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SMES, TRADE AND DEVELOPMENT IN UKRAINE

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Abstract

This paper presents a detailed study of the functioning of SMEs in Ukraine. The SME sector is an important constituent of Ukraine's economy: it accounts for 99.8% of the total number of enterprises, and employs 67.8% of the total workforce in the country. However, SMEs experience a number of difficulties such as low productivity, low investment attractiveness, insufficient involvement in international value chains, weak capacity to enter foreign markets, inability to overcome a high level of corruption, and insufficient state support. This analysis pays special attention to the specifics inherent to transition economies, to the potential that Ukrainian SMEs have to integrate into global value chains, to internationalize cluster development and to the ways various stakeholders support business activities. This analysis takes into account the fact that Ukraine is currently experiencing the most difficult economic and social period since it became an independent state. The SME sector, being in its initial stage of development, has been affected tremendously. We present our expert opinion based on qualitative analysis of the data in hand. We unveil the bottlenecks of business development that are hard to identify when looking at the official, highly-aggregated data.

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Introduction

In Ukraine, a country with a transition economy, the nascent sector of small and medium-sized enterprises (SMEs) has traditionally been considered essential for integration into global competitive markets. However, the development of a regulatory framework, necessary infrastructure, and supportive service networks is slow and uneven. We discuss in detail the numerous bottlenecks relating to the specific features of Ukraine's economy and the barriers to the development of SMEs. The SME sector's capacity to compete in international markets is still weak. The successful functioning of the SME sector depends significantly on state support, the assistance of civil NGOs, business associations, and intergovernmental bodies.

The SME sector is playing an important role in the economic life of Ukraine. Since 1991, SMEs have become essential for job creation. Around two-thirds of the population are engaged in the SME sector. In 2013, SMEs represented 99.8% of the total number of enterprises, among which microenterprises and small enterprises (80% and 15%) predominate. The SMEs are active in trade (51% - engaging 30% of the sector's workforce), manufacturing (7% - engaging 25% of the workforce), transport services (5%), and agriculture (4% - engaging 10% of workforce), ICT services (5%), real estate (5%), and science-related professional activities (6%).

However, an important observation made throughout our analysis is that the official figures give only a partial picture of SME sector development. Our analysis is based not only on national statistics, but also on supplementary international surveys and additional expert data. For example, according to official figures, the natural person-entrepreneurs represent around 80% of SMEs. Among them, microenterprises account for 80% and engage 73% of the sector's workforce. The expert studies reveal that 77% of these natural person enterprises can be classified as "pseudo self-employed", and are only registered nominally for the purpose of tax evasion. This example shows that more analytical work should be undertaken in order to get a realistic picture of SME sector development in Ukraine. The purpose of our study was to carry out a detailed qualitative analysis of the existing statistical data.

We then go on to discuss the perspectives of SME sector development, in particular cluster development. Success in business is demonstrated through the dynamic development of organizational and communication technologies. This phenomenon is especially important for small and medium-sized business development. Interconnected economic systems, structured in the course of a modern network economy, create the efficient synergy of large and small business forms, leading to industrial cluster development. These complex structures may increase the sustainability and resistance of both the SME sector and the national economy. The development of industrial clusters in both the domestic and international arenas, allow markets to retain their competitiveness during their segmentation and convergence. The recovery of business activities in international markets post-crisis is expected to be faster for those SMEs which have succeeded in integrating into the modern economy and which have gained from inclusive development. We consider such SMEs to be more adapted to the high-risk conditions which are inherent to global economy.

Our paper has the following structure: in section 1, we analyse the effects of the 2008-09 global crisis on Ukraine's economy in general, and on the SME sector in particular. Specifically, we emphasize the resulting economic and social instability, and consequent political crisis, which ended in nationwide civil protests, and wrought drastic changes in all areas of the country. These events, aggravated by military conflict in the east of the country, affected all aspects of economic life, in particular the SME sector. In section 2, we depict regional and global integration trends, and evaluate the Doing Business ranking of Ukraine. In section 3, we describe the entrepreneurial landscape of Ukraine, presenting statistical information relevant to SME sector development. In section 4, we provide evidence of numerous regulatory and structural barriers to the functioning of the SME sector, both in domestic and foreign markets. In section 5, we discuss different perspectives regarding the development of industrial clusters. Finally, in sections 6 and 7, we consider development policies and support for SMEs by various stakeholders.

1. Ukraine in the landscape of world economy

The drastic changes and challenges that Ukraine has recently encountered in both political and economic life, limit the analysis of current entrepreneurial activity. A study of the Ukrainian business environment

requires a clear understanding of the current phase in the development of the national economy. First, we will describe the effect of the global economic crises on Ukraine's economy, and then we will depict the consequences of the revolutionary events of 2014 and subsequent military intervention.

The Ukrainian economy was hit heavily by the crisis of 2008-09. In 2009, GDP dropped by 14.8% and industrial production shrunk by 21.9% against the previous year. Ukraine's production has been traditionally orientated towards the foreign rather than the domestic market, which has created dependency on imported goods. Furthermore, trade balance was distorted by populist distributional policies: individual income growth created an even higher demand for imported consumer goods. The trade deficit widened remarkably in 2009 because of a sharp decrease in exports by 40.7%.

In 2010-11 the improving world economic situation seemed to favour the recovery of Ukraine's economy. However, optimistic forecasts were not long-lasting and the global economic slowdown persisted. Necessary structural transformation was not being undertaken. As a result, Ukraine's high dependence on foreign markets pushed it into an even deeper economic depression by 2012.

In 2012-13, the Ukrainian economy slowed down due to the influence of the following factors:

- Economic depression in developed countries, particularly in the EU,
- Deterioration of economic relations with the Custom Union of Russia, Belarus and Kazakhstan (CU RBK),
- Deterioration of the entrepreneurial climate in Ukraine as a result of growing fiscal pressure and corruption,
- Deceleration of investment processes as a consequence of poor financial performance of business and global foreign investment shortage.

Confronted with the risk of economic depression, the Ukrainian Government attempted to boost flagging economic growth by stimulating domestic consumer demand and budget-financed investment. However, the efficacy of these measures was rather weak and superficial. Government intervention required large budget expenditures and labour market reforms and business regulation were suspended. Corruption, in turn, blocked the implementation of national development programmes.

In 2012-13, government policy was significantly influenced by Ukraine's intention to sign the Association agreement with the EU. During this period a number of legislative acts were approved, creating a legislative and institutional basis for wider integration with the EU. Meanwhile, political pressure from the Russian Federation increased in the form of "trade wars" and a decline in bilateral trade. Some business groups opposed the signing of the Association, anticipating the loss of competitive advantages based on preferences, non-transparent economic schemes, and protectionist trade policies. Some representatives of public management also feared the risks of the termination of corruption schemes.

The structural discrepancies, as mentioned above, influenced the competitiveness figures of Ukraine, as estimated by The Global Competitiveness Index of World Economic Forum.

The Global Competitiveness Index (GCI) 2014-2015¹ ranks Ukraine at the 76th position out of 144 countries, up from the 84th position a year before. First of all, the ranking emphasizes Ukraine's weak institutional framework (in 130th place). A detailed review of 21 individual components constituting this institutional pillar suggests that Ukraine continues to suffer from excessive red tape, poor property rights protection (including intellectual property rights), poor law enforcement, lack of transparency, wasteful government spending, bad protection of minority shareholders' interests, etc. Similarly, Ukraine is ranked 115 at the "burden of government regulation" indicator. The GCI also highlights the inefficiency of the domestic goods market where Ukraine occupies the 112th place.

Owing to recent reforms, Ukraine performs relatively well regarding the ease of starting a business (in 57th place for the "number of procedures to start a business", and in 96th place for the "number of days to start a

¹ Global Competitiveness Report, 2014-2015. WEF, Geneva, 2014.

business” indicators). It also performs strongly on the trade tariffs indicator (in 43rd place), due to its accession to WTO. Meanwhile, customs procedures appear to be especially burdensome for the private sector (it is in 118th place on the “burden of customs procedures” indicator), preventing the internationalization of small and medium-sized firms. Ukraine does not perform well in the effectiveness of anti-monopoly policy (where it is in 136th place), effect of taxation on incentives to invest (in 137th place) and the business impact on rules for FDI (in 125th place).

The macroeconomic environment pillar was ranked at the 105th position, mainly due to low gross national savings and underperforming country credit rating. Similarly, financial markets development is lagging behind (in 107th position), based on the performance of unsound banks, insufficient financial services and poor regulation of security exchanges.

At the same time, the GCI demonstrated that some improvement had been made regarding the competitive advantage of Ukraine, attributing it to the group of efficiency-driven economies and Ukraine ranks at the 38th place for market-size. As for the pillars responsible for human capital development, Ukraine is ranked in 40th place for higher education and training (secondary and tertiary education enrolment) and in 43rd place for health and primary education (due to the high quality of primary education). The infrastructure pillar is ranked at the 68th position, performing relatively well in railway infrastructure and telecommunications. Similarly, the innovation pillar of Ukraine is placed strongly for high innovative activity (the 48th place for availability of scientists’ and engineers’ services). However, it is stressed in the GCI report that Ukraine’s economy suffers from poorly performing private spending and government procurement. Therefore, by the end of 2013, there were four main factors which caused the destabilization of Ukraine’s economy:

- Abundant fiscal pressure for business,
- Excessive corruption,
- “Anti-European counterrevolution” motivation of some social groups,
- Increasing political pressure from the Russian Federation.

The above-mentioned factors have contributed to the political crisis and dramatic revolutionary events of February 2014. The political crisis amplified the existing economic problems. The consequences were as follows:

- Sharp decline of investment attractiveness of Ukraine which suspended FDI inflow,
- Distrust of national currency and devaluation due to high uncertainty level and inconsistent regulator’s policy,
- Distrust in the banking system, followed by outflow of deposits from the banks,
- Reduction in government capacity, causing suspension of reforms and weakness of anti-crisis measures,
- Further economic decline due to regulatory disorganization.

Along the unfolding economic crisis, the external risks aggravated the situation as destabilized regions in the south and east of the country went out of Kyiv’s control, Crimea was annexed by Russia, and open military aggression by Russian troops continued in eastern Ukraine. These events had tremendous effects on the Ukrainian economy:

- Market actors and potential investors revised down their expectations.
- The economy lost the significant economic potential of Crimea and of two industrially developed regions.

- The national budget spending was reoriented towards military mobilization and defence, which diverted the resources from other areas of the budget and further diminished domestic demand.
- A significant portion of “civil” resources from other sectors were mobilized for military purposes, including employees, transport and fuel.

The results of 2014 have witnessed deplorable macroeconomic dynamics: GDP decreased by 6.8% and industrial output fell by 10.1%, inflation galloped, reaching 24.9% and devaluation of the national currency for 2014 reached 97%. In 2015, this trend continued as the outflow of bank deposits reached 23% in hryvnia and 40.3% in US dollars. All these factors, augmented by a deterioration of borrower solvency, caused the crisis of the banking sector. The economy was trapped in a vicious cycle: incomes and investment reduced, aggregate demand compressed, which in turn led to the next phase in the slowdown of economic activity.

Based on the above, we can conclude that any current analysis of entrepreneurship in Ukraine will have quite limited efficacy due to these dynamic changes. Moreover, there is a significant lack of statistical information. On the basis of the scant data available, present studies provide only an approximate analysis of entrepreneurship in Ukraine.

2. Regional and global integration of Ukraine

A high level of trade openness has traditionally characterized the economy of Ukraine. According to the national accounts statistics in 2013, exports of goods and services were equal to US\$ 78.1 billion and accounted for 46.9% of GDP. Total foreign trade as a share of GDP was 102.2%. However, this high level of openness leaves Ukraine vulnerable, as the instability of world markets strongly affects the Ukrainian economy. Trade structure is characterized predominantly by intermediate goods on the export side and final goods on the import side. Imbalances in a trade structure left over from Soviet times, lead to instable export earnings due to the vulnerability of recurrent declines in trade.

As has been noted above, there was a recovery in exports during 2010-2011. However, an insufficiently diversified export structure caused a significant slowdown of export activities when demand for Ukrainian products in international markets decreased.

Ukraine's exports comprise mainly of low technology-intensive goods. Figure 1 shows the export structure in pre-crisis 2013. Metallurgical products accounted for 27.8%, mineral products for 11.8% and raw agrarian products for 15.7%. The share of machine building reached 16.3%. The last few years have seen the gradual increase in the share of agrarian goods.

With regards the geographic patterns of trade, the destinations of Ukrainian exports have become more diversified as Ukraine gradually reduced its orientation towards post-Soviet markets. In 2013, 34.8% of exported goods went to CIS countries, 27.0% went to Europe and 26.6% went to Asia. However, foreign markets are quite segmented for Ukrainian exports. Machine-building products are orientated mainly towards post-Soviet markets. Exports to European markets are constituted mostly of low value-added goods.

During the global economic crisis, goods exports from Ukraine had an overall negative dynamic. In 2012, exports grew by a negligible 0.6%; in 2013 they decreased by 8%: and in 2014 they decreased by 13.5%. Deteriorating Ukraine-Russia relations has caused a significant decline in trade with the neighbouring custom union. Exports to Russia decreased by 11% in 2012, by 14.6% in 2013, and by 33.7% in 2014. Export losses were compensated, to some extent, by reorientation towards other destinations. In particular, exports to EU grew by 1.5% and reached 31.5% of total goods exports. This happened partly due to free trade preferences provided to Ukraine by the EU after the agreement to sign the Association.

The Ukrainian import structure is primarily defined by a high dependence on energy resources. Natural gas and crude oil account for 15.8% of total imports (Figure 2). Until 2014, the Russian Federation was the main energy goods supplier to Ukraine. About a quarter of imports were represented by machinery and equipment products for both investment and consumption purposes. In 2014, imports decreased by 28.3%,

mainly due to a reduction in natural gas supplies (by 50.6%), weak demand from domestic consumers and a decrease in production capacity and FDI.

A characteristic feature of Ukrainian economy is a disproportionate level of involvement in cross-border activities in various sectors. Producers of intermediate goods are highly dependent on foreign markets. According to our estimates, 70% of all industrial goods were exported in 2012. In the pre-crisis period, more than 60% of chemical products, 70% of metallurgical products and more than 75% of machinery were exported. At the same time, exporters depend highly on imports, in particular on energy resources, raw materials and spare parts. According to estimates by Ukrainian researchers², in 2011 the import share of Ukrainian exporters accounted for 73%. The largest import share was attributed to the “economic locomotive” sectors: in metallurgy 74% of goods were imported, in machine building, 85%, and in agricultural production, 40%. We believe that this phenomenon distorts the macroeconomic situation of the country due to the unfavourable exchange-rate dynamics and declining terms of trade. Therefore, exports promotion measures are not effective enough for the narrowing trade deficit.

During the period of economic stability, the import growth rate exceeded the production growth rate, revealing a disparity between production and aggregate demand structures. Between 2010 and 2012 the import of goods doubled while industrial production grew only by one third. In 2005-12, the share of imported manufactured goods in domestic consumption increased by 1.6% accounting for 60.6%. On average in various manufacturing sectors, the share of imported goods in consumption exceeds 50% and has an upward trend. Particularly in the pre-crisis period, the share of imported goods in domestic consumption was more than 80% in machinery and chemical sectors, more than 75% in textile, clothes and furs sectors, and about 40% in the metallurgic sector.

Service exports account for a large part of total Ukrainian exports (US\$ 14.8 billion, or 19% in 2013). More than half (56%) is represented by transportation services and 22.5% by pipeline transportation (hydrocarbons transiting through Ukrainian territory). Services belonging to modern ITC technologies (telecommunications, informational, business, intellectual property-based services) constitute in total 21.3% of service exports from Ukraine (Figure 3).

As expected, the import of services is smaller (US\$ 7.6 billion, or 9% of total imports), and the above-mentioned modern ITC services attain 39.3% in the service imports structure. It is worth mentioning that the share of services, relating to intellectual property and royalties, is quite high (Figure 4). However, some experts argue that service imports are used in corruption schemes for the grey capital outflow. This negative phenomenon needs to be mentioned in the analysis of foreign trade activity in Ukraine, and steps for opening further discussion should be undertaken.

Unlike foreign trade, foreign investment still does not play a significant role in the internationalization of the Ukrainian economy. The total amount of FDIs attracted during 1991-2014 was equal to US\$ 45,916.0 million, or US\$ 1,072.0 per capita. In pre-crisis 2013, the share of foreign investors was only 1.6 % of the total capital investment.

The recession has been accompanied by a consistent reduction of FDI inflow into Ukraine: while in 2012 FDI inflow was equal to US\$ 6.0 billion, in 2013 it decreased to US\$ 5.7 billion, with an outflow of US\$ 2.8 billion. In 2014, foreign investors contributed US\$ 2,451.7 million to the Ukrainian economy and, outflow was US\$ 1,345.6 million. During 2014, the FDI amount in Ukraine measured in US dollars depreciated by US\$ 2.2 billion, due to the devaluation of the hryvnia.

