 confectionery enterprise CEOs.

Most of those enterprises that reported growth indicated that this increase was around 10-30 percent. Larger businesses stood out with

comparatively high growth rates compared to enterprises of other sizes (Chart 8.2).

**TABLE 8.2. GROWTH OF ENTERPRISE PERFORMANCE INDICATORS IN 2005\***

Growth of performance indicators in 2005 vs. 2004	Enterprise size		
	Small enterprises	Medium-sized enterprises	Large enterprises
Production volumes in physical terms	20.7%	23.3%	23.1%
Product range	16.1%	20.3%	16.2%
Sales volume (in monetary terms)	19.3%	13.4%	23.8%
Production costs	15.2%	11.2%	13.6%
Profits from sales activities	18.3%	16.6%	21.5%
Average employee salary	16.6%	17.6%	21.1%

Source: Survey of 102 confectionery enterprise CEOs.

\* Indicators that grew for enterprises of all sizes in the sector.

**TABLE 8.3. GROWTH OF ENTERPRISE PERFORMANCE INDICATORS AMONG LARGE ENTERPRISES IN 2005\***

Growth of performance indicators in 2005 vs. 2004	Enterprise size
	Large enterprises
Percentage of potential production capacity	16.5%
Potential production capacities	15.0%
Profitability of production activities	15.0%
Labor productivity	17.9%

Source: Survey of 102 confectionery enterprise CEOs.

\* Indicators that grew for large enterprises in the sector.

## DOMESTIC AND INTERNATIONAL STANDARDS

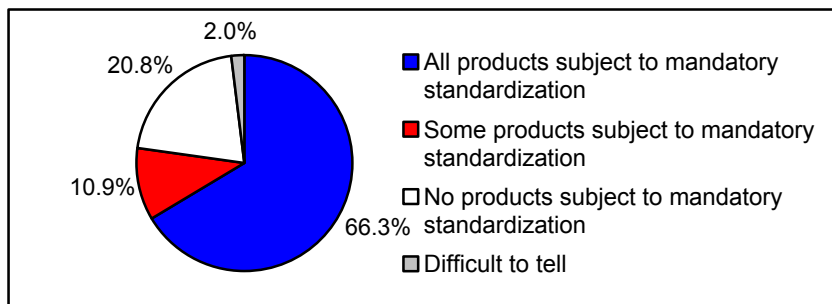
Of the surveyed enterprises, 66.3 percent reported that all of their products were subject to mandatory standardization. Another 11 percent reported that some of their products were subject to standardization (Chart 8.3).

The prevailing majority of large and medium-sized businesses (77.8 percent and 75.9 percent,

respectively) reported that all of their products were subject to standardization.

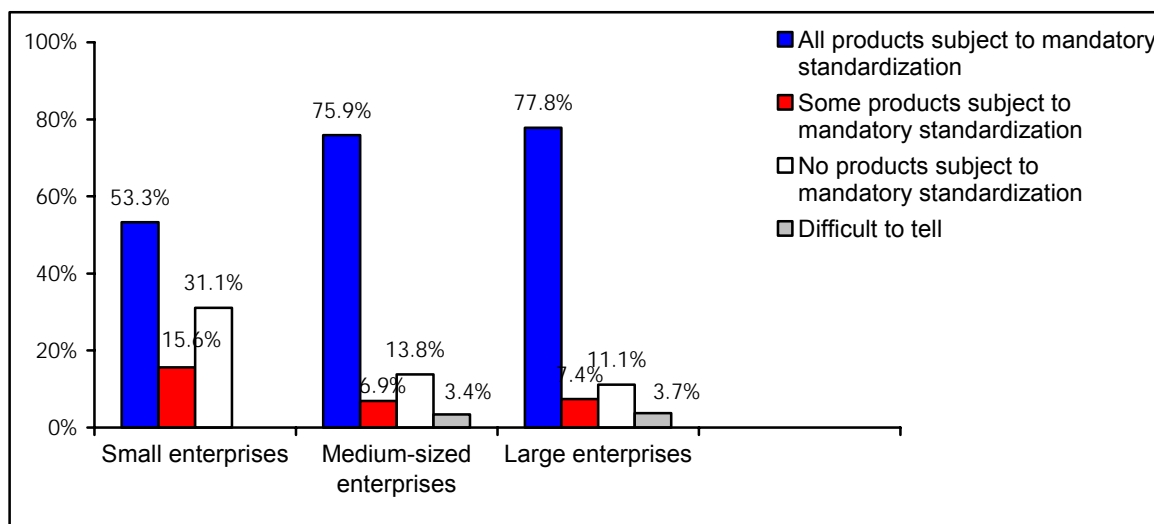
Small businesses accounted for the largest share of enterprises (31.1 percent) that did not produce any goods that were subject to standardization (Chart 8.4).

**CHART 8.3. MANDATORY PRODUCT STANDARDIZATION**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 8.4. MANDATORY PRODUCT STANDARDIZATION (BY ENTERPRISE SIZE)**

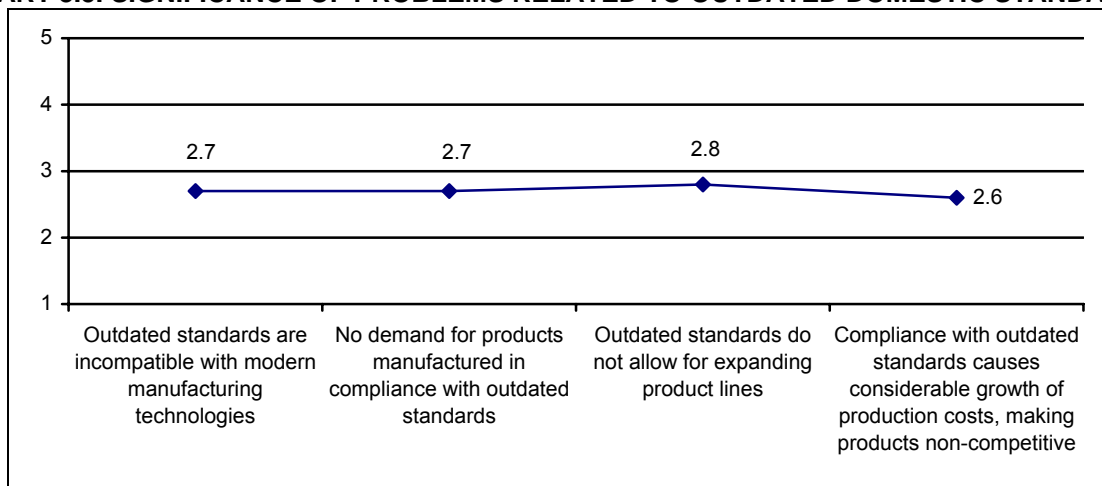


Source: Survey of 102 confectionery enterprise CEOs.

Even when obsolete standards were applied, confectioners tended not to consider this practice to be a problem (it should also be noted that over 26 percent of enterprises declared that applicable standards were not obsolete at all).

The most significant problem in terms of application of outdated standards was that it limited enterprises' product ranges (Chart 8.5).

**CHART 8.5. SIGNIFICANCE OF PROBLEMS RELATED TO OUTDATED DOMESTIC STANDARDS**



Source: Survey of 102 confectionery enterprise CEOs.

**DOMESTIC AND INTERNATIONAL CERTIFICATES**

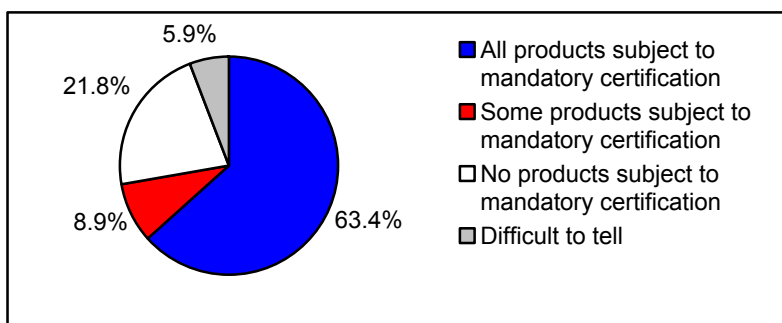
Of the surveyed entrepreneurs, 63.4 percent reported that all of their products were subject to mandatory certification. Another 9 percent stated that some of their products were subject to certification (Chart 6.8).

manufactured only products that were subject to mandatory certification.

Small businesses accounted for the largest share of producers (33.3 percent) with no products subject to mandatory certification (Chart 8.7).

