

## ANALYSIS

# Ukraine war is weakening the business environment in Finland

Finnish economy | 08.07.2022 | Petri Mäki-Fränti, Juuso Vanhala

### AUTHORS



Petri Mäki-Fränti  
Senior Economist



Juuso Vanhala  
Head of Forecasting

The war in Ukraine is affecting industrial sectors and individual companies across Finland, though in an uneven manner. The results of a business survey show that the majority of companies believe they can replace relatively quickly the lost volume of exports to Russia with new markets. Some companies, however, stated that they will be unable to replace any of the lost volume of exports. Manufacturing industries, in particular, are suffering from supply chain problems and rising costs. Companies estimate that they will be able to compensate for the impact of higher costs on profitability by, for example, raising their sales prices. As a consequence of the war, companies' investments, too, will remain slightly below the level planned.



In early 2022, Finland's economy had largely recovered from the shock caused by the COVID-19 pandemic. Russia's invasion of Ukraine then weakened the operating environment of many Finnish companies once again. The economic impacts of the war are not limited to the contraction of Finland's foreign trade with Russia, however. Before the war, some Finnish companies had extensive production or business activities in Russia, Belarus or Ukraine. With the war breaking out, companies have had to abandon most of their business operations. Energy prices have risen and raw material imports from Russia are drying up, which has pushed up the costs for companies and has created supply bottlenecks. As a result of the increase in general economic uncertainty, companies have had to consider their investments more closely. However, the war in Ukraine is affecting industries and individual companies in Finland in very different ways. Service industry companies, in particular, suffered from the COVID-19 pandemic, but now particularly manufacturing industries are hit by the contraction in turnover and rising costs.

This article assesses the impact of the war in Ukraine on companies' near-term outlook for turnover and for their supply chains, and the extent to which companies are able to adapt to the situation by looking for new markets for their products and adjusting their production. The estimate of the financial situation and outlook for companies in the early part of the year is based on business survey data compiled by Finnish Industry Investment Ltd (Tesi) in April 2022. The survey looked at 630 Finnish small and medium-sized enterprises (SMEs) with 5–250 employees. Finnish Industry Investment has conducted business surveys since the outbreak of the COVID-19 pandemic, and the survey in April was their sixth. It was targeted at three main industries: manufacturing, accommodation and food service activities, and information and communication. The survey sample is representative of the three industries in question, but the results of the survey cannot be extrapolated beyond these industries.

The survey data was combined with the companies' financial statements data for 2020. As a result, the statistical key figures calculated from the survey (mainly averages) could be weighted by turnover, exports or number of staff, thus avoiding giving too much prominence to smaller companies.<sup>1</sup>

## Weaker outlook for companies

In the surveys conducted in December 2021 and April 2022, companies were asked to estimate their turnover for 2022. In all three industries, companies on average expected an increase in turnover at least in nominal terms (Chart 1).

Significant differences emerged between the industries and between companies within each industry in terms of their expectations and the way in which these changed. Growth expectations

were highest in accommodation and food service activities, where the average of growth expectations, weighted for turnover, reached some 25% in April. In information and communication industry companies, growth expectations were about half of that. The weakest expectations were reported in manufacturing, where nominal turnover was expected to grow by just over 3% on the previous year. The expected growth in turnover includes the impact of higher prices, and at the time of the survey, inflation was projected to be high in 2022. A significant share of the slow growth in turnover expected by manufacturing companies was attributable to the fact that companies will pass the higher costs on to prices, which may lead sales volumes to shrink, despite growing turnover.

The changes in growth expectations in each of the industries clearly reflected the changes in the global situation between December and April. In accommodation and food service activities, expectations for growth in turnover improved clearly compared with December. In late 2021, the restrictions on food services were tightened due to the emergence of the Omicron variant of COVID-19, but the virus situation calmed down during the winter and the restrictions were lifted. During the spring, there were signs of a release in the pent-up demand for food services that had accumulated during the pandemic.

In manufacturing, growth expectations were already muted in December compared with the other two industries. The supply bottlenecks and materials shortages caused by the war were already then limiting growth opportunities in manufacturing. The results of the April survey showed that growth expectations nevertheless decreased further by almost half from December's figure of about 5%. Supply-side problems have continued to mount, and expectations for the growth in turnover are also dampened by the weak growth outlook for Finland's exports markets. In relative terms, the growth outlook weakened particularly for companies engaged in exports to Russia. For these companies, their expectation of the growth in nominal turnover was low, at a little under 2%.

