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Navigating challenges: Policy solutions for Ukrainian firms on the road to recovery

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Abstract

The armed conflict has had a profound impact on Ukraine's economic landscape, leading to significant declines in both economic growth and industrial production. The UNIDO Enterprise Survey 2023 sheds light on the challenges encountered by Ukrainian firms and emphasizes the need for strategic interventions to safeguard firms' economic lifelines, upgrade their production capabilities, foster market expansion and diversification, and mitigate transaction costs arising from ineffective government regulations. While existing government support addresses firms' immediate needs, a notable gap is evident between the support being received by firms and the support they need. To bridge this policy gap and enhance financial resources and technological capabilities across all levels, government agencies must bolster coordination to mobilize and efficiently allocate fiscal resources for expanding support coverage. Marginalized stakeholders, such as local governments, must be more closely involved in policy formulation and implementation. Additionally, cultivating public-private partnerships that prioritize Ukraine's strategic alignment with economic integration in the EU is essential.

Key Messages

- 1.** Policymakers in Ukraine must prioritize initiatives aimed at safeguarding firms' economic lifelines and at boosting both production capabilities and industrial diversification.
- 2.** While firms' immediate financial needs are being met to a larger extent, a notable policy gap exists in other areas of firm support such as reducing administrative burdens and enhancing production capacities.
- 3.** To achieve green growth, government agencies should strengthen firms' financial and technological capabilities and foster public-private partnerships that prioritize economic integration with the EU.

Understanding the war's economic ramifications on Ukraine: The need for country-specific policy instruments

Ukraine has been grappling with profound challenges in recent years, including the non-recognized annexation of Crimea and outbreak of armed conflict in eastern Ukraine in 2014, and the full-scale invasion of the country in 2022. These developments have resulted in a significant decline in the country's gross domestic product (GDP) and industrial production.² The share of its manufacturing value added (MVA), employment in industry, export volume and revealed comparative advantage (RCA) of the country's key industries, namely food and beverages, tobacco, wood and basic metals, have also suffered major blows.³

The ongoing war has exacerbated the challenge of achieving inclusive and sustainable industrial development and is affecting each region (oblast) and firms operating in various sectors differently. Regions at the frontline, including Zaporizhzhia, Donetsk, Kharkiv, and the City of Kyiv, have witnessed the most significant drop in industrial production, MVA, exports, labour supply and business expectations.⁴ According to the UNIDO Enterprise Survey 2023⁵, 61.7 per cent of sampled firms have suspended their operations, with 43.2 per cent forced to cease their activity for one and three months, on average. The survey results highlight the disruptive nature of the ongoing conflict and its

disproportionate impacts, underscoring the urgent need for strategic interventions to help businesses navigate the tumultuous effects of the conflict.

The implementation of targeted policies and institutional reforms is crucial for achieving post-war recovery and increased growth. They cover four broad areas, namely i) macroeconomic management and sustainable reforms; ii) structural policies for long-term and equitable growth; iii) policy initiatives aimed at promoting social inclusion, and iv) effective public sector management.⁶ The literature on armed conflict, recovery and growth suggests that firms operating in countries or regions impacted by armed conflicts or crises in general often encounter a similar set of problems, such as lack of cash flow (financial constraints), input and labour shortages (production constraints) and reductions in demand (consumption constraints).^{7 8 9} During crises, governments tend to focus on short-term policy measures only, such as loan guarantees, soft loans, grants and subsidies as well as tax relief packages. However, the impacts of a conflict vary depending on its nature, the country's economic landscape and the characteristics of its firms, i.e. policy interventions need to be tailored to specific contexts.^{10 11} We draw on data from the UNIDO Enterprise Survey

2023 to analyse the effects of the ongoing armed conflict on firm performance in Ukraine and to identify the challenges they have encountered and assess the effectiveness of existing policy measures. Drawing on these insights, we propose policy recommendations to accelerate post-conflict recovery and inclusive and sustainable industrial development.

