

## **Strategy for Small and Medium-sized Enterprise Development in Ukraine until 2020**

### **General Part**

The Small and Medium-sized Enterprise Sector (SME) contributes to creation of new jobs, growth of the Gross Domestic Product (GDP), and development of the competitiveness and innovative potential of the national economy.

The Strategy for Small and Medium-sized Enterprise Development in Ukraine until 2020, hereinafter referred to as the "**Strategy**", has been developed in fulfilment of Decree of the President of Ukraine #5 dated January 12, 2015 and the Government's Action Plan for the Year of 2017 as approved by Cabinet of Ministers Instruction #275 dated April 03, 2017.

The Strategy allows for the following authorities:

- Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part, as ratified by Law of Ukraine # 1678-VII dated September 16, 2014, hereinafter referred to as the "Association Agreement";
- Transport Strategy of Ukraine until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 2174 dated October 20, 2010;
- Basic Principles (Strategy) of the Ukrainian State Environmental Policy (the "Environmental Policy Strategy of Ukraine") until 2020 as approved by Law of Ukraine # 2818-VI dated December 21, 2010;
- Energy Strategy for Ukraine until 2030 as approved by Instruction of the Cabinet of Ministers of Ukraine # 1071 dated July 24, 2013;
- Strategy for the Agrarian Sector Development until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 806 dated October 17, 2013;
- National Strategy for Regional Development until 2020 as approved by Resolution of the Cabinet of Ministers of Ukraine # 385 dated August 06, 2014;
- Comprehensive Programme for Developing the Ukrainian Financial Sector until 2020 as approved by Resolution of the Central Bank Board # 391 dated June 18, 2015;
- Strategy for Developing the Technical Regulation System until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 844 dated August 19, 2015;
- Action Plan for Implementing Best Practices of Proper and Effective Regulation as Reflected by the World Bank Group in the Doing Business Ranking Methodology as approved by Instruction of the Cabinet of Ministers of Ukraine # 1406 dated December 16, 2015;
- Strategy for Overcoming Poverty as approved by Instruction of the Cabinet of Ministers of Ukraine # 161 dated March 16, 2016;
- Concept for Reforming the State System of Intellectual Property as approved by Instruction of the Cabinet of Ministers of Ukraine # 402 dated June 01, 2016;
- 2016-2017 Action Plan for Implementing the Strategy for Overcoming Poverty as approved by Instruction of the Cabinet of Ministers of Ukraine # 573 dated August 08, 2016;

- Action Plan for Deregulating Business Operations as approved by Instruction of the Cabinet of Ministers of Ukraine # 615 dated August 23, 2016;
- Concept of the State Targeted Programme for Resuming and Developing Peace in Eastern Regions of Ukraine as approved by Instruction of the Cabinet of Ministers of Ukraine # 892 dated August 31, 2016;
- Strategy for Reforming the Public Finance Management System for 2017 through 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 142 dated February 08, 2017.

The Strategy covers all key spheres of the social life and, accordingly, is reflected in major strategic and policy documents which affect small and medium-sized business development directly or indirectly (see Annex 1). Therefore, the Strategy enables the Government of Ukraine (GoU) to coordinate activities of other government authorities for the purpose of implementing well-balanced and comprehensive policies in the sphere of business development according to today's requirements.

In addition, by its Resolution # 1090-VII dated April 13, 2016, the Parliament of Ukraine has approved Recommendations of the Parliamentary hearing titled "Business Development in Ukraine and Support of Small and Medium-Sized Businesses". The Recommendations identify priority areas and selected measures of the government policy intended to stimulate entrepreneurship and, thus, to ensure the economic growth in Ukraine. *Inter alia*, they call for development of this Strategy.

The Strategy conforms to a number of policy and strategic documents, such as the High-Tech Development Strategy until 2025, Export Strategy of Ukraine: Road Map for Strategic Development of Trade for 2017 through 2021; Strategy for Industrial Complex Development until 2025; National Energy Strategy until 2035; Sustainable Development Goals for 2015 through 2030; Programme for Reforming the State Supervisory (Controls) System.

Signing of the Association Agreement, which incorporates the Deep and Comprehensive Free Trade Area Agreement (DCFTA), is a historically crucial step for Ukraine. It signifies the European choice of Ukraine with regard to democracy, rule of law, and human rights. By implementing the Association Agreement, Ukraine will modernise its economy, boost trade, and ensure compliance of economic regulations with the best European and international practices. It is essential for SMEs to adapt themselves to new conditions for operations.

The Cabinet of Ministers of Ukraine acknowledges dramatic challenges faced by the national economy and small and medium-sized businesses. It is committed to developing a robust and competitive SME sector in the future based on principles of the EU's Small Business Act and the EC/OECD's SME Policy index (see Annex 2).

Business development is one of priority tasks of the government policy, and the Strategy and Action Plan for Implementing the Strategy constitute its key elements.

Creating a proper enabling environment for business development is an integral part of such development. In order to achieve its strategic goals, Ukraine is constantly working on improving the regulatory environment (through deregulation).

In 2016, the Government approved an Action Plan for Deregulation of Business Activities (Instruction of the Cabinet of Ministers of Ukraine of 23.08.2016 # 615). Implementation of the Action Plan will enable Ukraine to solve the urgent problems in the areas of

administrative services, public supervision, information technologies(IT), agriculture, food, construction, transport, customs, currency and tax regulation.

Besides, the Government undertakes a systematic review of regulatory documents aimed at improving the effectiveness of regulations. This review will result in the abolition of inefficient and unnecessary regulations and amending them in accordance with international best practices. Currently, the following key areas are covered: agriculture and food safety; construction; energy; transport and infrastructure; IT and telecommunications.

Activities aimed at raising Ukraine's position in the World Bank's "Doing Business" rating are being carried out under the Action Plan on implementing best practices related to efficient and effective regulations, as presented by the World Bank Group, "Doing Business" rating methodology (Cabinet of Ministers Instruction #1406 dated December 16, 2015). The goal is to ensure that Ukraine is in Top 20.

This Strategy aims at creating a solid foundation to ensure gradual growth of SMEs with allowance for temporary limited financial support and significant challenges faced by the country.

The Strategy may be implemented by means of:

- Well-coordinated efforts of government agencies, local governments, and other stakeholders;
- Systematic approach to development and implementation of government policies in the field of entrepreneurship development;
- Definition of anticipated results of the Strategy implementation;
- Implementation of the Action Plan for implementing the Strategy;
- Effective cooperation of government agencies, local governments, SMEs and their associations;
- Mobilisation of all available resources.

### **Analysis of the Current Status of SME Development**

In Ukraine, SMEs have been operating in difficult social and economic development conditions for a long time. In 2014, Ukraine entered economic crisis (for the third time in the history of its independence) caused by a geopolitical conflict (pertaining to the temporarily occupied territory of Ukraine as a result of the military aggression of the Russian Federation and the antiterrorist operation), which resulted in destroyed production facilities and transport infrastructure, lost inter-industry and logistics ties, complicated international relations, unavailability of energy resources (coal), a significant increase in investment risks, and negative expectations of the population. Besides, accumulated systemic imbalances had a significant adverse impact, which brought about the national currency depreciation and inflation processes.

After a sharp decrease in GDP in 2014 and 2015 (6.6% and 9.8%, respectively), with an increase of the CPI (24.9% and 43.3%), the economy showed signs of recovery and strengthening of positive trends during 2016 (2.3% in 2016) according to the State Statistics Service of Ukraine (hereinafter referred to as the "State Statistics Service"). Thus, in the year of 2016, capital investments were increased by 18%, FDI (share capital) in the economy since the beginning of the investment went up by 4.2% as of 31 December 2016 YoY, CPI growth slowed down and amounted to 12.4% in 2016. Today, the Ukrainian national economy is the economy of a country which is actually at war and has irrational economic relationships

caused by temporary territorial losses, imposition of various economic sanctions and political limitations that continue exerting a negative impact on the country's economic development. For instance, the unemployment rate was increased significantly and remains high (9.3% of population aged between 15-70 on average in 2016) while exports of goods and services continued to decline, the reduction amounted to four percent in 2016 YoY (based on the payment balance methodology).

SMEs play an important role in Ukraine's economy in terms of the number, employment and sales (of goods and services).

The Law of Ukraine "On Development and State Support of Small and Medium-Sized Businesses" defines legal and economic principles of the state policy on SMEs support and development. In addition, this Law amended the Commercial Code of Ukraine, according to which businesses are divided into micro, small, medium and large businesses based on the number of employees and annual income from all business operations. These definitions partially comply with the legislation of the European Union (hereinafter, EU), in particular, Regulation EC 70/2001, in the part pertaining to the criteria of number of employees and annual income from any activity, but it does not include the third criterion, the balance sheet. Given a significant depreciation of the national currency, SMEs distribution based on the above-mentioned criteria has changed.

At the same time, the Law of Ukraine on State Support to Business Entities sets forth criteria which conform to the Commercial Code of Ukraine (Part 3 of Article 55).

While carrying out business operations, companies in Ukraine may apply a simplified (streamlined) system of taxation, accounting, and reporting. The simplified system of taxation (SST) was introduced in 1998 in order to stimulate small business development and reduce the magnitude of grey employment.

Pursuant to the Tax Code of Ukraine, legal entities or self-employed individuals (so-called "FOPs") may pay a single tax (instead of a number of taxes and duties) and use streamlined accounting and reporting procedures. This is an important issue for small companies taking into account the fact that the tax administration is often perceived to be a major impediment to business development. Such companies are to pay the Personal Income Tax and the Single Social Contribution (SSC) for their employees. Employees pay SSC at the rate of 22% of the minimum wage (the minimum wage is UAH 3,200 effective 01 January 2017). Nowadays, there are four groups of SST taxpayers.

The latest statistics (Annex 3) show that there were 423 large enterprises in Ukraine (or 0.02% of the total number of companies) in 2015. The rest are SMEs, including 15,510 medium-sized enterprises and 1.96 million small business (327,814 small businesses and 1.6 million self-employed individuals (FOP)). A significant depreciation of the national currency (hryvnia) in 2014-2015 meant that some businesses that were usually perceived as large, had income below EUR 50 million. That is why, they were counted as medium-sized businesses in the statistics.

In 2015, the number of large and medium-sized enterprises decreased by 15% and 7%, respectively, as compared to 2014 (Annex 3). This may lead to a transfer of small and medium-sized businesses to other groups because of a low demand and liquidity problems. Over 2,000 businesses were declared bankrupt and entered the liquidation process in 2014 and 2015 (the database of the High Commercial Court of Ukraine). At the same time, the number of micro enterprises grew, and new businesses were set up (or resumed operations) by people that lost jobs or moved out of the anti-terrorist operation area. The value of SME products

(goods and services) was increased by 28.9% in 2015 due to an increase in consumer prices and accounted for 63.0% of the total sales. Overall, the number of SMEs was growing in the years of 2014 and 2015.

Downscaling of some large companies and relatively higher resilience of SMEs under crisis conditions led to an increase of the percentage of SMEs in Ukraine (Annex 4). In 2015, SME sector in Ukraine accounted for 79.1% of employees and 59% of the added value which is higher than in neighbouring Poland and Germany.

On the whole, medium-sized companies are larger than those in the EU and generate greater percentages of the added value (39.1%) and employment (32.2%). Micro enterprises are quite numerous but not very productive as they account for 35.2% of the employees and 8.9% of added value. Micro enterprises in both EU and Ukraine are characterized by low productivity (29.2% and 21.1%, respectively).

In 2015, SMEs generated 59% of the total added value of business entities (Annex 5). A substantial share of it was generated by SMEs operating in trade and industry, with a significant contribution from agricultural companies and those providing miscellaneous services. The micro businesses focused on providing services where little investment is needed for production: 32.1% of the value added by micro enterprises was in trade. This may reflect the low barriers to entry business, sufficient profit margins and opportunities for tax optimisation. Medium-sized companies supply predominantly services but 30.3% of value added is generated in industry. The share of agriculture in value added is significant for small enterprises 20.5% (excluding micro companies). This is explained by the trade-off between higher productivity gains and additional spending on dealing with many land leases in numerous locations.

In the service sector, there are more SMEs than large companies. Out of 423 large enterprises, 400 operate in agriculture, industry, trade or transport, 11 companies operate in the construction and IT and telecommunication sectors, and the rest operate in other spheres. Besides that, there are SMEs for which it is difficult to transfer to a higher category (for example, for micro business to become a small business). Overall, this means that Ukrainian SMEs are diverse, and development of the SME sector requires differentiated policy responses and instruments of implementation.

The reasons for starting a business in Ukraine vary. According to international surveys (Amway Global Entrepreneurship Report, 2016), over 34% indicated that it is an additional income, 21% - self-realization, 16% - a possibility to be independent of the employer, 14% - an alternative to unemployment. Thus, reasons for starting SMEs range from ensuring decent living standards to implementing own ideas.

SME operations indicators by regions shows variations in the number of SMEs per 10,000 residents and number of employees (Annex 6). The largest number of self-employed individuals are in Kharkiv oblast (537 per 10,000 residents and 8.7% of the total number of the self-employed). Most urbanized regions report higher numbers of SMEs, whereas the central part of Ukraine is characterized by lower figures because of its proximity to Kyiv. The percentage of self-employed individuals in the employment structure reflects in the first place the location of large enterprises. Many such businesses are located in the abovementioned regions.

Traditionally, Ukraine's national economy is characterized by an unfavourable enabling environment for businesses which poses obstacles to the private sector development. The evidence from surveys and international rankings, such as the World Bank's Doing Business

(WB DB) and the Global Competitiveness, suggest that Ukraine's enabling environment for businesses is not as good as its regional peers and similar economies. However, there is also evidence that the situation has been improving rapidly in the recent years. For example, the country's WB DB Rank in 2017 was 152<sup>nd</sup> in 2012, but has significantly improved by 2017 to 80<sup>th</sup>. Such pattern demonstrates that Ukraine has a significant potential and is implementing reforms intensively; however, the enabling environment for businesses needs to be improved. However, Ukraine's position is 85 among 138 countries in the Global Competitiveness Index 2016-2017 ranking, published by the World Economic Forum. Ukraine's ranks on "business compliance with modern requirements" and "innovation" are 98<sup>th</sup> and 52<sup>nd</sup>, respectively.

