

The report on preliminary research "Ukraine's Middle Class"

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1. Justification

The middle class plays an important role in the economic and social life of any country. A sufficiently large middle class (certain estimates claim more than 30%) is laying the foundations of social stability and economic development in any country. This middle-class group is reported to include middle and lower-ranked management, skilled workers, craftspeople, or people who run their own business.

The middle class is most active in the markets, and accounts for the lion's share of demand, for which the following explanation can be suggested: the wealthy, despite having high average expenditures, are a comparatively small class in developed countries, while on the other hand, the share of the poor in society is larger, although their average expenditures are comparatively small. Concurrently, the behaviour of the middle class in the market is the most rational (and therefore, predictable), compared to the wealthiest, for whom there are virtually no financial limitations, and the poorest, who are mostly concerned with tending to their basic needs.

In Ukraine, the middle class is only emerging, although there are reasons to expect that in the near future it will be evolving dynamically. Scoping at the volumes and peculiarities of middle-class demand, the values and lifestyle of this group of the population will allow us to forecast the development of certain markets in future, when the middle class further increases, and to assist companies with marketing strategy implementation, specifically, advertisement campaigns, product positioning in the market, etc.

2. Research goal and objective

The goal of the “Research on Ukraine’s Middle Class” research project is to evaluate the impact of changes in the behaviour and number of the middle class in Ukraine on the development of domestic markets.

Therefore, we have set the following research objectives:

- To assess the number and structure of the middle class;
- To examine the behavioural peculiarities of the Ukrainian middle class in the labour, consumer goods, and services markets;
- To forecast the development of specific markets triggered by changes in the number of the middle class in Ukraine and its behaviour.

3. Research method

Large-scale research on the middle class, and forecasting the dynamics of certain markets wherein this class is the key consumer, require the employment of a number of different instruments. We aim to acquire the primary information by a representative opinion poll. In order to forecast the dynamics of separate consumer markets, we plan to construct an econometric model, using the opinion poll data, indicators of development dynamics of independent markets, and socio-economic indicators from the state statistics.

In order to verify the forecast's accuracy, we plan to make data comparisons between Ukraine and at least one developed country, and also a country with transition economy where the middle class has a lengthier development history. This comparative analysis is built on the hypothesis that development of the middle class and evolution of its behaviour manifest similar trends in different countries. Since the middle class in developed countries has already passed through the formation stage, corresponding historic data will allow us to more accurately model and forecast a behaviour pattern for the Ukrainian middle class.

4. Research output

Under the project's framework, we intend to issue an annual research report consisting of the following two parts:

- analysis and forecast of the quantitative and qualitative evolution of the middle class in Ukraine;
- forecast of the behaviour of the middle class in certain markets.

The choice of markets will depend on the relevant aspects of the demand for this research by enterprises in the sector.

If a consortium of clients for the overall research is created by the end of November 2002, the first report will be issued in February–March 2003. The research of certain markets will be published depending on when the groups of clients for these researches were formed.

5. Research content

In view of the objective of the given research, we plan to incorporate the following parts in the research report.

5.1 Definition of the middle class

This section should answer the following key questions: who is to be considered the middle class and how big is it.

Researchers from different countries emphasise that income levels cannot be considered the only criteria for assigning persons to the middle class. In addition, the behaviour of people in the labour and consumer goods markets should also be taken into account. Therefore, apart from welfare level, the following criteria can be suggested: education level, professional qualifications and employment opportunities, consumption standards (which turn out to be rather high in the middle class), self-identification as a representative of the middle class, and the ability of fitting into to the transformation process.

5.2 Peculiarities of the middle class

The key objective is to characterise Ukraine's middle class, to pick out certain groups with similar features.

We place special emphasis on the following features: age, education, employment, average income, family size, place of residence (big cities or elsewhere), and values of average Ukrainians (this information may be of use when conducting advertisement campaigns).

5.3 Consumer behaviour of the middle class

The objective of this section is to describe the consumer behaviour of the middle class. The key issues we intend to answer are the following:

- How big a share of their income do average Ukrainians spend on consumption?
- What is the structure of their consumption?
- What criteria are they guided by when buying goods (price, quality, recognised brands)?
- Where do middle-class Ukrainians do their shopping?
- How does the middle class react to advertising: to what advertising are they more responsive, what impact does it have upon consumer behaviour?
- What are the media preferences of the middle class?
- Is the middle class happy with the products (their quality, price, availability in stores) that are offered in the market.

5.4 Savings of the middle class

The objective of the section is to analyse in what way and how much average Ukrainians save.