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Navigating economic challenges by addressing policy gaps: The path to recovery for Ukrainian firms

The armed conflict in Ukraine has exacerbated the bottlenecks faced by firms and has introduced new challenges in terms of labour supply, production capabilities, access to energy, finance, government support and consumer demand. For instance, 82.2 per cent of the sample stated that the conflict had intensified the already prevalent shortage of skilled labour. Furthermore, 44.7 per cent of respondents reported a newly emerging concern, namely the loss of workers due to conscription into the armed forces. Each firm has incurred losses and damages totalling USD 866,300, on average. The ongoing conflict has had a severe impact on firms' cash flow, with 80 per cent experiencing shortages since the outbreak of the war. Firms have adopted various strategies to mitigate these challenges, including reducing expenditures (47.9 per cent), obtaining personal or family loans (46.5 per cent), delaying payments to suppliers or workers (36.9 per cent) and securing loans from commercial banks (30.7 per cent).

The survey results also reveal that the majority of firms (70 per cent) have experienced input shortages as a result of the conflict. In response, they have sought alternative domestic and international suppliers (49.3 per cent and 29.1 per cent, respectively) and utilized inventories (29.1 per cent). Access to financial resources (e.g. European Union (EU) grants) (58.5 per cent) and exploring new international markets (34.3 per cent) emerged as top priority areas requiring immediate government support. However, despite the potential

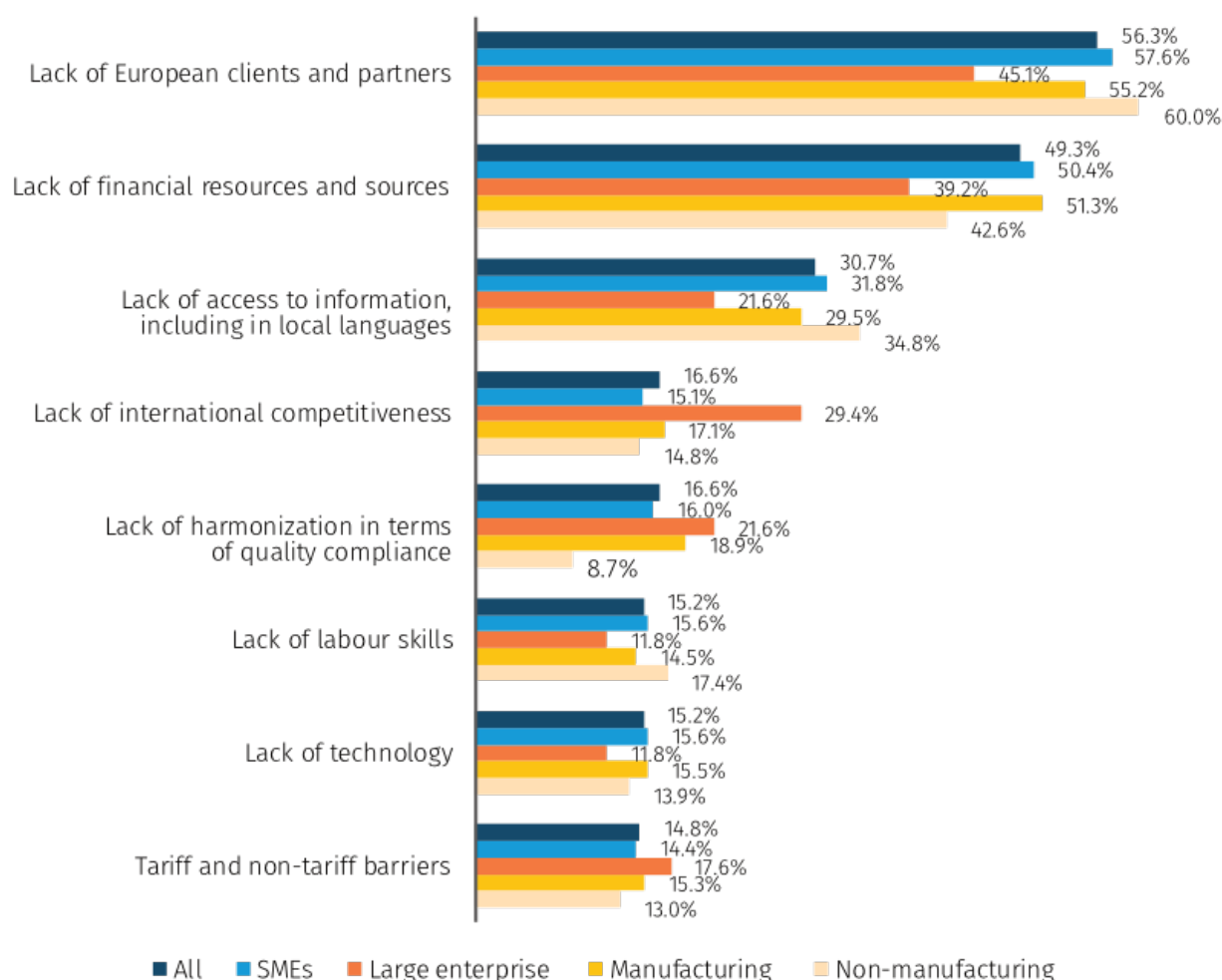
opportunities for recovery through closer economic integration with the EU, a substantial share of firms (around 82 per cent) have not yet redirected their business activities towards the EU. The greatest obstacles across all firm types to deeper EU integration include a lack of European clients and partners (56.3 per cent), insufficient financial resources (49.3 per cent) and limited access to information, including language barriers (30.7 per cent) (Figure 1). There is thus a pressing need for increased attention and targeted support to facilitate and accelerate Ukraine's integration into the EU market.