Comparison of Ukraine's "Doing Business – 2017" rating with those of European and Central Asian economies shows that all countries in the said group (Poland, Kazakhstan, Belarus, Russian Federation, Moldova, Kyrgyzstan) are ahead of Ukraine with Poland leading the group (24<sup>th</sup>). Main topics of Doing Business 2017 show that the worst issue is resolving insolvency (150<sup>th</sup>). However, there are also good results such as getting credit rank (20<sup>th</sup>) due to availability of international lending and financing from various international financial organizations. As for other rating components, Ukraine holds the following places: property registration – 63<sup>rd</sup>, protection of investors – 70<sup>th</sup>, enforcement of contract fulfilment – 81<sup>st</sup>, taxation – 84<sup>th</sup>, international trade – 115<sup>th</sup>, connection to grids – 130<sup>th</sup>, obtaining construction permits – 140<sup>th</sup>.

Corruption is a serious problem hindering development of a favourable business environment. It is widely regarded as one of the key reasons for the stunted growth of private sector, the low diversification of economy and exports and the low productivity levels. The Corruption Perceptions Index 2016 ranks Ukraine 131<sup>st</sup> out of 176 countries. In Ukraine, SMEs encounter corruption regularly in business licensing, taxation, inspections, customs, etc. The BEEPS V 2014 survey respondents mention access to finance (21.3%), corruption (19.2%), tax rates (15.5%), political instability (11.9%) and grey economy (7.7%) as their top five constraints for doing business (EBRD, 2014). In 2012-13 the informal payments reported by firms to secure government contracts increased from 3.8% in 2009 to 14.2% of the contract value according to the same survey. Almost 100% of firms declared making informal payments to secure a public contract. The slow growth of the private sector is among key reasons for the poor economic performance. Evidence of this structural problem includes low growth rate/productivity; low inflows of FDI, particularly in export-oriented manufacturing, high energy intensity.

The SME Economic Policy Index (SME PI, Eastern Partnership Countries, 2016) assesses the progress of the state SME policies in all six Eastern Partnership (EaP) countries towards attainment of the ten principles of the Small Business Act for Europe (SBA). The SME PI 2016 shows that SME development progress in Ukraine has been modest.

There are two key points to note in relation to assessment of SME policy under 2016 SME Economic Policy Index. Firstly, Ukraine hovers around the score of 2, which is far below the good practice threshold (5). Secondly, even comparing with the regional average, Ukraine is performing poorly whereas Georgia is the star performer in the region, followed by Armenia.

The SME PI provides sound recommendations for the development and implementation of the SME Strategy in Ukraine. SME development has a major role to play in enhancing economic competitiveness, restoring sustainable growth and levelling the playing field for business and investment in the country. In order to diversify the country's sources of economic growth, SME policies should be enhanced.

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Most provisions of the Association Agreement entered into force in November 2014, and those on the Deep and Comprehensive Free Trade Area (DCFTA, Title IV of the Association Agreement) entered into force in January 2016. The Association Agreement envisages profound trade liberalization and large-scale adaptation of the legislation. This will facilitate further economic integration in the EU common market once the transitional period is over. The Association Agreements stipulates the rule of law as one of most essential elements, thus obliging Ukraine to conduct broad judicial and law enforcement reforms and intensify fighting with corruption.

For the SME sector, the DCFTA creates new opportunities at both domestic and external markets. In foreign trade, the DCFTA establishes a duty-free market access to the largest market and envisages a reduction of non-tariff barriers to trade. Currently, SMEs play a relatively limited role in Ukraine's foreign trade. According to the State Statistics Service, only 5.9% of all SMEs export goods and services. As SMEs are involved in value chains of larger exporters, they receive certain benefits from trade liberalization. Moreover, trade liberalization improves an access to capital and raw materials which is very beneficial to SMEs as they, unlike large companies, have a small chance to negotiate discounts directly with producers.

At the national level, the DCFTA fosters also development of a better enabling environment for businesses. Harmonization of the Ukrainian legislation in the sphere of competition and institutional structure with EU standards and practices should facilitate de-monopolization of the economy and stimulate the SME sector development. Better protection of intellectual property rights (IPR) will stimulate innovation and faster economic development. An increase in transparency and predictability in the trade policy is also beneficial to the SME sector as it requires access to information most of all.

According to the Association Agreement, the parties will establish a close cooperation in improving the enabling environment for businesses, specifically, small and medium-sized businesses (Article 378) with allowance for principles of the European Charter for Small Enterprises, which was signed on June 19, 2000. Adoption of the Strategy will become a critical step in this direction.

The system of technical regulation of industrial produce in Ukraine must conform to the EU system. This means that Ukraine needs to harmonize relevant national laws and regulation with the EU Acquis, adopt mandatory technical regulations for selected product categories, and maintain the regulatory alignment by transposing all changes in the respective EU legislation. Ukraine has already launched the process of harmonization. Basic general safety requirements to products are harmonized with the EU standards, and most technical regulations are either identical to or based on the relevant EU regulations.

The situation with food safety remains complicated. Ukraine needs to develop a domestic food safety system which would be harmonized with that of the EU. The Comprehensive Strategy for implementing Chapter IV (Sanitary and Phytosanitary Measures) of Title IV "Trade and Trade-Related Matters" of the Association Agreement, which was approved by Instruction of the Cabinet of Ministers of Ukraine # 228 dated February 24, 2016, foresees implementation over 250 EU standards. Today, there is a national procedure for EU control in

place which enables Ukrainian companies to export animal products. However, most farms and agriculture companies producing and marketing food products operate at the domestic market. Most of them have not brought their operations in compliance with food safety requirements. Procedures for implementing new standards in line with EU requirements can pose major challenges for SMEs operating at the domestic market. At the same time, the EU Acquis foresees that small producers supplying produce to local markets or producing traditional regional specialties might be subject to less stringent food safety requirements. Therefore, it is imperative to create proper conditions so that small and medium-sized businesses could obtain such privileges.

Costs of implementing environmental standards impose an extra burden on businesses. Transition to new production standards aligned with international practices is a time-consuming process (taking 10+ years on average).

The DCFTA sets clear requirements to operations of all business entities. They are less stringent than those existing in Ukraine. Therefore, SMEs complying with these requirements will benefit from this process. However, Ukraine's business environment is characterized by low compliance. The DCFTA will present an additional challenge for SMEs in the short-run by forcing them to follow the rules. It could be the case in Intellectual Property Rights infringement, which has been widespread in Ukraine, labour safety regulations, and other spheres.

Efficient and effective implementation of this SME Strategy and associated Action Plan depends on proper coordination of key stakeholders' efforts. Today, the SME institutional framework consists of:

- Cabinet of Ministers of Ukraine as the highest authority in the executive branch of power which is responsible for implementation of government policies and has the right of legislative initiative including that with regard to SME development;
- Ministry of Economic Development and Trade: According to Paragraph 1 of the Regulation on the Ministry approved by Instruction of the Cabinet of Ministers # 459 dated 20 August 2014, MoEDT is a central executive authority responsible for formulating and implementing policies in the sphere of entrepreneurship. Currently, state budget funds allocated for support of SME development are insufficient. Therefore, there is a need to enhance approaches to policy development and implementation, inter alia, by means of developing institutional capacities;
- Entrepreneurship Council under umbrella of the Cabinet of Ministers of Ukraine as a standing advisory body which, among other functions, drafts proposals on creating legal, economic and organisational conditions for further business development of the business activities;
- Other central executive authorities which influence SME development directly or indirectly within their powers, such as the Ministry of Finance; Ministry of Education and Science; Ministry of Social Policy; Ministry of Regional Development, Construction, and Utility Sector; Ministry of Justice; Ministry of Foreign Affairs; Ministry of Energy and Coal Mining Industry; Ministry of Infrastructure; Ministry of Information Policy; Ministry of the Youth and Sports, Ministry of Agrarian Policy and Food; Ministry of Ecology and Natural Resources; Ministry of Temporarily Occupied Territories; State Statistical Service; State E-Government Agency, State Regulatory Service;
- Local executive authorities which ensure implementation of national and regional socio-economic development programmes, including (in case of making a relevant

decision) SME development programmes that are funded from relevant budgets or other sources not prohibited by law;

- Local governments which approve programs of socio-economic development of relevant administrative territorial-and-administrative units that are funded from local budgets or other sources not prohibited by law and monitor implementation of such programmes;
- Business Ombudsman Council as a standing advisory body of the Cabinet of Ministers of Ukraine which promotes transparency of governmental authorities, business and economic entities under governmental control and prevents corruption and/or other violations of the business entities' interests;
- SME support infrastructure: This includes business associations; research institutions; consulting and advisory bodies and other support agencies established under umbrella of central executive authorities and local state administrations; Ukrainian Chamber of Commerce and Industry; 25 Regional Chambers of Commerce and Industry; associations of entrepreneurs and employers, etc. It is impossible to provide exact statistics on SME infrastructure because the criteria of affiliation with an organization involved in SME development and support are unclear. As of 01 January 2016, there were 310 business centres, 2,660 business development service/consultancy providers, 55 business incubators, 161 entrepreneurship support funds, 17 industrial parks;
- Framework legislation, specifically:
  - Law of Ukraine on Development and State Support of Small and Medium Entrepreneurship in Ukraine which lays a foundation for SME development and defines principles and areas of policies with respect to small and medium-sized businesses;
  - Concept of the National Programme for Small and Medium-size Entrepreneurship Development for 2014 through 2024 approved by Instruction the Cabinet of Ministers of Ukraine # 641 dated 28 August 2013. The Programme was never developed and will be replaced by the Strategy and associated Action Plan;
  - National Programme for SME Development in Ukraine approved by Law of Ukraine # 2157-III dated 21 December 2000. No budget funding has been allocated to this programme since the year of 2014;
  - Recommendations of Parliamentary Hearings, approved by the Parliament of Ukraine on 13 April 2016 under # 1090-VIII which identify priority areas and actions with regard to implementing government policies aimed at promoting entrepreneurship initiatives for the purpose of economic growth in Ukraine;
  - Other laws and regulations in the sphere of entrepreneurship.

### **Problems that Need to Be Solved**

Listed below are problems in the SME sector which have been identified based on data of a profound analysis of the status and trends of SME development including an analysis of the external and internal environment of SMEs (see Annex 7):

- Lack of established and effective coordination of stakeholders (central and local executive authorities, local governments, business associations (NGOs), international organisations, and international technical assistance projects that are being implemented in Ukraine;
- Poorly coordinated government policies in the sphere of business development;
- Unstable and unpredictable regulatory environment for SMEs;

- Lack of interaction between central and local executive authorities and local governments with regard to solving current problems faced by small and medium-sized businesses;
- Insufficient institutional capacity for implementation of government policies in the sphere of entrepreneurship development;
- Small Foreign Direct Investment (FDI) and limited investments in export-oriented entities;
- Limited budget funding as a result of the economic recession in 2014 and 2015 (limited government support of certain areas of the government policy, specifically, small and medium-sized business development);
- Limited SME access to resources (financial, property, natural, etc.);
- large grey economy (some 20% of the employed population as estimated by EIB);
- Insufficient protection of property rights, insufficient judicial independence, ineffective spending of State budget;
- Inadequacy of the existing SME support infrastructure with regard to the needs of SMEs and the quantity and quality of services available at the regional level.

In so doing, the following considerations should be taken into regard:

- Decentralisation provides broader opportunities to local governments. This should facilitate business development;
- Ukraine is characterised by low quality of institutions as compared to other countries. This is caused by imperfection of the legislation in the sphere of ownership protection, insufficient independency of the judicial system, and improper spending of budget funds;
- The Association Agreement, DCFTA, and new markets offer significant new opportunities, in particular for export operations;
- Despite having the educated workforce, Ukraine features the lowest productivity in Europe and Central Asia;
- Ukrainian economy is characterized by high level of monopolisation.

### **Objective and Timeframe for Implementing the Strategy**

The Strategy is intended to facilitate business development in Ukraine, create favourable conditions for opening and running SMEs, and expand the SME sector by consolidation of all stakeholders' efforts to ensure socio-economic development of the country and raise standards of life.

The Strategy is expected to be implemented by the year of 2020.

### **Ways and Means to Solve Problems**

The Strategy will be implemented in those strategic directions which are based on the accomplished analysis of the sphere of business development in Ukraine with allowance for international practices and, indirectly, take into account principles defined in the Small Business Act (SBA) and SME Economic Policy Index recommendations. These are:

- Direction 1: Creating a favourable environment for SME development;
- Direction 2: Improving an access to finance for SME;
- Direction 3: Simplifying Tax Administration for SME;

Direction 4: Promoting Entrepreneurial Culture and Developing Entrepreneurial Skills;

Direction 5: Promoting SME Export / Internationalisation;

Direction 6: Improving competitiveness and developing the innovation potential of SMEs.

### **Direction 1: Creating a Favourable Environment for SME Development**

The first strategic direction focuses on legislation, information, strategic and policy documents, institutional environment, stakeholders' cooperation, public-private dialogue. In addition, it covers important issues to be resolved in such areas as developing a proper enabling environment, assessing impact of changes in the legislation on business operations, establishing streamlined procedures for registering and liquidating businesses and obtaining licenses and permits, expanding SME access to public procurements.

Direction 1 envisages the following measures:

#### *Improving Information Provision Including Enhancement of the State Statistics System*

Today, too little information on the status and development of small and medium-sized businesses is being collected and made available. Availability of statistical indicators and careful analysis of statistics are essential to formulate a coherent government policy in the sphere of business development.

