



Business
OMBUDSMAN
Council

SYSTEMIC REPORT

BIG CHALLENGES FOR SMALL BUSINESS

EVALUATION OF SMALL AND MEDIUM-SIZED
ENTERPRISES DEVELOPMENT STRATEGY
IN UKRAINE FOR THE PERIOD UP
TO 2020 AND FURTHER POLICY PROSPECTS



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LIST OF ABBREVIATIONS

Abbreviations	Definition
Association Agreement	Association Agreement between Ukraine, of the one part, and the European Union, the European Atomic Energy Community and their Member States, of the other part, ratified with the Law of Ukraine dated September 16, 2014 No. 1678-VII
BOC	Business Ombudsman Council
CEB	Central executive body
CMU	Cabinet of Ministers of Ukraine
EBRD	European Bank for Reconstruction and Development
ECA	Export Credit Agency
EDF	Entrepreneurship Development Fund
EU	European Union
Export Strategy	Export Strategy of Ukraine (Strategic Trade Development Road Map 2017-2021), approved with the CMU's Resolution dated December 27, 2017 No. 1017-r
GDP	Gross Domestic Product
GUF	German-Ukrainian Fund
ILO	International Labor Organization
KCSA	Kyiv City State Administration
M-Test	M-Test is a component of the Regulatory Impact Analysis based on a methodology for calculating small-sized business standard costs to execute a specific regulatory act. M-Test results allow substantiating options for mitigating an administrative burden on small-sized businesses
MFA	Ministry of Foreign Affairs of Ukraine
MinEconomy	Ministry of Economic Development, Trade and Agriculture of Ukraine
MinFin	Ministry of Finance of Ukraine
NBU	National Bank of Ukraine
OECD	Organization for Economic Co-operation and Development

Abbreviations	Definition
RIA	Regulatory Impact Analysis, introduced in the Law of Ukraine “On Principles of State Regulatory Policy in the Sphere of Economic Activity” in 2004
SACI	State Architectural and Construction Inspectorate of Ukraine
SFS	State Fiscal Service of Ukraine
SME	Small and medium-sized enterprise/Small and medium-sized entrepreneurship
SME Development Office	Small and Medium-sized Entrepreneurship Development Office under the MinEconomy
SME Strategy	Small and Medium-Sized Entrepreneurship’s Development Strategy in Ukraine for the Period Up to 2020, approved with the CMU’s Resolution dated May 24, 2017 No. 504-r
SRS	State Regulatory Service of Ukraine
SSC	Single contribution for mandatory state social insurance
StateStat	State Statistics Service of Ukraine
STS	State Tax Service of Ukraine
Technical Regulation Strategy	Strategy of Development of Technical Regulation System for the Period Up to 2020, approved with the CMU’s Resolution dated August 19, 2015 No. 844
USAID CEP	The Competitive Economy Program in Ukraine, funded by the US Agency for International Development and implemented by Chemonics International Inc.

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FOREWORD

Micro-, small and medium-sized enterprises (SMEs) in Ukraine have always been existing in complicated social and economic circumstances. The current situation is stipulated with surmounting the third economic crisis starting from 2014 in view of a geopolitical conflict at the East of the country, annexation of Crimea and now it can be characterized with emphasizing the importance of the SME economy segment as a crucial one.

In Ukraine, SMEs are an important source of employment being significant contributors to Ukraine's gross domestic product (GDP). According to the State Statistics Service of Ukraine (StateStat), SMEs comprise a lion's share of a total number of enterprises in Ukraine in 2018, a number of medium-sized enterprises accounts for 16,5k, small — 182.3k of which micro — 176.5k companies (including nearly 148.4k individual entrepreneurs) which employ 6.9mn employees¹, exceeding 40% of the hired workforce.

The SME's development is one of priorities for the Ukrainian Government, enshrined not only in the EU-Ukraine Association Agreement, but also embodied in the SME's Development Strategy for the Period up to 2020, approved with the CMU's Resolution No. 504-r dated May 24, 2017 (SME Strategy). To have the SME Strategy implemented, the CMU adopted the Action Plan, approved with the Resolution dated May 10, 2018 No. 292-r, which, in turn, provides for the achievement of certain objectives of state authorities related to the directions determined in the SME Strategy.