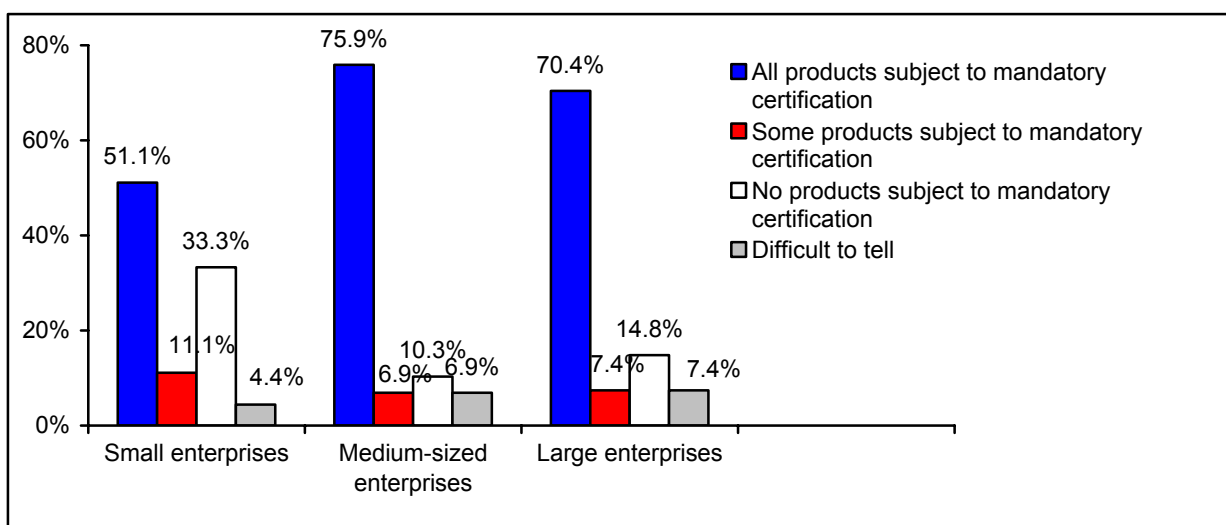
Most large and medium-sized businesses (70.4 percent and 75.9 percent, respectively)

**CHART 8.6. MANDATORY PRODUCT CERTIFICATION**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 8.7. MANDATORY PRODUCT CERTIFICATION (BY ENTERPRISE SIZE)**

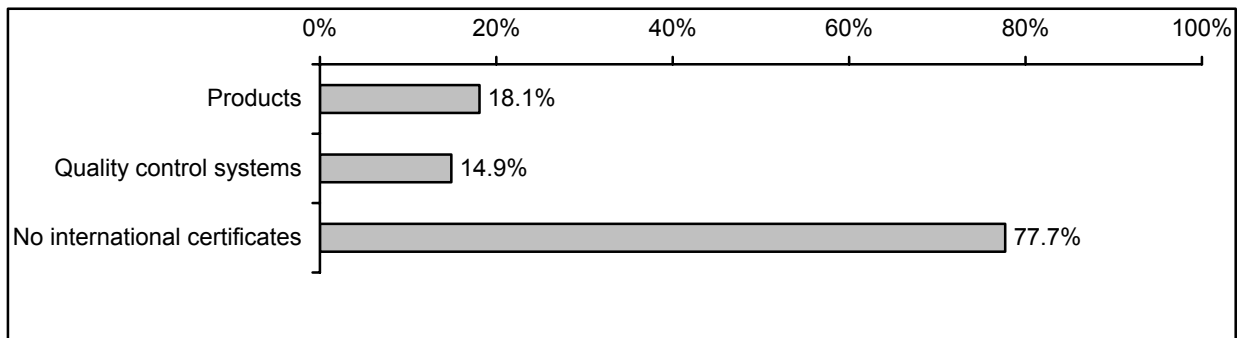


Source: Survey of 102 confectionery enterprise CEOs.

The majority of the surveyed confectioners (77.7 percent) had not completed international certification procedures. These were mostly small and medium-sized companies (Chart 8.8).

Large businesses that exported their products appeared more likely to have international certificates for their products and quality control systems (Chart 8.9).

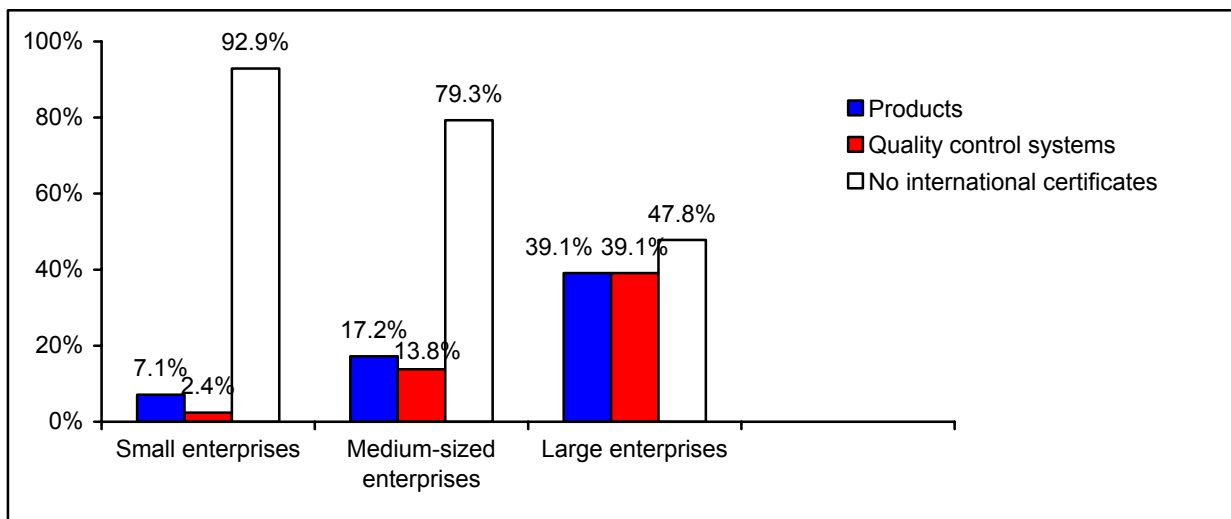
**CHART 8.8. INTERNATIONAL CERTIFICATION\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 8.9. INTERNATIONAL CERTIFICATION (BY ENTERPRISE SIZE)\***



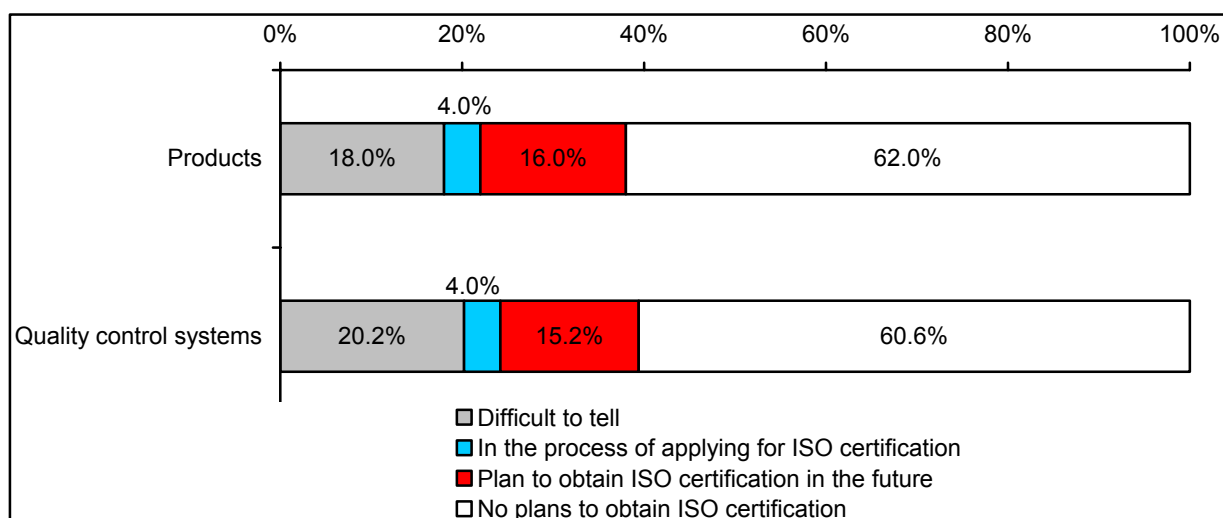
Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

Most confectionery enterprises did not plan to certify their products (60.6 percent) or quality control systems (62.0 percent).

Large businesses accounted for the largest share of enterprises that either planned to earn ISO certification or already had it.

It is important to note that acquisition of international certificates was a precondition for large businesses to enter international markets and enhance their competitiveness (Chart 8.10).