About 77% of FDI came to Ukraine from EU countries. The top-10 investing countries, responsible for 83% of total FDI, are: Cyprus (US\$ 13.7 billion), Germany (US\$ 5.7 billion), Netherlands (US\$ 5.1 billion), Russia (US\$ 2.7 billion), Austria (US\$ 2.5 billion), United Kingdom (US\$ 2.1 billion), British Virgin Islands (US\$ 2.0 billion), France (US\$ 1.6 billion), Switzerland (US\$ 1.4 billion) and Italy (US\$ 1.0 billion). A significant number of offshore financial centres witnessed the active use of foreign jurisdictions for the repatriation of previously leaked Ukrainian capital, both now and from the post-Soviet period.

² Serebrjansky D., Zubrisky A. (2014) *Vertikalna Spetsializatsia v zovnishnij torhivli krajn, shcho rozvyvajutsja: pryklad Ukrainy* (Vertical specialization in foreign trade of developing countries: the case of Ukraine). *Ekonomika Ukrainy* (Economy of Ukraine), Vol. 8. P. 26 (in Ukrainian).

With regards the sectoral distribution of the FDI inflow, the financial sector (financial and insurance activity and operations with real estate) receives 33.4% and the wholesale and retail trade sectors receive 13.1% of the total FDI (Figure 5). Out of the total industrial FDI the manufacturing industry receives 32.3% and the metallurgy and food industries receive 56%.

The FDI outflow from Ukraine is still quite insignificant being US\$ 6.4 billion at the end of 2014, of which US\$ 5.8 billion went to Cyprus. Moreover, US\$ 5.4 billion of the FDI outflow amount was concentrated in the spheres of professional research and technical activity (all from the Donetsk region). These figures indicate that this investment is a form of offshore business activity.

It is important to remember that the military aggression in eastern Ukraine, shortly after the annexation of Crimea in March 2014, influenced every aspect of foreign economic relations in Ukraine. In particular, in 2014, exports from the Donetsk region decreased by 32.2% and from Lugansk by 46.2%. In 2013, Crimea and the regions of Donetsk and Lugansk (which are partly occupied) accounted for 26.8% of total exports and for 9.2% of total imports. Therefore, these regions accounted for US\$ 6.6 billion out of the total US\$ 9.4 billion of Ukraine's export losses in 2014.

The annexation of Crimea caused the loss of US\$ 1.8 billion of FDIs invested in this region previously (assessment of 2013). US\$ 4.4 billion was invested in the economies of the Donetsk and Lugansk regions. No relevant information concerning the state and current price of those assets can now be obtained. Altogether, the above-mentioned assets constituted 10.6% of FDI in 2013 prices. Therefore, we believe that these losses will not be too sensitive for national economy internationalization. However, the high level of risks relating to the escalation of military conflict and an unfavourable investment climate resulting from the political crisis may cause foreign capital outflow from other regions of the country.

3. Entrepreneurial landscape of Ukraine

Since 1991, the formation of entrepreneurship as a basic market institute, and the following improvement of the institutional structure of enterprises were decisive for the process of economic transformation in Ukraine. During this period, when the administrative economy was transforming into a market economy, an extremely diverse "entrepreneurial landscape" was created, where small and medium-sized businesses took a key role in the economy.

More recently in 2012, legislative changes harmonized the criteria for the structure of business entities by size with European standards and now the Commercial Code of Ukraine distinguishes enterprises by size. Microenterprises are defined as employing no more than 10 persons, with gross income not exceeding the hryvnia equivalent of €2 million during the year of observation. The same figures for small and large enterprises are 50 and 250 employees respectively, and €10 million and €50 million of gross income. Any other enterprises are attributed to the medium-size group. For statistical purposes microenterprises are often considered the same as small ones. Self-employed (or natural person-entrepreneurs) are also considered within this group of SMEs.

Since natural person-entrepreneurs are widely represented in the entrepreneurial landscape and organizationally do not differ much from enterprises *per se*, in this paper, we consider, natural person-entrepreneurs to be the same as small and medium-sized entities, unless otherwise stated.

One has to note that Ukrainian legislation does not consider the size value of assets as the third structuring criterion approved by the EU. EU legislation determines this parameter to be not more than € 2 million for microenterprises, €10 million for small enterprises and €43 million for medium ones. This difference can be explained by the specific features of asset-valuation in Ukraine: their value often can be too low due to excess wear, structural imperfections or improper market valuation mechanisms. For example, by the end of 2013, the average asset-value for small enterprises was €1.2 million, for medium-sized entities it was approximately €10 million, and for microenterprises it was €270,000.

During 2010-13, the share of employees engaged by medium-sized enterprises decreased, while the share of employees engaged by large companies increased.³ The share of large enterprises in total products sold increased by 0.8 points.⁴

According to 2013 data, the share of small and medium-sized enterprises (SMEs) reached 99.8% of the total number of business entities in Ukraine. The share of small entities (SE) reached 14.1%, and the lion's share of entrepreneurial landscape (80.9%) was represented by microentities (McE) (Table 1, Figure 6).

In 2013, the SME sector employed 67.8% of the total labour force, which is in line with the EU average. Wages paid by SMEs accounted for 53.9% of the total, with SE and McE accounting for 27.1% and 16.0% respectively. The share of SMEs in products sold was 57.5%, with only about 16.5% of the total volume attributed to SE and McE.

Therefore, a specific feature of Ukraine's entrepreneurial landscape is the significant difference in labour productivity of enterprises of different sizes. The biggest difference is at the McE level: 10.7% out of the total personnel engaged receive only 5.7% of the total paid wages. The share of products sold per person engaged by McE is 2.7 times less than in large enterprises; and 2.2 times less than in medium-sized entities (ME) (Figure 7). Therefore, the average yearly wage of a McE employee was 2.7 times less than in a large enterprise, while it was 1.5 times less at ME level. However, it has to be mentioned that this difference may reflect a high level of shadow economy in SME sector, in particular, a significant part of wages is paid "in envelopes".

Against this background, 64.2% of total assets possessed by the SMEs look unexpectedly high.⁵ In particular, 16.1% of balance assets are held by McEs, and 12.4 % by SEs. However, this provides neither higher productivity nor higher incomes of employees.

Therefore, the SME sector has low efficiency given the level of resources utilized – shares of personnel and assets (Figure 8). This is a result of the following reasons:

- Insufficient quality of management in the SME sector.
- The conscious concentration of low-quality assets within the special schemes of large companies' profits "privatization" (a special term, used when final profitable operations are being concentrated in affiliated private SEs, while losses – at large and medium-sized companies, are left in public property) .
- Insufficient quality of productive assets due to lack of investment and low innovativeness.

Of small and medium business entities, 77.2% is represented by natural person-entrepreneurs, and 99.2% of them function as microbusiness entities. In total, natural person-entrepreneurs represent 80.5% of all McEs, employ 72.7% of the labour force in the sector, but contribute only 53.1% of products sold by McEs. The level of labour productivity in these entities is 68% of that of McEs.

As for the sector dimension, the majority of SMEs is concentrated in the "wholesale and retail trade" and "repair of motor vehicles and motorcycles" sectors (henceforth denoted as trade) (Tables 3-5, Figures 9-12). This sector corresponds to 51.7% of the total number of SMEs. Next, 7% of SMEs belong to "industry", 5.4% to "transportation and storage, postal and courier activities" (transport), 4.1% to "agriculture, forestry and fishery" (agriculture) (Figure 13). Together the four sectors (trade, industry, transport and agriculture) accounted for 80.1% of the total production of Ukrainian SMEs. The share of SMEs in business services provision is rather small: 5.0 % of SMEs are concentrated in "information and telecommunication services" (information); 5.3% in "operations with real estates"; and 5.6% in "professional, scientific and technical activities" (professional activities).

³ Statistically engaged persons are calculated as employees plus owners of the business, founders and their family members. The majority of the difference is concentrated in the small business sector and are, in fact, workers and beneficiaries of the enterprises, thus, we believe useful to include in this indicator. This is especially useful when we consider enterprises and natural person-entrepreneurs and SME entities together.

⁴ Here and below, if not otherwise specified, we use the data of *Derzhstat* – The State Statistics Service of Ukraine.

⁵ Due to its nature, the term "assets" here is applicable only to enterprises.

Of the workforce employed by SMEs, 23.6 % worked in industry and 9.4 % in agriculture (Figure 14). The industry sector accounts for 21.4% of products sold by SMEs, while 49.2% of products come from the trade sector (Figure 15). It is worth mentioning that the sphere of trade is characterized by a high level of productivity: 30.0% of personnel engaged in the sector produce 49.2% of gross production.

Within the trade sector, 99.9 % of business entities are registered as SMEs. They engage 87.5% of the labour force and produce 72.2% of the sector's products. The polarization of entities is a characteristic feature of this sector: microentities constitute 97.5% of the total number (89.3 % of them are natural persons) and produce 14.7% of sectoral products. Furthermore, MEs with 0.4% of the sectoral share, produce 43.8% of the product. A similar phenomenon takes place in the agrarian sector, where MEs outperform in output and employment parameters, accounting for only 4.1% of the total number of entities in the sector. SEs active in industry and agriculture sectors employ 29.7 % of the total number of employed persons and produce 25% of the gross product.

Analysing the entrepreneurial landscape of Ukraine, it is important to take into account the huge diversity of the SME sector. Statistical data may incorrectly reflect the real situation, in particular, when making the comparisons with other countries. In a recent study of SMEs in Ukraine on behalf of Friedrich Naumann Foundation for Freedom, experts of a German independent economic consultancy body, Berlin Economics GmbH⁶, revealed five groups of companies complying with the criteria for SMEs but having different motivations for their activity:

- Subsistence businesses. Self-employed entrepreneurs and microenterprises with the aim of generating minor incomes of business owners. The activity of such enterprises has a small level of entrepreneurial motivation. Typical examples of such activities are small market stalls or tiny retailers.
- Freelancers. Self-employed people engaged in activities with non-scalable (creative) business-models: journalists, writers, scientists, designers, photographers etc.
- Stuck-in-the-middle companies. Enterprises that do not grow due to the lack of aspiration, undefined barriers to growth or reluctance to loose fiscal preferences given to small business. We believe this type of nominal SME is created to "privatize" the profits of medium-sized and large enterprises with the aim of optimizing taxation of large enterprises.
- Innovative growing companies. Enterprises using market, productive or technological innovations to grow and upscale the business.
- Pseudo self-employed. Natural persons who possess the legal status of self-employed, but who in reality do not, by any means, act as entrepreneurs. These persons, in fact, work as employees. The aim to be registered as entrepreneurs, for some of them, is to avoid income and social tax payments or employment regulation. For others, the aim is to engage in tax fraud and money laundering with no actual business activity.

According to expert estimates, out of the 77% of natural-person SMEs, half refers to the pseudo self-employed, or 38% of the total number of SMEs, while the other half principally consists of freelancers and subsistence businesses. Only 5% correspond to entrepreneurs who are growing innovative companies. This fact explains the low level of productivity in the SME sector. It allows us to argue that, despite the advances in aligning the quantitative indicators of development closer to European levels, SMEs in Ukraine are forced to play the social support functions of entrepreneurship in the absence of better employment alternatives. SMEs are hardly efficient at national level when compared according to the measures of potential for entrepreneurial and innovative development.

This in turn impedes the establishment of an integral network in the entrepreneurial environment, characteristic of the European economic model, where the realization of the competitive potentials of large,

⁶ Towards a Modern SME Policy in Ukraine, BE Berlin Economics GmbH. Source: http://www.ukraine.fnst.org/files/1185/2014_11_03_SME_in_Ukraine_final.pdf.

medium-sized and small businesses is taking place within the process of clustering, mutual cooperation and subcontracting, creation of niche market and venture entrepreneurship, etc.

The political crisis in 2014 negatively influenced Ukrainian SMEs. Enterprises active in the sectors of trade and services, where the majority of SMEs are concentrated, were among those most greatly affected by deteriorating economic activity. Economic decline, reduction of real personal income and diminishing social budget expenditures narrowed the domestic market. Due to the lack of recent data concerning the situation in the SME sector, we can only suggest the approximate estimates of activity indicators in trade, transport, and business services. In particular, wholesale trade turnover in 2014 decreased by 15.0%, retail trade by 8.6%, and in the transport sector, freight turnover reduced by 9.1% and passenger turnover by 11.7%.

The annexation of Crimea and the military conflict in the east of the country negatively influenced the transport and tourism sectors and the related hotel and catering businesses. Over 161,000 SMEs were located in Crimea. They represented 7.7% of the total number of Ukrainian SMEs and produced 5.7% of the sector's products.

The plight of SMEs in the east of Ukraine, in Donetsk and Lugansk regions (together called Donbass) is even worse. The state has lost control over part of these territories and military action has caused destruction, serious damage or the interruption of activity for a majority of SMEs. The same is true for the SMEs registered in the frontline territory controlled by the government. In total, these two regions accounted for 22.0% of Ukrainian SMEs, generating 25.4% of total products from SMEs.⁷

In other regions of the country, the business environment was affected by high political and economic uncertainty, rapid inflation, the sharp devaluation of the hryvnia and the signs of a banking crisis, as well as changes in consumer preferences due to their loss of real income.

When analysing the state of SMEs in Ukraine, one has to mention the influence of national currency devaluation. The hryvnia depreciated twice during 2014 and continued falling in early 2015. Since one of the income criteria for SMEs is income level, which is evaluated in euros, currency devaluation has changed the structure of entrepreneurial landscape.

4. Bottlenecks of SMEs creation, activity and internationalization

Support for entrepreneurship development was officially declared as one of the principal goals of the Ukrainian Government more than a decade ago. In 2004, this priority was established by the Law of Ukraine, "On the Basics of a State Regulatory Policy in the Field of Commercial Activity". The legislative basis for government policy regarding small and medium-sized entrepreneurship development was set by the Law "On the Development and State Support of Small and Medium-sized Entrepreneurship in Ukraine" in 2012.

4.1. Regulatory barriers to SME activity

Taking into account that the most visible barrier for entrepreneurship development in Ukraine is the excessive cost of regulatory requirements, which is a fertile ground for massive corruption, the main objective of the policy was the deregulation of commercial activity.

The necessity to improve business activity after the 2008-09 crisis gave a new impulse for deregulation. The vector of legislative changes was determined by Ukraine's official intention to sign the Association Agreement and move further towards integration with the EU.

During 2010-14 a number of important changes, aimed at supporting entrepreneurial activity, were introduced in the regulatory sphere:

⁷ Some enterprises from occupied territories in Crimea and Donbas had a chance to re-register in the "peace" territory. However, there are no data concerning their number and size. We can assume that this information is relevant mainly for large and, in part, medium-sized companies.

- Easing business registration by eliminating the minimum capital requirement for company incorporation; reducing the number of approvals from 1200 to 84; easing the procedures for obtaining approval; reducing number of licenses by more than 30% and reducing the number of licensed activities by 90%. As a result, the number of procedures required to start a business was cut to six, time requirement was reduced from 27 to 21 days, and the cost was reduced to 1.2% of per capita income.
- Cancelling the obligatory certification for the majority of products, and cancelling the obligatory registration of the declaration of compliance for manufacturing products; separating the functions of standardization, compliance control and market surveillance between different bodies of the government in order to abandon the practice of simultaneous regulation and control in technical regulation.
- Unifying the administrative services; reducing by one-third the number of paid administrative services provided by central government; providing services at the “single window” in administrative services centres (more than 160 newly-created centres).
- Implementing regulations at a national and local level in the construction sphere, to streamline procedures, has reduced its number by 70%; easing requirements for approvals and technical conditions; and simplifying the process for registering real estate ownership rights.
- Making the payment of taxes easier and less-costly for firms by revising and unifying tax legislation; reducing the number of payments from 44 to 22; reducing corporate income tax rates; unifying social security contributions; simplifying tax returns and introducing online tax payments;
- Easing procedures for the processing of customs documents; reducing the length of custom proceedings.
- Releasing tax and customs declarations online and reducing the number of physical inspections.
- Amending legislation to streamline commercial dispute resolution and to increase the efficiency of enforcement procedures; introducing more guarantees for secured creditors.
- Introducing an effective time limit for processing transfer applications to the land registry; streamlining procedures and revamping the property registration system.
- Improving access to credit information by collecting data on firms from financial institutions; extending the coverage of individuals by private credit bureaus.
- Streamlining the process of obtaining access to utilities, for example, electricity.