The key research issues include the following:

- The share of savings in the incomes of the middle class;
- In what form are the savings made?
- What needs are these savings made for?

- How much trust is put in financial institutions and instruments?
- What the middle class lacks in a given market (for instance, accessible lending mechanisms)?

5.5 Behavioural model of the middle class

The objective is to develop an econometric model of middle class behaviour.

We plan to use the information generated by the opinion polls to construct an econometric model. The model can include a number of equations, which will allow to determine factors affecting the size of the middle class, its incomes, expenditures on certain consumer goods, level of savings, etc.¹ The resulting interdependencies can be used to forecast the development of the middle class and changes in its behaviour.

5.6 Development forecast for certain markets where the middle class is an important consumer

The econometric model outlined above and the conducted analysis will allow us to forecast demand dynamics in certain markets where the major consumers are (or will be in the nearest future) representatives of the middle class. The forecast for demand dynamics in certain markets will enable businesses to more rapidly and efficiently respond to changes.

6. Results of preliminary research

The goal of our preliminary research was to employ the above-defined approach in order to identify the number and the basic features of the middle class in Ukraine. In order to do preliminary selection and research of the middle class, we used the data from the monthly opinion polls (omnibuses) conducted by the GfK-USM company. The opinion polls are representative for all the Ukrainian population aged 15–59. We used the opinion polls conducted in the course of the past three years (2002, 2001, and 2000).

6.1 Criteria for singling out the middle class

Based on the set of questions given in the omnibus, we used the following criteria to pick out the middle class:

1. Social and demographic indicators (education, profession, employment status);
2. A subjective estimate of the financial status of households;
3. An indirect estimate of the income level of respondents;
4. An objective estimate of the material status of households, given that they possess a certain set of durable goods.

6.2 Stages of singling out the middle class

Our methodology of selecting the middle class was divided into the following stages:

1. Construction of a filter on the basis of the first two criteria, which assisted in singling out respondents who can be referred to as the basic middle class;
2. Assessment of respondents' incomes and determining what was understood as low, average, and high income;
3. Exclusion of respondents with below-average income from the basic middle class, resulting in the middle class per se;
4. Singling out the upper-middle class with the help of a cluster analysis.

¹ For instance, we can generate demand elasticity indicators for certain goods on the basis of the middle-class incomes, forecast the future size of the middle class on the basis of development indicators of Ukraine's economy, small- and medium-scale business, etc.

6.3 Singling out the basic middle class

Therefore, the first stage was dedicated to picking out respondents based on the following characteristics:

- Respondents with vocational, incomplete higher, and completed higher education (57.1%);
- Respondents who are not pensioners, not registered as unemployed, and are not unskilled workers (82.7%);
- Respondents who consider the material status of their family as average or above average (41.4%).

After such a sorting of the 2002 opinion poll data, we have 24.5% of respondents left.

Estimation of the income level of respondents

Numerous opinion polls testify that respondents tend to significantly underrate their income when answering a direct query about their personal income. With this in mind, we applied an indirect method of estimating respondents' incomes.

The basic assumption of our method is the consistency of (logic in) respondents' replies. The method is based on respondents' replies to the question of how they assess their living standards (on the scale of "poor" to "wealthy") and respondents' opinions regarding the size of income which should correlate with certain living standards.

Employing such an approach, we received the following distribution of respondents' estimated incomes.

% of all respondents	
UAH monthly	%
0–100	6.6
101–200	9.3
201–300	14.0
301–400	12.2
401–500	14.4
501–600	8.0
601–700	5.2
701–800	7.7
801–900	1.2
901–1,000	9.7
1,001–1,200	1.0
1,201–1,400	0.4
1,401–1,600	2.8
1,601–2,000	3.1
2,001–2,500	1.0
2,501–3,000	1.2
3,001–3,500	0.1
3,501–5,000	1.4
5,000+	0.7

Source: GFK-USM, calculations by ICPS.

In order to obtain a clearer picture about income levels, we grouped the generated results in accordance with respondents' opinions as to what level of income is to be considered as high, above-average, average, below-average, and low (see Table 2).

Table 2. Distribution of respondents by income groups

Type of income	Income, UAH monthly	%
	5,001+	1.5
High	1,701–5,000	5.8
Above-average	801–1,700	15.3
Average	451–800	34.0
Below-average	226–450	27.4
Low	100–225	13.6
	0–99	2.4
<i>Total</i>		100

Source: GFK-USM, calculations by ICPS.

The Table 3 features the distribution of respondents according to the income levels that we estimated for the past three years. Income levels of respondents varied over the three years; nevertheless, we assumed (as had been empirically proven) that purchasing power was roughly the same. Therefore, 2002 was taken for the basic period. The size of incomes for 2000 and 2001 was re-estimated, with inflation in the respective years taken into account. Such an approach allowed us to generate a single scale of incomes (in 2002 prices) for the three years.