**CHART 8.10. PLANS TO PURSUE ISO CERTIFICATION**

Source: Survey of 102 confectionery enterprise CEOs.

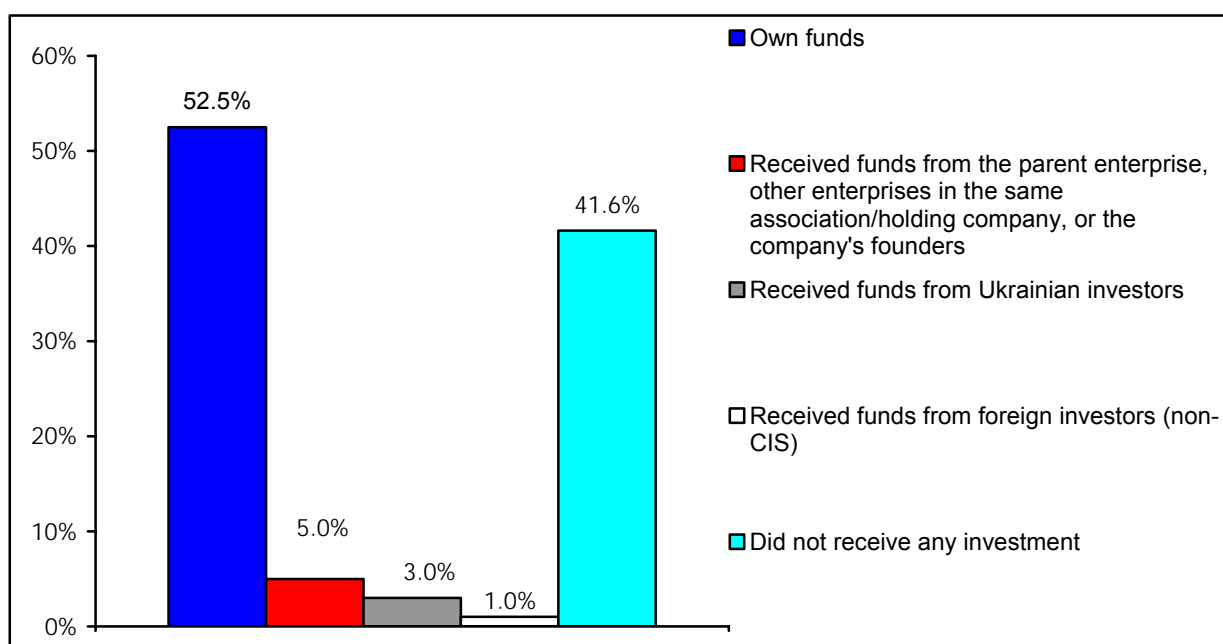
### LEVELS, STRUCTURES, AND ORIGINS OF INVESTMENT IN ENTERPRISE DEVELOPMENT

The generally positive dynamics of sector enterprise operations may be explained, specifically, by targeted investment in development of these enterprises (over 60 percent of surveyed enterprise CEOs reported that some form of investment was made toward development). The most common source of investment (irrespective of enterprise size) was companies' own funds (Chart 8.11).

Judging from information provided by the surveyed CEOs confection enterprises attracted very few external investors from Ukraine (in the case of foreign investors, this figure was even smaller). Only 4 percent of respondents to the

survey reported that they received investments from outside of their own companies, and most of these investments came from Ukrainian investors.

Companies that received external investment typically received it in monetary form. The following factors were identified as major problems for attracting investors: the lack of a clear and well-founded business plan, the absence of international quality control systems, ageing equipment, and outdated production technologies. The confections sector's overall lack of appeal to investors was due to the low level of development and poor organization of enterprises' operations.

**CHART 8.11. SOURCES OF INVESTMENT IN CONFECTIONERY COMPANIES IN 2005\***

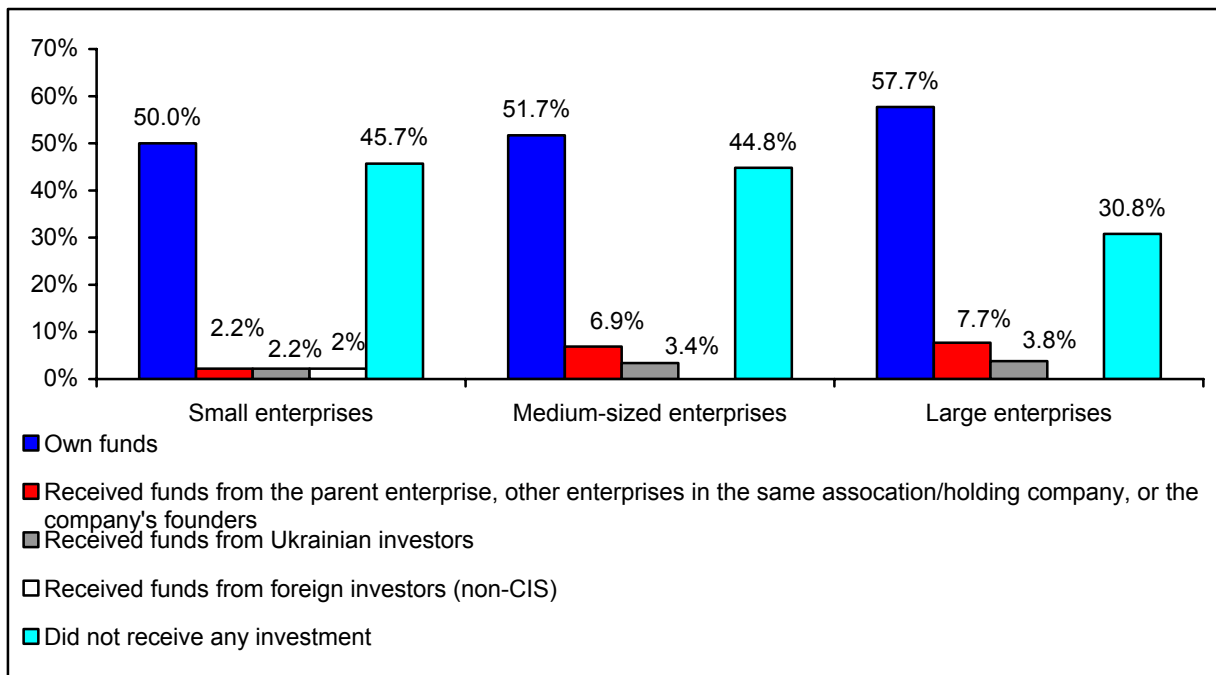
Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

Refusals by companies to invest in their own operations had almost no correlation to enterprise size: 30.8 percent of large companies, 44.8 percent of medium-sized enterprises, and 45.7 percent of small enterprises, and 45.7

percent of small businesses reported no internal investments in their companies' development over the course of 2005 (Chart 8.12).

**CHART 8.12. SOURCES OF INVESTMENT IN CONFECTIONERY COMPANIES IN 2005 (BY ENTERPRISE SIZE)\***



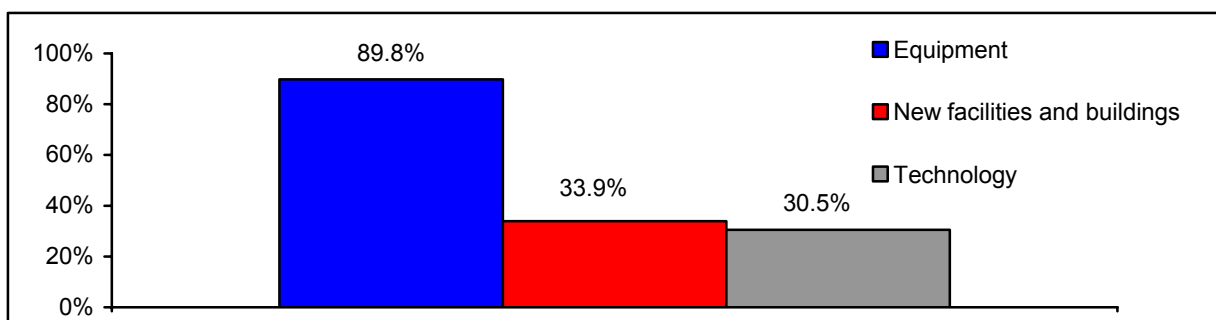
Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

In 2005, sector companies mostly used investment for equipment maintenance. It is important to note that large businesses were more likely to pay attention to innovations in production;

this is why they invested in technological development in addition to fixed assets (Charts 8.13 and 8.14).