Despite the prevailing challenges, a significant share of firms has demonstrated resilience amid the crisis. Around 60.5 per cent of surveyed firms reported that their annual profits had either increased or had remained constant in 2023 compared to the previous year, although operating costs have surged (60.3 per cent). The primary drivers of rising costs include the higher cost of materials and energy and the shortage of labour, aligning with the reported bottlenecks and challenges induced by the ongoing conflict. Nearly half of the responding firms (46.5 per cent) expected to continue operating for more than 12 months, while 61.1 per cent maintained full on-site operations. Nevertheless, one-third of the firms (35.4 per cent) anticipated ceasing operations within the next six months, signifying an urgent need for support from the government and other stakeholders.

The surveyed firms identified several key policy measures they consider essential for facilitating recovery from the conflict. These include grant support (44.7 per cent), followed closely by tax exemptions or reductions (41.1 per cent) and preferential loans (38.7 per cent). Other measures cited were assistance for upgrading production (31.7 per cent) and expanding into foreign markets (29.9 per cent). These results, coupled with the preceding analysis of the obstacles to deeper integration into the EU market, underscore the importance of prioritizing targeted policy actions to facilitate Ukraine’s green recovery and promote inclusive and sustainable industrial development. Specifically, attention should be directed towards initiatives focused on:

1. safeguarding economic lifelines and fostering short-term recovery;
2. restoring and upgrading production capabilities;
3. fostering market expansion and diversification, and
4. reducing the transaction costs incurred from inefficient government regulations and administrative processes.