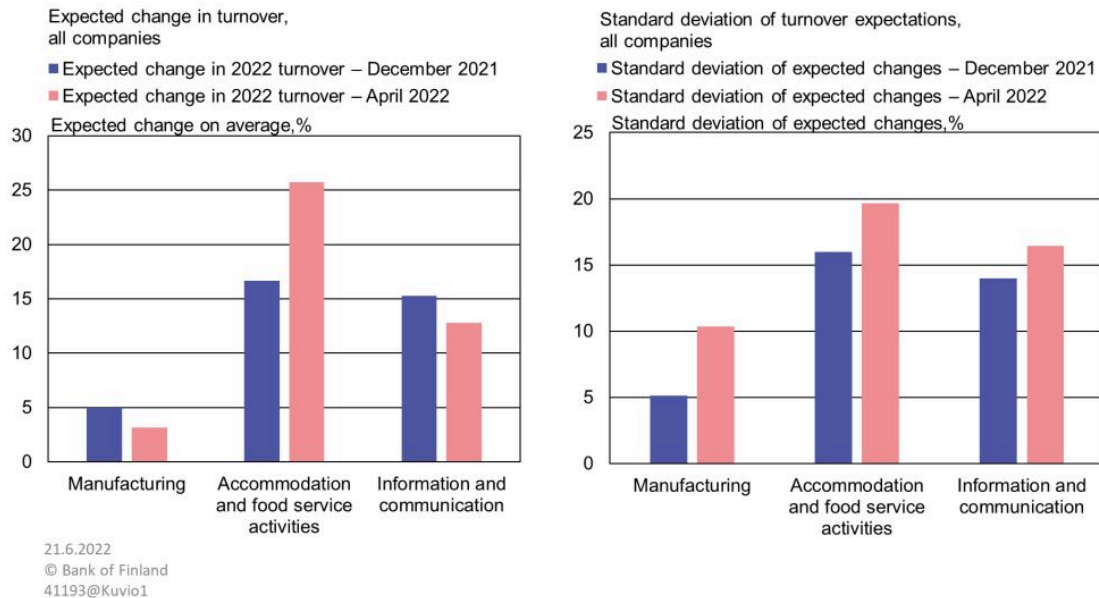
The inter-company differences in growth expectations are described using the standard deviation of turnover expectations, which is calculated separately for each industry (Chart 1, right-hand side). The standard deviation increased between December and April, particularly in manufacturing. To the extent that this was due to the war, the result was as expected, because even within an industry, the impacts of the war on the financial position of companies differ considerably. The standard deviation of expectations also increased in accommodation and food service activities, which may reflect differences between companies in the importance of foreign demand.

In information and communication, the change in turnover growth expectations and standard deviations was less marked than in the other two industries, as business activity in this industry is

less sensitive to changes in the COVID-19 situation or the impacts of the war.

Chart 1.