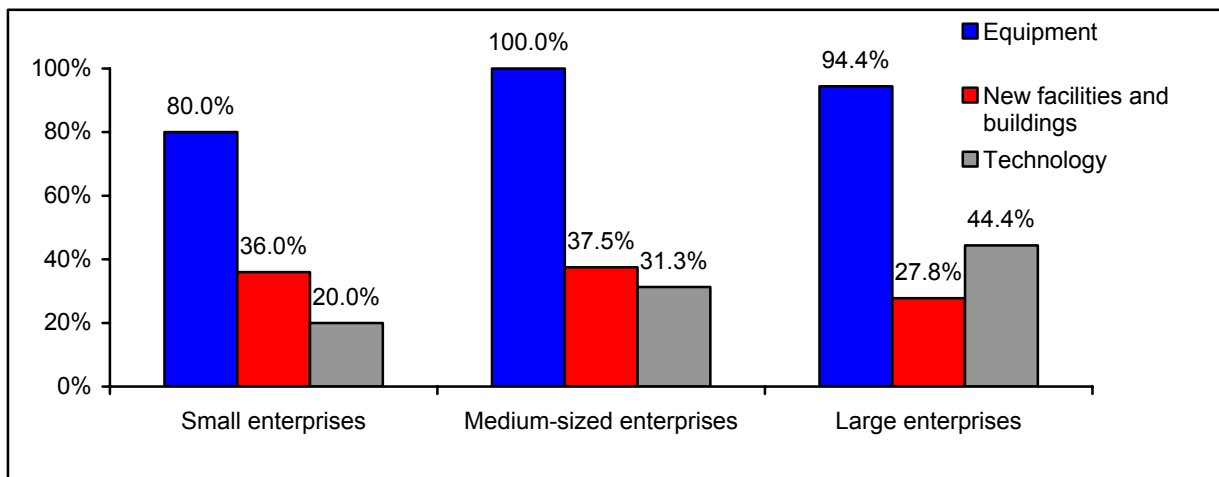
**CHART 8.13. PURPOSES OF INVESTMENT IN CONFECTIONERY COMPANIES IN 2005\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 8.14. PURPOSES OF INVESTMENT IN CONFECTIONERY COMPANIES IN 2005 (BY ENTERPRISE SIZE)\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

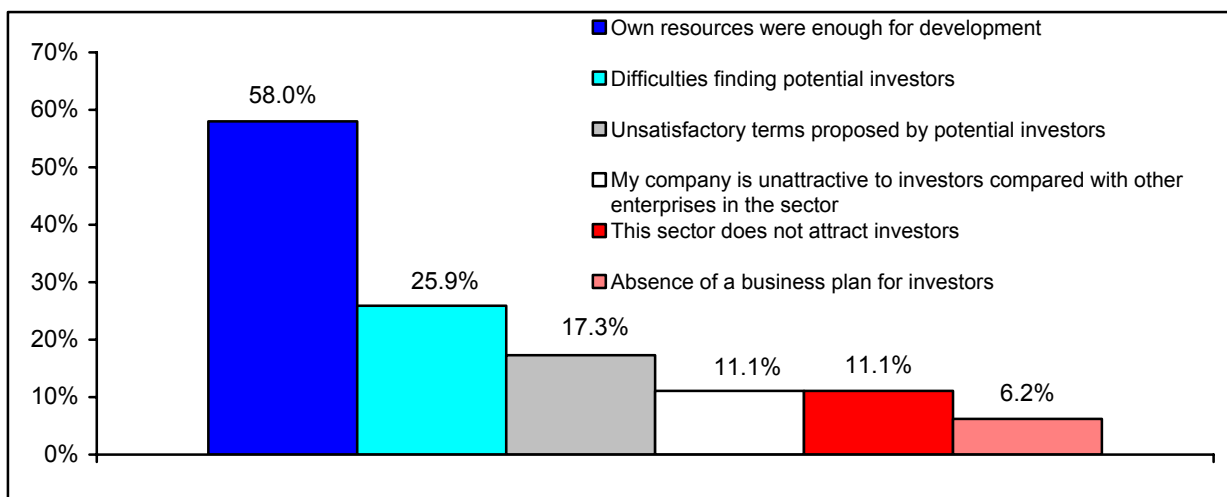
When analyzing reasons for failure to attract external investment, more than half of the survey respondents stated that their own companies' resources were enough. The least common reasons were a lack of a business plan for potential investors and the confections sector's overall lack of investment appeal.

When one considers the dynamics of key development indicators, it is impossible to state that small and medium-sized confectionery companies do not need additional investment. However, their managers may not see real value in external investment or may simply have no real opportunities to attract investors. For their part, large businesses may indeed have enough of their own funds and be reluctant to give up total

control over company operations (an inevitable requirement for those who choose to work with outside investors).

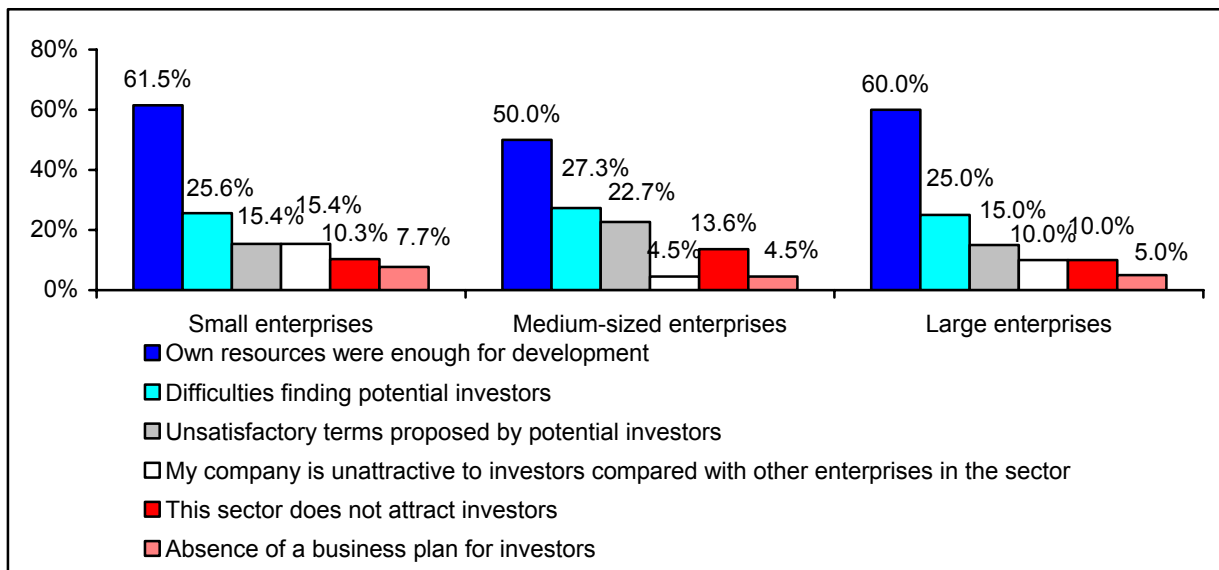
The brightest prospects for attracting potential external investors rested with medium-sized businesses. This is logical because these companies have already successfully "overcome" the stage of operating as small firms, and managers feel that their companies still have potential for growth. Meanwhile, judging by the information shown in Chart 8.16, medium-sized enterprises tended to be more concerned about the attractiveness of the sector for investors and unsatisfactory terms proposed by potential investors.

**CHART 8.15. REASONS FOR FAILURE TO ATTRACT EXTERNAL INVESTMENT\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 8.16. REASONS FOR FAILURE TO ATTRACT EXTERNAL INVESTMENT (BY ENTERPRISE SIZE)\***

Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

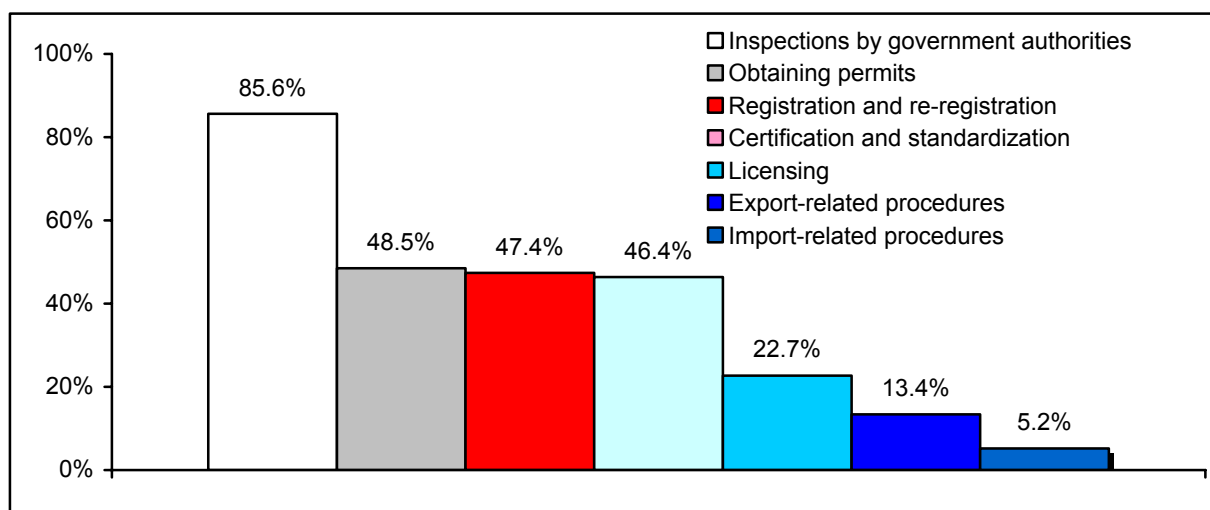
# SECTION 9. THE REGULATORY ENVIRONMENT

## ADMINISTRATIVE BARRIERS

According to confectionery company managers, interactions with government authorities usually took place during routine inspections of their enterprises. This situation was typical among all types of businesses. Interactions with government authorities for any other reason did not happen very frequently (Chart 9.1).

Large businesses were comparatively more concerned about administrative procedures connected with foreign economic activities (due to the fact that they had a greater level of involvement in said activities); see Chart 9.2.

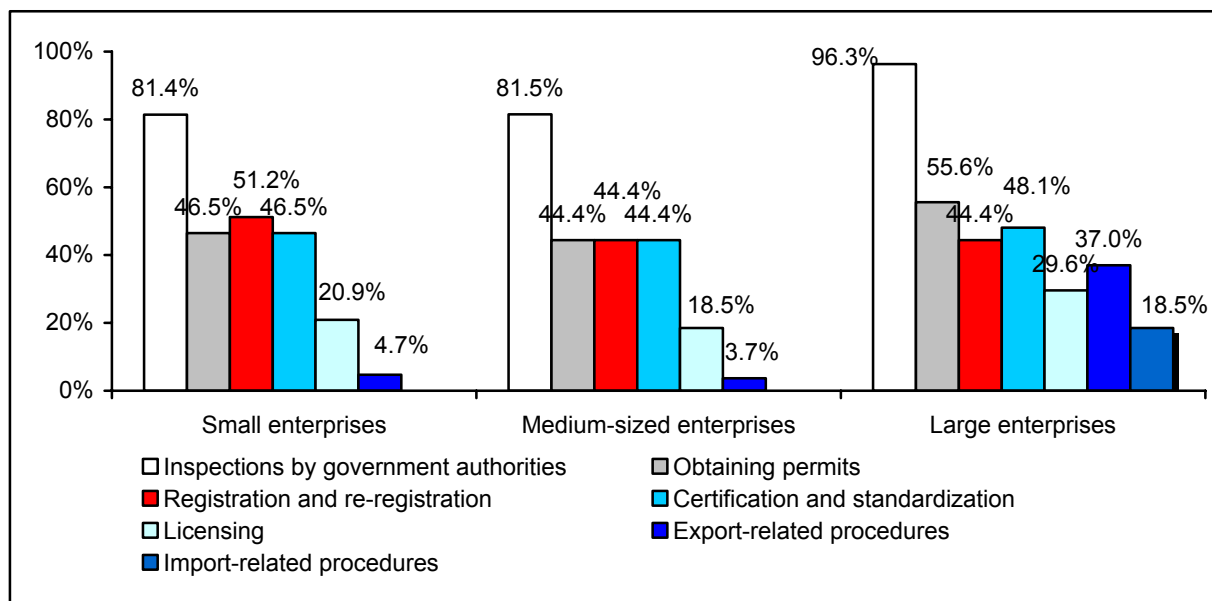
**CHART 9.1. ADMINISTRATIVE PROCEDURES COMPLETED BY CONFECTIONS SECTOR ENTERPRISES IN 2005 (IN %)\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 9.2. ADMINISTRATIVE PROCEDURES COMPLETED BY CONFECTIONS SECTOR ENTERPRISES IN 2005 (BY ENTERPRISE SIZE)\***



Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

The main problem that arose when completing either registration/re-registration or permit issuance procedures was the excessive amount of time required (caused by long lines, paperwork, and inefficiency on the part of government officials).

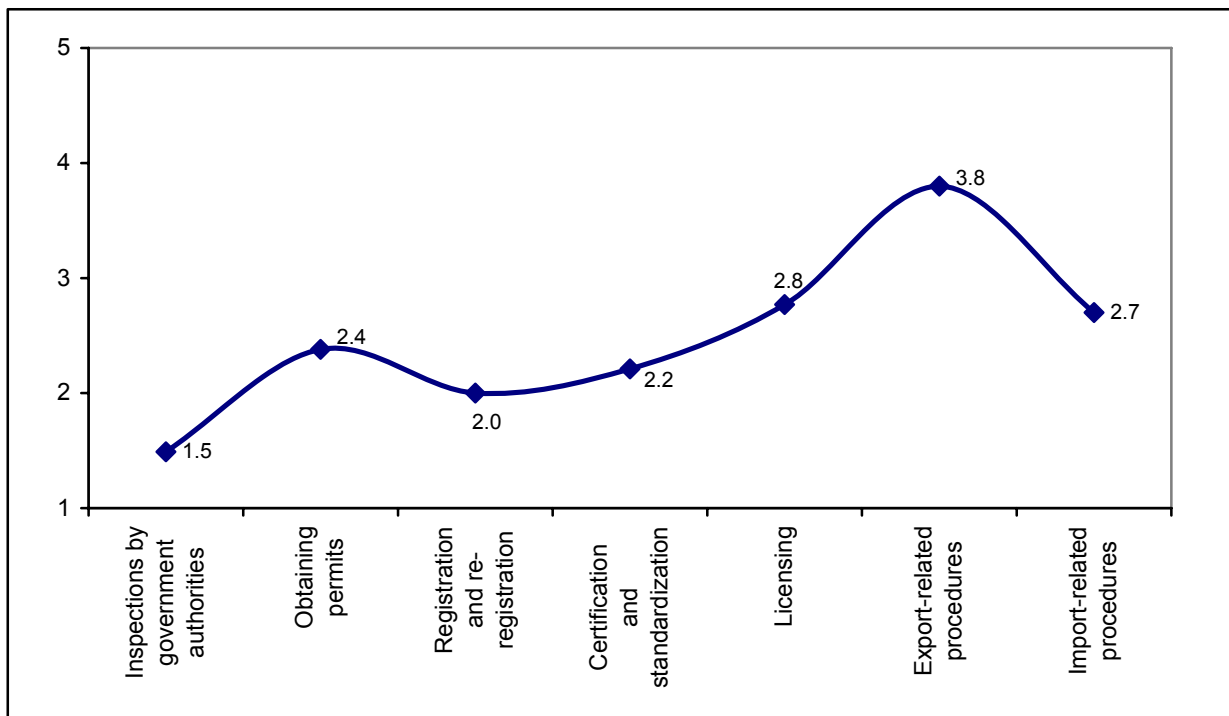
Companies engaged in export and import operations noted that in addition to inefficiency on the part of government officials when completing paperwork, the burdensome and complex nature of Customs procedures, unpredictable and vague legislation, and sizes of official monetary fees created problems.

When discussing business inspections, entrepreneurs expressed concerns that the inspections were too frequent and disrupted regular business operations. Enterprise managers also complained of breaches of conduct

committed during inspections (graft and other inappropriate behavior on the part of inspectors, and a general lack of coordination between different government authorities) and excessive strictness when imposing limitations on business operations and fining enterprises ("premeditated fines").

However, as observed in Chart 9.3 below, business managers generally evaluated difficulties that arose during the aforementioned administrative procedures as not very serious (except for problems related to exporting products). Inspection-related problems were perceived as "routine" issues that managers handled as part of their daily activities (although all businesses completed inspection procedures frequently, they ranked inspection-related problems as the least serious).

**CHART 9.3. EVALUATION OF PROBLEMS ENCOUNTERED WHEN COMPLETING ADMINISTRATIVE PROCEDURES\***



Source: Survey of 102 confectionery enterprise CEOs.