FIG. 1: THE MAJOR BOTTLENECKS FOR DEEPER INTEGRATION INTO THE EU MARKET¹²

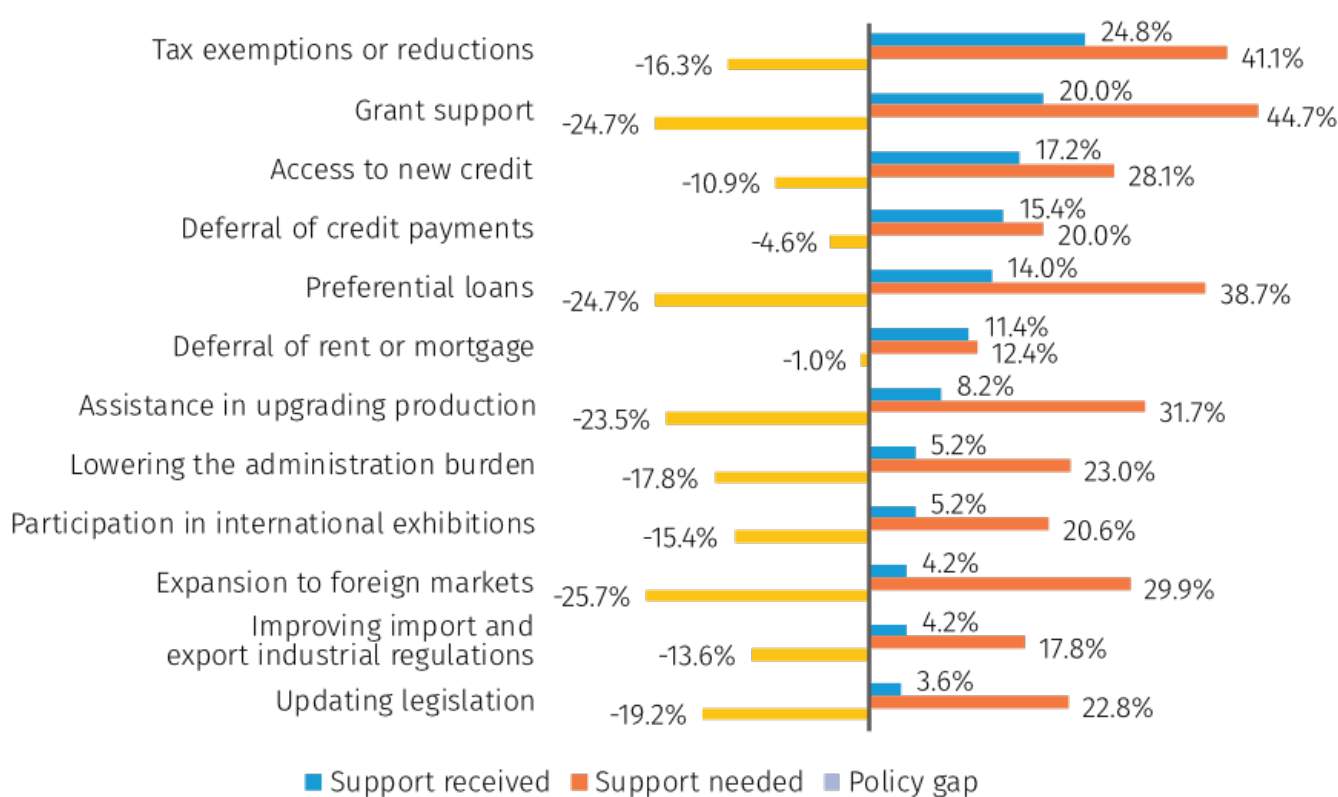


Source: UNIDO enterprise survey 2023

Our analysis reveals that the lack of adequate support for firms in line with their needs represents a major challenge for navigating the impacts of the conflict (Figures 2 and 3). We conducted a comparison using data derived from two survey questions: one question gauged the share of firms satisfied with the policy instruments currently being provided by different

organizations ('support received') while the second one focused on the share of firms calling for policy instruments aimed at recovery of firms from the conflict's impacts ('support needed'). We treat the disparity between these two shares as a policy gap or policy area that requires further attention.