The State Statistics Service of Ukraine is the only official and free source of up-to-date statistics on SME development. Most statistics concern legal entities, while there is much less information on self-employed individuals. The State Statistics Service should accumulate and make available more information on self-employed individuals as well as additional data on business demography, data on SME export operations.

Statistics on the SME sector is available also from the State Fiscal Service. It can be obtained at an official request (statistics on number of taxpayers among legal entities and individual entrepreneurs, income from entities using SST, etc.). Such indicators should be published grouped by SME types according to the legislation. Moreover, there are discrepancies between the SFS data and the Joint State register of legal entities, individual entrepreneurs and NGOs.

The National Bank of Ukraine (NBU) will release data on bank loans to SMEs (loan volume and conditions for SMEs, etc.).

It is envisaged to develop a publicly accessible unified system of indicators for the purpose of keeping track of the development of and general situation with small and medium-sized businesses with involvement of central and local executive authorities (State Statistics Service, MoEDT, NBU, SFS, etc.). There is a need to extend the list of indicators in the annual report on SME development SBA Factsheets so that benchmarking with other countries and EU could be made. There is also a need for developing a unified web portal where the information and statistics will be posted in order to satisfy users' needs.

#### *Following the Think Small First Principle*

In the process of drafting regulations, government authorities perform a Regulatory Impact Assessment (RIA, costs and benefits) according to the methodology for Making the Regulatory Impact Assessment (Resolution of the Cabinet of Ministers of Ukraine # 308 dated March 11, 2004), which is one of the major instruments of the State Regulatory Policy. In order to improve the quality of RIA, in 2015, pursuant to Regulation of Cabinet of

Ministers of Ukraine #1151 dated December 12, 2015 “On Changes to Cabinet of Ministers Regulation # 308 dated March 11, 2004” a mandatory tool for regulatory bodies, which evaluates SME costs, was introduced (the M-test), which is an important part of the process of implementing the “Think Small First” principle.

Overall, the RIA-test is similar to the SME-test in the EU and evaluates the costs SMEs incur for ensuring compliance with regulations. The RIA methodology needs to be improved and applied effectively. This will involve development of capacities of civil servants to use these tools and consultations with SMEs at the regional level.

Other aspects of Think Small First should be considered for introduction in the future, such as the declarative principle / silence is consent, etc., as well as the introduction of non-regulatory measures.

#### *Simplifying Procedure of Registering New Businesses*

The registration procedure has been greatly simplified since 2012. Today, it takes little time (Law of Ukraine “On State Registration of Legal Entities, Individual Entrepreneurs and Non-Governmental Organisations”). These changes are reflected the Doing Business ranking, where the indicator of Starting Business improved by from the 112<sup>th</sup> position in 2012 to the 20<sup>th</sup> position in 2016. After legislative amendments in 2015, the company registration can be completed usually within 24 hours but can also take two or three days. Now, local executive authorities and local governments and notaries have the right to register companies, and, effective April 2016, the principle of “silent consent” was applied to the registration of a company as a taxpayer. A company may start operations once the financial institution has sent the information on opened accounts to the State Fiscal Service (SFS).

There is still a need in business support centres which would help novices with registration and reporting and also support businesses throughout their lifespan, for instance, through hot lines.

#### *Simplifying Procedure for Liquidating Businesses*

Business liquidation/termination procedure for legal entities is not simplified and remains time consuming. Theoretically, the process takes several months but may last much longer in reality. The simplified procedure applies to self-employed individuals (an individual should apply for liquidating the registered entity). It is envisaged that the business liquidation procedure will be simplified, thus saving time and costs.

#### *Providing Services of SMEs through One-Stop-Shops and Common State Portal for Administrative Services*

Development of administrative services in general and for SMEs in particular focuses on establishing Centres for Administrative Services (CASs), ensuring proper regulation of their operations, and making sure that central and local executive authorities and local governments provide administrative services through the network of CASs. Currently, 701 one-stop-shops are set up in Ukraine.

They provide SMEs with more than 50 administrative services, including registering businesses and property (recording changes in the appropriate registers) and obtaining required permits and licenses.

To ensure provision of e-services, a test version of the Unified State Portal for Administrative Services is operated. Beginning March 2016, 12 MoEDT services in the sphere of foreign economic activities (registration of export contracts, issuing import/export licences for goods) are automated, and four services of the State Architecture and Construction Inspections (related to beginning of carrying out preparatory and construction works) are incorporated into the portal.

Further activities will focus on:

- Extending the network of the centres (specifically, to united territorial communities), creating remote workstations for centres administrators;
- Securing financial support to centres;
- Decentralising powers with regard to provision of most popular administrative services and expanding powers of local governments;
- Modernizing and expanding functionality of the Unified State Portal for Administrative Services and expanding the list of administrative services which are provided electronically.

### *Streamlining Bankruptcy Procedure and Promoting the "Second Chance"*

The revised bankruptcy legislation (Law of Ukraine “On Restoring Debtor Solvency or Declaring a Debtor Bankrupt”) broadly complies with international good practice. For example, founders (participants, shareholders) or other persons including the director of an insolvent company can bear the subsidiary responsibility and be sued if responsible for bankruptcy (and also if the debtor's assets are insufficient). At the same time, the procedure remains inefficient, which is reflected in the 148<sup>th</sup> position of Ukraine out of 190 countries (according to the indicator of Resolving insolvency in the WB DB 2016). The bankruptcy procedure is too expensive, time-consuming, complicated and delivers a low recovery rate to investors. The bankruptcy procedure typically means the liquidation (instead of restoring solvency) of the company. Thus, there is a need to increase efficiency of the procedure.

Establishment of special bankruptcy procedures for SMEs is envisaged by Item 24 of the Action Plan for Implementing Good Practices in Effective Regulations reflected in the WB Doing Business methodology which was approved by Instruction of Cabinet of Ministers of Ukraine #1406 dated 16.12.2015. It is necessary to undertake a detailed analysis the reasons for this and to ensure that second chance is available to entrepreneurs wishing to restart their business operations.

### *Enhancing System of Issuing Licenses/Permits*

From 2014 through 2016, a large number of permits and licenses for conducting different types of entrepreneurship activity were cancelled: the number of permits was reduced by 40% and the number of licenses went down by 46%. This facilitated the processes of registering and carrying out selected business operations. The e-licenses system was introduced; unlimited validity term of licenses is approved; it is prohibited for authorities to demand from SMEs information that is already available in other registers; businesses may submit declarations on compliance of entities' logistics with statutory requirements electronically.

Based on results of the business climate assessment with regard to improvement of licensing procedures and reduction of licensing costs between 2013 and 2016 ("Annual Business Climate Assessment in Ukraine: 2016", USAID LEV Program), an emphasis was made on eliminating excessive costs and shortening the duration of the procedure. 29.9% and 17.7% of SMEs report that the licensing procedures were streamlined and got complicated in 2016, respectively.

There is a need to continue optimising the number of economic activities which are subject to licensing and obtaining permits, including broader application of the declarative and silent consent principles. There are plans to simplify administrative procedures for carrying business operations and introduce issuance of permit electronically.

#### *Continuing Harmonization of Legislation on Technical Regulations and Conformity Assessment*

Ukraine is in the process of shifting from obligatory certification of products to assessment of compliance with technical regulations. From 2005 through 2016, the list of goods that are subject to certification was reduced by 87.6% by excluding product which are covered by technical regulations and low-risks products. The Law on Technical Regulations and Conformity Assessment establishes a single legal and organisational basis for conformity assessment in accordance with the requirements and provisions of the Agreement on Technical Barriers to Trade (WTO). 49 technical regulations were adopted in Ukraine, 46 of which were developed based on the EU legislation. 48 regulations are mandatory.

Effective January 01, 2018, Decree of the Cabinet of Ministers of Ukraine #46-93 dated May 10, 1993 "On Standardisation and Certification" will become null and void, and the list of products which are subject to mandatory certification will be repealed.

Efforts will be made to accede to the Agreement on Conformity Assessment and Acceptance of Industrial Products, which allows products covered by the Agreement to come into EU market without additional tests and conformity assessments. Technical regulations in three sectors – machinery safety, low voltage electrical equipment, and electromagnetic compatibility – are already harmonized with European legislation. The possibility of extending the Agreement on Conformity Assessment and Acceptance of Industrial Goods to other priority categories of industrial goods will be studied. Such measure will enable Ukraine to make Ukrainian products more competitive and expand Ukrainian export capacities.

Development of the Roadmap (timeline of actions) for introduction of the official evaluation of the Ukrainian quality infrastructure by the EU will continue.

#### *Reducing Burden of Supervision on SMEs*

Inspections of companies are criticized because of their punitive rather than preventing nature. According to MoEDT statistics, during 2016 more than UAH 15,000,000 fines were imposed on businesses by various state supervisory (control) authorities. At the same time, the number of offenses revealed by such authorities is not going down.

In the year of 2016, 68% of SMEs reported that they were inspected by one entity: 23.9% were inspected by fire department and 15.6% by the SFS (ABCA, 2016; USAID LEV Program). At the same time, 46.3% of companies reported reduction of the number of inspections between 2013 and 2016. This is a result of a temporary moratorium on inspections of small companies and reduction of the number of state supervisory (control) authorities.

Comprehensive planned inspections were introduced in 2016. In so doing, the number of contacts between businesses and inspectors was reduced by 16%.

The Law of Ukraine "On Temporary Specifics of Exercising State Supervision (Control) in the Sphere of Business Operations" imposes a moratorium on taking planned measures for exercising state supervision (control) in the sphere of business operations by state supervisory (control) authorities until December 31, 2017.

The Law of Ukraine "On Principles of State Supervision (Control) of Economic Activity" came into force effective January 01, 2017. It simplifies and liberalises state supervision (control), extends the rights of an entity, reduces the frequency and duration of inspections, prohibits the use of sanctions in case of full entity's compliance with orders to eliminate violations and introduces an integrated automatic system of state supervision (control).

It is necessary to implement provisions of the Law of Ukraine "On Principles of State Supervision (Control) of Economic Activity". This involves bringing existing sectoral laws in specific areas of economic activity in compliance with the provisions of the said Law which simplify and liberalise state supervision (control).

#### *Enforcing Contracts / Out-of-Court Settlements*

Contract enforcement remains inefficient and court settlement is ineffective. This is reflected in the low position of Ukraine in the Doing Business for the indicator of Enforcing contract (81<sup>st</sup> position), primarily explained by high cost of the procedure (usually the contract enforcement procedures fee amounts to half of the price of the lawsuit) and poor quality of justice adjudication (inefficient proceedings, lack of automation, availability/accessibility of alternative dispute resolution methods). Court decisions are implemented very slow. The Law of Ukraine "On Enforcement Proceedings" envisages engagement of private enforcers. Besides, there is a need to develop institutional capacities of government authorities and ensure adequate funding.

It is planned to develop an open Unified Register of Debtors with information on unfulfilled property obligations of debtors and use automated procedures for registering documents electronically.

Disputes between SMEs can be settled out of court by arbitration if both parties specified such option in their contract. However, few contracts include arbitration provisions. There are few reputable arbitration providers in Ukraine, and they work primarily on international trade issues. Currently, there is currently no legislation on mediation. However, the Draft Law of Ukraine "On Mediation" was adopted as the basic draft law on the subject on November 03, 2016 (registration #3665).

The Law of Ukraine "On Agencies and Individuals Enforcing Decisions of Court and other Authorities " was enacted on October 05, 2016. It is intended to regulate activities of private enforcers. Therefore, Ukraine has a mixed enforcement system.

Practical implementation of this Law and associated regulations will require that adequate financial resources are available and SMEs have a proper access to numerous government registries.

#### *Expanding Access to Public Procurements for SMEs*

The Law of Ukraine "On Public Procurements" complies with EU Directives. All central executive authorities and state-owned companies as well as other customers including local governments have been conducting e-procurements through a system called ProZorro since April 2016 and August 2016, respectively. ProZorro must be used for purchases of goods and services above UAH 200,000 and for works above UAH 1,500,000. The system is also used for procurement for smaller purchases. Participation in tenders costs UAH 17+ for tenders up to UAH 20,000 and UAH 1,700 for tenders over UAH 1,000,000. The tender surety bond is limited by law to 0.5% of the planned value of the tender for works and 3% for services and can be provided electronically.

Contracts can be split into smaller lots, which is very convenient for SMEs and stimulates engagement of a larger number of companies. SMEs need to be better informed on opportunities for participation in public procurements and be trained to improve their capacities to use such opportunities.

#### *Enhancing Labour Legislation*

Ukraine inherited its Labour Code from the former Soviet Union (1972). Despite numerous amendments, the Labour Code of Ukraine provides little labour market flexibility, fails to ensure proper accomplishment of existing tasks, and does not meet modern requirements. The legal procedure for dismissing employees is very complicated. This poses a major problem for small and medium-sized enterprises, since they lack human capital and need to adjust staffing levels quickly and affordably to changing market conditions. The legislation does not protect employees adequately and penalizes employers for violations.

In order to satisfy all needs of small and medium-sized businesses, the labour legislation should be enhanced. (The Parliament passed the Draft Labour Code of Ukraine (registration #1658) at its first reading in late 2015.)

#### *Ensuring Development Effective Public-Private Dialogue (PPD)*

Building efficient and result-oriented dialogue between the government and the public constitutes a basis for effective implementation of public policies. Pursuant to paragraph 12 of the Regulation on Public Consultations on Formulating and Implementing State Policies, which was approved by Cabinet of Ministers Regulation # 996 dated November 03, 2010, consultations on draft regulations relating to the strategic public policy objectives, regulatory activity in a particular area should last at least 15 days. However, according to the Law of Ukraine "On Access to Public Information" draft regulations should be published no later than 20 working days before their consideration with a view to adoption. In addition, according to the Law of Ukraine "On Principles of Regulatory Policy in Economic Activity", the period for feedback from individuals, legal entities and associations is to be set forth by the developer of regulatory act and cannot be less than one month and more than three months beginning the date of publication of the draft regulation and regulatory impact assessment.