Table 3. Distribution of respondents by income groups (2000–2002)

% of all respondents

Income level (UAH monthly)	2000	2001	2002
5,001+	1.4	1.3	1.5
1,701–5,000	4.9	3.2	5.8
801–1,700	14.0	16.9	15.3
451–800	26.3	26.2	34.0
226–450	32.5	29.1	27.4
100–225	15.4	20.1	13.6
0–99	5.4	3.2	2.4
<i>Total</i>	100.0	100.0	100

Source: GFK-USM, calculations by ICPS.

6.4 Estimate of the size of the middle class

Ultimately, in addition to the already used selection criteria for respondents (social and demographic indicators and a subjective estimation of the financial status of households), we introduced a third criterion, that is, an indirect assessment of income levels. To this end, we additionally discarded the respondents, whose income, in accordance with the above scale, was below-average and low (that is, below 451 UAH). Thus, after applying all the above criteria, we obtained a social group which we call the middle class.

The Table 4 presents the estimated proportion of the middle class in the Ukrainian population in 2000–2002.

Table 4. The share of the middle class in the Ukrainian population, %

	2000	2001	2002
Middle class	14.9	17.4	19.5

Source: GFK-USM, calculations by ICPS.

The table 5 contains the distribution of middle-class representatives by the level of income estimated with an indirect method.

UAH monthly	%
451–500	14.1
501–600	13.1
601–700	6.8
701–800	13.6
801–900	1.7
901–1,000	17.6
1,001–1,200	3.6
1,201–1,400	0.5
1,401–1,600	7.0
1,601–2,000	8.8
2,001–2,500	2.3
2,501–3,000	3.0
3,001–5,000	5.3
5,000+	2.7

Source: GFK-USM, calculations by ICPS.

6.5 Singling out the upper middle class

The last stage of our analysis was to separate out the wealthier people, that is, the upper middle class, from the middle class. In order to achieve this, we used our three available estimations of the welfare of respondents. Two of these we had already used before, that is, a subjective estimate of household living standards given by respondents and an indirect assessment of respondents incomes, and the third one that was an objective estimate of material situation on the basis of possession of certain durable goods.

The material status of households can be assessed by their possession of a certain number of durables (luxury items or, in other words, expensive goods indicative of the middle class). We assume that the possession of certain luxury items indicates belonging to a group of well-off households. Thus, by applying a regression analysis, we picked out the following eight luxury items: a mobile telephone, a microwave oven, a personal computer, a video camera, an apartment purchased with the household's own money, an automatic washing machine, a video cassette recorder, and an automobile. Based on the number of luxury items in the household, we calculated the indices of their material situation.

In sum, we used the three estimations of the material situation to conduct the statistical procedure of the cluster analysis, which allows to single out groups of respondents with different degrees of manifestation of these characteristics. The cluster analysis helped us to disaggregate our middle class into two groups—the better off and the less well off. The distribution of all respondents into three groups—non-middle class, middle class, and upper-middle class—is given in Table 6.

	2000	2001	2002
Non-middle class	85.1	82.6	80.5
Middle class	11.2	13.1	14.7
Upper-middle class	3.7	4.3	4.8
<i>Total</i>	<i>100</i>	<i>100.0</i>	<i>100.0</i>

Source: GFK-USM, calculations by ICPS.

7. Characteristics of the middle class

7.1 Social and demographic characteristics

Now, let us try to describe the distinctive features typical of representatives of the middle class, that is, how they differ from the rest of society. Initially, we will present the differences in middle-class representatives by certain social and demographic indicators.

The tables below give a distribution of respondents who either belong or do not belong to the middle class, by the level of education, age, and place of residence (based on 2002 data).

		Middle class	Other respondents
Size of a settlement	Rural areas	17.6	32.2
	City up to 50,000	20.6	23.0
	City 50–100,000	7.8	8.1
	City 100–500,000	22.4	18.7
	City larger than 500,000	31.7	18.1
	<i>Total</i>	<i>100.0</i>	<i>100.0</i>
Age	15–19	2.5	13.9
	20–29	32.8	20.7
	30–39	32.1	21.9
	40–49	23.6	23.2
	50–59	9.0	20.3
	<i>Total</i>	<i>100.0</i>	<i>100.0</i>
Education	Elementary		0.5
	Incomplete secondary		11.3
	Completed secondary		41.9
	Vocational	49.4	30.0
	Incomplete higher	9.3	3.5
	Higher	41.4	12.8
	<i>Total</i>	<i>100.0</i>	<i>100.0</i>

Source: GFK-USM, calculations by ICPS.