FIG. 2: SUPPORT RECEIVED AND SUPPORT NEEDED BY UKRAINIAN FIRMS, 2023¹⁵



Source: UNIDO enterprise survey 2023

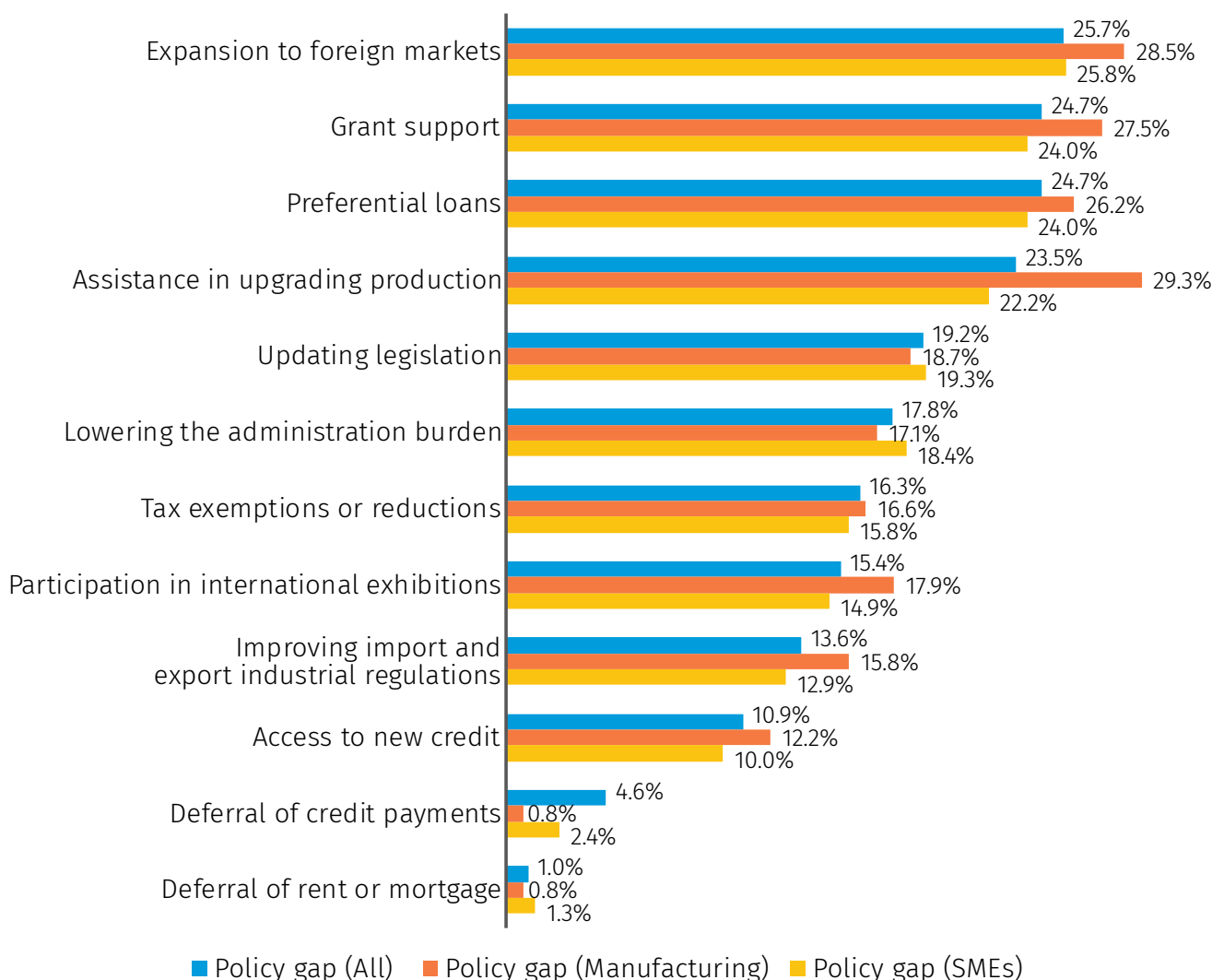
Figure 2 illustrates that a significant disparity (policy gap) exists between the support being received by firms and the support they need, namely grant support (24.7 per cent), preferential loans (24.7 per cent), assistance for upgrading production (23.5 per cent) and expansion into foreign markets (25.7 per cent). In addition, based on discussions with Ukrainian stakeholders¹³, factors such as lack of awareness about available support programmes, complex application processes and

documentation requirements also contribute to this gap. Figure 3 presents the policy gap by firm type, i.e. manufacturing firms and SMEs. We find that the policy gap across most instruments—except for updating legislation, reducing administrative bottlenecks and loan deferment—tends to be larger for manufacturing firms than for other firms. By contrast, the policy gap for SMEs is similar to that of all firms.

The financial measures currently being provided by the national government align with the top two policy support measures firms are in need of, namely (i) tax exemptions or reductions, and (ii) grant support, as well as with the top three policy support measures with the lowest policy gap, namely (i) deferral of rent or mortgage: (ii) deferral of credit payments, and (iii) access to new credit (Figure 2).¹⁴ This alignment suggests that existing government support adequately addresses the priority to safeguard firms' economic lifelines and facilitate short-term recovery, hence meeting firms' most immediate needs.

Other areas that warrant extended interventions include (i) revising the regulatory framework to reduce administrative burdens; (ii) reforming legislation; (iv) adapting import-export regulations; (iv) implementing business upgrading initiatives, including the improvement of production processes; (v) advocating for Ukrainian businesses in foreign markets, and (vi) promoting active participation of Ukrainian firms in international fairs. If we consider the support provided/support needed ratio as the measure that indicates the extent to which firms were satisfied, we find that these are the areas with the lowest levels, respectively 23 per cent (i); 16 per cent (ii); 24 per cent (iii); 26 per cent (iv); 14 per cent (v). and 25 per cent (vi) (Figure 2).