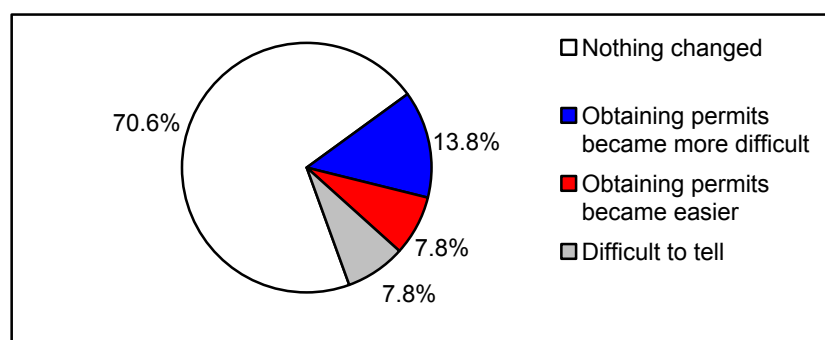
\* The problems were rated on a five-point scale wherein 1 = "minor problems" and 5 = "major problems."

According to confectionery enterprise managers' assessments of their interactions with government authorities, the general business environment in Ukraine was still restrictive. The overwhelming majority of respondents noted that processes for obtaining permits either remained unchanged (meaning that the problems discussed above remained unaddressed) or had become even more complicated.

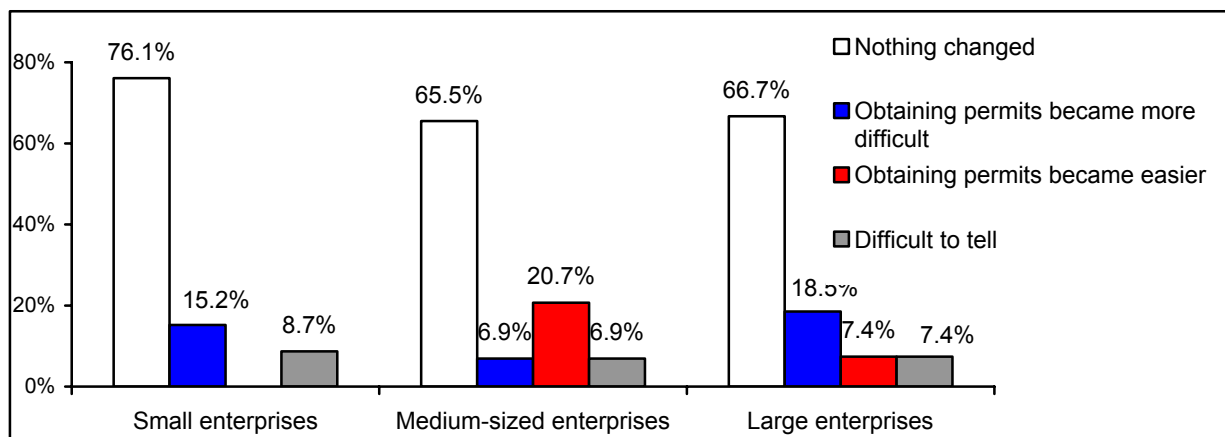
Meanwhile, medium-sized businesses were less likely to report administrative barriers (a larger

share stated that the process of obtaining permits had become easier than among small and large enterprises). We may assume that small and medium-sized firms were indeed more sensitive to administrative hurdles: small businesses tended to lack sufficient influence to combat arbitrary red tape, while medium-sized businesses faced difficulties in terms of conducting foreign economic activities.

**CHART 9.4. DIFFICULTY OF OBTAINING PERMITS IN 2005 (COMPARED TO PREVIOUS YEARS)**



Source: Survey of 102 confectionery enterprise CEOs.

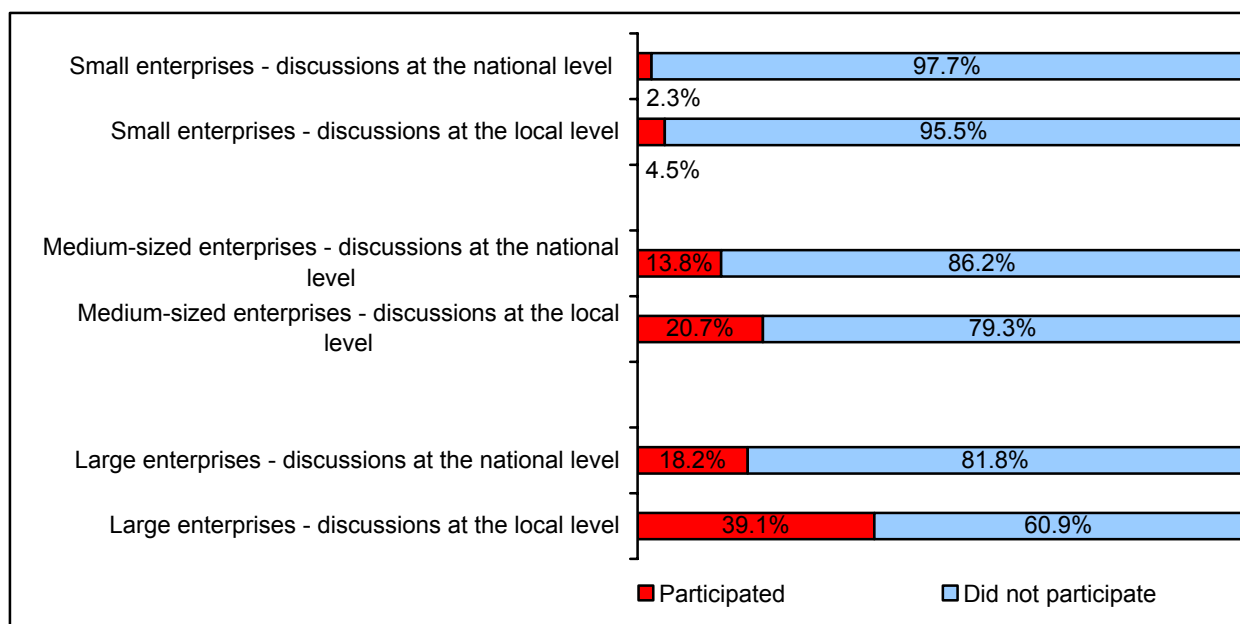
**CHART 9.5. DIFFICULTY OF OBTAINING PERMITS IN 2005 (COMPARED TO PREVIOUS YEARS, BY ENTERPRISE SIZE)**

Source: Survey of 102 confectionery enterprise CEOs.

### MEANS OF INFLUENCING THE REGULATORY ENVIRONMENT

As stated in previous reports, enterprises rarely participated in regulatory authorities' discussions of draft resolutions affecting business activities. This applied to enterprises' relationships with both national and local government authorities. While a

few large and medium-sized businesses may have exercised at least some influence over regulatory decision-making (mostly at the local level), small businesses had virtually no role in these processes (Chart 9.6).

**CHART 9.6. PARTICIPATION IN DISCUSSIONS OF DRAFT REGULATIONS AFFECTING BUSINESS ACTIVITIES IN 2005**

Source: Survey of 102 confectionery enterprise CEOs.

Managers of businesses whose representatives did participate in discussions of draft regulations noted that they did not do this on a regular basis (see Chart 9.6).

With no opportunities to engage in discussions of draft decisions regulating business operations, entrepreneurs had to resolve problems involving interaction with government authorities in other ways.

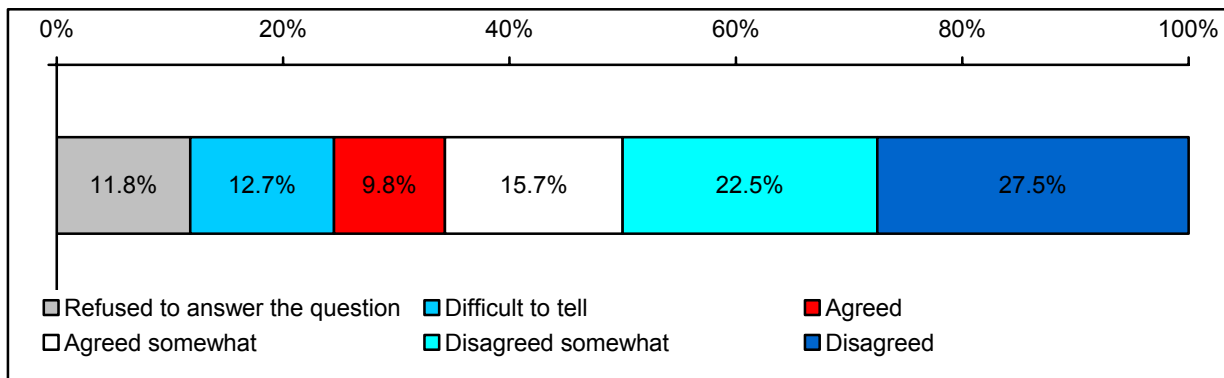
One-fourth of the surveyed businesses acknowledged that it was quite common for

enterprises in the confections sector to give so-called "unofficial payments" to government authorities. As demonstrated by this survey's findings, small enterprises tended to suffer from this practice more than medium-sized or large businesses (if we consider the shares of those who cited a need to make unofficial payments, and those who refused to answer this question). We may assume that managers of large businesses who were "aware" of the practice of unofficial payments perceived these as not only an imposed duty (as with small companies), but

also as an affordable way to address regulatory problems if they had not yet established