Most regulations developers comply with the above provisions by posting draft regulation on official web sites. At the same time, central executive authorities actively engage stakeholder in cooperation. Advisory and other subsidiary bodies are set up under umbrella of central and local executive authorities whose activities aimed at public involvement in policy making processes.

Such form of consultation needs to be rigorously enforced and enhanced. It is advisable to use other forms of dialogue and discussion such as round tables, seminars, public hearings etc., which can influence the decision-making process. There is a need to further develop Public Private Dialogue (PPD) for the SME sector, as a regular two-way mechanism of dialogue and cooperation. The reformed and restructured Entrepreneurship Council (which includes representatives of Regional Councils of Entrepreneurs) should become an important element of the dialogue via an SME-focused Working Group.

#### **Direction 2: Expanding an Access to Finance for Small and Medium-Sized Business**

In most countries, the number one barrier to business development is a limited access to finance. Today, lending of small and medium-sized businesses in Ukraine is insufficient. Most companies satisfy needs in capital investments with their own funds (69,4% in 2016

according to the State Statistics Service). Therefore, there is an urgent need to improve commercial bank finance, diversify the financial products (guarantee schemes, leasing, factoring, export insurance, etc.) and ensure that financial products are better tailored to the needs of the SME sector.

Particular attention should be paid to measures intended to stabilise the financial sector in the regions affected by the anti-terrorist operation in Donetsk and Lugansk oblast, which are under the control of the Government and the adjoining territories. Support from the international financial institutions, including guarantees from the World Bank, EBRD, etc. could help stimulate lending by post-conflict risk sharing with banks operating in these areas.

In addition, attention needs to focus on encouraging banks to develop targeted long-term and low-interest SME lending programmes to respond to needs (e.g. education, private construction, starting a business, consumer loans, etc.). Measures should be taken to green operations of small and medium-sized businesses (production of eco- and bio-products, introduction of environment-friendly technologies).

Strategic direction 2 envisages:

#### *Expanding Lending of Small and Medium-Sized Businesses by Commercial Banks*

Today, the banking sector comprises 99 licensed banks, three of which are state-owned and 39 have foreign investment. SMEs have limited opportunities to obtain loans: only 26.7% of small and 33.2% of medium-sized companies are planning to apply for a loan in the near future (NBU BTS, 2017Q1). Such situation is caused by high interest rates, excessive collateral requirements and complex procedures. Currently, there are about 24 banks providing finance to SME clients (12 at the national level and 12 at the regional level). There exist the Independent Banks Association which *inter alia* stimulates SME lending by means of pilot initiatives to test new lending methodologies/products, develop SME capacity to access financial products/services, tools and techniques (e.g. collateral assessment, cash-flow based lending, managing foreign currency risk, currency hedging both for loans and exports, etc.). Such technical support, together with funding, can also be provided by the German-Ukrainian Fund (GUF) under its programmes and projects of financial support to small and medium-sized businesses. The process of lending small and medium-sized businesses will be facilitated by implementation of the Comprehensive Programme for Developing the Ukrainian Financial Sector until 2020 which aims to resume funding of the national economy (specifically, the Restart Lending Initiative).

Establishing effective cooperation of commercial banks will help meet all SMEs needs in finance on affordable conditions.

#### *Securing Deposits*

During the crisis period of 2014 – 2015, a significant share of SMEs had difficulties with payments because of liquidity problems faced by banks or lost their funds in failed banks altogether. Such sort of problems may significantly limit areas of SME activities. Pursuant to Law Section II "Final and Transitional Provision" Item 6 of the Law of Ukraine "On Amending Selected Pieces of the Ukrainian Legislation with Regard to Enhancing the Individual Deposit Guarantee System and Taking Insolvent Banks out of the Market", self-employed individuals are entitled to be refunded from the Individual Deposit Guarantee Fund for their deposits with banks relegated to the insolvent category after January 01, 2017.

Better enforcement of relevant rules of the NBU and general stabilisation of the currency system will improve the situation for small and medium-sized businesses as banks finance accounts for a significant percentage of the micro-businesses' capital. The new NBU rules and regulations for the banking sector (e.g. minimum capital requirements) will make it possible to secure SME deposits over time through banks consolidation.

#### *Using Credit Guarantee Schemes (CGSs)*

CGSs play an important role as they help overcome the disincentive of commercial banks to lend to SME lacking adequate collateral. Well-managed CGSs that require moderate financial support to function would be a relatively low-cost solution to improve access to credit for the SMEs. There are international good practices in creating effective, SME-oriented CGS. The European Investment Bank (EIB) establishes a CGS worth Euro 40 million for innovative companies. Such CGSs may become an additional tool for SME financial support.

CGSs should be designed to operate on a commercial basis and be targeted on SMEs whose development is constrained by the inability to meet current collateral requirements of the commercial banks for investment purposes.

#### *Intensifying Use of Promissory Notes*

This is a financial instrument that contains a written promise by one party to pay a certain sum of money to another party either on demand or on a specified day in the future. A promissory note typically contains all the terms pertaining to the indebtedness, such as the amount, interest rate, maturity date, date and place of issuance and issuer's signature. However, in the past this instrument was used for tax evasion and money laundering purposes.

SMEs may use promissory notes as an additional source of finance to increase their working capital and reduce its cost. Awareness raising about promissory notes and their benefits will help change a negative perception of this financial tool in the society and promote their use.

#### *Intensifying Lending by Non-Banking Financial Institutions (NBFIs)*

Effective use of credit non-bank financial institutions that specialise in lending to SMEs can be an alternative to bank lending.

During the initial nine months of 2016, NBFIs (credit unions and other financial institutions) extended loans to SMEs amounting to UAH 3,900,000,000. In the above sum, the number of loans granted by credit unions was UAH 123,000,000 (3.2% of the loan portfolio of NBFIs for SMEs). The share of loans granted by credit unions to support agriculture was 49% (UAH 60,100,000), and other commercial loans accounted for the remaining 51% (UAH 62,900,000).

In view of the above, it is necessary to promote the development of NBFIs specialised in providing finance to SMEs.

#### *Reducing Information Asymmetry by Running Credit History Bureau (CHB)*

The coverage of individuals by private credit bureaus was increased up to 40% of the adult population in 2015. In so doing, the credit information system is fragmented. Obtaining information on borrowers' identity, tax, bankruptcy and credit history is time-consuming and leads to delays and extra costs for credit approvals ("Financing Small and Medium-sized Business in the Neighbourhood Countries: Ukraine"; EIB report, 2016). There are seven private credit bureaus and one credit registry in the central bank. Beginning 2014, banks are

required to provide credit history of corporate borrowers to CHBs. According to the World Bank (DB 2016), CHBs have information on 122,000 companies (out of 343,000). However, corporate credit histories do not seem to be a priority for CHBs. This limits services offered for corporate borrowers.

Setting up a specialised CHB for corporate clients will ease an access to bank credit for SMEs. It is feasible to establish a consolidated Credit Register to further enhance the system and reduce information asymmetries. CHBs can help reduce credit provisions and interest rates for SMEs by solving the information asymmetry problem.

#### *Reducing Finance Deficit for SMEs through Provision of Leasing Services*

Leasing can fill the financing gap for SMEs needing new equipment (e.g. industrial and agricultural equipment) but do not using borrowing opportunities. For such companies, leasing is an efficient way to fund their needs, specifically, by means of tax accounting which is used rarely. 4,119 leasing contracts were signed for the total value of UAH 7,800,000,000 during nine months of 2016. These funds were used predominantly for purchase of vehicles and farming equipment ("Information on the state and development finance companies, lessors and pawnshops of Ukraine, Key indicators of financial companies and lessors for 9 months of 2016"; The National Commission for State Regulation of Financial Services Markets).

The demand for leasing from SMEs may be increased by raising awareness of the benefits of equipment leasing and extending leasing to a broader range of equipment. High interest rates and absence of tax privileges for companies on simplified taxation (no VAT / CIT) may constrain the demand for leasing from SMEs. The legislation on financial leasing needs to be revised according to international good practices for the purposes of enhancing transaction mechanisms, creating proper conditions for mobilising investments with such mechanisms for modernisation of fixed assets of small and medium-sized businesses. This should be combined with leasing promotion through leasing and business associations.

#### *Reducing Finance Deficit for SMEs through Provision of Factoring Services*

Factoring is another – effective – way to diversify SMEs' to access finance using their receivables as a collateral. A boost to working capital is possible since, in the beginning of 2015, SMEs had receivables equal to 69.2% of annual sales. During the nine months of 2016, financial companies signed 14,521 factoring contracts with the total value of UAH 11,300,000. Most of them (over 80%) were bad debt transfers from financial institutions to collecting companies ("Information on the state and development finance companies, lessors and pawnshops of Ukraine, Key indicators of financial companies and lessors for 9 months of 2016". The National Commission for State Regulation of Financial Services Markets).

Creating mechanisms for mobilising assets by financial institutions to finance factoring operations (including subordinated debt), introduction of requirements that would limit risks faced by financial institutions and increase awareness of factoring opportunities will expand opportunities to finance SMEs' needs.

#### *Using Venture Capital Opportunities, Attracting Funds of Informal Investors (Business Angels), Pooling Resources for Project Funding Purposes on a Voluntary Basis (Crowdfunding)*

Currently, venture capital and similar forms of financing, such as Business Angels and crowdfunding are not used much by start-ups and SMEs with a growth potential. Alternative

sources of funding remain for SMEs the most widely used source of receiving capital. Ukrainian law is favourable to venture funds: such funds had UAH 232 bln in assets in 2015 (Annual report "Ukrainian Securities Market: Full Rebooting", the National Commission for State Regulation of Financial Services Markets (2015)), but these are commonly used as holding companies for asset management, tax optimisation and privacy protection. There are few genuine venture funds and they do not serve many SMEs. There are no special provisions for crowdfunding in Ukrainian legislation but it is possible under general contract law.

There is a need to review and enhance the legislation to discourage misuse of venture funds while securing advantages for genuine investors would help expand such financing including that for small and medium-sized businesses.

The establishment of a network of informal business angels with an appropriate legislative background, would also be a useful development for small and medium-sized businesses.

There is a need to review contractual law to secure transparency and creditor rights protection in crowdfunding systems.

#### *Extending a Range of Sources of Funding SMEs*

Innovative small and medium-sized businesses and newly created SMEs experience difficulties with attracting finance because of lack of credit history and venture capital.

Using various instruments to mobilize finance will open new opportunities for SME development. Raising awareness of opportunities provided by international programmes and projects, specifically, those under the EU Framework Programme of Research and Innovations "Horizon 2020" (hereinafter referred to as the "Horizon 2000 Programme") will foster utilisation of the innovation potential of small and medium-sized businesses.

#### *Export Funding / Insurance/ Guarantees*

Export finance is available to SMEs on the same terms as that to larger companies. Therefore, exporters with steady foreign currency inflows have a better access to loans than other borrowers. They may also borrow in foreign currency at an interest rate of 8 p.p. to 10 p.p. lower than in hryvnia. Ukraine does not provide state-sponsored export guarantees or insurance. The state-owned Ukreximbank is the largest player in export finance but it does not provide such sort of services. At the same time, the Law of Ukraine "On Ensuring Large-Scale Expansion of Export of Ukrainian Products (Works, Services) by Means of Insurance, Guarantees, Lending of Export on Easy Terms" envisages establishment of an Export Credit Agency which provide insurance, re-insurance, and guarantee services under contracts ensuring export development on a voluntary basis. The Agency will participate also in implementing a program of partial refund of interest on export loans.

Considering the opportunities of DCFTA and the wide availability of state-supported export loans / guarantees / insurance, etc. in many competitor countries, support for export finance for SMEs is needed urgently.

#### *Implementing International Financial Reporting Standards (IFRS) in the SME sector*

The Law on Accounting and Financial Reporting defines the standards of reporting and accounting for companies operating on the territory of Ukraine. SMEs are eligible for simplified reporting, as approved by the Ministry of Finance. Currently, the IFRSs are compulsory for public joint stock companies, banks, insurance companies. and enterprises

carrying out business operations included in the list set forth by the Cabinet of Ministers of Ukraine. SMEs use the simplified national reporting standards, which are less demanding than IFRS.

The Draft Law of Ukraine “On Auditing” (Registration #2534) which, if adopted, will apply to all financial institutions and enterprises will toughen the standards. Small and medium-sized enterprises that would like to attract foreign investment / improve their chances of accessing commercial finance may wish to adopt IFRS. There is a need for awareness raising and provision of co-financed support to help SMEs achieve IFRS standards.

### **Direction 3: Simplifying Tax Administration for SMEs**

Despite certain improvement of the business climate in Ukraine (+3 positions according Doing Business 2017), Ukrainian companies spend for resolving tax issues by 1.6 hours more than the average company in Europe and Asia and twice as much as the average company in OECD member states. 27% of SMEs stated that tax administration is one of the major impediments to their business development and 77% report that simplification of tax administration should be the priority measure (ABCA (2016); USAID LEV Program). SMEs would like to see the State Fiscal Service (SFS) a service provider, rather than an inspector.

Simplification of tax administration and changes in the operation of the SFS should improve SMEs' perception of the process. The Strategy is not intended to address tax rates. The major task is to simplify tax administration, specifically, with regard to registration, payments, VAT refund, informal economy, tax status (e.g. self-employment /FOP).

On 03 April 3 2017, the Cabinet of Ministers of Ukraine approved the Medium-term Plan of Priority Actions of the Government until 2020. The plan envisages a number of key reforms, which should ensure stable economic growth and contribute to the creation of a more favourable business environment including measures to streamline tax administration processes.

Moreover, in order to build a modern and effective public financial management system which would be capable of providing high-quality public services, accumulating resources efficiently and distributing them in accordance with the national priorities in the medium and long term perspective, the Cabinet of Ministers of Ukraine approved the Strategy of Reforming Public Finance Management for 2017-2020 by its Instruction # 142 dated February 08, 2017.