In addition, since the middle of 2014, the Cabinet of Ministers established a six month (two year for SEs) moratorium for any inspections of commercial entities, except by those of State Fiscal Service or on a special permission from the Cabinet of Ministers. Later, the moratorium was extended until the middle of 2015.

Since the beginning of 2015, amendments to fiscal legislation have come into force, positioned as the next stage in tax reform. Meanwhile, the design of the changes was influenced by the fact that it was prepared in the context of the 2015 State Budget preparation. Therefore, the changes had a predominantly fiscal significance.

In particular, since January 2015 the number of centralized taxes have been reduced from 22 to 11, the test mode of the electronic VAT administrating system was launched and the introduction of an individual electronic taxpayer office has been planned since the middle of the year.

At the same time, the personal income tax rate was raised, as well as indirect taxes, including taxes on real estate, excise taxes on alcohol, tobacco and fuels, taxes on rental and deposits income. Therefore, the resulting influence of these amendments on the entrepreneurial environment should be analysed cautiously. For example, 62% of representatives of large and medium-sized business in the EU, surveyed

in January 2015 by the European Business Association, were pessimistic about the changes mentioned above. They pointed out the imperfections and contradictions in the legislative norms, and the lack of a complex approach to tax reform.⁸

The coherence of entrepreneurship support policy is negatively influenced by the instability of its institutional framework. The State Committee of Ukraine for Entrepreneurship Development, created in 1997, went through a number of reorganizations. In particular, when in 2010 it was liquidated, and the new State Service of Regulatory Policy and Entrepreneurship Support was created. The Service started a full-scale functioning only in 2012. In April 2014, this institution was also closed down. Instead, a State Regulatory Service in charge of regulatory policy, market surveillance and approvals was created.⁹ The functions of the SME support were conferred to the Ministry of Economic Development and Trade. The head of State Regulatory Service was appointed only in January 2015.

However, the creation in 2015 of the Business Ombudsman Council by the Cabinet of Ministers may be considered to be an important step forward. It is a non-governmental independent institution aimed at assisting the improvement of the investment climate and eradication of corruption in Ukraine. One of the key objectives of the Council is to enhance transparency of the public authorities, of local governments and state-owned or partially-controlled businesses. Its role also includes assistance in preventing infringements of the legitimate interests of business.¹⁰

All the above-mentioned changes in the regulatory environment affected the dynamics of Ukraine's ratings according to the World Bank's "Doing Business" yearly estimates. According to the World Bank, the reforms allowed Ukraine to improve conditions for entrepreneurship and to move from 142nd place out of 187 countries in 2010, to 112nd in 2014, in their Doing Business ranking (Table 6, Figure 16)¹¹ Improvements took place in five out of seven comparable positions. Ukraine took fourth place out of 50 countries, approaching the fastest towards so-called "frontline" reforms. The most significant changes took place in the category for starting a business, moving from 134th to 47th place (the cost was reduced by 4.5 times); dealing with construction permits moved from 181st to 41st place (the procedures number was reduced by three, the time of registration by 6.5 times, and the cost by 2.4 times); registering property went from 141st to 97th (time of registration was halved, the cost was reduced by 40%); paying taxes went from 181st to 164th (the number of payments reduced from 147 to 28 and the time to pay by 1.9 times).

In the Doing Business-2015¹² ratings, Ukraine continued its success, having moved from 112nd to 96th position among 189 countries. It is worth mentioning that Doing Business-2015 data was collected between July 2013 and July 2014, and therefore does not take into account the changes that have happened in Ukraine after the political crisis and military intervention.

Ukraine also moved up the rankings of registering property and paying taxes, where it moved up by 38 and 56 steps respectively. In paying taxes, progress consisted of reducing the number of payments to five per year. However, in the starting a business classification, Ukraine had a downward shift from 47th to 76th place and in dealing with construction permits it went from 41st to 70th position. Later changes can be ascribed not to any negative changes in the national regulatory environment, but rather because Ukraine is lagging behind the significant progress of other countries in these spheres.

Benchmarking comparisons of Ukraine's ratings with similar neighbouring countries (Table 6) show a significant lag in the trading across borders ranking. Ukraine's 154th place in the rating has been determined by its lengthy export and import procedures, and costly customs processing. In the field of taxation Ukraine is also lagging behind due to the time necessary to pay taxes, and the relatively high total tax rate level (52.9%). Despite evident progress made, excessive time for starting a business remains one

⁸ <http://www.eba.com.ua/en/information-support/eba-news/important/item/31115-2015-2-11-1221>

⁹ <http://www.dkrp.gov.ua>

¹⁰ <http://www.eba.com.ua/uk/information-support/eba-news/important/item/31015-2015-1-30-0943>

¹¹ World Bank; International Finance Corporation. 2013. Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises. Washington, DC: World Bank Group. © World Bank. <https://openknowledge.worldbank.org/handle/10986/16204>.

¹² World Bank Group. 2014. Doing Business 2015: Going Beyond Efficiency. Washington, DC: World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/20483>.

of the obstructions in the development of entrepreneurship. Experts also stress the costs of contract enforcement and insufficient credit information transparency.

However, the World Bank data should be viewed cautiously when evaluating the real situation for SMEs in Ukraine as standard international indicators do not entirely reveal the systemic problems of the economy. The imperfections of national economic policy also have to be taken into account. In particular, according to an entrepreneurial environment study conducted by the International Financial Corporation (IFC) in 2013,¹³ the majority of surveyed entrepreneurs (21.3%) considered the problems of accessing finance to be one of the greatest barriers for business development in Ukraine. In addition, 19.2% of surveyed entrepreneurs identified corruption as the largest problem, 15.5% considered it to be the level of taxation and 11.9% thought it to be political instability (possibly explained by inconsistency of government regulatory policy and legislation instability). The disparity between the positions of different-sized enterprises is significant. So far, for large companies the top 3 bottlenecks looked to be: “corruption-access to finance-political instability”. For MEs the set was different: “access to finance-corruption-tax rates”. Finally, SEs ranked the bottlenecks as “corruption-access to finance-political instability”¹⁴.

The Global Competitiveness Index, 2014-2015 ranks the most problematic factors for doing business as: corruption (17.8% of respondents); policy instability (14.0%); access to finance (13.9%); government instability (10.5%); inefficient government bureaucracy (8.8%); inflation (8.0%); and tax rates (7.7%).¹⁵

Similar approaches to bottlenecks can be found in the IFC report from 2014, “Ukraine: Opportunities and Challenges for Private Sector Development”.¹⁶ Contrary to the previous study, based on a survey of entrepreneurs, the experts give a more complex picture, stressing the imperfect regulatory environment, including tax administration, limited access to finance, insufficient level of competition, inappropriate legislation, weak property rights protection, inefficient public sector management, state capture (i.e. harmful influence of special interest groups or individuals on public policies at the expense of society), corruption, low public awareness and political, administrative, and business culture.

These findings hardly fit with the Doing Business ratings, where Ukraine holds leading positions in the “getting credit” ranking (17th place in 2015). This rating does not take into account the acceptability of the excessively high cost of credit resources nor high risk expectations, pushing banks to be quite reluctant to provide credit. As the IFC reports, 43.4% of respondent enterprises plan to take a loan within the next quarter. This ratio implies the remaining 60% of enterprises are voluntarily excluded from credit.

The respondents planning to take a loan are predominantly large enterprises from processing industries, agriculture, and construction. However, small and start-up enterprises have limited prospects for accessing credit due to a combination of misaligned macro-level policies, limited long-term funding, group ownership structures in banking, weak infrastructure, an underdeveloped legal environment for lending, and stagnant capital markets. Most banks are employing stricter risk-metrics in this sector, which results in prohibitively high interest rates on SME loans.¹⁷

Therefore, despite improvements in the regulatory environment, according to many formal indicators there are still a number of institutional bottlenecks for entrepreneurship development in Ukraine. The most important among them are the following:

- Overload of commercial activity by different procedures. Simplifications, made in last years, were often were rather formal, touching upon the narrow-fields procedures. The introduction of the “Single window” did not bring a significant reduction in time and costs for regulation fulfilment. This was a reason for the appearance that a huge number of natural-person entrepreneurs were benefiting from the simplified system of taxation and accounting.

¹³ World Bank; International Finance Corporation. 2014. Enterprise Surveys : Ukraine Country Profile 2013. Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/20924>.

¹⁴ In this study authors have used a specific gradation: small enterprises having less than 20 employees and large more than 100.

¹⁵ Global Competitiveness Report, 2014-2015. WEF, Geneva, 2014.

¹⁶ International Finance Corporation. 2014. Ukraine: Opportunities and Challenges for Private Sector Development. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/16711>.

¹⁷ International Finance Corporation. 2014. Ukraine : Opportunities and Challenges for Private Sector Development. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/16711>.

- Insufficient definition and protection of property rights. The most widespread economic crimes are crimes against property, which accounts for two-thirds of the total registered crimes.
- High corruption level in government and judicial powers. Attempts to eradicate corruption undertaken by state powers and civic society after the revolutionary events in 2014, as a majority of experts and practitioners admit, have not yet resulted in any significant success
- Unbalanced mechanisms of commercial disputes settlement. This may be a result of contradictory statements of some legislative acts, the low level of legal culture, widespread legal ignorance and the lack of respect for the law by business entities, as well as the weak law enforcement mechanisms of the state.¹⁸
- Insufficient level of entrepreneurial culture and managerial knowledge of the majority of SME representatives. This makes the transaction costs of entrepreneurship excessive, it reduces the efficiency of enterprises and reduces motivation and development prospects.

The influence of the above-mentioned factors cause the macroeconomic bottlenecks that diminish entrepreneurial activity, including:

- The limited capacity of the domestic market and low purchasing power. This primarily impedes the development of the service segment of SMEs, both in retail and business services;
- The significant level of market monopolization, including in retail networks, creates high market access barriers and complicates the access to resources. This incidentally creates the grounds for the so-called “manual control mode” management of resource flows through corruption mechanisms.
- Problems of commercial activity financing. The high cost of lending, caused by high level credit risks level and the profitable alternatives of banking assets placement, is a strong obstacle for the development of enterprises (e.g. in 2010-13 this alternative was represented by consumer credit inspired by rapid growth in real incomes). Preferential micro-crediting instruments, as a component of international support programmes, are still not widespread.

These bottlenecks influence the ability of SMEs to enter international markets. The internationalization process is especially hard for SEs due to their low capacity for establishing foreign relationships, including:

- Language barrier, information search, business contacts,
- Knowledge of international legislation, coordination of economic cooperation, lack of appropriate skilled professionals in companies’ staff,
- The lack of information about international markets, which complicates the finding of reliable partners, increases the risks of internationalization,
- Barriers to foreign market entry (tariff and non-tariff regulations), including compliance with technical and safety regulations.
- Negative influence of exchange rate in the background of rapid national currency devaluation in 2014 to early 2015.

4.2. Problems associated with foreign trade activity and market entry

The national statistics office of Ukraine does not provide systematic information concerning the foreign trade activity of SMEs. The data collection is currently in experimental phase, and the aggregated data are not published yet. To our knowledge, the most comprehensive source of information on Ukrainian business

¹⁸ Системна криза в Україні: передумови, ризики, шляхи подолання : аналіт. доп./ Я. А. Жаліло, К. А. Кононенко, В. М. Яблонський [та ін.]; за заг. ред. Я. А. Жаліло. – К. : НІСД, 2014. [Systemic Crisis in Ukraine: premises, risks, ways out: analytical report. Ed. by Y.Zhalilo.- National Institute for Strategic Studies. – Kyiv, 2014 – in Ukrainian]. pp. 51-52.

internationalization is the Enterprise Survey carried out by the World Bank and the International Financial Corporation (IFC).¹⁹ In particular, business owners and top managers of 1002 firms were interviewed from January 2013 to November 2013. As previously mentioned, enterprises classification is carried out according to the number of employees. Enterprises with up to 20 employees are considered to be small, those with 100 employees or more as large. The aggregated indicators of trade integration are presented in comparison with the EU benchmarks in Table 7 and Figure 17.

The data obtained show quite low level of SMEs involvement in export activity. Only 11.8% of small enterprises exported directly or indirectly and 95.9% of the sales from small enterprises are intended for domestic market. Therefore the SMEs export activity is rather low, and cannot be considered as a driver of short-term economic growth.

While assessing the reasons of low involvement of Ukrainian SMEs in export activities we should take into account the full complexity of the phenomena. First of all, these are “standard” barriers for SME internationalization, described by numerous studies as based on a country-level analysis. In particular, OECD surveys reveal the following barriers:

- Shortage of working capital to finance exports;
- Problems of identifying foreign business opportunities,
- Limited information to locate prospective markets,
- Inability to contact potential customers,
- Problems obtaining reliable foreign representation,
- Lack of managerial time to deal with internationalization,
- Inadequate quantity of and/or untrained personnel for internationalization,
- Difficulty in matching competitors' prices,
- Lack of domestic government assistance/incentives,
- Excessive transportation costs.

As can be seen from the list above, limited resources and few international contacts, as well as the lack of necessary managerial experience in foreign activities are typical critical constraints to the internationalization of SMEs.²⁰

Secondly, the insufficient competitiveness of the majority of SMEs is a significant barrier to entering foreign markets. It is the result of lack of investment in structural modernization and scarce motivation to innovate. According to the IFC data, in 2013 Ukrainian firms with an internationally recognized quality certification accounted for 16.6% of the total number of firms, of those 12.4% were small enterprises and 19.6% were medium enterprises. The same indicator for Poland was equal to 33.1%.²¹

The third reason to explain the low export activity of SMEs is the, specific structure of Ukrainian exports. Ukraine exports mainly in primary sectors, i.e. metallurgy, chemical products, etc., which are out of range of small business capacities. The same is valid for a large share of services exports.

Fourthly, the regulatory framework negatively influences the export activity of SMEs. As mentioned above, according to the Doing Business report, a huge lag had been detected for the indicators of foreign trade

¹⁹ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>.

²⁰ OECD (2009), “Top Barriers and Drivers to SME Internationalisation”, Report by the OECD Working Party on SMEs and Entrepreneurship, OECD.

²¹ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>.

sophistication and foreign trade cargo processing when evaluated on an international level. As shown by the IFC, the heaviest burden is borne by SEs: if the average time to clear direct exports through customs takes 4.1 days, for SEs this indicator equals 4.8 days. Moreover, 20% of exporters define customs and trade regulations as the major constraint for their business. The expected adverse by-product of excessive regulations is a high level of corruption. The share of exporting firms that identify corruption as the largest constraint, accounts for 59%, 1.6 times more than for domestically orientated companies.²²

Finally, the specific entrepreneurial landscape, as discussed above, distorts the motivation for export activity. As BE Berlin Economics GmbH researchers showed, only 5% of SME entities are attributed to real entrepreneurs, while the rest are only registered nominally. Therefore, the low level of export activities of Ukrainian enterprises is partly explained by this phenomenon.

At the same time, OECD experts stress the increasing recognition of growth opportunities associated with internationalization. SMEs increasingly seem to seek access and integration into the supply chains of international players. Another important motivation is the possession of relatively competitive resources, including human capital and solid scientific knowledge base.²³

The involvement of SMEs in import processes in Ukraine is much higher and does not differ significantly in the same indicators for the CEE countries. First of all, it concerns small and medium-sized businesses (Table 7, Figure 18). According to the IFC surveys, 46.6% of manufacturing SEs use material inputs and/or supplies of foreign origin. At the same time, for the whole SME sector this share should be much higher due to the concentration of small businesses in the trade sector mainly dealing with imports. Neither high regulatory barriers nor corruption inhibit import development. 41.9% of SMEs give bribes to obtain import licenses, in particular, 78.2% of SEs. Productive SEs take 5.9 days to clear imports from customs, while large enterprises take 3.7 days and medium-sized businesses take 2.7 days. It takes 26.6 days for SEs to obtain an import license, compared with an average 17.4 days.²⁴ High “resistance” of import business could be explained by its high profitability and low elasticity of substitution of imports of goods that do not have domestic analogues.

The internationalization level of Ukrainian business in the sphere of foreign investment remains quite low. According to the OECD, the data share of foreign investment in Ukrainian enterprises’ capital equals to 1.2%. In particular, in Poland this indicator reaches 5.9%. In the SE sector foreign capital accounts for only for 1.2%, in MEs for 0.9%. The concentration of foreign investments in the large business sector is natural given the quality of the investment climate in Ukraine. It is an unfavourable investment climate that prevents small investors from entering the Ukrainian capital market. They are often unable either to counteract macroeconomic and physical risks, or to ensure a sufficient legal rights protection.