### Expected change in turnover and standard deviation of turnover expectations



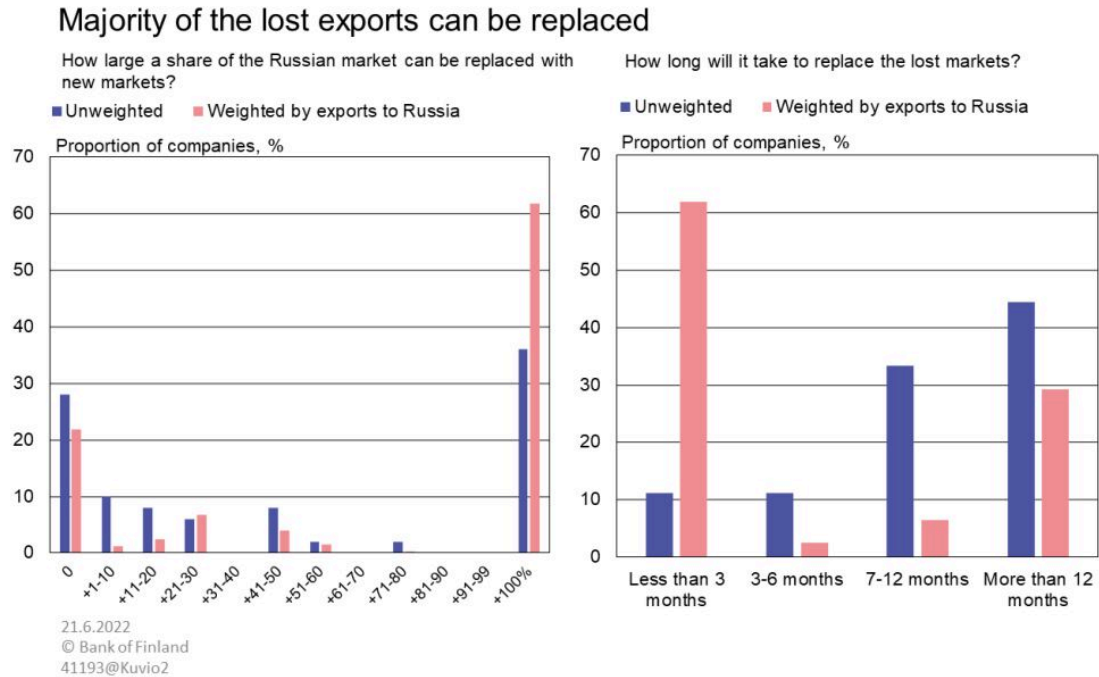
## New markets will be found for lost exports

Some 41% of the respondents were engaged in exports in 2021. Just under one fifth of these companies exported to Russia, Belarus or Ukraine, and the majority of the companies were in manufacturing. To a certain extent, exporting to Russia involves larger companies, as those in the survey that exported to Russia accounted for 75% of the total volume of exports among all respondent companies. Russia typically accounted for only a minor share, i.e. 1% to 5%, of a company’s total volume of exports. Only slightly less than 4% of the companies estimated that exports to Russia accounted for more than 5% of their total exports.

In the survey, the companies also estimated how large a share of the lost markets they believe they can replace with new markets. Here, two quite distinct groups of companies could be identified. Companies which estimated that they are unable to replace any of the lost exports accounted for about a quarter of the combined total exports to Russia of companies responding to the survey. Companies that estimate they can completely replace the lost markets accounted for over 60% of the combined total exports to Russia (Chart 2).<sup>2</sup> Based on export-weighted figures in particular,

companies will be able to replace the lost export markets fairly rapidly. Some 60% of the companies estimated that they will be able to replace the lost markets in less than three months.

Chart 2.



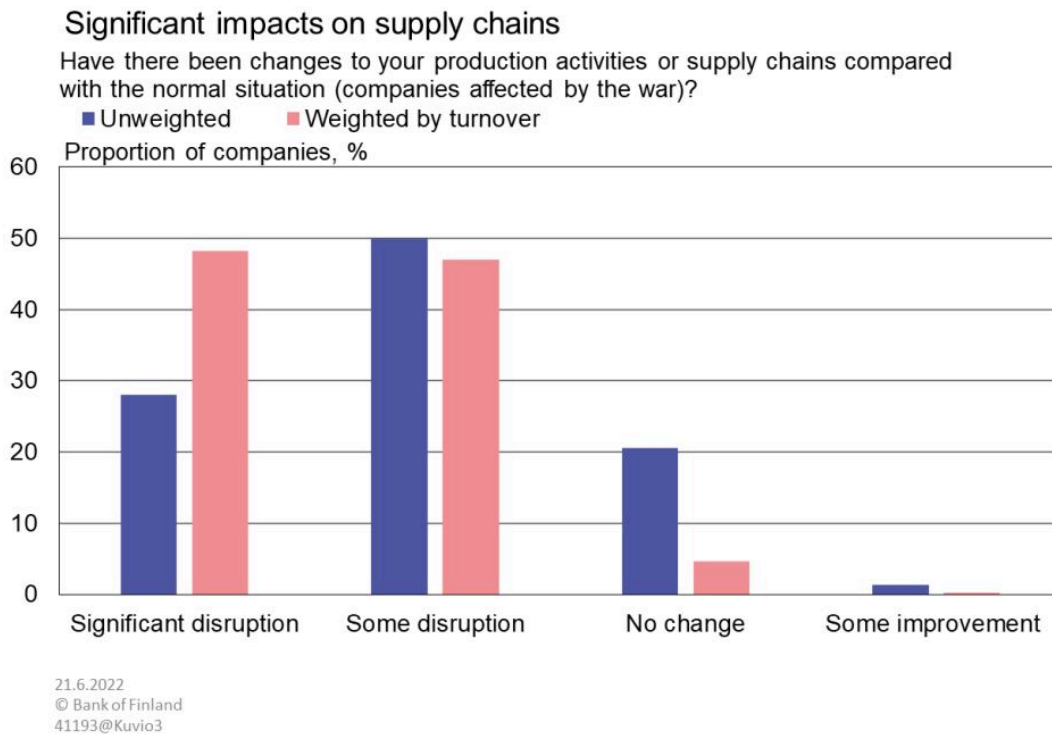
## War has disrupted supply chains but companies estimate disruptions will be temporary