Inter alia, this Strategy sets out tasks to improve the stability and predictability of the tax system and improve the quality and efficiency of tax administration. To accomplish these tasks, a Medium-Term Strategy for Developing the Tax System will be developed. It will be coordinated with Strategy for Economic Development, Reform of Budget Process and Pension System. Therefore, simplification of tax administration for SMEs will be carried out as part of accomplishing tasks and measures under Medium-term Plan of Priority Actions of the Government until 2020 and associated Action Plan.

Strategic direction 3 envisages:

#### *Implementing Electronic Tax Registration*

The tax registration process has been changed but it still does not meet SMEs' needs. Beginning 2016, the State Fiscal Service (SFS) cannot reject company registration or approve de-registration if the company is not operating at the place of registration. Besides, beginning

April 2016, the principle of "silent consent" applies to the registration of a company in the taxpayer capacity. A company may start operation once a financial institution has send information on opened accounts to the SFS.

A good foundation exists but there is a need to ensure enforcement of the provisions. Further simplification of tax registration would involve also provision of e-services.

#### *Streamlining Tax Reporting System, among Other Things, by Means of Taxpayer's Electronic Cabinet*

Simplification of tax reporting by companies is essential. At the moment, companies pay all taxes into separate accounts with the State Treasury and then submit reports for each tax paid. Tax payment and reporting are simple for those operating under the SST as it includes only one annual payment of unified tax and one reporting for the 1st and the 2nd groups and quarterly payment and reporting on the unified tax for the other groups.

Electronic tax reporting is becoming available to taxpayers. In so doing, various providers of software for electronic reporting should enable easy data interchange (transaction counterparties use different software). Introduction of an "electronic cabinet" for each taxpayer, which is intended to minimise interaction between a taxpayer and tax inspectors, will make it possible to monitor tax payments in a real-time mode, thus preventing tax arrears and delays with reporting.

The Law of Ukraine "On Amendments to the Tax Code with Regard to Improving the Investment Climate in Ukraine" envisages that the taxpayer electronic cabinet will be implemented effective July 01, 2017. It will feature such capabilities as an access to all tax information, reconciliation of payments to the budget, completion and submission of tax reports, tax and excise invoices registration, information about inspections and correspondence with supervisory authority.

#### *Ensuring Effective Value-Added Tax Refund*

For micro and small enterprises, efficient VAT payment and refund are crucial since other means of liquidity are usually limited. An electronic system of VAT administration was introduced in 2015 for the purpose of uncovering instances of misusing the right for VAT refund. This system aimed to reduce fraud and was expected to ensure timely and full VAT refunds to exporters. However, the introduction of two registers of companies for VAT refunds in 2016 did not facilitate solution of the problem of non-transparent VAT refunds and VAT refund arrears remained (UAH 16 bln as of October 2016; according to WB DB 2016, the refund period averages 28.2 weeks).

The Law of Ukraine "On Amendments to the Tax Code with Regard to Improving the Investment Climate in Ukraine" is intended to improve electronic VAT administration and introduce a single public records requests for VAT refund and an Interim Public Register of applications for returning budget refund.

Enhancement of VAT administration will result in improved liquidity for SMEs. This would reduce the strong incentive to be registered as an SST and pay the single tax which includes VAT. Separate registration of a small or medium-sized business in the added tax payer capacity will not be required.

### *Addressing Late Payment Issue*

Prior to the introduction of the ProZorro e-procurement system, SMEs suffered from late payments in relation to public procurement-related contracts. Solution of this problem became possible thanks to an electronic appeal procedure and better public control over procurements. The Ukrainian legislation addresses the issue of late payments between companies. Late payments may be subject to 3% penalty which is indexed to inflation. The maximum amount of such penalty may not exceed the double size of the discount rate of the NBU.

To further protect SMEs, the maximum term of payment should be set, say, at 60 days, as in it is the case in the EU member states.

### *Simplifying Requirements to Documentation Maintenance*

The Law of Ukraine "On Amendment Selected Laws of Ukraine Regarding Removal of Administrative Barriers to Service Exports", which came into force effective January 03, 2017, amended the Law of Ukraine "On Accounting and Financial Reporting in Ukraine". These changes aim to simplify document flow at enterprises by reducing the requirements to primary documents and the number of required details of primary documents. The changes will simplify accounting and reduce the time for processing business transactions for both for large enterprises and for SMEs.

### *Reducing Informal Employment at SMEs and Facilitating Transfer of Employees from the Grey to Formal Economy*

According to estimates of the Ministry of Economic Development and Trade, the informal economy accounts for 35% of officially reported GDP (nine months of 2016). Informal employment was officially estimated at 4.3 million persons (State Statistics Service, 2015). Most of these people are employed in agriculture, trade, and construction. The partial or full operation of some companies in the informal economy leads to unfair competition (advantages through false, fraudulent or unethical business conduct) for SMEs in the formal economy, thus restricting their growth potential. Major reasons for informal employment are high regulatory pressure, excessive administration burden, frequent changes in legislation, unstable political environment, etc.

Simplification of regulations and tax administration, introduction of smart regulation and stable policies will reduce the magnitude of the informal employment. It is necessary to initiate campaigns for raising awareness of corporate governance and corporate social responsibility as well as to foster employment formalisation by using effective communications ("hot lines"), on the one hand, and raising awareness of relevant stimuli, on the other.

It is necessary to create the conditions to transfer workers from the informal sector into the formal one, thus ensuring their social protection and social insurance.

### *Increasing Labour Market Flexibility*

An individual who is registered as a self-employed individual on a simplified tax system uses a streamlined tax administration and bears a smaller tax burden than full-time employees. This can encourage some large and middle sized firms, including a number of SMEs, to let their employees register as private entrepreneurs under SST, allowing companies to save costs and time (Single Social Contribution and Personal Income Tax). Large enterprises may split into smaller companies in order to be eligible for SST to avoid the usual tax and accounting

obligations. It results in lower fiscal revenues from these sources and unfair competition for companies that register their workers as full-time employees and pay taxes in full.

Optimising functions of Social Protection Funds will increase their attractiveness for employees who will demand official employment. This is consistent with the Strategy for Reforming Public Finance Management. Its Task 3 titled "Expanding the Tax Base" envisages elimination of conditions for the abuse of the simplified tax system by reviewing conditions of its application to categories of persons, activities, income ranges and tax rates. Besides, there is a need to revise the labour legislation in order to increase labour market flexibility by employing best international practices.

#### **Direction 4: Promoting Entrepreneurial Culture and Developing Entrepreneurial Skills**

The quality of human capital is widely recognised as being the number one priority of modern countries aspiring to become more innovative, competitive and wealthy. This approach should apply across the entire education system. Results of education system operation does not match needs of small and medium-sized businesses. SME owners recognise the importance of developing the skills of their workforce but remain reluctant to invest in people, perhaps fearing that their competitors will lure them away. It is critical to raise the profile of SMEs and entrepreneurship by holding appropriate events to maximise human entrepreneurial potential with allowance for specifics of various categories of the population.

Strategic Direction 4 envisages:

##### *Developing and Promoting Entrepreneurship Culture*

Currently, the entrepreneurship culture in Ukraine is at a low level. The business development patterns reflect partially a cultural preference for employment rather than self-employment. Statistics on SME developments reveal that a large percentage of entrepreneurs are actually in employment relationships with customers of their services. Results of independent surveys show that self-employment is often a strategy selected by individuals to survive, rather than to implement own ideas or become independent from employers (32% as compared to 21% and 16%, respectively; Amway Global Entrepreneurship Report, 2014). Today, the Ukrainian society holds negative perceptions in respect to entrepreneurship and business. Partially, this is a reflection of the post-soviet economy.

Better awareness and understanding of the positive role of entrepreneurship in the society will foster an increase in the number of small and medium-sized businesses. Therefore, a long-term information campaign is needed to counteract the current perceptions by presenting entrepreneurial role models and portraits of business success in cooperation with the media. There is also a need for information campaigns to improve the entrepreneurial image and introduce competitions and prizes, such as for "Best entrepreneur / SME / innovator / exporter." Organising contests and competitions at secondary schools and at the national, regional, and local levels will stimulate creativity and develop entrepreneurship potential of young peoples, thus, contributing to attainment of the above goal.

The Ministry of Education and Science of Ukraine is planning to include entrepreneurship competence in curricula with allowance for best practices and recommendations in accordance with "European Entrepreneurship Competence Framework" effective 2018. There also plans to train teachers in new (innovative) teaching methods, provide educational institutions with educational literature, and develop an efficient education infrastructure. In such a way, a comprehensive entrepreneurial learning framework will be created.

### *Participation in the Global Entrepreneurship Monitor*

The Global Entrepreneurship Monitor (GEM) is an important tool for analysing entrepreneurship. GEM uses data of Adult Population Surveys and National Expert Surveys.

The information obtained from the GEM surveys provides critical policy-relevant insights into entrepreneurship and is used by formulation of government policies in the sphere of small and medium-sized businesses.

### *Conducting SME Ukrainian-EU Weeks in Ukraine on a Regular Basis*

The SME Ukrainian – EU Week has been conducted in Ukraine since 2016. This event contributes to disseminating information on financial and non-financial support available to small and medium-sized businesses. All relevant stakeholders should be involved in the organisation of appropriate events, including central and local executive authorities, local governments, chambers of trade and commerce, NGOs including business associations, academia, regional representatives, international organisations, international projects, etc.

### *Stimulating Life-Long Learning*

Aiming to satisfy population needs in education, attention should be paid to the life-long learning, which is one of essential elements in European model of education (the European Reference Framework as envisaged by Recommendation of the European Parliament and of the Council of 18 December 2006 on Key Competences for Life-long Learning (2006/962/EC)).

SME engagement with vocational and higher education institutions as well as careers guidance and support services can be important in the bid to meet business skills' needs and wider employment concerns.

Special attention should be paid also to information training of the population in specific types of entrepreneurship. This will help SMEs to improve their performance; ensure sustainable development of the SME sector; and make sure that the education system meets needs of small and medium-sized businesses.

Today, the offer at the labour market does not match the demand. Such situation negatively affects both employers and employees.

The system of vocational training should take into account precise and realistic forecasts of the future demand for qualified labour at the labour market in order to satisfy needs of small and medium-sized businesses. There is a need to use best international practices to collect data and apply modern forecasting methods and systems.

### *Encouraging Employers to Train their Employees*

SMEs' capacities with regard to ensuring training of their employees are quite limited. According to data of the 2016 Annual Business Climate Assessment in Ukraine (USAID LEV Program), 20% of SMEs report a lack of qualified employees as one of the major impediments to business development. International programs for awarding best employers, such as “Investors in People”, offer practical tools to for training and professional development of employees and set relevant standards to guide employers.

Vocational training programs need to be modernized in order to allow for labour market's needs by economic activities.

Professional retraining of SME employees and effective assistance to be provided by the State Employment Service to registered unemployed individuals willing to become entrepreneurs are also necessary.

#### *Intensifying Training of SMEs in Export Operations*

To be able to operate at international markets, small and medium-sized businesses must possess relevant knowledge and practical skills including those related to export, import, funds mobilisation, cooperation with businesses in various countries. Besides, it is important to build a networking capacity of businesses and increase the professional standards of training providers (regulatory, management and high-level occupational skills).

Potentially, the COSME Erasmus for Young Entrepreneurs Programme is a very important support instrument that can strengthen both training in internationalisation and training for entrepreneurship culture. Therefore, it is important to enable individuals willing to become entrepreneurs and existing SMEs to participate in this programme.

#### *Ensuring Equal Rights and Opportunities for Women and Men in the SME Sector*

According to data of the 2016 Annual Business Climate Assessment in Ukraine (USAID LEV Program), the SME gender profile is characterized by the following gender structure: three quarters (men) to one quarter (women).

By its Instruction #229 dated April 05, 2017, the Cabinet of Ministers of Ukraine approved the Concept of the State Social Program for Ensuring Equal Rights and Opportunities for Women and Men until 2021.

Statistics provided in the said Concept suggest that the actual situation with ensuring equal rights and opportunities for women and men in Ukraine is unsatisfactory. The Concept emphasises a need to expand economic opportunities for women in the sphere of employment and develop their entrepreneurship potential. There is also a need in statistical indicators broken down by genders as they are essential for using a gender-based approach in programs, documents, strategies, and plans at all levels including the sphere of small and medium-sized businesses.

#### *Supporting Entrepreneurship for Selected Categories of the Population (Internally Displaced People (IDP), the Former Military, Young People, Seniors*

There are no specific state entrepreneurship support programmes for IDPs, the ex-military, youth, 50+ individuals etc. The only exception is entrepreneurship training provided by the State Employment Service (SES) to the registered unemployed. In the year of 2016, 166,600 registered unemployed individuals were trained. According to the Law of Ukraine “On Employment”, the unemployed receive a lump-sum unemployment benefit payment to start a business, however, its effectiveness is unknown as no assessment was made and the payment is only sufficient for start-up activities. According to the State Employment Service, 59,600 ex-servicemen who participated in the anti-terrorist operation used its services since 2015 including 29,900 ex-servicemen in January and February 2017. 2,100 such individuals started their own business using the Employment Service payments since 2015 (44 individuals in January and February 2017). A number of support programs for IDPs and the ex-military are administered with engagement of civil society institutions and international organisations.

Establishing proper coordination and monitoring of performance of these programmes is an essential for improving the support system for special groups, and for IDP businesses in

particular, with involvement of local executive authorities and local governments among other things. Intensification of public education campaigns on the support programmes will ensure that such programs are implemented successfully and needs of target categories of the population are satisfied. Introduction of entrepreneurship training for various age groups will help them (specifically, young people) to overcome challenges in regaining employment.

### *Improving Financial Literacy*

According to data of the 2016 Annual Business Climate Assessment in Ukraine (USAID LEV Program), 47% of the surveyed SMEs need consulting and training in business start-up and development.