Since SMEs' complaints (including those from micro-business) take an important place in the Business Ombudsman Council's (BOC) activities, the BOC's Supervisory Board has proposed a topic of SMEs for this systemic report. The BOC's systemic recommendations are expected to be applied for further comprehensive analysis of the SME Strategy's implementation measures and elaboration of further state policy for SMEs.

The report commences with **overall situation assessment by SMEs and efficiency of the Action Plan to the SME Strategy**. In the BOC's view, there is a need to review the Action Plan, which should have been implemented by January 1, 2020. The Government should approve updated measures for SME's realistic support and development, covering activities for all these groups of business entities (micro-, small and medium-sized), and allocating appropriate financial resources for the implementation of such measures. In the BOC's view, an overall focus of this report should relate to those structural changes in the SME sector which will facilitate the transformation of small enterprises into medium-sized ones and create conditions for more rapidly growing small businesses to appear.

An important place in interaction between the state and SMEs is held by the **SME Development Office** currently operating under the Ministry of Economic Development, Trade and Agriculture of Ukraine (MinEconomy). The BOC recommends introducing the practice of informing SMEs of

¹ StateStat. Table "Number of Employed Personnel of Large, Medium-Sized, Small and Microenterprises by Types of Economic Activity in 2010-2018" without taking into account the results of activity of banks, budgetary institutions, as well as for 2014-2018 except for the temporarily occupied territory of the Autonomous Republic of Crimea, the City of Sevastopol and a part of temporarily occupied territories in Donetsk and Luhansk Regions.

major legislative amendments (for example, through publication at the SME Development Office's website)² that directly set new requirements for micro- and small businesses. Such information from a reliable source would considerably help institutionally weak micro- and small enterprises to comply with the law and would not create prerequisites for claims from regulatory authorities against them.

We also believe that activities aimed at fostering the entrepreneurial culture and the development of entrepreneurial skills held by the SME Development Office should be complemented with application of compliance practices among SMEs. The BOC singled out several types of recommendations on the SME Development Office's capacity building in this area, in particular, by encouraging the development of a partnership network with collective actions in the private sector, increasing training capacity of the created platform aimed at raising awareness of companies about international compliance standards and implementing them in the private sector.

Given that the BOC has also analyzed the issue of SMEs' access to finance, aggregation of up-to-date information on funding programs and grants, relevant educational programs for SMEs, including their preparation for bank financing and loan application, is also a rational direction in activities of the SME Development Office.

Another important part of the work is to increase the capacity of **local authorities to implement substantiated regulatory policies for SMEs and control measures** that would facilitate the development of SMEs, increase their business volumes and help them carry out their activities in compliance with the national legislation. For this purpose, especially for the SME Development Office, it would be expedient to develop guidelines for

local self-government authorities on a uniform presentation/placement of information necessary for business at their websites.

In addition, the State Regulatory Service (SRS) holds an important place in creating favorable environment for the SMEs' development. In the BOC's opinion, the SRS should regularly carry out awareness-raising activities among central and local governmental officials on compliance with the requirements of the Law of Ukraine "On Principles of State Regulatory Policy in the Sphere of Economic Activity" (preparation of RIA, publishing information, public discussions, professional dialogue with respective business associations, M-Test application).

Tax authorities have a significant impact on SMEs' activities. It is the SMEs that are often subject to specific and sometimes excessive **control by tax authorities**. The reason for this is usually malpractice of those market players taking advantage of the simplified regulation for micro- and small business. However, the BOC finds it necessary to emphasize tax authorities should focus on scrutinizing factual circumstances rather than applying common practice of a formal approach to these entities.

In particular, the Ministry of Finance of Ukraine (MinFin) and the State Tax Service of Ukraine (STS) should amend a procedure of tax invoice suspension so that the tax authorities explicitly provide a taxpayer with not formal but actual reasons that led to a decision on suspension of tax invoices or inclusion in the list of risky taxpayers. Such information should allow the taxpayer to refute such reasons or to understand how to adjust his business activity.

It is important to note that the top management of the STS and the State Customs Service (SCS) should take organizational steps to ensure mandatory and prompt enforcement of court decisions by their subordinates and

² During the preparation of this report, several expert opinions were also expressed about the practice of informing the SMEs, which should be tied to the task of a higher level - the digitization of relations between the state and SMEs, which would allow to rapidly deploy and integrate the state's interaction system with many small enterprises. This task would continue to implement lower-level sub-tasks, including the creation of a single register of SMEs, the creation of specialized online services for SMEs, the deepening of statistical information on the development of SMEs, the dissemination of information of various nature, etc.

bring them to disciplinary liability for delays in such enforcement.