Of the companies that responded to the survey, only some 3% have production activity in Russia, Belarus or Ukraine, although large companies are somewhat overrepresented.<sup>3</sup> However, for many companies, the war has disrupted production in other ways. Companies were asked about disruptions in supply chains using two different approaches. They were asked to assess whether their production activities or supply chains overall have experienced changes compared with the normal situation (incl. disruptions other than those caused by the war). Companies in the manufacturing as well as information and communication industries were also asked separately whether the war in Ukraine has had an impact on production.

About half of all companies in the survey (weighted by turnover) estimated that at the time of the survey, the war in Ukraine was having an impact on production or on the operation of their supply chain. Some companies even estimated that their operations have been disrupted significantly;

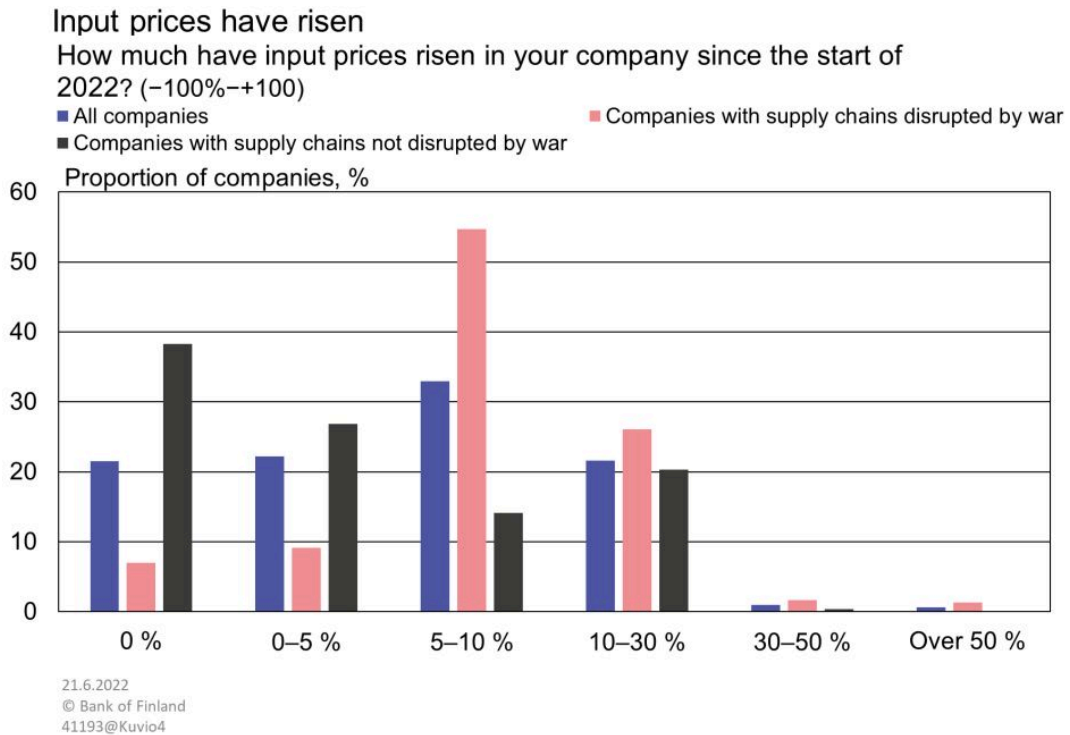
these companies represented about half of the turnover of the companies affected by the war (Chart 3). The figure, however, also includes disruptions in production and supply chains that are explained by factors other than the war. In addition to the war, production was hampered particularly by problems in the availability of materials, raw materials and electronics components, as well as logistics.