Inadequate financial literacy poses another problem. Financial literacy is a capability to oversee financial resources over the life cycle and their effective combination. A significant obstacle to the growth of sustainable SMEs is a lack of knowledge, skills and awareness to cope and direct the finances of their companies in a professional way. Business people make ineffective financial decisions because of the lack of financial knowledge, lack of time to learn about personal financial management, complexities in financial transactions and the extensive variety of choices in financial products/services. Besides, a lack of business management complicates an access to finance barriers for SMEs.

Awareness raising and conducting of training to improve financial literacy levels among SMEs through engagement with commercial banks, non-bank financial institutions and business associations and chambers of trade and commerce will produce positive results in the short run. It is also necessary to support financial literacy at school level. Continued use of the “financial literacy” course in the educational curriculum will also give positive effects.

### *Fostering Development of Social Entrepreneurship*

Social entrepreneurship is a process of implementing innovative solutions to social and environmental problems. The legislation in force does not provide the definition of “social entrepreneurship” notion. According to international practices, social enterprises are typically classified as (i) for-profit organisations which use their resources to creatively address social issues; (ii) not-for-profit organisations which help individuals establish their own for-profit businesses; or (iii) not-for-profit ventures which use their profit to fund their own programmes or to create new jobs.

A study of best international practices in the sphere of social entrepreneurship will make it possible to assess the current situation in Ukraine and make proper decisions aimed at expanding opportunities for one or another type of entrepreneurship.

### *Facilitating Corporate Social Responsibility of Small and Medium-Sized Businesses*

A positive impact of business operations on the environment, consumers, employees as well as a contribution to development of communities where business operations are carried out constitute general goals or the corporate social responsibility.

Sustainable Development Goals officially known as "Transforming Our World: the 2030 Agenda for Sustainable Development" defining 17 sustainable development goals approved by the UN General Assembly in 2015 gave push to incorporation of the social responsibility in corporate activity plans.

The SME awareness of the importance and benefits of the corporate social responsibility remains quite low and needs to be raised so that SMEs have better understanding of the use and benefits of the responsible attitude to their business operations. Such attitude involves additional competitive opportunities and opportunities to improve life of the society for SMEs.

### **Direction 5: Promoting SME export/internationalisation**

With the signing of the Association Agreement, there is a decisive re-orientation of trade flows from Russia towards the EU member states and other countries. This event opens new and expand existing opportunities including those for the SME sector (only 5.9% of SME carry out export operations).

In view of a need to develop a diversified and competitive economy, special attention should be paid to implementation of European standards for industrial, agriculture, and food products. Ukraine's Export Strategy: Ukraine Strategic Trade Development Roadmap 2016–2020 will define the national trade policy priorities and measures.

Strategic Direction 5 envisages:

#### *Creating Favourable Conditions for Carrying out Export Operations by Small and Medium-Sized Businesses*

Implementation of the DCFTA and other trade agreements will result in major changes at the domestic market. Alignment of economic regulations including safety requirements, IPR protection, competition and state aid policy, etc. with the EU norms will make the business environment more predictable and transparent. However, this will require more attention to regulatory compliance.

A short-term task is to increase the competitiveness of domestic SMEs by establishing a truly business-enabling environment (smart regulation, improved access to finance, de-monopolisation of the economy, and corruption fighting). Special attention should be paid to involving SMEs in international value chains through promoting business linkages and industrial clusters.

Creation of the deep and comprehensive free trade area with the EU creates new opportunities for developing the export potential of SMEs through provision of duty-free and low non-tariff barriers access to an EU market of 500,000,000+consumers. However, as there are few SMEs carrying out export operations, only a small percentage of SMEs will be able to benefit immediately from preferential access to the EU market.

Fostering development of the trade support infrastructure for the purpose of providing necessary services to interested SMEs will be an important task of the Ukraine's Export Strategy: Road Map of the Trade Development Strategy for 2017 through 2021 to be adopted by the end of 2017.

#### *Stimulating Export Operation of Small and Medium-Sized Business Through Introduction of Relevant Training and Information Sharing*

Lack of partners, limited access to finance, lack of information, and burdensome trade procedures are the main obstacles precluding SMEs from international markets.

Strengthening capacities of such trade support institutions as chambers of commerce, business associations, providers of trade finance, consultancies and other public/private institutions

delivering trade-related services is essential to address the lack of partner and information problems for the SME. The capacities organisation representing interests of small and medium-sized businesses should be expanded. In order to develop the SMEs' potential, further education and training with a focus on export readiness are necessary, including co-financing of B2B/trade fairs and other business events in order to stimulate a stronger export orientation.

#### *Approximating the Ukrainian Legislation to the EU Acquis and Standards*

Approximation of the Ukrainian legislation to the EU acquis and standards in the sphere of food and non-food products quality and safety, labour safety, and environment protection and safety may pose a serious problem for small and medium-sized businesses because of a need to incur extra costs of bringing their operations in compliance with the EU standards.

Measures to help small and medium-sized businesses may include provision of consulting services and development of a competitive market of compliance assessment services for the purpose of providing a better access for small and medium-sized businesses. Financial support of innovative small and medium-sized businesses needing compliance assessment services will also contribute to technological development.

#### *Raising Awareness of Opportunities Provided by the Enterprise Europe Network (EEN) and the EU Programme, "Improving the Competitiveness of SMEs (COSME) (2014-2020)"*

The current Ukrainian representation in the EEN is insufficient. Only a few Ukrainian SMEs are registered with the EEN, the largest network of enterprises in Ukraine which was set up by the European Commission in 2008. It operates as part of the EU-funded programme titled "Improving the Competitiveness of SMEs (COSME) (2014-2020)".

In March 2017, Ukraine ratified the agreement on Ukraine's participation in the EU programme "Improving the competitiveness of SMEs (COSME) (2014-2020)", which, among other things, will enable Ukrainian SMEs to join the EEN more actively. It is feasible to educate Ukrainian SMEs on opportunities and benefits of participation in the said programme and Enterprise Europe Network.

#### **Direction 6: Improving competitiveness and developing the innovation potential of SMEs**

Development of a competitive market environment is an important condition for SME development, where the focus is on competitiveness, price, innovation, etc. Therefore, facilitating SMEs to become competitive and innovative is important for both domestic market (by stimulating SMEs to provide better services, set lower prices, and introduce innovations) and international markets (by assisting SMEs to access potential opportunities offered by the Association Agreement / DCFTA and other free trade agreements). Enhancements should be made in such spheres as developing consulting and services to businesses; creating an infrastructure to support of start-ups and growing enterprises (e.g. incubators/accelerators); and assisting SMEs with use of R&D, establishing linkages with domestic and foreign investors, and accessing EU-funded programmes, such as COSME and HORIZON-2020, specifically, at the regional level.

Strategic Direction 6 envisages:

### *Expanding the Range and Quality of Services to Small and Medium-Sized Businesses*

During recent years, services to businesses have become accessible to a larger number of SMEs mostly thanks to an increase in the number of donor-funded initiatives (programmes, projects). At the same time, the state budget funding remains quite limited. Providers of such services concentrate primarily on the medium and large companies, that can afford such services, and hardly cover micro and small companies, specifically, prospective and newly created SMEs. Services focus mainly on current rather than strategic activities, and the services are characterized by a high added value.

Critically important is to develop the market of these services (to extend the list of services and improving their quality), specifically those services which aim at improving the SMEs' performance, competitiveness, innovation, productivity, energy efficiency, access to new domestic and international markets, and increasing the total added value. Such development can be stimulated by relevant initiatives (voucher, co-financing etc.). There is also a need to improve provision of public services to prospective and newly-created SMEs. Given the diversity of the country, it is important for policy attention to be given to regional access, including advisory services in rural areas in particular.

### *Improving the Quality of Consulting Services*

Consulting small and medium-sized businesses for the purposes of improving business organisation and introducing cutting-edge business processes is crucially important for small and medium-sized businesses. It is important to ensure that growing innovation and export-oriented SMEs obtain the necessary skills, knowledge and support to help them to the next stage of development.

This means the importance of assisting business consultancy organisations to raise their professional standards and diversify their services, especially in relation to high-value adding business consulting services.

### *Strengthening Institutional Capacities of Business Support Associations*

Business support association (BSOs) play a crucial role in support of SME development with regard to their information, training, support and advocacy functions in relation to their members. Today, there is no reliable information on the number of BSOs or their services. A survey of BSOs ("Business Support Institutions: Concept, Specifics, Models" Centre for Civic Expertise, Representative Office of the Friedrich Naumann Foundation in Ukraine, USAID LEV Program; 2016) received feedback from 103 BSOs. It shows a multiplicity of institutional forms (e.g. NGOs, Charity, Association, etc.) and variety of founders (private, public, partnerships). They represent one or several sectors or industries, and their focuses vary (e.g. 57 are membership organisation, business associations, while the rest include incubators, business centres, and think tanks). Chambers of Commerce have been established in all oblasts of Ukraine and represent an important economic resource.

There is a need to review the current situation with business associations, create proper conditions for strengthening their institutional capacities, implement best international practices in order to improve the quality of services to SMEs, increase membership, exercise advocacy efficiently, and ensure their sustainability through benchmarking.

### *Allowing for Regional Specifics of Small and Medium-Sized Businesses*

SME development patterns vary considerably by regions. While some regions are implementing SME development strategies or programmes, others are not. In so doing, the quality of such strategies/programmes varies. Every often and then, such strategies and other policy documents may not conform to national policies or not be implemented in a consistent manner. They may be underfunded or lack adequate infrastructure.

There is a need to ensure that regional SME development strategies or programmes are agreed on at the national, regional and local levels (with allowance for specificities of each region) and reflect actual needs of SMEs, that resources are used effectively, and that monitoring, coordination and evaluation are embedded at regional level. Coordination with strategic directions of this Strategy will result in better regional SME coordination, facilitate better coordination of regions' efforts, and establish a dialogue at the national and local levels.

The armed conflict in the eastern regions led to the destruction of production facilities and transport infrastructure, loss of inter-sectoral and logistic linkages, complication of international relations, and increased investment risks. As a result, SMEs in Donetsk and Luhansk oblasts shrank their operations. Central and local executive authorities and local governments should pursue effective policies and use proper instruments to support SMEs in the above regions during both the conflict and on post-conflict periods.

### *Modernising Existing SME Support Infrastructure*

Currently, the SME support infrastructure consists of chambers of trade and commerce, responsible structural units of local governments and local executive authorities, NGOs, business associations etc. Besides, pursuant to the Law of Ukraine “On Principles of State Regional Policy” and Resolution of the Cabinet of Ministers of Ukraine "On Approving the Model Regulation on a Regional Development Agencies" # 258 dated February 11, 2016, 25 Regional Development Agencies (RDAs) will be set up for the purpose of supporting small and medium-sized businesses at the regional level.

The existing SME support infrastructure needs to be modernised to ensure a proper and timely consulting and informational support and maintenance of small and medium-sized businesses on an ongoing basis.

The said goal will be attained by means of setting up regional business support centres with the existing infrastructure. This effort will be funded partially through international technical assistance (for instance, the European Bank for Reconstruction and Development will create regional business support centres).

### *Intensifying the Process of Transferring Scientific Development to the Sphere of Entrepreneurship*

Academic Entrepreneurship is a way to transfer knowledge and technology from science and higher education to the private business sector and can contribute to the innovativeness and competitiveness of SMEs. Quite often, however, Academic Entrepreneurship is underdeveloped partly because of an inefficient support infrastructure. There are science parks, business incubators, and similar institutions in higher education and state-owned research institutions, but these typically lack resources and capacities. Cooperation among institutions is limited so cannot make use of the potential economies of scales and positive learning curve effects.

There is a need to facilitate cooperation of existing infrastructure facilities and higher education institutions towards promoting and supporting academic entrepreneurship with a focus on SMEs such as through virtual incubators/ science parks, etc. to ensure exchange of knowledge, experience and good practice; expert pooling; and developing a network of consultants (mentors) from the private sector, government authorities, and civil society institutions.

#### *Launching Target Initiatives with Regard to Clusters and Value Chains*

Clusters play a relatively small role in facilitating the economic growth. Information on the number of clusters in Ukraine is not available. Most clusters exist in traditional industries (e.g. construction, agriculture and textile). High-tech clusters have not yet developed except for in IT.

There is a need to implement comprehensive cluster support programmes to strengthen a number of promising clusters with a focus on SMEs in various sectors and based on partnership of companies, government, and international organisations. A more systematic approach to promote SMEs' integration in value chains should be developed through business linkages promotion, cluster support, and modernisation of production facilities

#### *Stimulating Mobilisation of Foreign Direct Investments*

Foreign Direct Investments (FDI) can facilitate SME development by creating linkages between foreign and domestic companies, resulting in transfer of know-hows and latest technologies.

As attracting FDI for the SME development purpose is crucial for economic development, it is essential to foster initiatives designed to link FDI with the SME sector and ensure proper backward linkages.

#### *Stimulating Funding of Research and Development*

The current spending for R&D as a share of GDP is low (0.61%, including 0.21% of the public spending). Moreover, linkages between R&D sector and the real economy are weak and constrain the development of new products and services, processes, technologies, etc. Ukrainian SMEs demonstrate a low level of innovation (13.1% of surveyed SMEs in 2012-2014 as compared with almost a half in the EU (according to the 2012-2014 EBRD survey). In order to facilitate innovation, the focus of SME development policy should shift towards growth- and innovation-oriented SMEs. This goal can be attained by improving the linkage between academia/research institutions and SMEs by setting up mechanism for co-financing the “R&D - transfer into real products and services” chain by the stakeholders as well by raising SMEs' awareness of such programmes as COSME, Horizon-2020, Enterprise Europe Network, etc.

#### *Intensifying Transfer of Technologies*

Transfer of technologies provides a good opportunity to boost competitiveness of companies including SMEs. However, the weak linkage between SMEs and R&D is one of the main barriers on a way to efficient transfer of technologies. Establishment of technology transfer offices including those recently set up in many Ukrainian universities and research institutions not always facilitated transfer of technologies on the whole and SME development in particular because of insufficient funding or lack thereof.