At the same time, enterprises with foreign capital are at the frontline of business internationalization: 59.1% of enterprises with more than 10% of foreign capital share, participate in export activities; 22.2% of their output is sold at foreign markets. In total, foreign investment accounts for 7.6% of exporters’ capital. A similar picture can be observed on the imports side: 70.1% of enterprises with foreign capital participate in import activities, with the share of import in their inputs reaching 49.4%.²⁵

In the future we should expect a gradual increase in the internationalization level of Ukrainian business, particularly in the inclusion of SMEs into international economic activity. This process should be based on the following:

- Spreading of modern information and communications technologies, which reduce the transaction costs of access to external markets,
- Growing relationship with European business within the framework of the implementation of the EU-Ukraine Association,

²² <http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>.

²³ OECD (2009), “Top Barriers and Drivers to SME Internationalisation”, Report by the OECD Working Party on SMEs and Entrepreneurship, OECD.

²⁴ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>.

²⁵ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>.

- Development of transborder cooperation,
- Activation of FDI inflow and the deeper engagement of Ukrainian companies in international value chains (subcontracts, technical and commercial cooperation, etc.).
- Improvement of knowledge, practice and personnel qualification in the field of international business cooperation;
- Further self-organization of the business community and special supportive policies;
- Realization of the Ukrainian Diaspora potential in business communications.

5. Cluster development and their role in facilitating internationalization of SMEs in Ukraine.

The organization of modern industrial clusters as an integral network, linking various sectors of the economy, is considered to be essential for economic development. The Global Competitiveness Report estimates that the state of cluster development in Ukraine to be quite negative. In 2011 ratings, Ukraine was in 106th place by the “State of cluster development” indicator. In 2015, they went down in the rating to 128th place, despite a slight increase in their rating value from 2.9 to 3.0. These changes show that Ukraine is lagging behind worldwide cluster development trends.

This can be explained by the implementation of an inefficient cluster development model within the Ukrainian economy. In 2003, the Cabinet of Ministers announced the State Industry Development Programme for 2003-2011. Later, the State Strategy of Regional Development for the period until 2015 was adopted in 2006. The focus of these programmes was the creation of research-based industrial clusters. Furthermore, the State Economic Programme for innovative infrastructure development, 2009-2013 (adopted in 2008) developed projects for the creation of innovative technological clusters with involvement of local productive resources. However, these programmes proposed no specific instruments for the realization of the projects.

Nevertheless, the first six clusters were created in Ukraine between 1998 and 2000, in the framework of the international programme for the economic recovery of the Podillja region, with the financial support from USAID programme. Specifically, clusters were created for clothing, construction, food processing, tourism (in particular green tourism), food producing and handicrafts.

Next, woodworking cluster was created in the Rivne region with the financial support of the “Eurasia” foundation. A transport cluster was created in the Cherkasy region. In the Zhytomyr region a construction cluster was organized, involving banks, construction companies and educational institutions, with developed natural stone deposits and the construction industry. A tourism cluster was developed in the Zaporizhzhya region.

An experience of the development of these seven clusters was used in the Autonomous Republic of Crimea. It concerned the creation of tourist and recreational clusters, as well as enterprises in areas of food production, medical and educational institutions, transport companies, hotels and utility. Innovative ecological clusters in water supply systems and in solid domestic waste processing were created in Sebastopol in 2005.

In the Ivano-Frankivsk region, an association “Galitsia Innovative Cluster” was created in 2012, presenting a group of localized interrelated companies, equipment, spare parts, special services suppliers, research and educational institutions.

As a further example of the most successful industrial clusters developed in Ukraine, Lviv Informational Technologies and Business Process Outsourcing Cluster (Lviv IT-BPO Cluster) should be mentioned. Since 2010 this association of leading companies in information technologies and business outsourcing processes took the initiative and made systematic changes in the business environment of the city.

In the Zaporizhzhya region an industrial innovative cluster was created in the field of agricultural machine building. In the town of Izmail (Odesa region) the clusters of alternative energy production and education were introduced.

The potential of agrarian sector development further calls for the development of clusters in the agrarian sphere. Since 2007 in the Poltava region, the cluster project of ecological food production was realized, aiming to support the inspection and production control of ecological products, their certification and sale. In 2009, in the Chernivtsy region, the Ukrainian-Romanian “First Agrarian Cluster” was created, targeting the cultivation of fruit and berries and horticulture development. It successfully fulfilled the main task of ensuring coordination between producers, certification inspections, transport carriers and consumers. In the same year, in the city of Rivne, the regional agro-industrial innovative cluster “Agroinnovatsii” was created by local authorities, research institutions, high schools, five producing companies, three innovative structures and service companies. Also in Rivne, the “Natural Milk” cluster was founded by seven agricultural companies of Rivne, Ternopil and Lviv regions. In 2011, in the Vinnytsya region, following the framework of the Project of Support of Sustainable Regional Development (SSRD) financed by the EU, a food-processing cluster was created. The activity of this cluster facilitates cooperation and partnership development between farmers and food-processing firms. The programme of cluster development in the food industry, production of organic products and further cooperation with similar producers in neighbouring regions was expanded in the Kirovograd region.

Ukraine has experience of transborder initiatives and the creation of transborder cluster creation also exists in Ukraine. Ukraine borders with seven different countries, four of which are EU members. Nineteen out of Ukraine’s 25 regions are frontier regions, and their total area equals 77% of the total territory of the country. This creates the natural conditions for the development of transborder clusters as a strategic priority.

Regional transborder clusters in the areas of tourism, recreation and eco-energy are being created in Ukraine-Poland. The possibilities of creating a transborder tourism cluster have been studied in the Chernivtsi region. In the Zakarpatsky region, which borders all four neighbouring EU countries, a transborder logistical cluster is being created. In this region, the cluster of contractors “Karpaty” was created jointly with partners from the frontier regions of Hungary and Slovakia in 2004.

The international innovative cluster “Competitiveness” was created as a voluntary association of research and educational institutions from Ternopil, Khmelnytsky, Chernivtsi and Ivano-Frankivsk regions and their Polish counterparts. It aims to integrate science and production, to improve organizational, economic, ecological and technological conditions of sustainable regional development and to ensure synergy in the “education-science-practice” chain.

Experience of transborder cooperation has also been gained at the eastern border. In particular, in 2008 in the Kharkiv Region, a transborder tourist cluster was created, aiming to restore routes of green tourism and historical memorials. In 2007, the same region, together with the Belgorod region of the Russian Federation, formed a small foundation for the support of entrepreneurial support in construction clusters. In the Kharkiv and Lugansk regions, the possibility of realizing transborder cluster projects in transport, machine building, agriculture and medicine were discussed. However, Ukraine-Russia cooperation initiatives are not feasible anymore or have been suspended after Russian aggression against Ukraine.

To summarize, cluster development in Ukraine is in its initial phase. Globally, the most promising sectors are tourism and agriculture. At the regional level, the characteristic features of the regions are being recognized, including: special production capacities, natural resources, geographical position (frontiers or transit-supportive), etc. Clusters in research and innovative spheres, reflecting intentions for applied research and business cooperation, receive special attention.

To a large extent, cluster development processes were influenced by external factors such as donor programmes, transborder partner initiatives and needs to adapt to international cooperation requirements. However, given the fact that the creation of clusters does not require substantial financial resources, we expect that more industrial clusters will be created using internal resources when sufficient organizational experience will be accumulated in the future.

Unrealized cluster development potential is still high in Ukraine. The existent product chains and intrasectoral cooperation chains between enterprises often do not produce stable institutionalized communication networks for the following reasons:

- The lack of appropriate facilitation policy and imperfect legislative basis for the functioning of clusters.
- The lack of investment and innovative mechanisms of cluster creation and functioning.

Cluster development associations in Ukraine can now benefit from cooperation synergy. However, this steady cooperation is often impeded by:

- The lack of mutual confidence and interest conflicts between potential cluster members.
- Opaque nature of some SME activities, that prevents them from sharing commercial information.
- Varying strategic partners concentrated around large businesses.
- The lack of knowledge concerning potential practices, advantages and the possibilities of cluster cooperation.

We expect that significant advancements in cluster development in Ukraine will be made, if sufficient state support is provided. The reasons for this are:

- The widening and diversification of industrial networks of SMEs.
- Technological advances increase the autonomy of even small enterprises in areas of logistics, supply and sale and resource supply (including energy) which lessens their dependence and favours the introduction of “soft” integration structures.
- Changes in competition characteristics both in domestic and foreign markets where the weight of marketing, logistics, quality management and other synergy-sensitive factors become more important.
- Diversification, product specialization, and its complementarity which reduces direct competition, but increases the importance of cooperation.
- Creation of business associations as an important basis of practical informational and methodological support of cluster development.

The development of favourable conditions for cluster development is expected in the agrarian sector, with consistent advancements in agrochemistry and agromachine-building, as well as supply-sales and processing logistics. In addition, clusters in the sector were motivated by the needs to adapt agroproduction for European market requirements and standards.

Touristic and recreational spheres remain attractive for cluster development, because of the huge number of geographically localized small and micro business entities involved to the sector. More likely, the touristic potential of Ukraine will be low in the medium term, due to factors related to political instability. Local “green”, ethnic, historical, cultural tourism clusters development can be considered in the future.

The creation of industrial technological clusters will be supported by innovative potential, accumulated on the basis of existing technological and industrial parks. Those clusters can also be viewed as the instruments for regional economic recovery, concentrating mainly in traditional sectors (food, light industries, energy production etc.). Clustering potential in complex knowledge-intensive production (e.g. machine-building) is the most probable in the territories of large industrial agglomerations. However, this process may be impeded, because the majority of these agglomerations are concentrated in the east of the country, areas which are currently occupied or conflict-affected territories.

Transport and logistics clusters will be significantly developed owing to the high level of geographical concentration of the Ukrainian economy. In the medium term, the reorientation of transport flows will take place, strengthening communication means in western and southern directions. The growth of logistics companies should be expected. One of the additional factors for development is the expected partial privatization of “Ukrzaliznytsya”, a state monopolist in railway transportations.

Clusters will continue playing a significant role in the internationalization of Ukrainian businesses. Naturally, the main beneficiaries will be represented by small and, to some extent, medium-sized enterprises, with cluster integration increasing their market power:

- Clusters facilitate small entities in accessing foreign markets, helping overcome the typical barriers to internationalization (as mentioned above).
- Support will be given to the realization of the EU-Ukraine Association agreement, in particular with regards adapting to European market requirements.
- Transborder cooperation will be intensified: in the economic decentralization process. It is an important instrument of the Euro-integrational advancement of Ukraine.
- Cluster networks will simplify the integration of Ukrainian companies into international value chains, especially those with foreign investment potential.
- Cluster associations in some specific sectors (handicrafts, energy efficiency, ICT, medicine, education, etc.) can favour cooperation with international-aid agencies within the framework of structural modernization and Euro-adaptation programmes.

6. SMEs development policies in facilitating internationalization

Ukraine, as a country with an open export-orientated economy, suffers from the absence of export promotion policies. Any financial instruments of exporters support, either in formats of export crediting or export insurance, have not yet been created. The state-owned “Ukreximbank”, working with exporters, has no ability to fulfil its obligations due to the lack of special banking regulations, adapted to the specific features of export crediting.

The consequences of such neglect in export support policies are the non-flexible export supply of Ukrainian companies, its concentration in low value-added goods and the slow implementation of technological innovation. As for the specificities of Ukraine’s export activities, the necessity to secure them from exchange-rate risks impedes the sales of currency revenues by exporters in the domestic market. In addition, quite often export and import operations were used for the realization of shadow economy schemes for example, capital or profits leakage, cheating with custom value and fictive exports in order to get VAT refund etc.

This model creates high barriers for entering external markets for new companies, especially for small businesses. Experience showed that any deregulation of entrepreneurial activity hardly improves the internationalization of SMEs. In addition, as the Doing Business ratings show (Table 6), the trading across borders ranking of Ukraine has a downward trend.

We consider that elaboration of measures intended on increasing transparency and fighting corruption at customs is essential for the stimulation of trade activity both in imports and exports.

We appreciate the Ministry of Economic Development and Trade (MEDT) for their efforts in extending export support policies. Meanwhile, the institute of Trade Representative at the Ministry, established in August 2014, was later abandoned, leading to a reasonable concern amongst experts and practitioners. Namely, the Representative was entitled to realize Ukraine’s foreign trade policy and represent the economic interests of Ukraine at foreign markets.

MEDT has a “State support of Ukrainian export” Internet portal (<http://www.ukrexport.gov.ua>), which provides information in Ukrainian, English and Russian regarding the state of the economy and the markets of Ukraine and partner countries; specific features of legislation of partner countries; regulations of

foreign trade in Ukraine; contains databases of exporters, export and commercial proposals; international business events, etc. According to the tasks declared on the portal, this portal helps Ukrainian companies to enter foreign markets, provides information to foreign companies searching for the opportunities on Ukrainian markets and looking for Ukrainian suppliers and helps establishing relations in B2B format between enterprises and professional associations, etc.

After Ukraine's WTO accession, a committee for enquiries, notification processing and informational services was created at MEDT Department of Cooperation with WTO. This committee supplies business and NGOs with information concerning WTO-related issues. In particular, it is possible to obtain texts of actual documents or notified projects and its translations, to make an enquiry about technical requirements of some goods, to take part in bilateral or international agreements on technical regulations, to comment on projects, to send official inquiries for the texts of legislative documents of partner countries and get explanations, etc.

Economic departments of Ukrainian embassies abroad provide entrepreneurs support with the establishment of business contacts promotion of sales. The Ukraine Representative at the EU (<http://ukraine-eu.mfa.gov.ua/en>) establishes communications in B2B format, supports the promotion of business proposals from Ukrainian companies and gives consultative support. However, some experts highlight the weak coordination between MEDT and MFA with regard support of exporters.

It is difficult to assess the influence of deregulation on FDI attraction. On one hand, Ukraine is moving upwards in the Doing Business rating which increases its investment image. On the other hand, as we have stressed above, the high level of corruption and the instability of legislative processes are still the main bottlenecks for entrepreneurial development in Ukraine. These are mostly small investors who are vulnerable to these sorts of barriers. They are considered as important sources of financing for SMEs, but they do not have direct political support. In this context, the creation of the Business Ombudsman Council has to be viewed as an essential step to the improvement of the investment image of Ukraine.

The attraction of local markets to foreign investors could be improved by the creation of investment passports for the regions, cities and districts, prepared under the support of the State Agency of Investment and National Projects.²⁶ These passports contain information about the competitive advantages of the region, the development of priority spheres, economy branches and sectors, detailed investment success stories and proposals for greenfield and brownfield investors. We believe it is an important step forward in Ukraine's investment opportunities promotion. However, some experts and practitioners claim that passport creation was based on formal approaches, and are generally sceptical about the Agency activity (it was liquidated in 2014).

7. Business institutions in SMEs internationalization support

The institutional support of SMEs by various business associations is an important component in the absence of efficient and consistent state policy. By the beginning of 2014, Ukraine counted about 2150 entrepreneurial NGOs (mainly at regional level). These NGOs provide entrepreneurship support infrastructure, facilitate the rights and interest protection of small and medium-sized business entities; provides the information on entrepreneurial initiatives concerning essential problems of regional development; establishes an efficient cooperation of state bodies with business community. These NGOs often facilitate the internationalization of SMEs by supplying appropriate information, expert advice and, legal support. They, according to the general goal of economic openness and, export support promotion policies declared by the Government.

The IFC experts state that the relatively weak involvement of civil society, especially NGOs representing small and medium enterprises (SMEs), in monitoring the business environment and driving the reform process is an important obstacle to private sector development.²⁷ While large businesses often have

²⁶ Some passports examples are available at the following sites: <http://www.investment.kharkov.ua/en/investment-and-kharkiv-region/general-information-about-the-region>; <http://www.investkr.gov.ua/map>; http://dniproinvitesyou.org/wp-content/uploads/2013/07/Investpass_2014_en.pdf.

²⁷ International Finance Corporation. 2014. Ukraine: Opportunities and Challenges for Private Sector Development. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/16711>.

influence on the business climate, SMEs lack resources that would help them to access policy-makers. Business associations of SMEs are not strong enough and largely focus on practical advice to cope with the existing regulatory problems and not on influencing government policy.

Positive trends in Ukraine's society development (especially after the drastic post-revolutionary 2014-15 events) include increased appreciation of NGOs' role in business by the entrepreneurial community. To a large extent, this phenomenon correlates with a general increase of civic engagement. Meanwhile, the current situation in the national economy shows the high importance of the role of consistency in government economic policy and a balanced choice of priorities, and appropriate progress in economic reforms for business development. We expect further growth of attention to business networks creation fuelled by the services provided by business-associations.

The Chamber of Commerce and Industry (CCI)²⁸ is the leading business association providing direct support in the sphere of business internationalization. The main objective of the CCI is the creation of favourable conditions for entrepreneurial activity, assistance to development of scientific, technological and trade relations between Ukrainian companies and their foreign partners and representing economic interests of the Chamber members in Ukraine and abroad. Nearly 10,000 companies of different sizes are now members of the Ukrainian CCI. The Ukrainian CCI encompasses regional chambers of commerce and industry, operating in different administrative regions of Ukraine.