Chart 3.



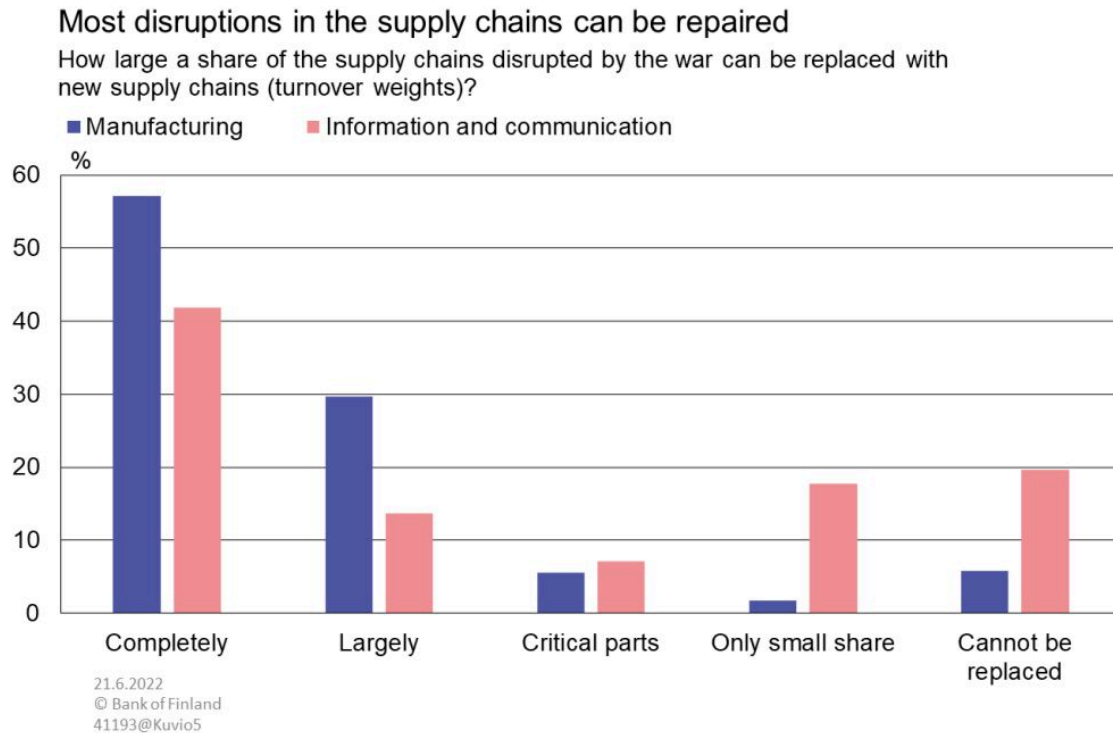
Supply chain disruptions and the rise in input prices were already eroding companies' turnover and profitability during the COVID-19 crisis. In the case of companies whose supply chains have been disrupted by the war, the prices of inputs have risen by more, and with greater frequency, than those for other companies (Chart 4). For more than half of these companies, and taking into account the turnover weights, the prices of inputs had risen by between 5% and 10% from the previous year. For about one company in four, input prices rose by between 10% and 30%. In the case of companies whose production the war has not disrupted, prices rose significantly less. The upward trend in input prices was evident the most in logistics and materials costs.

Chart 4.



Most companies estimated that the impacts of the war on production and profitability will be temporary. Manufacturing companies that estimated they will be able to completely replace their supply chains disrupted by the war with new ones represented almost 60% of the turnover of companies in the sector, while those which estimated they will be able to largely replace them correspondingly represented about 30% (Chart 5). In information and communication, the situation was slightly weaker. The companies in this industry reporting that they will be able to only partially replace or be unable to replace supply chains accounted for about half the turnover of respondent companies.

Chart 5.



The impact of higher costs on profitability will ultimately depend on the ability of companies to pass the higher costs on to prices. The results of the survey show that companies are fairly successful in compensating for the higher production costs by raising their sales prices. Prices will rise at a fairly rapid pace this year, particularly in manufacturing. Manufacturing companies whose production the war has affected expect to raise their prices in 2022 by around 10%, on average.<sup>4</sup> For information and communication companies, the expected rise in prices will be about half of this.