On the whole, it is now necessary for the state to rethink the existing Labor Code, to introduce modern labor law based on the freedom of employment agreement, simplify tax administration and reporting, labor-related documenting, to reduce penalties for violation of labor legislation — all the mentioned aspects directly relate to SMEs' problems.

In particular, there is an issue of **audits and inspection visits** to employers **related to their compliance with the requirements of labor legislation**, which can put significant pressure on business. In this regard, the BOC proposes to streamline the possibility, grounds and procedure for carrying out such inspections and establish economically justified penalties, since such inspections are currently regulated by international conventions, laws and by-laws, which could be mutually contradictory.

Current state SME policy declares the importance of **promoting export activities/ internationalization of SME**. Sharing this approach, the BOC has carefully examined these issues both in the context of measures envisaged in Governmental strategies and various SMEs' needs.

Since the progress tracking of tasks implementation within an export promotion direction is not provided in the SME Strategy, whereas there are no clear quantitative and qualitative indicators of the SMEs' export in the Export Strategy of Ukraine (Strategic Trade Development Road Map 2017-2021) (Export Strategy), the BOC considers it necessary to recommend the MinEconomy, when determining further steps aimed at the export development, to provide for the indicators that would allow to monitor the progress particularly for SMEs and, when analyzing statistical data, to separate the effect of implemented measures from the indicators of large enterprises.

While we unconditionally support the idea of establishing and functioning of the Export Promotion Office, we consider it expedient to emphasize the necessity to continue providing the Office with proper resources to expand support services in accordance with the Export Strategy and the SMEs' demand, as well as to disseminate information about the Office's capabilities among SMEs' representatives. This recommendation is also in line with the OECD recommendations provided to the Government as part of the independent monitoring of the SME Development Strategy implementation in Ukraine.

Ensuring the transparent and efficient functioning of the Export Credit Agency (ECA) according to the best international practices is an important area for SMEs' support. While completing legislative steps to launch the ECA, it is recommended that the CMU, the MinFin, and the MinEconomy carry out additional analysis of: (i) the level of the ECA's capitalization and governmental support so that the institution can cover as many business representatives as possible, including SMEs, and to make their own functional accessible and (ii) the areas supported by the law, primarily in the context of their consistence with the identified priority sectors according to the Export Strategy.

An equally important component of the institutional support for exports is the final approval and implementation of the creation of a full-fledged foreign network (trade representative offices) provided with sufficient resources and functionality to effectively support domestic businesses, including SMEs, with gradual geographical expansion of such institutions. In this context, it is also expedient to ensure that these foreign institutions closely cooperate with the Export Promotion Office when processing requests from business entities, particularly SMEs.

Launching of the National export web portal with its proper and regular content filling for providing active and potential exporters

with useful and accessible information, with introduction of a separate section on incentives and opportunities of using innovations by exporters, as defined in the Action Plan to the Export Strategy, should become a significant component as well.

Limited **access to finance for SMEs** is one of the biggest obstacles to business development. In this context, the BOC advises to review and evaluate the relevance of measures set forth in the Action Plan to the SME Strategy and to prioritize those that may have rapid and significant impact on SMEs' access to finance.

It is also considered appropriate to analyze the implementation progress of regional financial and credit support programs for business entities at the expense of budgetary funds

that have been running since 2018 in terms of their effectiveness and to develop an optimal approach to providing financial and credit support to business entities in the regions.

At the same time, it is also important to prioritize the implementation of the SME Strategy for the development **of innovative activities** aimed at enhancing copyright protection, improving the national patent protection system, and harmonizing the national patent legislation with the relevant standards of the European Union (EU), in particular: introducing the European technical standards in Ukraine provided for in the Association Agreement; adjusting a process of transfer of intellectual property rights; introducing state support for patenting of intellectual property of Ukrainian innovators abroad through co-financing, etc.

1 GENERAL OVERVIEW

1.1. European dimension of SME

According to the Association Agreement, the parties have undertaken to develop and strengthen cooperation on industrial and entrepreneurial policies, thereby improving conditions for business activities for all business entities with a particular focus on SMEs.