FIG. 3: POLICY GAP IN UKRAINE BY FIRM TYPE, 2023¹⁶



Source: UNIDO enterprise survey 2023

To successfully narrow the identified policy gap, government agencies must enhance vertical and horizontal coordination to prioritize, mobilize and effectively allocate fiscal resources for expanding support coverage. Furthermore, marginalized stakeholders, such as local governments, must be more closely involved in policy formulation and implementation. Fostering public-private partnerships between government agencies, domestic and foreign

private sector entities, civil society and international agencies is also essential. These partnerships should be established during the policy formation stage and prioritize Ukraine's strategic alignment with economic integration in the EU, a crucial step for strengthening financial resources and enhancing the technological capabilities necessary for achieving inclusive and sustainable industrial development and green growth.

Endnotes

¹ This policy brief is based on the Ukraine Industrial Country Diagnostics 2023, which was part of the project "Green industrial recovery programme in Ukraine". We would like to extend our gratitude to the German BMZ (Germany Federal Ministry of Economic Cooperation and Development) for funding this project. We thank Florian Hespeel for designing and Niki Rodousakis for editing.

² Khaustova, V., Korwatanasakul, U., and Cantore, N. (2024), Analysis of industrial production and exports of goods from Ukraine and its regions, 2013–2022, Inclusive and Sustainable Industrial Development Working Paper Series, WP 2, UNIDO. https://downloads.unido.org/ot/33/87/33874969/WP_2_2024_FINAL.pdf

³ UNIDO (2024), Ukraine: Industrial Country Diagnostics 2023.

⁴ Ayele, Y., Korwatanasakul, U., and Cantore, N. (2024), The impact of the war on industrial sectors in Ukraine. Inclusive and Sustainable Industrial Development Working Paper Series, WP 3, UNIDO.

⁵ In 2023, UNIDO conducted the firm-level survey to assess the current and expected impacts of the ongoing armed conflict on Ukrainian firms, their needs, the government strategies being implemented in response and entrepreneurs' perception of existing and future support measures provided by the local and national government. The sample comprised 501 firms, 80 per cent of which were manufacturing firms. Roughly 90 per cent of the sample were small and medium-sized enterprises (SMEs) Geographically, the sample was distributed across five regions (northern (8 per cent), southern (8 per cent), central (12 per cent), eastern (23 per cent), and western region (12 per cent) and the City of Kyiv (27 per cent). Most of the firms (77.4 per cent) operate in multiple regions; 43.4 per cent started operating between 2000 and 2013, while 24.4 per cent were established between 2014 and 2019.

⁶ Hoeffler, A. (2012), Growth, aid and policies in countries recovering from war.

⁷ Del Prete, D., Di Maio, M. and Rahman, A. (2023), Firms amid conflict: Performance, production inputs, and market competition.

⁸ Petracco C. and Schweiger, H. (2012), The impact of armed conflict on firms' performance and perceptions.

⁹ Intarakumnerd, P. and Korwatanasakul, U. (2020), Business impacts and government support for firms' upgrading and innovation under COVID-19 in Southeast Asia.

¹⁰ Del Prete, Di Maio and Rahman, Firms amid conflict: Performance, production inputs, and market competition.

¹¹ Petracco and Schweiger, The impact of armed conflict on firms' performance and perceptions.

¹² Note: SME = small and medium-sized enterprise. Each percentage refers to the percentage of total firms of each firm type.

¹³ In 2023, UNIDO conducted consultations with various national counterparts, including policymakers, firms, non-governmental organizations and business associations to supplement the analysis (Ukraine: Industrial Country Diagnostics 2023).

¹⁴ The national government provided more support measures to Ukrainian firms than other organizations, such as international organizations, domestic and foreign private sector entities, non-governmental organizations and local governments (UNIDO, 2024).

¹⁵ Note: "Support received" refers to the share of firms that receive support, while "support needed" indicates the share of firms calling for policy instruments they consider crucial for their recovery amid the ongoing conflict. "Policy gap" represents the disparity between the support being provided and the support needed by firms. Support includes government support as well as support from other organizations, such as international organizations, domestic and foreign private sector entities and non-governmental organizations.

¹⁶ Ibid.



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