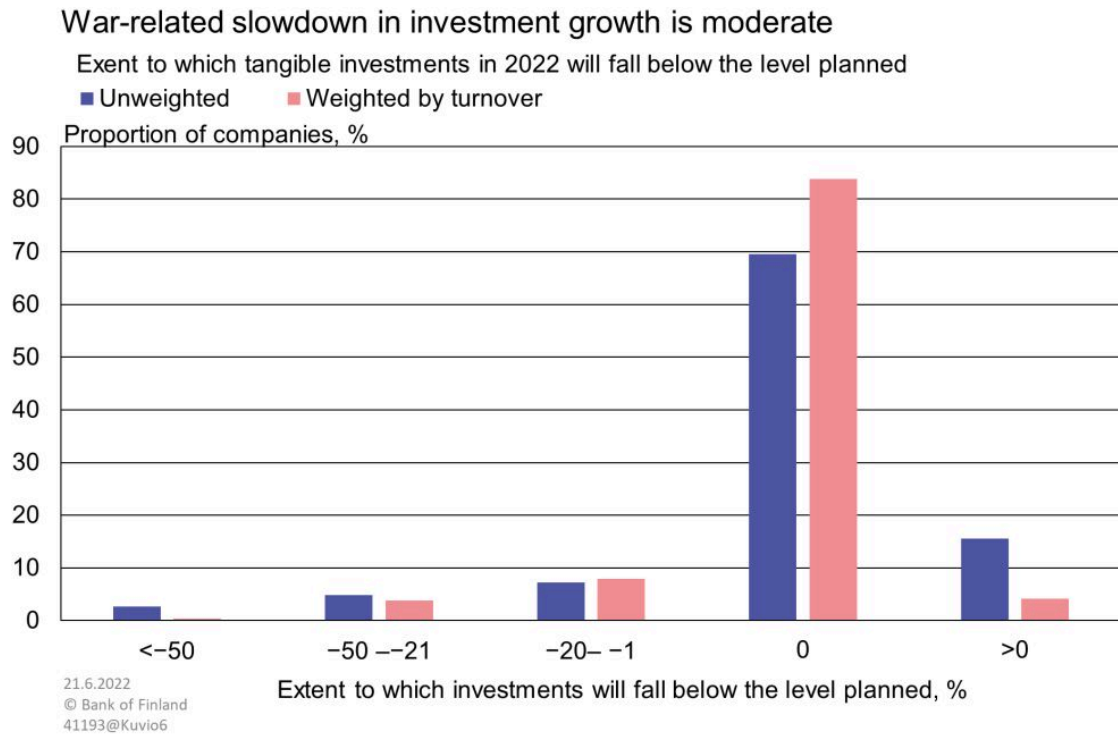
## Risk of investments remaining below planned level

Companies were asked to estimate how their tangible and intangible investments in 2022 will deviate from the level planned, and what the reasons would be for this. Some 15% of the companies reported that the volume of tangible investments will be smaller than expected. Even in these companies, investments will slow only moderately, in most cases by a maximum of 20%, based on figures weighted by turnover (Chart 6). About one in six respondents estimated that the volume of actual investments in 2022 will be perhaps even larger than planned.

The most common factor given for the slowdown in investment growth was the war in Ukraine,