Joining the EU-funded programme, "Improving the Competitiveness of SMEs (COSME) (2014-2020)", will help intensify transfer of technologies to SMEs through participation in the Enterprise Europe Network (EEN) and other thematic technology platforms, which are becoming more accessible thanks to closer integration with the EU. In addition, policy measures that encourage science to business linkages (e.g. cluster initiatives, technology parks) stimulate also greater cooperation and interaction of SMEs and academia/research institutes.

#### *Fostering Greening of Small and Medium-Sized Businesses*

Improving the environmental performance is one of means to increase SME competitiveness and strengthen their position as providers of services and goods. According to the SME PI (2016), "SME greening" is the weakest dimension of the SME policy in Ukraine. Currently, almost all financial initiatives are funded by international organizations. Ukrainian SMEs lack theoretical knowledge and practical skills in this area. Nor do they have capacities or receive support needed to be actively engaged in this process. There is a need to develop and implement policies of sustainable consumption and production and introduce environmentally friendly and energy efficient ways of doing business.

Improvement of the environmental performance of enterprises should be attained by (i) introducing European standards and requirements with regard to admissible allowable emissions in the atmosphere, discharges to water and/or injections into soils, transporting different types of pollutants according to the Protocol on Registers on Polluters and on Moving Pollutants and (ii) securing environmental rights of communities and every individual on the territory where the production facilities are located according to the Aarhus Convention.

Informational support and implement SME support tools will be improved in order to ensure compliance with the environmental legislation, implementation of sustainable consumption and production models, "green practices" of doing business including implementation of environmental management systems, environmental certification and environmental marking according to ISO requirements.

#### *Using Opportunities Offered by EU Framework Programme of Research and Innovations "Horizon 2020"*

Horizon-2020 is an EU Research and Innovation framework programme with €80 billion of funding for 2014 through 2020 for all countries not counting private investments. The programme seeks to generate breakthroughs, discoveries, etc. by taking great ideas from the lab to the market. Unfortunately, Ukrainian SMEs have largely failed to take advantage of the HORIZON-2020 SME instrument. Out of the 44 proposals funded (Euro 7,000,000) only two were associated with SMEs.

It is important to raise awareness and develop capacities of national contract points. (Today, there are two contract points for SMEs under umbrella of the Ministry of Education and Science and Ministry of Economic Development and Trade).

#### *Using Opportunities Offered by the EU-funded Programme "Improving the Competitiveness of SMEs (COSME) (2014-2020)"*

COSME programme, which was ratified in March 2017, has a budget of €2.3 billion for all countries for 2014 through 2020. The 2017 programme consists of 22 sub-programmes in three areas: access to international markets; improvement of the competitiveness

environment; and development of the entrepreneurship culture. It is crucial to raise awareness of the COSME opportunities and maximise Ukrainian SME participation in the programme.

### **Funding of Strategy Implementation**

The Strategy will be implemented with funds allocated from the state budget for a corresponding year to authorities responsible for taking measure under the Strategy, support from international technical assistance projects, and funds from other resources not prohibited by law.

### **Organisational Support and Strategy Implementation Mechanism**

The Ministry of Economic Development and Trade will coordinate and supervise implementation of the Action Plan for realizing the Strategy.

The Action Plan will be developed under MoEDT coordination within three months of the Strategy approval with engagement of relevant stakeholders. The Action Plan will define a list of measures, responsible executors, timeframe for tasks completion, and completion indicators (Annex 8)

In view of decentralization processes in Ukraine, local governments will play an important role in resolving issues of local significance, specifically, facilitation of SME development. To ensure proper projection priorities of government policies in the sphere of SME development onto the regional level, the dialogue between central and local executive authorities with engagement of regional councils of entrepreneurs should be strengthened.

To ensure effective implementation of government policies in the sphere of business development, MoEDT will hold semi-annual monitoring of the Strategy and Action Plan implementation with engagement of co-executors. The latter will delegate an authorised representative on SME matters for participation in task force meetings. In addition, representatives of the Entrepreneurship Council under umbrella of the Cabinet of Ministers of Ukraine may be engaged. There is plan to set up a task force on entrepreneurship as part of the Entrepreneurship Council.

Central and local executive authorities, local governments, business entities and their associations, businesses' and employers' associations, Entrepreneurship Council under umbrella of the Cabinet of Ministers of Ukraine, research institutions, public councils under auspices of central executive authorities and local state administrations; consulting, advisory, and other auxiliary bodies dealing with SME development; Business Ombudsman Council, regional councils of entrepreneurs, international organisations, donors-funded international technical assistance projects, and other entities may be engaged in implementation of the Action Plan for Realising the Strategy.

Based on results of the monitoring and information received from co-executors, MoEDT will prepare semi-annual progress reports on the Strategy and Action Plan implementation. To this end, MoEDT will coordinate the process of taking actions under the Plan, prepare and hold task force meetings (as a need might be but no less frequently than twice a year). If necessary, the measures will be implemented by means of issuing relevant acts of the Cabinet of Ministers of Ukraine or instructions of the Prime Minister of Ukraine.

In view of the existing budget constraints, MoEDT will hold meetings with representatives of international financial organisations and donor-funded international technical assistance

projects twice a year for the purpose of coordinating attraction of technical assistance for the Action Plan implementation.

To ensure that monitoring and evaluation of the Strategy implementation are transparent, open, and unbiased, an independent assessment may be made with engagement of international experts, research institutions, and other qualified parties. Results of such assessment will serve a basis for drafting a new strategy after the year of 2020.

Today, MoEDT is responsible for formulation and implementation of government policies in the sphere of business development according to the Regulation on the Ministry of Economic Development and Trade of Ukraine which was approved by Cabinet of Ministers Instruction # 459 dated August 20, 2014.

For the purposes of holding professional consultations on issues associated with business development and ensuring effective accomplishment of tasks set forth by the Strategy, a consulting-and-advisory body will be set up under umbrella of MoEDT, namely, the Office of Small and Medium Entrepreneurship Development. It will be funded by international technical assistance projects and from other sources not prohibited by law.

The above activities will lay a foundation for an effective institutional model for developing and implementing government policies in the sphere of entrepreneurship development.

In the year of 2019, should there be substantial changes in the economy and/or changes in the strategic priorities of the national policy including those made with allowance for best international practices, the proposed approaches to the institutional model for developing and implementing government policies in the sphere of entrepreneurship development may be revised.

### Anticipated Results

Implementation of the Strategy envisages attaining indicators which will enable responsible agencies to evaluate realisation of government policies in the sphere of business development.

Indicator	Current Value (Reporting Year)	2020 Value
<i>General Indicators</i>		
Innovative enterprises as a percentage of the total number of enterprises	14.6 (2012—2014)	20
Enterprises' spending for research and development activities as a percentage of the Gross Domestic Product	0.42 (2015)	0.426
Markets with competitive structure as a percentage of the total sales	42.7 (2015)	49.5
<i>Special Indicators</i>		
Share of small and medium-sized businesses as a percentage of the total added value	59 (2015)	60.5

Indicator	Current Value (Reporting Year)	2020 Value
Share of small and medium-sized businesses as a percentage of the total sales of produce (goods, services)	63 (2015)	66
Profit received by small and medium-sized businesses as a percentage of the total profit generated by all businesses	72.8 (2015)	78
Share of exporting companies as a percentage of the total number of businesses	5.9 (2014)	9
Share of small and medium-sized businesses implementing innovative products or processes as a percentage of the total number of businesses	7.4 (2012—2015)	7.9

Ukraine's position in international ratings will show how effectively government policies in the sphere of business development are implemented. It is planned that by the year of 2020 Ukraine will be in the top 20 countries by the Doing Business ranking (the 80<sup>th</sup> position in the 2017 ranking) and the third out of six Eastern Partnership countries by SME Policy Index (5<sup>th</sup> or 6<sup>th</sup> position out of six by 2016 assessment).

Beginning the year of 2017, new statistical indicators will be made known which will characterize SME development (SME export volume by economic activities, average export value per one small and medium-sized business, percentage of SMEs marketing/purchasing produce through Internet; percentages of newly created and liquidated employers, employer turnover rate). As sufficient statistics are accumulated, these indicators can be added to the above list.

### **Financial, Material-and-Technical, and Labour Resources**

Measures under this Strategy will be implemented with funds allocated from the state budget to relevant government authorities, support from international technical assistance projects, and funds from other resources not prohibited by law.

The level of funding and volume of material-and-technical and labour resources necessary to implement the Strategy will be determined on yearly basis based on actual funding availability.

**Annex 1: Major Strategic and Policy Documents Affecting SME Development Directly or Indirectly**

Document Title	Major Goals/Tasks
<i>General Strategic and Policy Document</i>	
"Ukraine 2020" Sustainable Development Strategy as approved by Presidential Decree # 5 dated January 12, 2015	<ul style="list-style-type: none"> <li>• To ensure sustainable development</li> <li>• To ensure national, Business, and public security</li> <li>• To ensure responsibility and social justice</li> <li>• To have pride in Ukraine and promotion in Europe and worldwide</li> </ul>
Association Agreement between the EU and Ukraine as ratified by Law of Ukraine #1678-VII dated September 16, 2014	<ul style="list-style-type: none"> <li>• Political dialogue and reforms</li> <li>• Foreign policy and security policy</li> <li>• Justice, freedom, and security</li> <li>• Trade</li> <li>• Economic and sectoral cooperation</li> <li>• Financial cooperation</li> </ul>
Government Medium-Term Plan of Priority Actions until 2020 and Government Priority Action Plan for 2017 as approved by Cabinet of Ministers Instruction # 275 dated April 03, 2017	<ul style="list-style-type: none"> <li>• Economic growth</li> <li>• Efficient governance</li> <li>• Human capital development</li> <li>• Rule of law and corruption fighting</li> <li>• Security and defence</li> </ul>
Action Plan for Deregulation of Business Operations as approved by Cabinet of Ministers Instruction #615 dated August 23, 2016	<ul style="list-style-type: none"> <li>• Creation of favourable conditions for business development</li> </ul>
Action Plan for Implementing Best Practices of Proper and Effective Regulation as Reflected by the World Bank Group in the Doing Business Ranking Methodology as approved by Instruction of the Cabinet of Ministers of Ukraine # 1406 dated December 16, 2015	<ul style="list-style-type: none"> <li>• Ukraine is in top 20 countries in the WB Doing Business ranking</li> </ul>
Strategy for Overcoming Poverty as approved by Cabinet of Ministers Instruction # 161 dated March 16, 2016	<ul style="list-style-type: none"> <li>• To reduce the magnitude of poverty in Ukraine and social exclusion on a phased basis; to introduce new mechanisms for preventing these phenomena</li> </ul>
2016-2017 Action Plan for Implementing the Strategy for Overcoming Poverty as approved by Instruction of the Cabinet of Ministers of Ukraine # 573 dated August 08, 2016	<ul style="list-style-type: none"> <li>• To reduce the magnitude of poverty in Ukraine and social exclusion on a phased basis; to introduce new mechanisms for preventing these phenomena</li> </ul>
National Strategy for Regional Development until 2020 as approved by Resolution of the Cabinet of Ministers of	<ul style="list-style-type: none"> <li>• To create conditions for rapid and well-balanced development of Ukrainian regions</li> <li>• To ensure territorial socio-economic integration and</li> </ul>

Document Title	Major Goals/Tasks
Ukraine # 385 dated August 06, 2014	spatial development <ul style="list-style-type: none"> <li>• To ensure effective governance in regional development</li> </ul>
Strategy for Developing the Technical Regulation System until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 844 dated August 19, 2015	<ul style="list-style-type: none"> <li>• To eliminate technical barriers to trade between the EU and Ukraine</li> <li>• To ensure fulfilment of Ukraine's under WTO agreement</li> <li>• To modernize the economy through increased investment and competitiveness of domestic products at the global market</li> </ul>
Strategy for Reforming the Public Finance Management System for 2017 through 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 142 dated February 08, 2017	<ul style="list-style-type: none"> <li>• Compliance with the overall budgetary-and-taxation discipline in medium term</li> <li>• More effective allocation of resources</li> <li>• Effective implementation of the state budget</li> <li>• Improved transparency and accountability in the public finance management system</li> </ul>
<i>Sectoral and Industrial Strategic and Policy Documents</i>	
Transport Strategy of Ukraine until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 2174 dated October 20, 2010	<ul style="list-style-type: none"> <li>• To ensure stable and efficient development of transport sector; to create proper conditions for socio-economic development, increased competitiveness of the national economy and improved living standards</li> </ul>
Comprehensive Programme for Developing the Ukrainian Financial Sector until 2020 as approved by Resolution of the Central Bank Board # 391 dated June 18, 2015	<ul style="list-style-type: none"> <li>• To create a financial system capable of ensuring sustainable economic development by means of effective re-distribution of financial resource in the economy based on development of a full-pledged competitive market environment according to the EU standards</li> </ul>
Energy Strategy for Ukraine until 2030 as approved by Instruction of the Cabinet of Ministers of Ukraine # 1071 dated July 24, 2013	<ul style="list-style-type: none"> <li>• To develop strategies for the following industries: electric power engineering, nuclear energy, coal, oil and gas</li> <li>• To integrate into the EU energy sector</li> </ul>
Strategy for the Agrarian Sector Development until 2020 as approved by Instruction of the Cabinet of Ministers of Ukraine # 806 dated October 17, 2013	<ul style="list-style-type: none"> <li>• To create proper organizational and economic conditions for effective development of the agrarian sector</li> </ul>
Concept for Reforming the State System of Intellectual Property as approved by Instruction of the Cabinet of Ministers of Ukraine # 402 dated June 01, 2016	<ul style="list-style-type: none"> <li>• To create an optimal – efficient and effective – state system of legal protection of intellectual property</li> </ul>
Action Plan for Implementing the Concept for Reforming the State System of Intellectual Property as approved by Instruction of the Cabinet of Ministers of	<ul style="list-style-type: none"> <li>• To create an optimal – efficient and effective – state system of legal protection of intellectual property</li> </ul>

Document Title	Major Goals/Tasks
Ukraine # 632 dated August 23, 2016	
<p>Basic Principles (Strategy) of the Ukrainian State Environmental Policy (the "Environmental Policy Strategy of Ukraine") until 2020 as approved by Law of Ukraine # 2818-VI dated December 21, 2010</p>	<ul style="list-style-type: none"> <li>• To stabilize and improve the environmental situation by incorporating the environmental policy into sectorial programmes and development strategies</li> <li>• To secure that the environment is safe for people's health and nature</li> <li>• To introduce an environmentally balanced system of natural resource management and conservation of natural ecosystems</li> </ul>

## Annex 2: SME Economic Policy Index

According to the Small Business Act for Europe, it is envisaged that an assessment of the SME development policy progress is to be conducted in all six Eastern Partnership (EaP) countries including Ukraine on a regular basis. In the process of such assessment, targeted recommendations on reforming SME policies are provided for the purpose of implementing best international practices by means of taking measure to develop a potential and apply mechanisms of the regional political dialogue.