The Chamber renders practical assistance to entrepreneurs in conducting trade and economy transactions in domestic and external markets. It assists export promotion and provides its members with a broad range of professional services, including consultations on foreign trade and market conditions, independent inspection of foreign trade goods, evaluating property, non-material assets etc. The regional chambers provide Ukrainian and foreign customers with economic and legal information, organize seminars, conferences and exhibitions in Ukraine and abroad, facilitate business negotiations.

The Ukrainian CCI keeps a non-government register of Ukrainian companies proving their sustainability as business partners in Ukraine and abroad. Certificates issued by the Chamber testify the reliability of Ukrainian companies *vis-a-vis* their foreign counterparts.

To facilitate international economic relations, the Ukrainian Chamber of Commerce and Industry establishes joint advisory bodies with its foreign partners, including business councils and joint chambers of commerce. The Chamber officials are members of about 70 intergovernmental commissions and working groups on trade and economic cooperation.

The Ukrainian National Committee of the International Chamber of Commerce (ICC Ukraine)²⁹ is authorized by the World Business Organization to assist the promotion of international cooperation and to create an opportunity for Ukrainian businesses to integrate into the international business community. The ICC Ukraine is a partner for numerous stakeholders: businesses, decision-makers and representatives of global community. The ICC's activity focuses primarily on large and medium-sized businesses.

The principal role of the ICC Ukraine is to build a tight partnership between the national committees of the World Business Organization in 93 countries. It gives an excellent opportunity to facilitate international trade, to explore new markets, to assist searching for partners and to improve general investment attractiveness.

The ICC Ukraine provides comprehensive support to local companies through expert consultations; public-private dialogue; working groups and activity of ICC committees; commissions and by representing the main business sectors in their development of entrepreneurs. Below we list the ICC Ukraine main programmes.

"Partnership of countries" – a programme encouraging international business ties through the global network in 93 countries. The project encompasses:

²⁸ <http://uccci.org.ua/en>.

²⁹ <http://iccua.org/language/en>.

- The search of trade and investment project partners for Ukrainian and foreign participants. For the efficient realization of this task a special counselling company - *ICC Ukraine Consulting* - was created.³⁰
- Organization of business forums in Ukraine and abroad.
- Active work within bilateral intergovernmental commissions with the participation of the ICC Ukraine members.
- Organization of regular meetings with trade and economic missions of foreign embassies.
- Participation of the ICC Ukraine members in the ICC commissions in Paris, expression of Ukrainian business interests and claims at the international level, participation in the process of elaboration of recommendations of international business to politicians.

The project itself encompasses the following commissions:

- On customs and trade procedures,
- On foreign economic activity,
- On investment and innovation activity.

“Single window - local solution”. A programme encouraging facilitation of international trade in the Odessa Region, in particular at customs of the seaports.

“Global Net Invest”. A programme developing an integrated system to encourage investment in Ukraine, which provides the following services:

- The creation of the integrated unified national database with open access to investment projects, compliant with international standards.
- The creation of a full electronic database of potential financing sources.
- The creation of electronic panel for coordination of the activities intended to investment climate improvement.
- The creation of the mechanisms for contracts security guarantees.
- The implementation of innovative technological projects.;
- The creation of the national coordination centre for the organization of forums, trainings, and other events, engaging the best experts in the investment sphere.

The largest and most powerful business association, the Ukrainian League of Industrialists and Entrepreneurs (ULIE)³¹ successfully combines the functions of influencing government policy, including export promotion, with practical support of business activities at foreign markets.

Aiming to support the search by Ukrainian companies for new business partners abroad, ULIE has created the Centre of Export Support,³² the main idea of which consists in the consolidation of exporters' efforts for exploration of new markets. This Centre supports: the search for new business contacts, the organization of information exchange concerning commercial proposals of enterprises, and the analysis of the problems arising in establishing new commercial contacts and consultancy for Ukrainian exporters.

³⁰ <http://iccuaconsulting.com>.

³¹ <http://uspp.ua/en>.

³² <http://uspp.ua/czentr-p%D1%96dtrimki-eksportu.html>.

The programme supports the opening of representative offices in the countries of major interest for Ukraine to support product sales. These offices consult entrepreneurs regarding: the search for partners; the organization of meetings with business representatives and public officials; the provision of infrastructure and resources for meetings and negotiations; the support for participation in exhibitions, fairs and presentations; and the protection of legal and administrative exporters' interests.

The European Business Association³³ (EBA) is an organization dealing with foreign business promotion in Ukraine. EBA provides a forum in which members can discuss and find solutions to common problems affecting business in Ukraine. With more than 900 members, the European Business Association (EBA) is the largest union of foreign businesses operating in the Ukrainian market.

The top activities of the EBA include: the protection of the interests of foreign and domestic investors at the highest state level; the promotion of leading businesses among their peers and nurturing close contacts between them; the assistance to businesses with the visibility of their activities on the Ukrainian map and PR opportunities; and the provision to member companies of comprehensive information about the economic climate of the country and its regulatory environment.

Smaller business associations are represented primarily, by different sector associations, and realize the support of the internationalization of their members on an episodic, non-systematic basis. The full-scale introduction of business services for export activity promotion is prevented by the low solvency of potential exporters that is mostly specific to small businesses. To some extent, this problem is solved by volunteer and grant supported initiatives of some NGOs, and by the provision of open access information.

A "Center of Business-technologies development"³⁴ is an NGO created with the IFC support, and later affiliated to the Center's administration SME Toolkit Ukraine portal.³⁵ Activities of the Center are directed at the organization of cooperation among entrepreneurs, public officials, international organizations, foreign companies, and research and educational institutions.

The "Association of Ukraine-EU business cooperation assistance"³⁶ is an NGO with the main objective of supporting the economic, social and research interests of Ukrainian enterprises within the framework of cooperation with the EU and to promote trade cooperation between Europe and Ukraine.

The Association provides informational support and assistance in the following:

- Development of competitive strategies for Ukrainian companies and businesses planning to enter European markets: analysis of competitive environment, identification of potential opportunities and risks, development of risk management strategies, analysis of legal framework of Ukraine and its transformation.
- Market research: the general situation in Ukrainian markets, the structure and characteristics of industrial markets, trends, key players, attractive areas for investment in certain spheres etc.
- Analytical support of companies in foreign economic activity: tools of risk management, analysis of tariff and non-tariff barriers, security of deals etc.
- Expert study of potential partners and competitors in Ukraine and the EU: assessment of business reputation, analysis of solvency and reliability of the company;
- Search and analysis of potential investment opportunities, study of investment climate in Ukraine, analysis of the legislative framework and its transformation, development of "investment passports" (current status and trends of economic and political situation in particular regions, their impact on specific markets, most attractive investment objects, forecasts for the region, etc.).

³³ <http://www.eba.com.ua/en/about-eba>.

³⁴ <http://btcd.org.ua/pro-nas>.

³⁵ <http://www.vlasnasprava.info>.

³⁶ <http://www.euassistance.org/en>.

- Interaction and cooperation with relevant commissions and committees of the European Union.

The Association for Promotion of International Business and Development³⁷ (town of Kremenchuk, Poltava region) actively supports the development of international cooperation, organizes visits for foreign business representatives, international business tours for Ukrainian entrepreneurs, investment forums and conferences etc.

The International Business Center of Kharkiv Polytechnic University founded the support programme “International Business Drive”.³⁸ International Business Drive unites initiatives of practice-orientated students and other faculty members that aim to assist Ukrainian companies in their integration into European and global value chains. Within this programme, companies can receive free consultancy and technical aid in areas such as the search for export opportunities, information on existing tariff and non-tariff barriers; preparing an application for international technical aid; market choice and study, partners search; information on compliance with certain market requirements; obtaining of international certification; organization of marketing campaigns; legal and customs support of deals; organization of international financial operations; and managing logistics of international transport carriage and distribution.

The examples mentioned above³⁹ show the gradual growth in the importance of decentralized business institutions and associations for the reduction of transaction costs associated with international activity in Ukrainian business.

³⁷ <http://apibd.com>.

³⁸ http://web.kpi.kharkov.ua/ibc/?page_id=101.

³⁹ The NGOS and regional associations presented are chosen as examples of internationalization supportive activity. The data are taken from open sources. The list does not have any promotional purposes and does not pretend to be comprehensive.

Conclusions

In the modern, globalized world, the progress of business internationalization should be led by the inclusive and multidimensional development of small and medium-sized enterprises, which is more appropriate in the conditions of high risks inherent to interconnected economies.

Ukraine experiences high macroeconomic, political and security risks, which distort its entrepreneurial landscape, and prevent the creation of proper business networks and the efficient development of SMEs.. Despite the achievements in the quantitative indicators of development at the European level, SMEs in Ukraine rather fulfil the social functions of small entrepreneurship, as an alternative to unemployment and in the provision of minor personal income sources. They are hardly efficient in the realization of the functions of national entrepreneurial potential and national competitiveness based on innovative development.

Business deregulation has been declared as one of the principal priorities of government economic policy. Meanwhile, the deregulation has been suspended by high fiscal revenues requirements, and by excessive red tape and state capture. There has been significant improvement in the entrepreneurial climate, which has been reflected in the Doing Business ratings, however, strong macroeconomic and institutional bottlenecks for SMEs development still exist.

For the most part, the bottlenecks are concentrated in the internationalization sphere, where inefficient regulations are combined with poor competitiveness of SMEs. Cluster development as a proven worldwide instrument of SME internationalization promotion is still at its initial stages. We expect that strong cluster development potential will be revealed with the development of SMEs and when institutional structure improvement is given the support and attention it receives from the multiple stakeholders.

A large part of SMEs in Ukraine is lacking internal incentives to raise their productivity and competitiveness. This impedes their inclusive development because they are unable to take part in international value chains and to enter competitive markets.

Multiple layers of SMEs in Ukraine, both “self-sufficiency” type enterprises and innovation–motivated ones, call for the elaboration of complex and multidimensional supportive state policies. “Self-sufficiency” type firms, primarily small and micro businesses, are important for policies intent on combatting unemployment. However, innovative businesses should be seen as building blocks and the institutional basis for the newly internationalized economy. The business-support policies for various types of SMEs should account for the specific features of the entrepreneurial landscape of Ukraine.

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Appendix I

Table 1. Shares of basic indicators of activity business entities by size in 2013

	micro	small	medium-sized	large
Total number	80.9%	14.1%	4.8%	0.2%
Number of engaged persons	10.7%	16.4%	40.7%	32.2%
Wages	5.7%	10.3%	37.9%	46.1%
Products sold	5.3%	11.2%	41.0%	42.4%
Assets	16.1%	12.4%	35.7%	35.8%

Source: Derzhstat – The State Statistics Service of Ukraine

Table 2. Basic indicators of activity of enterprises and natural persons by size

	2010	2011	2012	2013
Number of enterprises	378810	375695	364935	393327
<u>large enterprises, units</u>	586	659	698	659
% of total number	0.2	0.2	0.2	0.2
per 10 000 of population, units	0	0	0	0
<u>medium-sized enterprises, units</u>	20 983	20 753	20 189	18 859
% of total number	5.5	5.5	5.5	4.8
per 10 000 of population, units	5	5	4	4
<u>small enterprises, units</u>	357 241	354 283	344048	373 809
% of total number	94.3	94.3	94.3	95
per 10 000 of population, units	78	77	76	82
<u>of them, microenterprises, units</u>	300 445	295 815	286 461	318 477
% of total number	79.3	78.7	78.5	81
per 10 000 of population, units	66	65	63	70
Number of engaged	7 958.2	7 793.1	7 679.7	7 406.5
<u>large enterprises, thous. of persons</u>	2 400.3	2 449	2 484.2	2 383.7
% of total engaged	30.2	31.4	32.4	32.2
<u>medium-sized enterprises, thous. of persons</u>	3 393.3	3 252.6	3 144.2	3 012.1
% of total engaged	42.6	41.7	40.9	40.7
<u>small enterprises, thous. of persons</u>	2 164.6	2 091.5	2 051.3	2 010.7
% of total engaged	27.2	26.9	26.7	27.1
<u>of them, microenterprises, thous. of persons</u>	832.6	788.9	788.2	795.3
% of total engaged	10.5	10.1	10.3	10.7
Amount of products sold	3 366 228	3 991 239	4 203 170	4 050 215
<u>large enterprises, UAH mln</u>	1 401 596.8	1 775 829	1 761 086	1 717 391.3
% of total products sold	41.6	44.5	41.9	42.4
<u>medium-sized enterprises, UAH mln</u>	1 396 364.3	1 607 628	1 769 430.2	1 662 565.2
% of total products sold	41.5	40.3	42.1	41.0
<u>small enterprises, UAH mln</u>	568 267.1	607 782.4	672 653.4	670 258.5
% of total products sold	16.9	15.2	16.0	16.5
<u>of them, microenterprises, UAH mln</u>	181 903.1	189 799.1	212 651.2	216 111.4
% of total products sold	5.4%	4.8%	5.1%	5.3%
Number of natural persons-entrepreneurs	1 805 118	1 325 925	1 235 192	1 328 743
<u>medium-sized, units</u>	355	306	361	351
% of total number	0.0	0.0	0.0	0.0

	2010	2011	2012	2013
<u>small, units</u>	1 804 763	1 325 619	1 234 831	1 328 392
% of total number	100.0	100.0	100.0	100.0
<u>of them, micro, units</u>	1 793 243	1 313 004	1 224 315	1 318 703
% of total number	99.3	99.0	99.1	99.2
Products sold by natural persons-entrepreneurs	230 418.2	211 215.8	256 649.2	284 238.1
<u>medium-sized, UAH mln</u>	19 487.5	11 221.2	13 015.4	20 778.9
% of total products sold	8.5	5.3	5.1	7.3
<u>small, UAH mln</u>	210 930.7	199 994.6	243 633.8	263 459.2
% of total products sold	91.5	94.7	94.9	92.7
<u>of them, micro, UAH mln</u>	190 055.3	181 697.8	225 449.1	244 546
% of total products sold	82.5	86.0	87.8	86.0

Source: Derzhstat – The State Statistics Service of Ukraine

Table 3. Number of enterprises and natural persons-entrepreneurs by size and by type of economic activity in 2013

	large		medium-sized		small		of those - micro		Total	
	units	%	units	%	units	%	units	%	units	%
Total	659	100.0	19 210	100.0	1 702 201	100.0	1 637 180	100.0	1 722 070	100.0
Wholesale and retail trade; repair of motor vehicles and motorcycles	164	24.9	3 832	19.9	886 662	52.1	868 657	53.1	890 658	51.7
Industry	382	58.0	5 651	29.4	115 211	6.8	103 322	6.3	121 244	7.0
Professional, scientific and technical activities	6	0.9	813	4.2	96 233	5.7	92 901	5.7	97 052	5.6
Operations with real estates	3	0.5	600	3.1	91 410	5.4	87 903	5.4	92 013	5.3
Transportation and storage, postal and courier activities	37	5.6	1354	7.0	90 975	5.3	86 512	5.3	92 366	5.4
Information and communication	12	1.8	411	2.1	85 954	5.0	83 709	5.1	86 377	5.0
Agriculture, forestry and fishing	27	4.1	2 926	15.2	68 105	4.0	62 419	3.8	71 058	4.1
Accommodation and food service activities	1	0.2	444	2.3	51 632	3.0	48 727	3.0	52 077	3.0
Construction	13	2.0	1 215	6.3	51 755	3.0	45 881	2.8	52 983	3.1
Other	14	2.1	1 964	10.2	164 264	9.7	157 149	9.6	166 242	9.7

Source: Derzhstat – The State Statistics Service of Ukraine

Table 4 Number of persons engaged at enterprises and natural person-entrepreneurs by size and by type of economic activity in 2013

	large		medium-sized		small		of those - micro		Total	
	thousands of persons	%								
Total	2 383.7	100.0	3 054.2	100.0	4 291.2	100.0	2 915.1	100.0	9 729.1	100.0
Wholesale and retail trade; repair of motor vehicles and motorcycles	316.5	13.3	387.3	12.7	1 814.8	42.3	1 490.7	51.1	2 518.6	25.9
Industry	1 366.9	57.3	1 222.7	40.0	514.1	12.0	238.3	8.2	3 103.7	31.9
Transportation and storage, postal and courier activities	533.7	22.4	273.2	8.9	256.1	6.0	155	5.3	1 063	10.9
Agriculture, forestry and fishing	38.8	1.6	410.8	13.5	276.6	6.4	125.2	4.3	726.2	7.5
Professional, scientific and technical activities	11.4	0.5	112.7	3.7	216.1	5.0	148.6	5.1	340.2	3.5
Operations with real estates	2.4	0.1	54.7	1.8	218.3	5.1	145.2	5.0	275.4	2.8
Information and communication	76.8	3.2	62.2	2.0	159	3.7	112.2	3.8	298	3.1
Accommodation and food service activities	0	0.0	65.5	2.1	194.5	4.5	137.7	4.7	260	2.7
Administrative and support services	0	0.0	181.5	5.9	145.6	3.4	65.5	2.2	327.1	3.4
Other	37.2	1.6	283.6	9.3	496.1	11.6	296.7	10.2	816.9	8.4