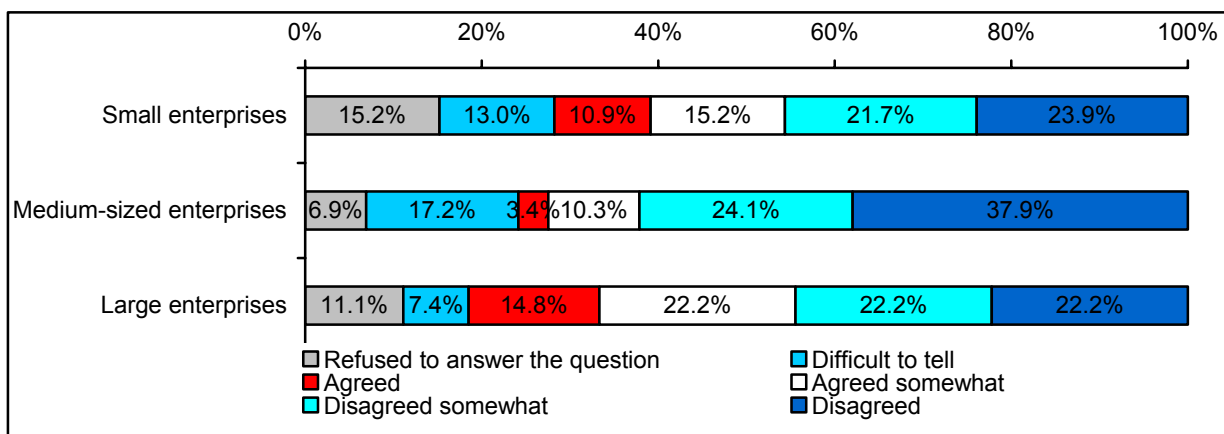
relationships with government officials (Charts 9.7 and 9.8).

**CHART 9.7. ARE UNOFFICIAL PAYMENTS TO GOVERNMENT AUTHORITIES COMMON? (% OF ENTREPRENEUR RESPONSES)**



Source: Survey of 102 confectionery enterprise CEOs.

**CHART 9.8. ARE UNOFFICIAL PAYMENTS TO GOVERNMENT AUTHORITIES COMMON? (BY ENTERPRISE SIZE)**



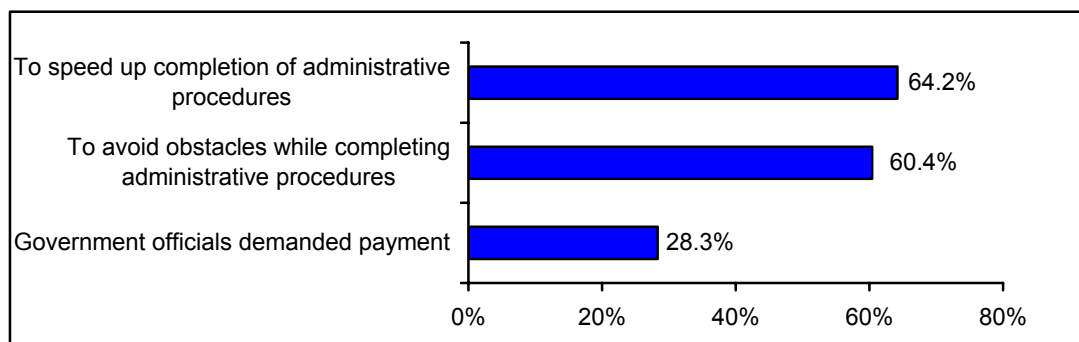
Source: Survey of 102 confectionery enterprise CEOs.

Reasons for making unofficial payments varied among businesses of different sizes. Small firms paid government officials because it was the only way to remove obstacles for their operations, whereas large and medium-sized companies made unofficial payments for additional benefits in the form of “fast-track” administrative procedures (Chart 9.9).

It is important to note that the survey results suggested that officials very rarely demanded “stimuli” directly. Instead, their actions or mere level of inactivity created an environment where business managers had to offer incentives in

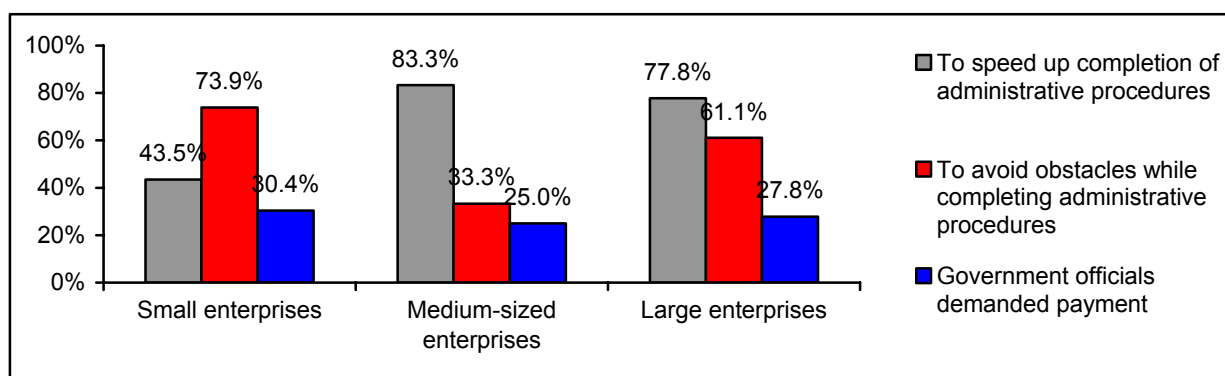
order to complete necessary procedures. The analysis of the most common reasons for unofficial payments demonstrated that this problem was particularly acute for small and large businesses in the confections sector. Medium-sized companies appeared to experience fewer problems with government officials (Chart 9.10).

Only some of the surveyed businesses agreed to estimate the typical size of unofficial payments; according to these estimates, the average payment did not exceed 5 percent of annual net profits.

**CHART 9.9. REASONS FOR UNOFFICIAL PAYMENTS TO GOVERNMENT AUTHORITIES\***

Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

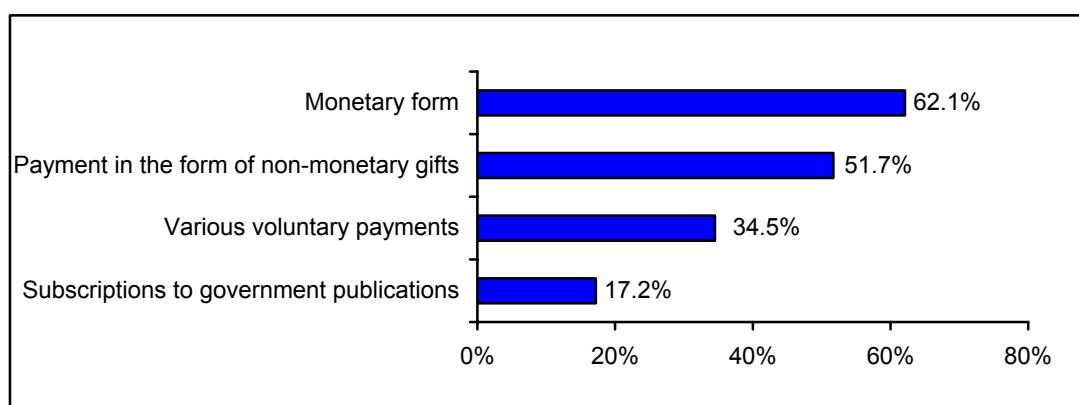
**CHART 9.10. REASONS FOR UNOFFICIAL PAYMENTS TO GOVERNMENT AUTHORITIES (BY ENTERPRISE SIZE)\***

Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

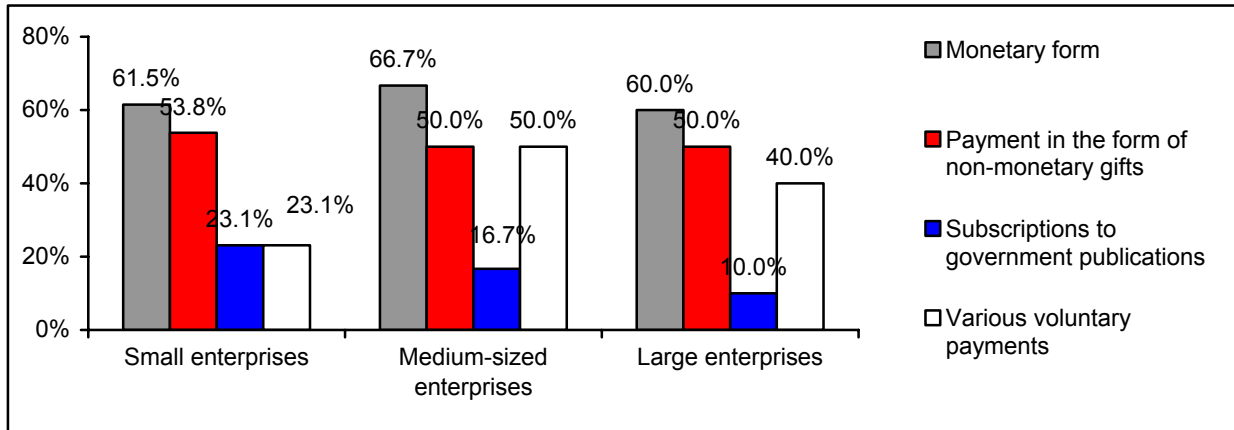
As for forms of unofficial payments, it became obvious that money was the most common form of unofficial payment. Payments in the form of non-monetary gifts were less popular (Chart 9.11).

While the majority of enterprises of all sizes paid officials in monetary form, medium-sized and large enterprises were more likely to make various other forms of voluntary payments to charity funds, etc. (Chart 9.12).

**CHART 9.11. FORMS OF UNOFFICIAL PAYMENTS\***

Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 9.12. FORMS OF UNOFFICIAL PAYMENTS (BY ENTERPRISE SIZE)\***

Source: Survey of 102 confectionery enterprise CEOs.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

# SECTION 10. BUSINESS ASSOCIATIONS

## BUSINESS ASSOCIATION MEMBERSHIP

The share of confectionery business entities that were full members of business associations was governed largely by enterprise size: large businesses were considerably more active in this sense than their small and medium-sized counterparts were (Chart 10.2).

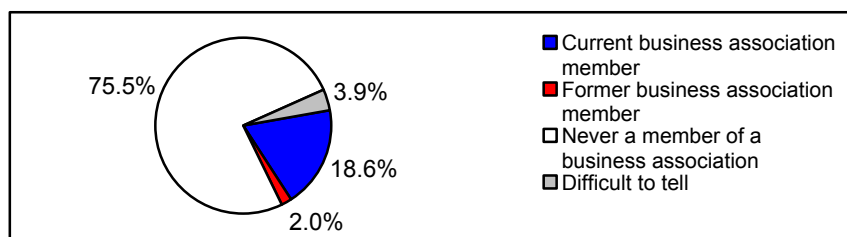
This situation was easy to understand, since large businesses demonstrated a relatively higher level of organization of various aspects of business operations (one of the distinctive features of a market leader). For this reason, it is not surprising that a relatively large share of leading sector enterprises concluded that in a number of instances (e.g., in relationships with government

authorities at various levels), organized collective action was much more effective than efforts by individual companies.

In terms of the types and levels of business associations in which large confectionery enterprises held membership, these were mostly industry-specific associations at the national (and less frequently, oblast) level. Participation of domestic confectionery enterprises in international business associations was more the exception than the rule (Chart 10.3).

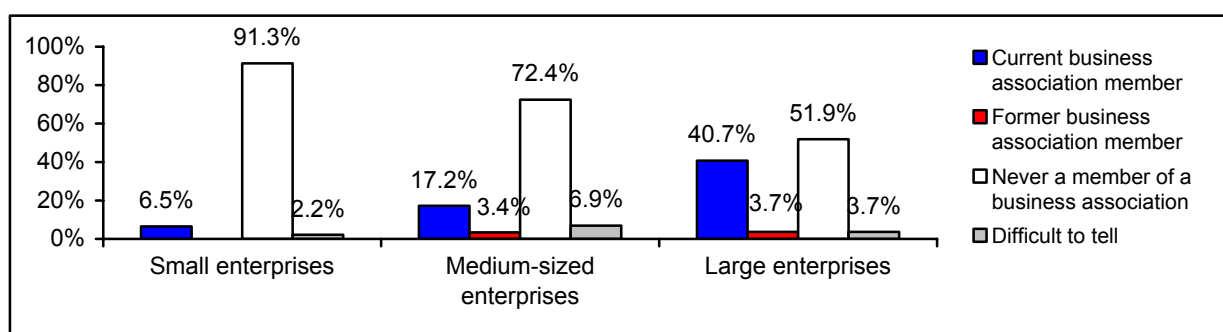
It is important to note that instances when companies were former business association members were extremely rare.

CHART 10.1. BUSINESS ASSOCIATION MEMBERSHIP



Source: Survey of 102 confectionery enterprise CEOs.

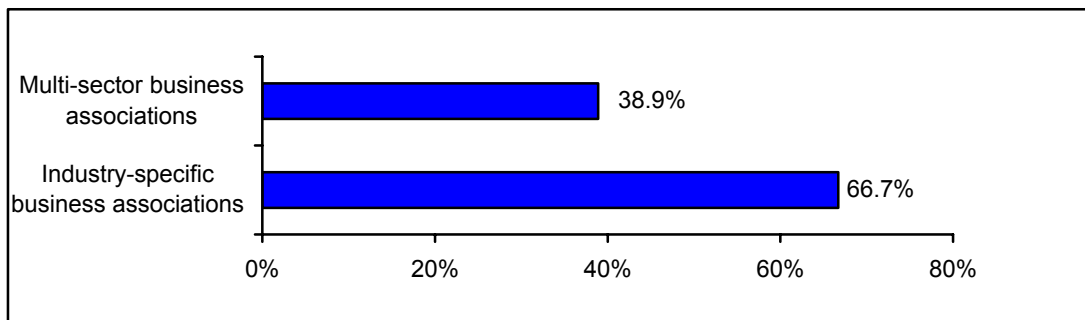
CHART 10.2. BUSINESS ASSOCIATION MEMBERSHIP (BY ENTERPRISE SIZE)



Source: Survey of 102 confectionery enterprise CEOs.

Two-thirds of those businesses that were members of business associations were members of industry-specific associations, while 39 percent were members of multi-sector business associations. Over half of the surveyed

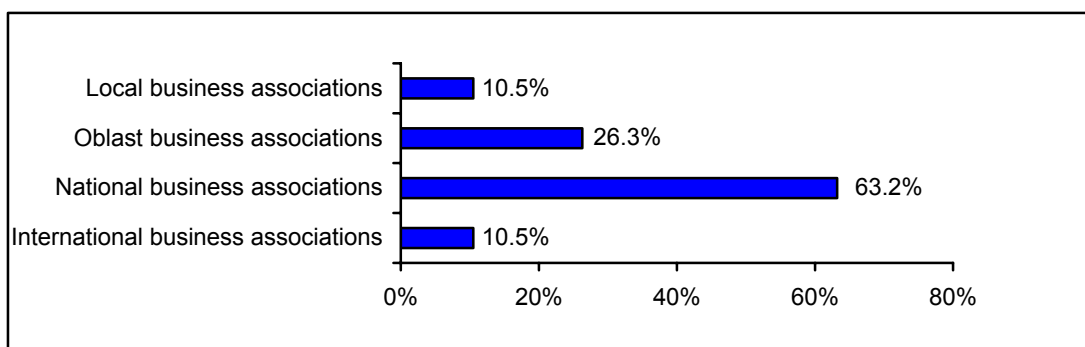
enterprises that were members of business associations belonged to national-level business associations (63.2 percent). Almost every tenth enterprise (10.5 percent) was a member of an international business association (Chart 10.4).

**CHART 10.3. MEMBERSHIP IN VARIOUS TYPES OF BUSINESS ASSOCIATIONS (% OF THOSE INVOLVED IN BUSINESS ASSOCIATIONS)\***

Source: Survey of 102 confectionery enterprise CEOs.

Number of respondents to this question in particular: 19.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.

**CHART 10.4. ENTERPRISE MEMBERSHIP IN BUSINESS ASSOCIATIONS AT VARIOUS LEVELS\***

Source: Survey of 102 confectionery enterprise CEOs.

Number of respondents to this question in particular: 19.

\* The sum total of percentages may exceed 100%, as respondents could choose several answers.