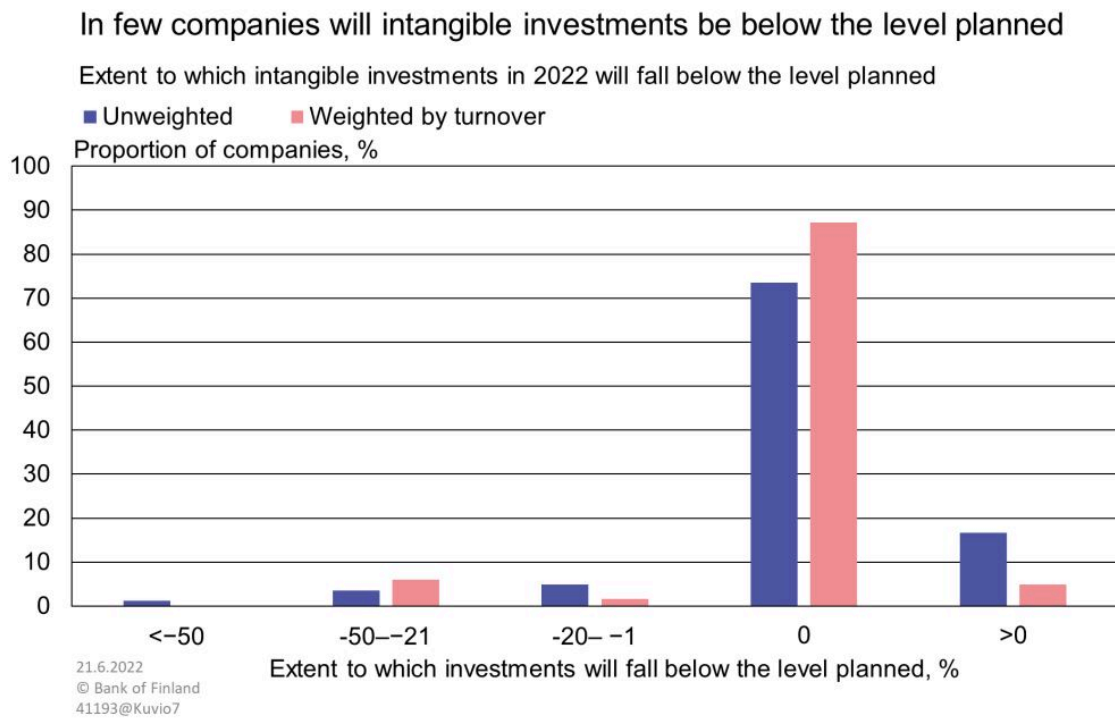
which was mentioned by nearly 70% of the companies whose tangible investments will fall below the level planned. Weighted by turnover, this share is over 90%. However, the slowing of investment growth for these companies will not, on average, be any more than for other companies that projected slower-than-planned investment growth. Other reasons given for the slower growth in investments included the prolonged COVID-19 situation and the higher costs of investment projects.

Chart 6.



Intangible investments will grow in 2022 as planned. Less than one in ten companies estimated that intangible investments in 2022 will be smaller than planned (Chart 7). In these cases, the respondents most commonly cited the war in Ukraine as the reason for this. These companies accounted for 87% of the turnover of the companies whose intangible investments will be below the level planned.

Chart 7.



## Conclusions

The war's impact on the Finnish corporate landscape is relatively small and temporary, or at least this is the case for the three industries that participated in the Tesi survey. The impacts are, however, distributed unevenly between and within the industries. The COVID-19 pandemic particularly affected service industry companies, but now it is manufacturing industry companies in particular that are suffering from the decline in turnover and rising costs. Even though the corporate sector and the main industries as a whole seem to be experiencing only a relatively small adverse impact, the effects are nevertheless considerable for some companies, particularly those that specialised in exporting to Russia or had business operations there.

The results of the business survey show that companies are in many respects able to adjust their operations to the weaker economic environment. This is reflected in estimates of the extent to which the lost export markets can be replaced and the time required, as well as the prospects for replacing supply chains. The situation of the companies is alleviated by the fact that trade with Russia has typically accounted for a relatively small share of their business. Companies seem to be able to pass the higher costs on to the prices of end products.

There is still uncertainty over what the effects of the war will be, and uncertainty is toxic for the

economy. It is slowing both investments and consumption in Finland. The key uncertainty factors include the size and duration of the rise in energy and raw material prices.

## Footnotes

1. Financial statements data for 2020 were not available for all the companies in the sample, and so the calculation of weighted figures does not include all observations. †
2. Total exports and exports to Russia in 2021, which were used as a weighting coefficient, were based on 2020 turnover figures and the estimates provided by the companies in the Tesi survey concerning their exports relative to turnover and the proportions of their total exports that go to Russia, Belarus and Ukraine. †
3. Companies with production activity in Russia, Belarus or Ukraine accounted for about 8% the staff of companies that responded to the survey. †
4. The estimate of the price rise is the same irrespective of whether the figures examined are unweighted or weighted by turnover. †

## Key words

exports, markets, non-financial corporations, supply chains, Ukraine, war