Source: Derzhstat – The State Statistics Service of Ukraine

Table 5. Volume of products sold (goods, services) by enterprises and natural person-entrepreneurs, by size and by type of economic activity in 2013

	large		medium-sized		small		of those - micro		Total	
	UAH mln	%	UAH mln	%	UAH mln	%	UAH mln	%	UAH mln	%
Total	1 717 391.3	100.0	1 683 344.1	100.0	933 717.7	100.0	460 657.4	100.0	4 334 453	100.0
Wholesale and retail trade; repair of motor vehicles and motorcycles	495 334.6	28.8	780 356.4	46.4	506 708.7	54.3	262 488.8	57.0	1 782 400	41.1
Industry	934 135.1	54.4	464 255	27.6	95 460	10.2	33 082	7.2	1 493 850	34.5
Transportation and storage, postal and courier activities	118 497.8	6.9	60 252.5	3.6	45 773.2	4.9	23 778.6	5.2	224 523.5	5.2
Professional, scientific and technical activities	77 974.6	4.5	455 01.3	2.7	41 261.9	4.4	23 991.1	5.2	164 737.8	3.8
Agriculture, forestry and fishing	23 440.6	1.4	891 37.3	5.3	53 700	5.8	188 62.2	4.1	166 277.9	3.8
Information and communication	39 236	2.3	24 261.2	1.4	30 781	3.3	19 669.6	4.3	94 278.2	2.2
Operations with real estates	2 278.4	0.1	18 618.8	1.1	40 620.8	4.4	24 125.8	5.2	61 518	1.4
Other	26 494.2	1.5	200 961.6	11.9	119 412.1	12.8	54 659.3	11.9	346 867.9	8.0

Source: Derzhstat – The State Statistics Service of Ukraine

Table 6. Some indicators of entrepreneurial environment by Doing Business

	UKRAINE			Some benchmarks	
	Doing Business 2010	Doing Business 2014	Doing Business 2015	Hungary, 2015	Slovak Republic, 2015
Ease of doing business (rank)	142	112	96	54	37
Starting a business (rank)	134	47	76	57	77
Procedures (number)	10	6	6	4	7
Time (days)	27	21	21	5	11.5
Cost (% of income per capita)	5.8	1.3	1.2	8.3	1.5
Dealing with construction permits (rank)	181	41	70	103	110
Procedures (number)	30	10	8	23	10
Time (days)	476	73	64	91	286
Registering property (rank)	141	97	59	52	11
Procedures (number)	10	8	7	4	3
Time (days)	93	45	27	16.5	16.5
Cost (% of property value)	2.6	1.9	2.0	5.0	0.0
Getting credit (rank)	30	13	17	17	36
Strength of legal rights (index, 0-10)	9	9	8	10	7
Depth of credit information (index, 0-6)	3	5	7	5	6
Public registry coverage (% of adults)	0.0	0.0	0.0	0.0	2.8
Private bureau coverage (% of adults)	3.0	28.3	48.0	74.6	65.7
Paying taxes (rank)	181	164	108	88	100
Payments (number per year)	147	28	5	11	20
Time (hours per year)	736	390	350	277	207
Total tax rate (% of profit)	57.2	54.9	52.9	48.0	48.6
Trading across borders (rank)	139	148	154	72	71
Documents to export (number)	6	6	8	6	5
Time to export (days)	31	29	29	17	16
Cost to export (USD per container)	1 230	1 930	1 880	885	1 525
Documents to import (number)	10	8	9	6	5
Time to import (days)	36	28	28	19	16
Cost to import (US\$ per container)	1 430	2 505	2 455	845	1 505
Enforcing contracts (rank)	43	45	43	20	55
Procedures (number)	30	30	30	34	33
Time (days)	345	378	378	395	545
Cost (% of claim)	41.5	43.8	46.3	15.0	30

Sources: International Finance Corporation; World Bank. 2009. Doing Business 2010 : Reforming through Difficult Times - Comparing Regulation in 183 Economies. World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/2562>; World Bank; International Finance Corporation. 2013. Doing Business 2014 : Understanding Regulations for Small and Medium-Size Enterprises. Washington, DC: World Bank Group. © World Bank. <https://openknowledge.worldbank.org/handle/10986/16204>; World Bank Group. 2014. Doing Business 2015 : Going Beyond Efficiency. Washington, DC: World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/20483>.

Figure 1. Structure of commodity exports from Ukraine in 2013 (%)

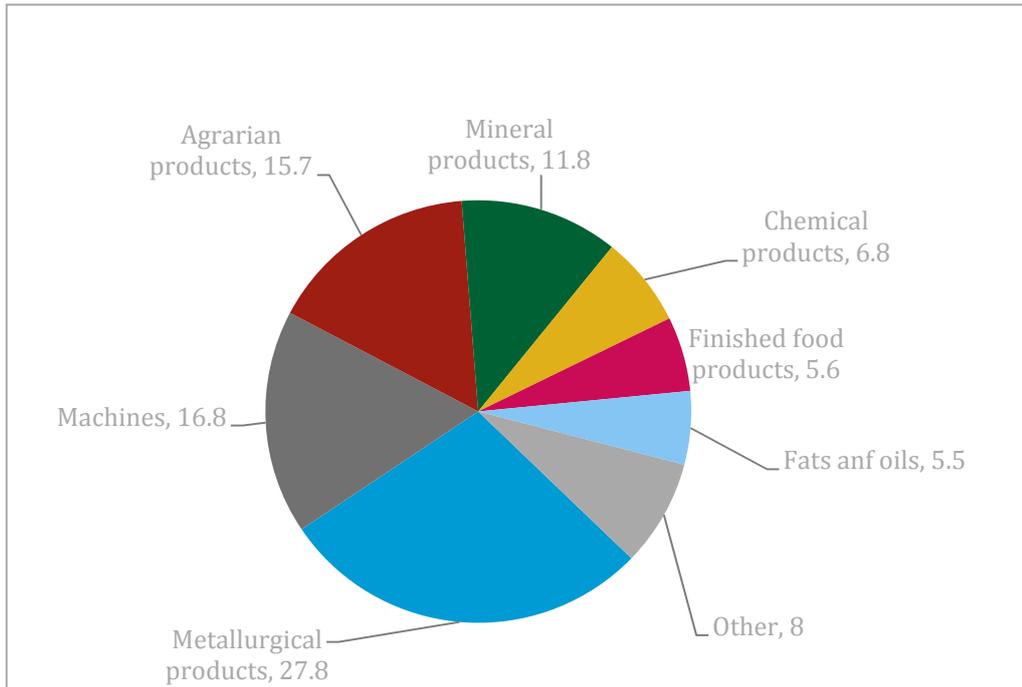


Figure 2. Structure of commodity imports to Ukraine in 2013 (%)

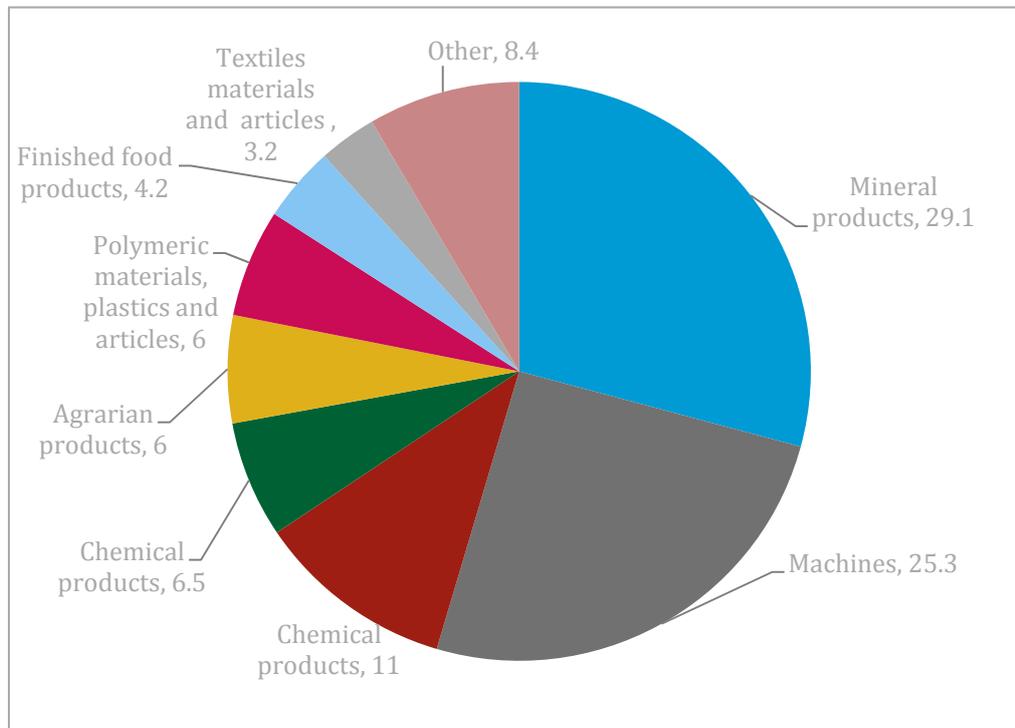


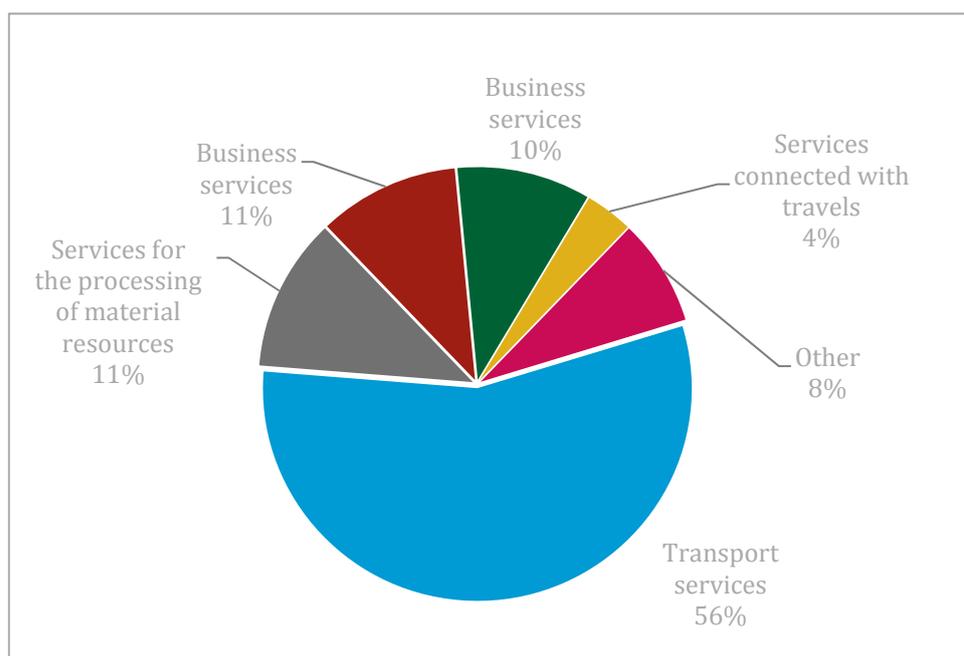
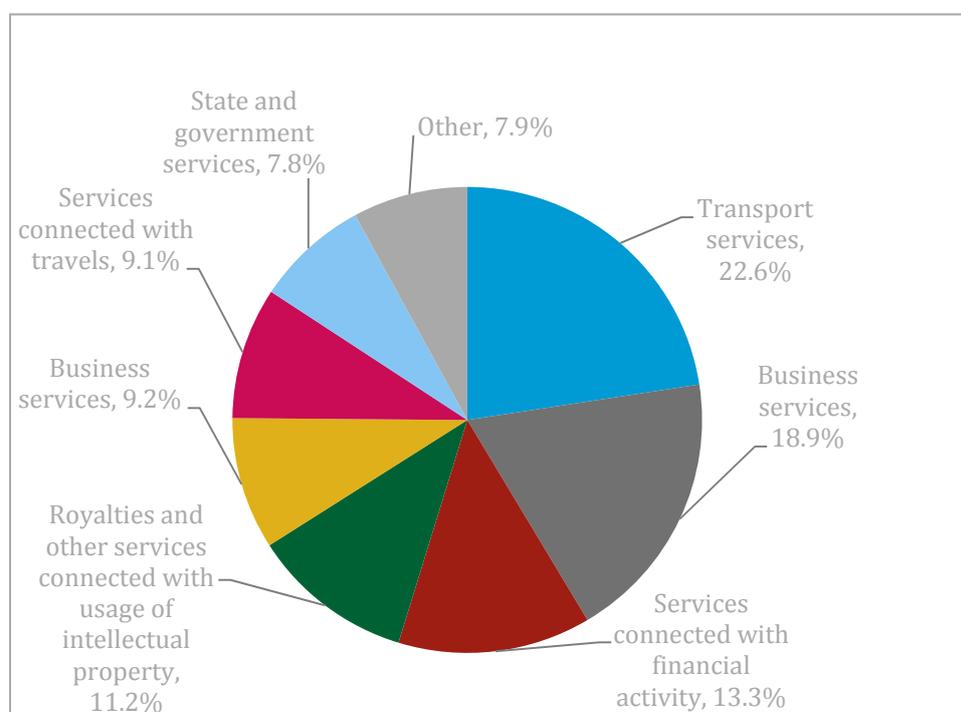
Figure 3. Structure of services exports from Ukraine in 2013**Figure 4. Structure of services imports in Ukraine in 2013**

Figure 5. Structure of FDI to Ukraine on 31 December 2014

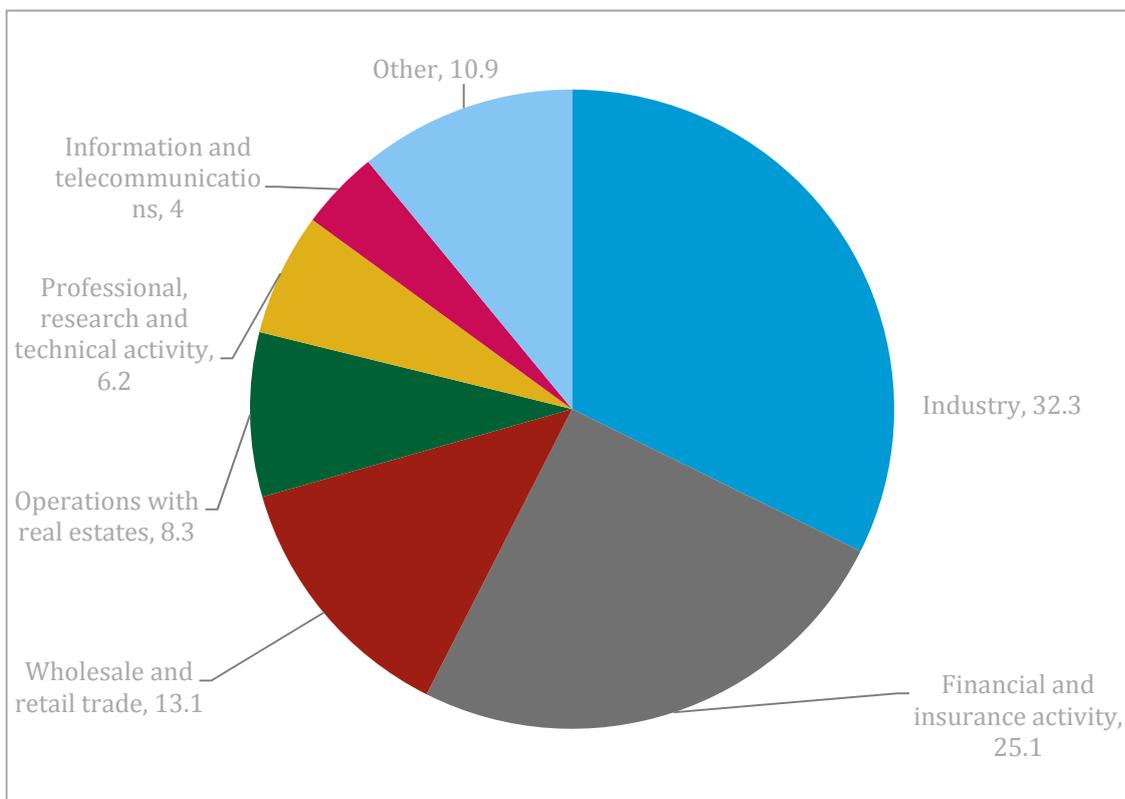


Figure 6. Distribution of main activity indicators by size of business entities, 2013 (%)