For this purpose, it was provided to implement the SME Strategy based on principles of the

European Charter for Small Enterprises³, and to monitor its implementation progress through annual reporting and dialogue. Such cooperation also provides for the specific attention to micro- and craft enterprises as their utmost importance is recognized in the Association Agreement as an EU-Ukraine economy element⁴.

1.2. SME's definition criteria

Table 1. SME's definition criteria

			Micro-	Small	Medium-sized	Large
European Union ⁵		Number of employees	<10	<50	<250	>250
		Annual turnover, EUR mn	≤2	≤10	≤50	>50
		Annual balance, EUR mn	≤2	≤10	≤43	>43
Ukraine	Law of Ukraine "On Accounting and Financial Reporting in Ukraine" ⁶	Average number of employees	<10	<50	<250	>250
		Net sales revenue, EUR mn	<0.7	<8	<40	>40
		Assets book value, EUR mn	<0.35	<4	<20	>20
	Commercial Code of Ukraine	Average number of employees per calendar year	≤10	≤50	All non-micro, small and large entities	>250
			and	and		and
		Annual revenue, EUR mn	≤2	≤10		>50

³ Available at: https://zakon.rada.gov.ua/laws/show/994_860

⁴ See Art. 378, 379 of the Association Agreement. Available at: https://zakon.rada.gov.ua/laws/show/984_011

⁵ See Commission Recommendation dated May 6, 2003 concerning the definition of micro-, small and medium-sized enterprises (2003/361/EC). Available at: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:EN:PDF>

⁶ The law does not assign individual entrepreneurs to micro-enterprises, only legal entities.

Within the EU, SMEs' definition varies across the Member States and can be applied when determining tax rates and providing financial support⁷. In turn, there are two approaches to the SMEs' classification in the effective Ukrainian legislation (see Table 1):

- Pursuant to Art. 2 of the Law of Ukraine "On Accounting and Financial Reporting in Ukraine"⁸, it is required that at least two of three conditions should be met.
- Pursuant to Art. 55 of the Commercial Code of Ukraine⁹ two conditions are required to be met to assign to one size or another.

The approach of the Commercial Code of Ukraine was implemented alongside the adoption of the Law of Ukraine "On Development and State Support of Small and

Medium Enterprises in Ukraine"¹⁰, which, with the exception of the annual balance criterion, is more in line with the approach used in the EU, in particular when identifying grounds for providing state aid and taking measures aimed at the SME's development. Thus, **we believe the criteria for SMEs in the EU, for the purposes of this document, are compatible with those in the national legislation.**

It should be noted that there is a **large gap between micro-, small and medium-sized businesses in Ukraine**. It is important to consider this in the context of further discussion of the SME Strategy, issues and activities of which are mostly related to small and medium-sized businesses, while micro-business issues have not been properly addressed.

1.3. Ukrainian SMEs and global ratings

A positive tendency in terms of the business development is showcased with dynamics of Doing Business Report, prepared by the World Bank. According to this source, Ukraine has improved from 112th position in 2014 to 64th in 2020. However, the competitiveness of the Ukrainian economy has not significantly improved over the recent years: as follows from the Global Competitiveness Index, administered by the World Economic Forum, Ukraine's position has been fluctuating around 80s over the last 4 years, which indirectly may indicate the necessity of unlocking capabilities

of SMEs, which actually are the economy driver.

The Bureaucracy Index 2018 conducted by EasyBusiness¹¹ showed that small businesses annually waste over EUR 1k of their revenue to perform 63 redundant bureaucratic duties consuming 469 man-hours. When comparing Ukraine to other countries participating in this study — the Czech Republic, Slovakia and Lithuania, one can see that Ukraine spends almost twice as much time on such procedures having approximately the same

⁷ Since 2003, the European Commission has updated the criteria recommended for use. It should be noted that under paragraph 3 of the European Commission Recommendation, an enterprise should be considered to be any entity, regardless of its legal form, engaged in economic activities, including in particular entities engaged in a craft activity and other activities on the individual or family basis, and partnerships or associations regularly engaged in economic activities.