Therefore, we can maintain that most middle-class representatives (54%) reside in cities with a population of more than 100,000, while among other respondents they were 36.8%. Moreover, the number of middle-class representatives dwelling in rural areas and small cities/towns is also quite significant.

Middle-class representatives are somewhat younger compared to other respondents—65% are aged 20–39. That is, the majority of the middle class comprises persons at the age of peak activity in the labour market.

A sizeable share of middle-class representatives (41.4%) has a higher education. Other representatives have an incomplete higher or vocational education, because we used the level of education as one of the features of singling out the middle class.

We can see from the Table 8 that middle-class representatives include more married respondents—73.5% among the middle class compared to 61.1% among other respondents. Apart from this, it is more frequent to encounter one-child families among middle-class representatives (43.5%) compared to other social groups (36%).

Table 8. Distribution of respondents by their marital status and number of children, %

		Middle class	Other respondents
Marital status	Single	18.5	25.5
	Married / cohabitation	73.5	61.1
	Divorced / separated	7.3	9.5
	Widowed	0.7	3.9
	<i>Total</i>	<i>100</i>	<i>100</i>
Number of children	One	43.5	35.9
	Two	9.6	13.8
	Three and more	1.0	1.9
	Childless / None	45.9	48.4
	<i>Total</i>	<i>100.0</i>	<i>100.0</i>

Source: GFK-USM, calculations by ICPS.

7.2 Living standards and material situation

Let us now focus on different indicators of the welfare level of respondents, in order to illustrate how much more middle-class representatives are well off than other respondents. The Table 9 below features the distribution of respondents in accordance with our estimation of average monthly per-capita income. Recall that when picking out the middle class, we used the criteria of income exceeding 450 UAH; that is why the income distribution for middle class in the table starts from this value.

Table 9. Distribution of respondents by the level of estimated per-capita average monthly income

UAH monthly	Middle class, %	Other respondents, %
0–100		3.4
101–200		9.1
201–300		17.4
301–400		17.5
401–450		3.1
451–500	12.1	12.6
501–600	12.8	8.4
601–800	20.2	12.1
801–1,000	20.6	9.4
1,001–1,500	11.9	2.9
1,501–2,000	9.0	1.8
2,001–2,500	2.5	0.6
2,501–3,000	3.0	0.7
3,001–5,000	5.3	0.6
5,000+	2.6	0.3
<i>Total</i>	<i>100</i>	<i>100</i>

Source: GFK-USM, calculations by ICPS.

In the table, we can see that 53% of middle-class representatives have incomes ranging from 601 to 1,500 hryvnias, while 22% exceed 1,500 hryvnias. However, it is also evident that the middle class is rather non-homogeneous, and that is why there is a need to pluck out several groups within this class. In our

analysis, we sought to pick out the upper-middle class, although to make a more in-depth and statistically justified analysis, it would be necessary to use larger samples.

The Table 10 includes the distribution of respondents based on their self-assessment of level of individual welfare.

Table 10. Distribution of respondents by their self-assessment of household material status			
Self-assessment of material status	Upper middle class	Middle class	Other respondents
Wealthy	39.0	3.0	0.8
Above average	49.3	41.0	10.3
Middle	11.6	56.0	58.2
Below average	—	—	19.6
Poor	—	—	11.1
<i>Total</i>	<i>100</i>	<i>100</i>	<i>100</i>
Source: GFK-USM, calculations by ICPS.			

Thus, representatives of the upper middle class assess their living standards mainly as “above average” (49.3%) or “wealthy” (39%), while almost all representatives of the middle class consider their living standards to be average (56%) or above average (41%).

A more objective indicator characterising the material status of households is their possession of certain durable goods. The table 11 contains the percentages of households for each social category which possesses certain durables. We give the percentage for goods that can be regarded as luxury items, since the availability of these goods in fact allows us to differentiate our respondents by welfare level. The rate of possessing these goods climbs up, especially in the category of the upper middle class.

Table 11. Distribution of respondents by their possession of durables				
% of those possessing this item to all respondents of a given social category				
		Upper middle class	Middle class	Other respondents
Luxury items	Video camera	9.4	1.7	0.5
	Personal computer	21.7	6.7	1.9
	Microwave oven	29.6	6.4	1.8
	Apartment purchased with the household's own money	29.6	15.0	10.0
	Mobile telephone	33.3	7.7	2.1
	Automatic washing machine	45.6	18.7	7.4
	Automobile	50.0	28.6	13.1
	Videocassette recorder	65.9	34.2	13.5
	Cordless telephone	14.5	3.0	1.8
	Audio system	73.9	54.8	33.2
	Photo camera	82.6	66.6	39.8
	Country cottage, dacha	10.1	5.4	4.6
Source: GFK-USM, calculations by ICPS.				