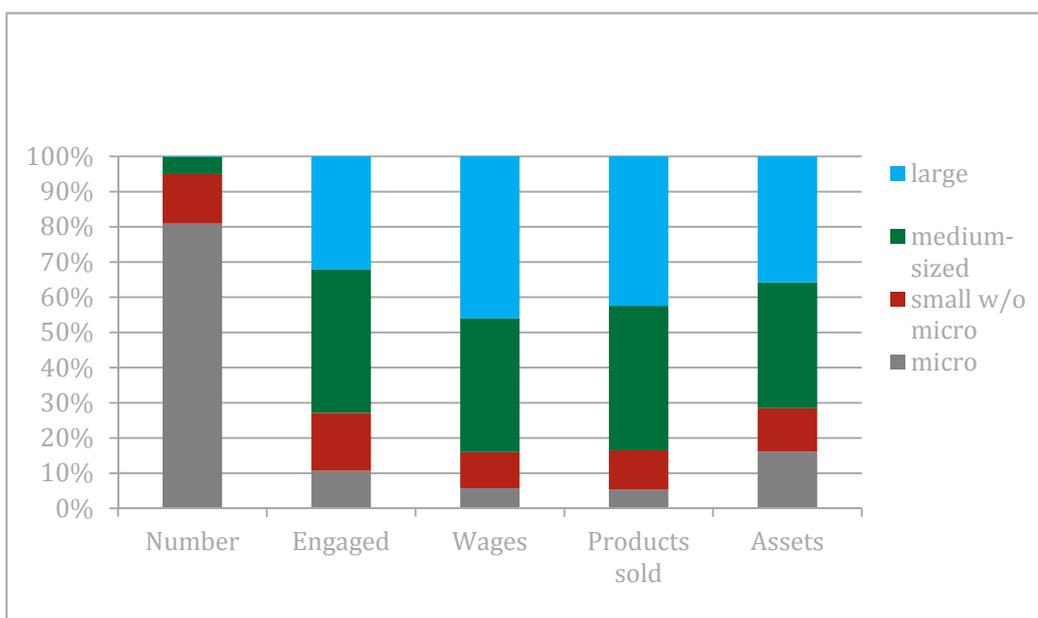


Figure 7. Labor productivity by entities size (products sold per 1 engaged person, UAH thousand)

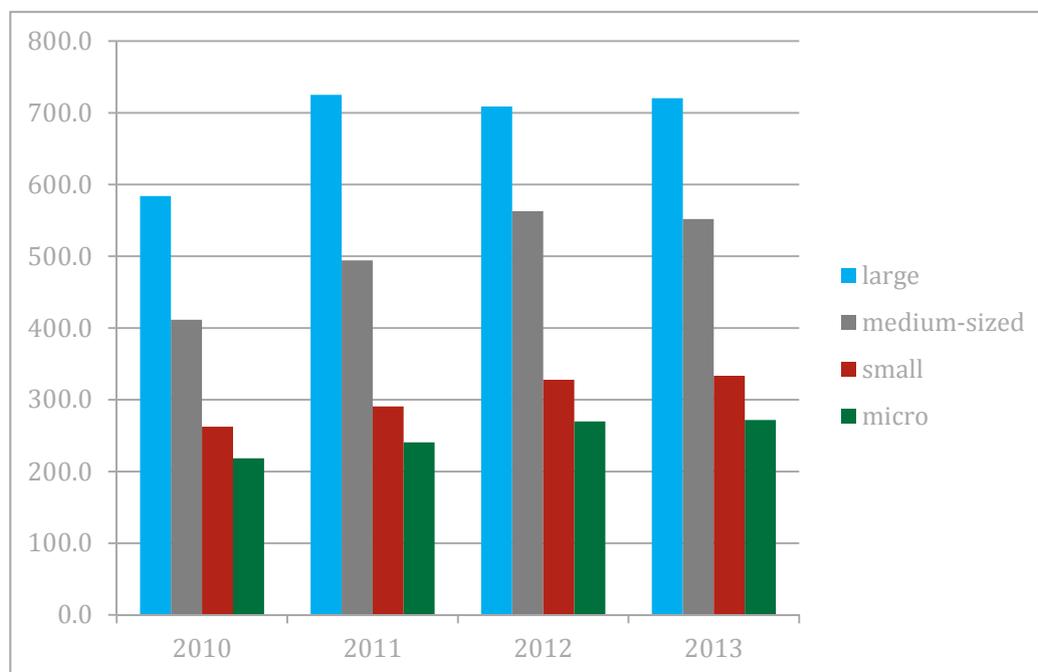


Figure 8. Shares of entities, 2013, (% of totals)

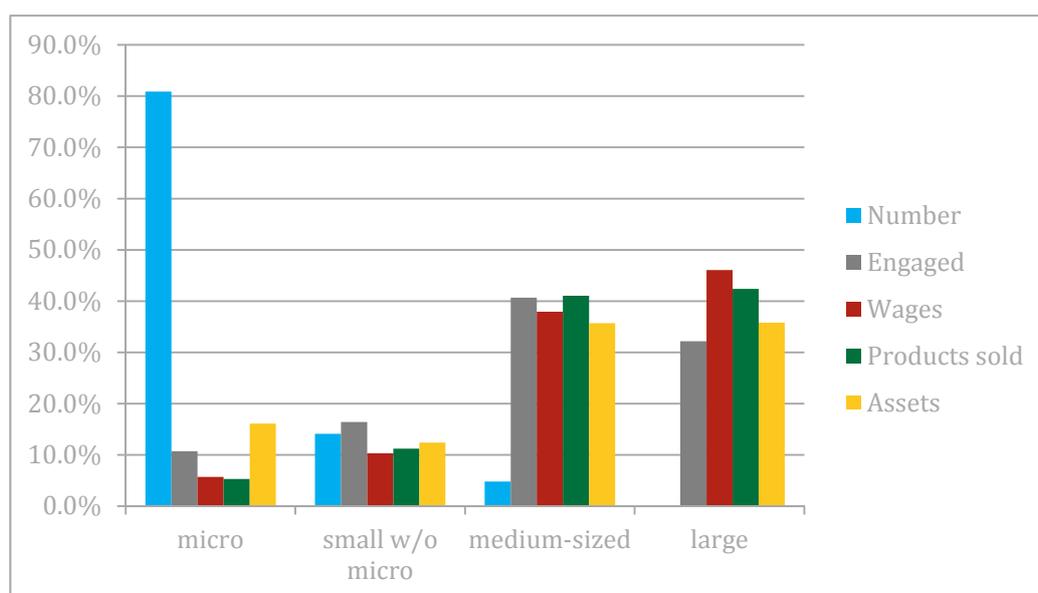


Figure 9. Number of entities distribution by size in main sectors of economy, 2013 (%)

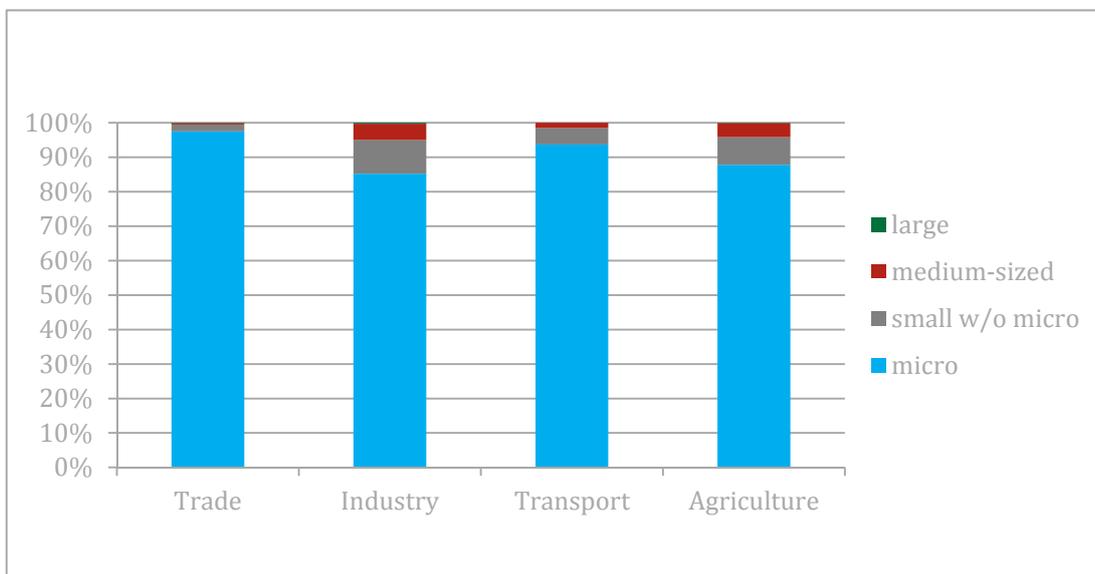


Figure 10. Engaged persons distribution by size of entities in main sectors of economy, 2013

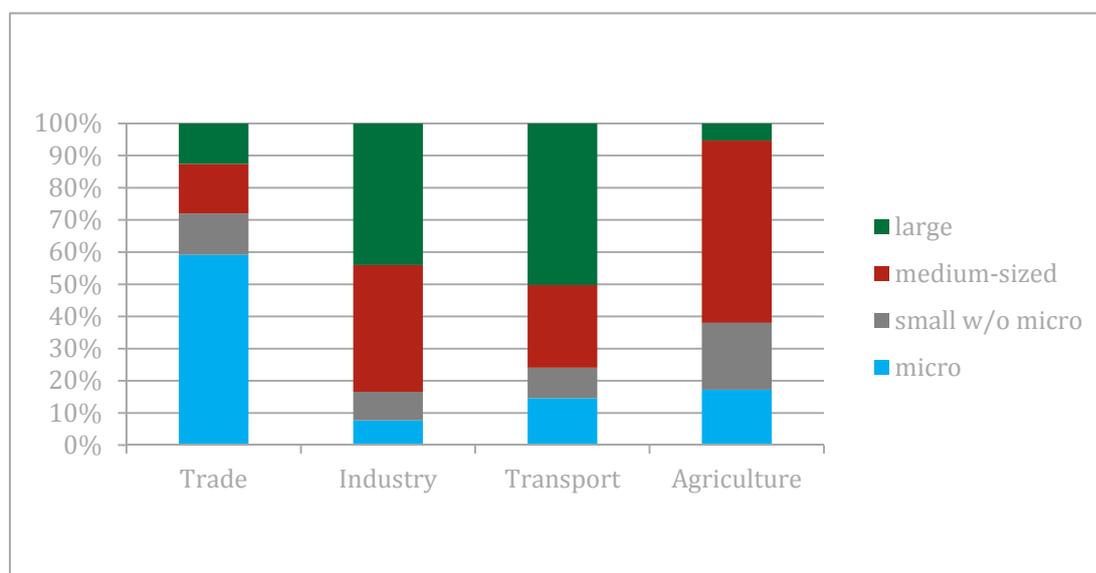


Figure 11. Products sold distribution by size of entities in main sectors of economy, 2013, (%)

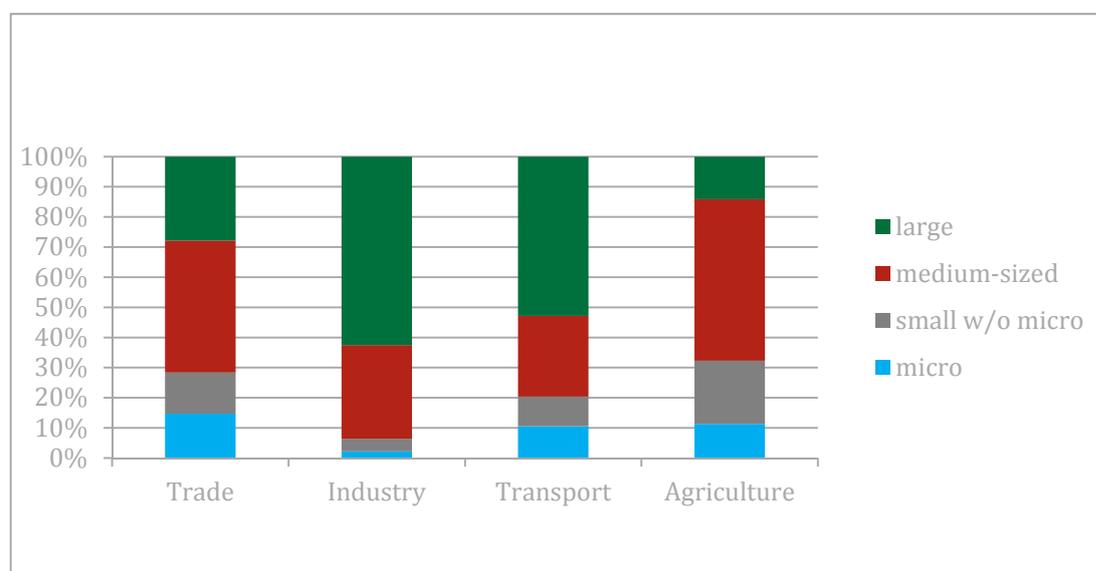


Figure 12. Asset distribution by size of entities in main sectors of economy, 2013,