SME Economic Policy Index assesses is a tool for searching and implementing best practices for emerging economies. It is intended to monitor and assess the progress of policies aimed at supporting small and medium-sized businesses.

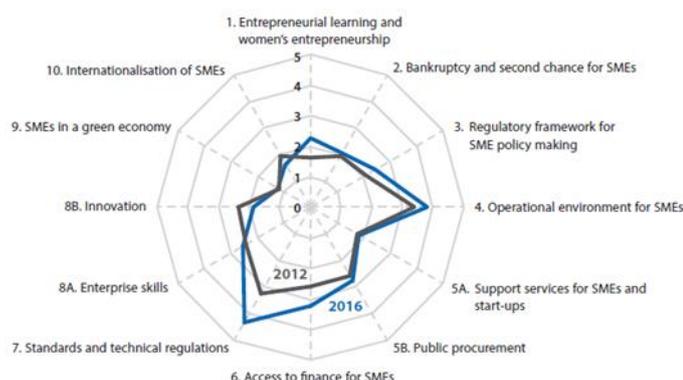
The Index has been developed by the Organisation for Economic Cooperation and Development (OECD) in partnership with the European Commission, European Bank for Reconstruction and Development (EBRD), and European Training Foundation (ETF).

In the Eastern Partner countries (Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova, Ukraine), the second assessment was undertaken in 2014-2015 (the first one was carried out in 2012), leading to the publication of the SME Economic Policy Index: "Eastern Partner Countries 2016. Assessing Implementation of the Small Business Act for Europe".

SME Policy Index assesses the progress of SME policies in all six Eastern Partnership (EaP) countries towards attainment of the ten principles of the Small Business Act for Europe (SBA). The analysis of each Eastern Partner country identifies strong and weak points in policy design and implementation, existing opportunities and risks, and provides a list of priority actions for reform.

The SME Economic Policy Index shows that SME development progress in Ukraine since 2012 has been modest (1 being lowest, 5 being best).

### SME Economic Policy Index Scores for Ukraine (2012, 2016)



### SME Economic Policy Scores for Ukraine (2016)

SME EPI Indicators	Ukraine	EaP Average	Best Performer
Entrepreneurial learning and women's entrepreneurship	2.25	2.52	2.7 (Georgia)
Bankruptcy and second chance for SMEs	2.05	2.71	3.16 (Armenia)
Regulatory framework for SME policy making	2.45	2.95	3.51 (Moldova)

SME EPI Indicators	Ukraine	EaP Average	Best Performer
Operational environment for SMEs	3.81	4.01	4.33 (Georgia)
Support services for SMEs and start-ups	1.84	3.13	3.93 (Armenia)
Public procurements	2.73	3.12	4.04 (Georgia)
Access to finance for SMEs	3.22	3.28	3.76 (Georgia)
Standards for technical regulation	4.34	3.76	Ukraine
Enterprise skills	2.56	2.66	3 (Georgia)
Innovations	1.86	2.57	2.91 (Armenia & Belarus)
SMEs in green economy	1.22	1.99	2.48 (Georgia)
Internationalisation of SMEs a	1.63	2.79	3.6 (Georgia)

SME economic policy index provides recommendations on the following five main directions:

1. Strengthening the institutional, regulatory, and operational environment of SMEs operations:
  - Develop and adopt the SME Development Strategy and Action Plan, taking into account the situation in Ukraine, which should envisage: institutional reforms, increasing interagency cooperation on economic policy and strengthening dialogue between policy-makers and business; optimizing mechanisms of control and performance assessment; specific targeted actions;
  - Adopt and implement updated RIA mechanisms which provide an analysis of regulatory impact on SMEs;
  - Implement a deregulation programme taking into account SMEs needs, including optimizing registration of business (improve interaction with tax authorities) and issuing licensing and permits, simplifying requirement of accounting and documentation for SMEs.
2. Improving SME access to finance:
  - Ensure further protection of creditor rights associated with foreclosures on collaterals, control over the execution of court decisions after reorganization;
  - Improve online access to the list of movable properties in the State Register of Pledged Movable Property, simplify its use, and improve the veracity of data in the Register;
  - Improve venture financing regulations, initiate cooperation with institutional investors, increase opportunities for venture funds and enhance protection of shareholders;
  - Introduce credit guarantee system for SMEs with involvement of international financial institutions at the initial stage.
3. Facilitating development of entrepreneurship competence and enhancing entrepreneurship skills:
  - Strengthen the leading role of the Ministry of Education and Science in the training process;
  - appoint an authorized individual who would be responsible for developing business acumen in the training process;

- Facilitate entrepreneurship among women, specifically, collection of more accurate and veracious data on prospects of female entrepreneurs;
- Collect data on SME entrepreneurship skills needs by carrying out regular surveys and creating sector working groups.

#### 4. Enhancing SME competitiveness:

- Develop and adopt Action Plan on development of a business-friendly service market, look for options of state support (for example, information web portal for SMEs);
- Review existing organizations and develop strategic and institutional framework of innovation policy, implement support programs in cooperation with the private sector;
- Increase SMEs involvement in public procurement;
- Provide regulatory and financial incentives for SME greening.

#### 5. Supporting SME internationalisation:

- Further improve systematic market surveillance, develop a Technical Regulation Strategy, strengthen institutional capacity of 5h3 national standardization authority;
  - Review the existing export policy, develop and implement an export promotion program: consider possibility of creating a new institution, and implement export financing and targeted support.
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**Annex 3: Number of Businesses in Ukraine and Related Indicators for 2010 through 2015**

Year	Economic Entities (Businesses)									
	Large		Medium-Sized		Small (excluding micro)		Micro		Total	
	Number	YoY change (%)	Number	YoY change (%)	Number	YoY change (%)	Number	YoY change (%)	Number	YoY change (%)
2010	586		21 338		68 316		2 093 688		2 183 928	
2011	659	12.5	21 059	- 1.3	71 083	4.1	1 608 819	- 23.2	1 701 620	- 22.1
2012	698	5.9	20 550	- 2.4	68 103	- 4.2	1 510 776	- 6.1	1 600 127	- 6
2013	659	- 5.6	19 210	- 6.5	65 021	- 4.5	1 637 180	8.4	1 722 070	7.6
2014	497	- 24.6	16 618	- 13.5	55 159	- 15.2	1 859 887	13.6	1 932 161	12.2
2015	423	- 14.9	15 510	- 6.7	47 555	- 13.8	1 910 830	2.7	1 974 318	2.2

Note: The above table does not include data on the performance of banks, budget institutions of the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol and part of the territory of antiterrorist operations

**Annex 4: Business Structure in EU and Ukraine**

Businesses	Businesses				Persons Employed				Added Value				
	EU-28	Germany	Poland	Ukraine	EU-28	Germany	Poland	Ukraine	EU-28	Germany	Poland	Ukraine	
Micro	92.70%	82.50%	95.20%	96.78%	29.20%	18.93%	36.26%	35.19%	21.10%	15.41%	17.942	8.92%	
Small (excluding macro)	6.10%	14.60%	3.70%	2.41%	20.4%	23.43%	14.47%	11.74%	18.20%	18.07%	%	14.19%	10.68%
Medium	1.00%	2.50%	0,95%	0.79%	17.30%	20.41%	18.20%	32.18%	18.50%	19.66%	20.19%	39.40%	
Small and medium	99.80%	99.51%	99.80%	99.98%	66.90%	68.93%	68.93%	79.11%	57.80%	53.41%	52.32%	58.99%	
Large	0.20%	0.48%	0.20%	0.02%	33.10%	37.23%	31.08%	20.89%	42.20%	46.86%	47.68%	41.01%	

Note: The latest available data were used for comparison purposes (the 2014 data for the 28 EU member state and the 2015 data for Germany, Poland, and Ukraine)

**Annex 5: Added Value and Employment by SME Size and Industry in Ukraine (2015)**

Industry / Company	Large		Medium		Small (Excluding Micro)		Micro	
	<i>Added value</i> (%)	<i>Employed</i> (%)						
Industry	51.7	36.3	30.3	45.7	13.6	8.5	8.9	9.5
Wholesale and retail trade; maintenance of vehicles and motorbikes	20.1	11.2	24.3	15	24.5	9.4	32.1	64.4
Transport and storage. posting and delivery services	10.5	50	7.9	24.5	6	7.7	7.1	17.8
Professional. scientific and technical activities	6.8	2.1	3.2	28.1	5.1	14.6	8.4	55.2
Other services	5.5		19.2		23.2		29.2	
Agriculture. forestry and fishery	4.1	7.5	12.4	53.9	20.5	18.2	10.6	20.4
Construction	1.3	1.2	2.7	38.5	7.1	27.4	3.7	32.9

Note: The above table does not include the data on the performance of banks, budget institutions of the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol and part of the territory of antiterrorist operations

### Annex 6: Businesses in Ukraine by Regions in 2015

Region / Indicator	Enterprises		Self-Employed Individuals	
	Number per 10,000 residents	Employed individuals as % of the employed population	Number per 10,000 residents	Employed individuals as % of the employed population
Oblasts:				
Vinnitsia	59	2.5	445	4.3
Volyn	54	1.7	419	2.9
Dnipropetrovsk	83	10.9	403	8.4
Donetsk		7		3.4
Zhytomyr	53	1.9	416	3.2
Zakarpattia	49	1.3	426	3.3
Zaporizhia	82	4.5	454	4.8
Ivano-Frankivsk	57	1.5	344	3.2
Kyiv	105	5.7	465	4.8
Kirovohrad	79	1.6	351	2.1
Lugansk		1.9		1.1
Lviv	74	5.6	401	6.4
Mykolaiv	91	2	409	2.7
Odesa	100	5.2	455	6.1
Poltava	70	3.6	386	3.8
Rivne	45	1.4	327	2.6
Sumy	52	1.9	356	2.7
Ternopil	48	1.3	371	2.6
Kharkiv	92	6.8	537	8.7
Kherson	75	1.4	396	2.6
Khmelnytskyi	54	1.8	456	3.6
Cherkasy	67	2.2	376	3.1
Chernivtsi	45	0.8	481	2.5
Chernihiv	57	1.7	363	2.4

Note: The above table does not include the data on the performance of banks, budget institutions of the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol and part of the territory of antiterrorist operations.

### Annex 7: Results of the Analysis of External and Internal Environment of SMEs in Ukraine

Strengths	Weaknesses
<p>Easiness of registering businesses</p> <p>Competitive labour costs</p> <p>Highly qualified labour</p> <p>Introduction of efficient regulation processes</p> <p>Successful elimination of trade barriers; adaptation to EU standards</p> <p>Improvements in the sphere of public procurements</p> <p>Large domestic market</p> <p>Streamlined taxation system</p> <p>Advantageous geographical location of the country</p> <p>Remote training including training in various entrepreneurship aspects</p> <p>Public involvement in development of national policies</p>	<p>Unfavourable macroeconomic situation</p> <p>Considerable corruption and regulatory pressure</p> <p>Lack of proper stakeholders' coordination to satisfy SME needs</p> <p>Undeveloped entrepreneurship culture</p> <p>Lack of assessment of SME needs in educational/training services</p> <p>Lack of accessible and long-term finance</p> <p>Loss of production facilities, logistic problems</p> <p>Low energy efficiency</p> <p>Insufficient internationalization of SME</p> <p>Large grey sector of the national economy</p> <p>Problems when closing enterprises</p> <p>Problems when doing tax administration of SMEs</p> <p>Power purchasing power of the Ukrainian population</p>
Opportunities	Weaknesses
<p>Support by the international community</p> <p>Agreement on Association between Ukraine, on the one hand, and the European Union, European Atomic Energy Community and their member states, on the other</p>	<p>Continuing geopolitical instability in the Eastern part of Ukraine</p> <p>Slow revival of the economy or new macroeconomic shocks</p> <p>Slow implementation of reform programmes</p>

<p>hand; other free trade agreement</p> <p>"Ukraine 2020" Sustainable Development Strategy and comprehensive reform programme</p> <p>Further development of the public procurements system</p> <p>Participation in the EU-funded Research and Innovation Programme, HORIZON-2020, and Competitiveness of Enterprises and Small and Medium-sized Enterprises Programme for 2014-2020 (COSME)</p> <p>Utilization of opportunities provided by the Enterprise Europe Network (EEN)</p> <p>Rapid development of information and telecommunication technologies and informatization</p> <p>Banking sector's capacity to grant loans to SMEs</p> <p>Increase in energy efficiency</p> <p>Increased capacities of employer associations</p> <p>Interaction of stakeholders providing support to SMEs</p>	<p>Unforeseen changes in the legislation</p> <p>Social unrest</p>
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**Annex 8: Action Plan to Implement the Small and Medium-Sized Enterprise Development Strategy of Ukraine until 2020**

Actions	Responsible Authorities	Timeframe	Indicator of Completion
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