This table shows a distinct dependence between the belonging of respondents to the middle class and their possession of durable goods. Along with that, we can draw the conclusion that the shares of respondents possessing these goods are not as high even for the upper middle class. For instance, only one-third of them has a mobile phone, practically half of them have neither a car nor a washing machine, and 70% do not have a microwave oven. Apparently, the explanation for this can be that the middle class began to emerge in Ukraine not so long ago, and its representatives have to first buy the most necessary goods.

Contrariwise, this testifies to the growth potential for some markets—as, for instance, household appliances, mobile communications, etc.

7.3 Expenditures

Opinion polls allow us to analyse household spending. In the course of the opinion polls, respondents were asked to specify their monthly expenditures for different goods and services. Respondents have assessed the size of those expenditures they make monthly (i.e., fixed ones), while expenditures for more expensive items, for which people usually save for a certain period of times, we have chosen to categorise as savings.

Thus, Table 12 highlights the distribution of respondents' incomes by types of expenditures and savings. Nevertheless, it should be borne in mind that expenditures declared by respondents can be somewhat underestimated. This can be due to the fact that the level of their expenditures may point to their level of income, which they are reluctant to make public. One more thing should be kept in mind, that Table 12 features the shares of expenditures only for respondents residing in cities with a population exceeding 50,000, because the rural area and small cities broadly depend on economic activities oriented at self-sufficiency, and this can distort the structure of expenditures.

Table 12. Distribution of respondents' expenditures			
Average % of given type of expenditures to the estimated income			
	Upper middle class	Middle class	Other respondents
Food	10	25	35
Public utility payments	3	8	13
Purchase of new clothing/footwear	4	7	7
Expenditures for education of children or other family/household members	2	4	5
Public transportation	1	3	4
Leisure time at restaurants/casinos/bars	3	3	2
Purchase of basic necessities (hygiene products, cosmetics)	1	3	3
Payments for communication services	1	2	2
Medical treatment and medicines	1	2	5
Books/periodicals/concerts/theatre/exhibitions	1	2	1
Other	3	5	6
Savings	69	36	16
<i>Total</i>	<i>100</i>	<i>100</i>	<i>100</i>

Source: GFK-USM, calculations by ICPS.

This table suggests the conclusion that expenditures for food among respondents whom we did not assign to the middle class are far greater in the overall breakdown of expenditures (35%), while savings are rather paltry (16%). In the meantime, the share of savings among representatives of the middle and upper-middle classes is picking up strongly—36% and 69%, respectively. The rate of these savings appears high enough, but, conversely, this can be explained by the rate of possession of durable goods, which we presented earlier in this report. We can assume that the middle class is presently making hefty savings to purchase luxury items, such as an apartment or automobile.

The table 13 also pertains to expenditures, but features the share of expenditures of each social category in the total volume of expenditures in a given market. It would be reasonable to compare these shares with the three groups we singled out. The idea is that, for instance, a very insignificant group of the upper middle class (5%) can account for 20–40% of total consumption in certain markets.

Table 13. Shares of expenditures of social categories in specific markets

% of total expenditures of respondents of a certain category in markets to total expenditures of all respondents in a given market

	Upper middle class (4.8%)	Middle class (14.7%)	Other respondents (80.5%)	Total
Leisure time at restaurants/casinos/bars	42	26	33	100
Books/periodicals/concerts/theatre/exhibitions	19	25	56	100
Purchase of new clothing/footwear	14	24	63	100
Payments for communication services	22	23	55	100
Purchase of basic necessities (hygiene products, cosmetics)	9	21	70	100
Food	7	21	72	100
Public transport	7	21	72	100
Other	9	20	71	100
Expenditures for education of children or other family/household members	10	20	70	100
Public utility payments	7	19	75	100
Medical treatment and medicines	8	15	77	100
Savings	44	14	42	100

Source: GFK-USM, calculations by ICPS.

These results can be interpreted in the following fashion. The upper middle class accounts for a hefty share of expenditures in the entertainment industry (restaurants, casinos, bars)—42%, and are active consumers of communications services (evidently, mobile communications)—22%, as well as consume more actively intellectual products (books/periodicals/concerts/theatre/exhibitions)—19%. It is most likely that the behaviour of the middle class in other markets also differs, but research of these markets requires to make special year-by-year surveys.