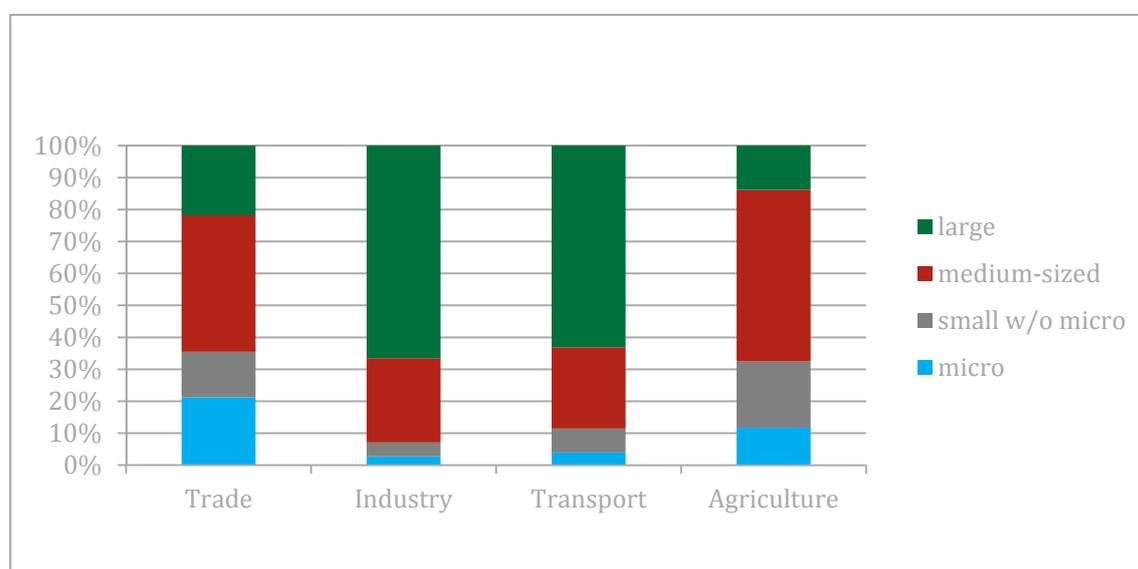


Figure 13. Sectoral structure of SMEs by number, 2013

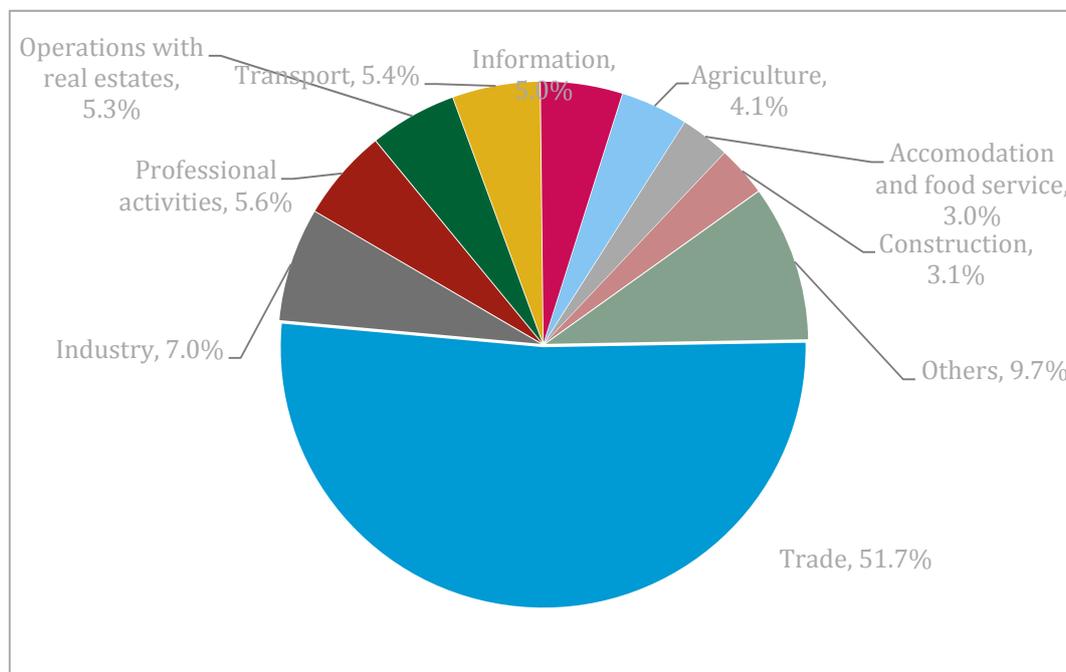


Figure 14. Sectoral structure of SMEs by number of persons engaged, 2013

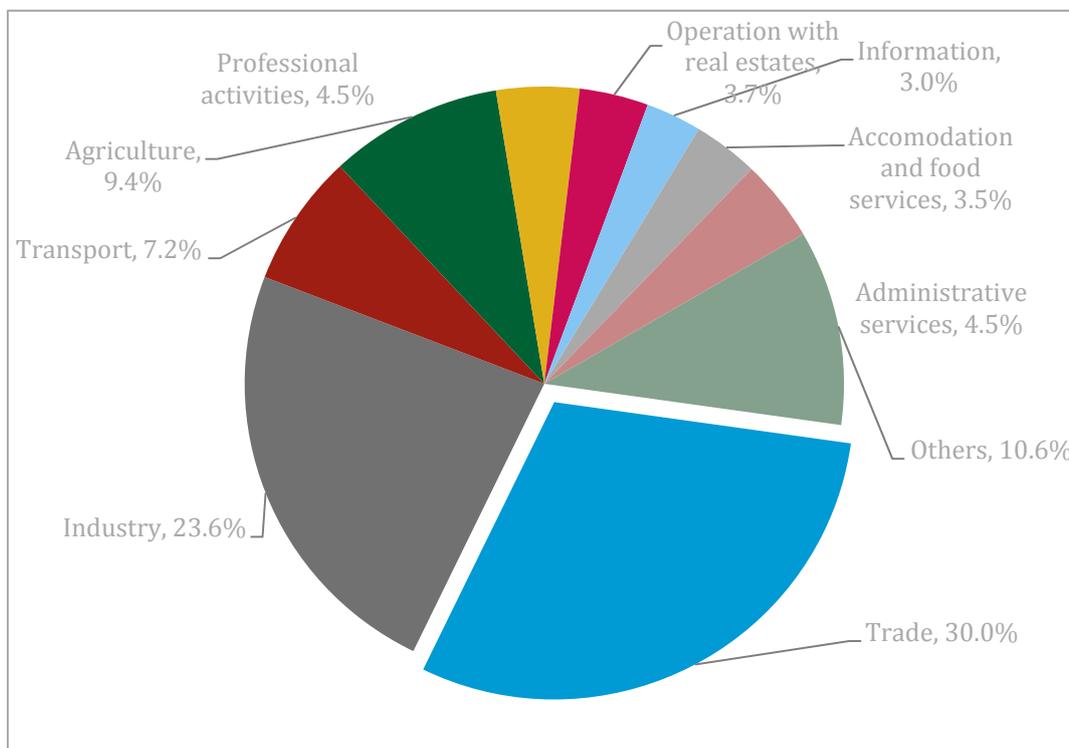


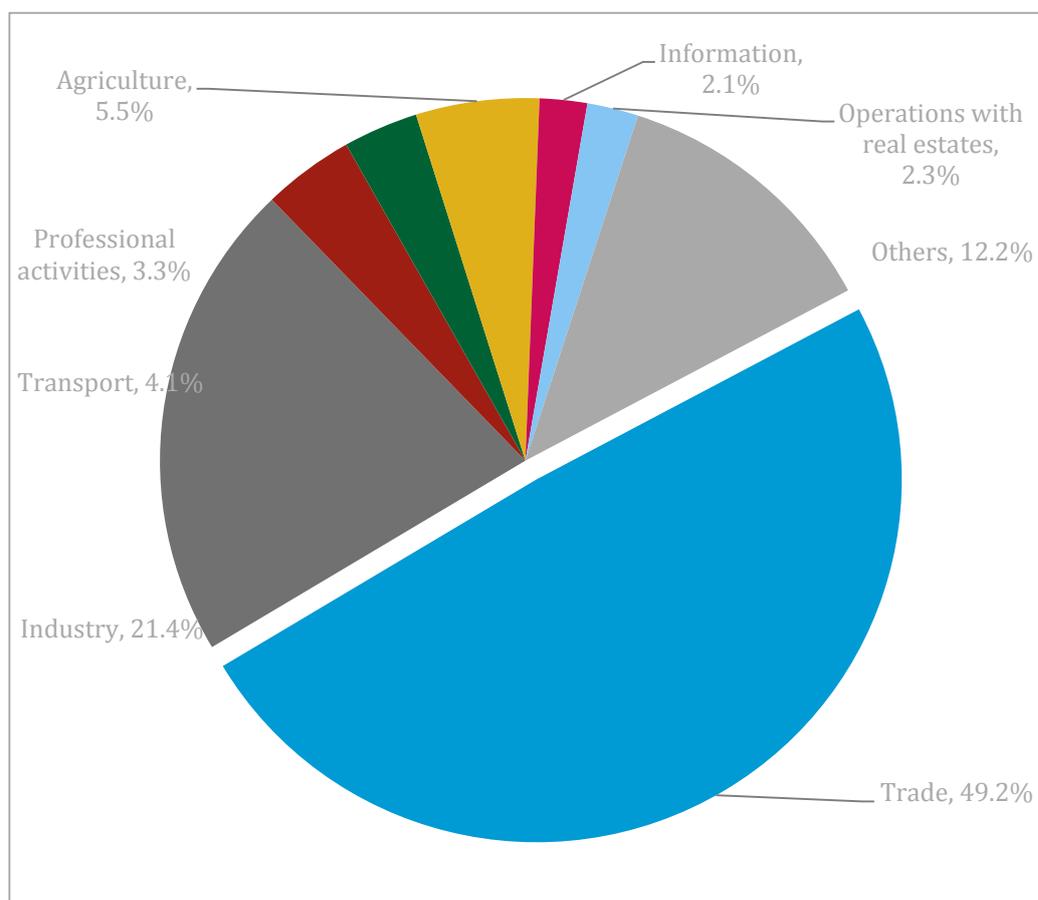
Figure 15. Sectoral structure of SMEs by products sold, 2013

Figure 16 Ukraine's ratings by Doing Business in 2010-2015

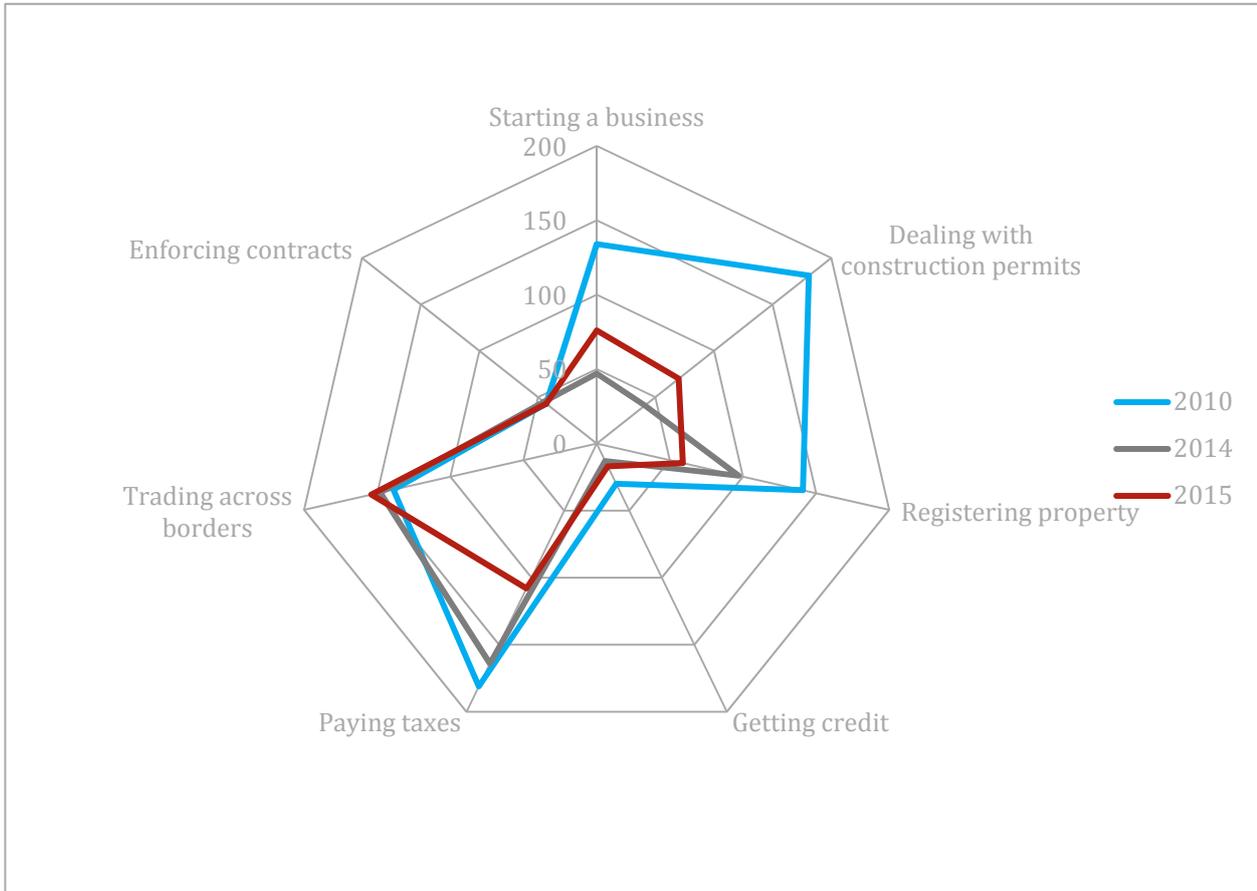
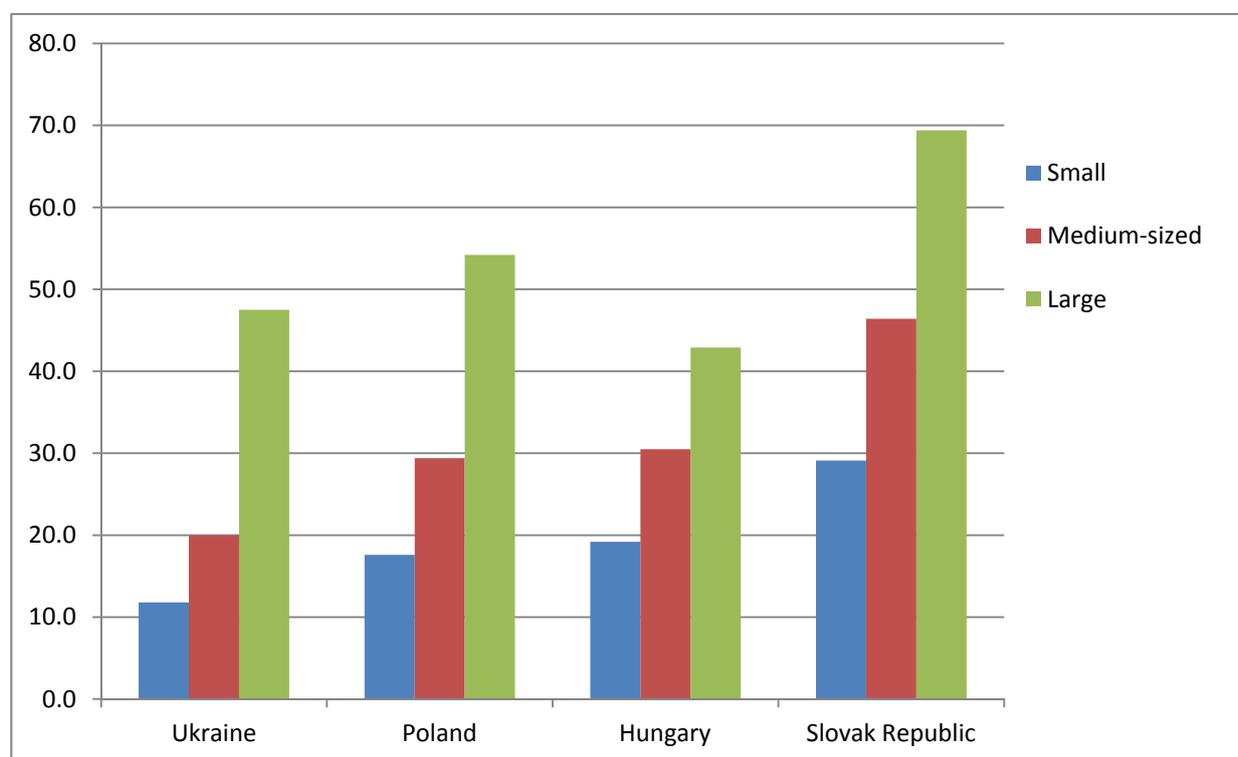
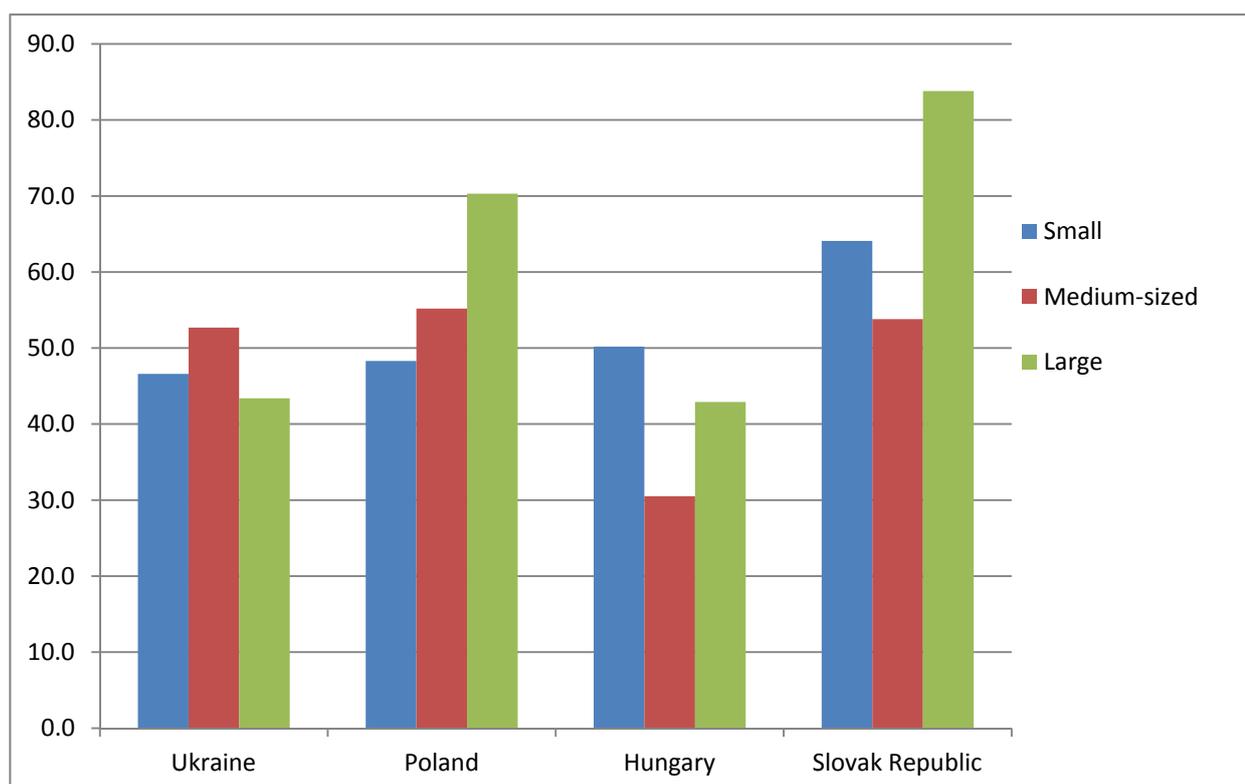


Figure 17. Share of exporting firms in 2013 (WB-IFC survey)**Figure 18. Share of manufacturing firms using inputs and supplies of foreign origin in 2013 (WB-IFC Survey)**



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