⁸ Available at: <https://zakon.rada.gov.ua/laws/show/996-14>

⁹ Available at: <https://zakon.rada.gov.ua/laws/show/436-15>

¹⁰ Available at: <https://zakon.rada.gov.ua/laws/main/4618-1>

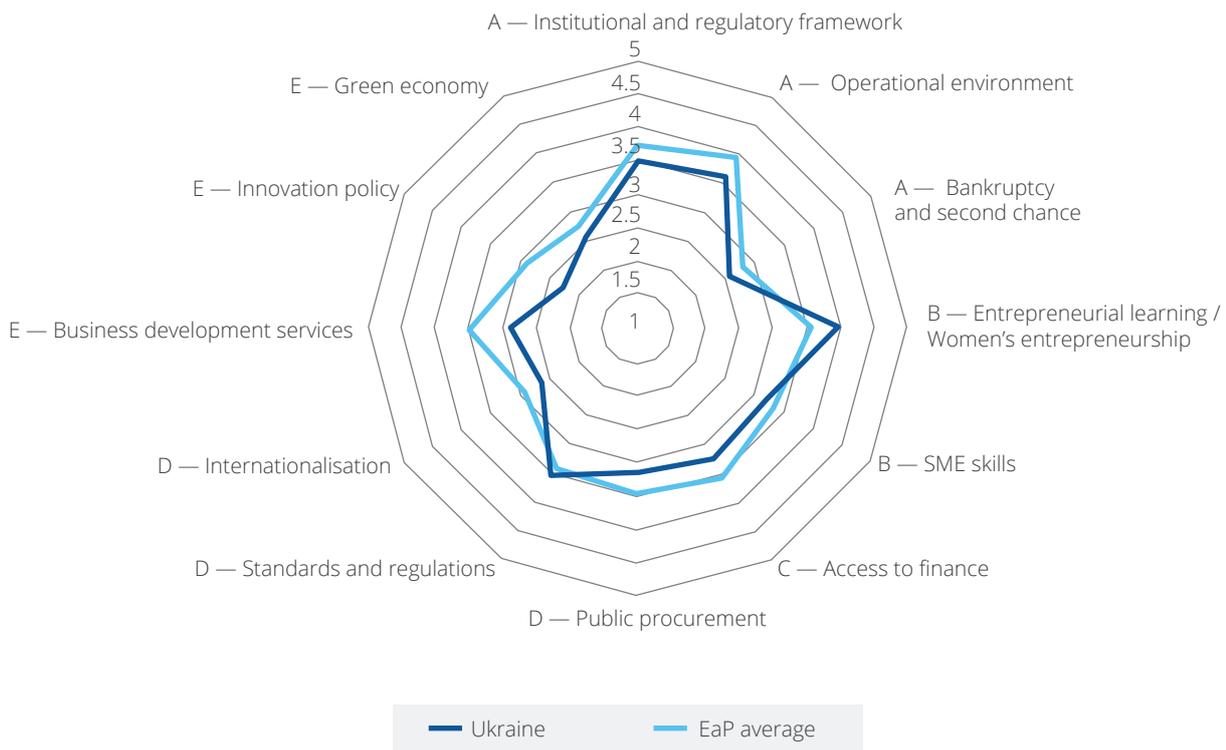
¹¹ Available at: <https://bureaucracyindex.in.ua/>

number of bureaucratic procedures per year. An in-depth analysis of bureaucratic procedures' composition shows room for the improvement in tax, management accounting and labor legislation.

According to the SME Policy Index for Ukraine in 2020 prepared by the Organization for Economic Co-operation and Development (OECD) within the Eurasia Competitiveness Program, despite significant improvements that have taken place since 2016, compared to other Eastern Partnership countries¹²

Ukraine is lagging behind the vast majority of indicators — innovation policy, institutional framework, operational environment, bankruptcy and second chance, green economy, business development services, internationalization, access to finance, public procurement and SME skills. Ukraine's advantage over the compared countries is seen only in the context of entrepreneurship training (including promotion of women's entrepreneurship) and regulation/standardization (see Chart 1).

Chart 1. SME Policy Index scores for Ukraine, 2020



Sources: OECD, EC, EBRD and ETF, SME Policy Index: Eastern Partner Countries 2020: Assessing the Implementation of the Small Business Act for Europe, SME Policy Index, OECD Publishing, Paris. OECD, Monitoring Implementation of Ukraine's SME Development Strategy 2020, OECD.

¹² Eastern Partnership was launched as a joint initiative in 2009. It includes Ukraine, Azerbaijan, Belarus, Armenia, Georgia, Moldova and the EU.

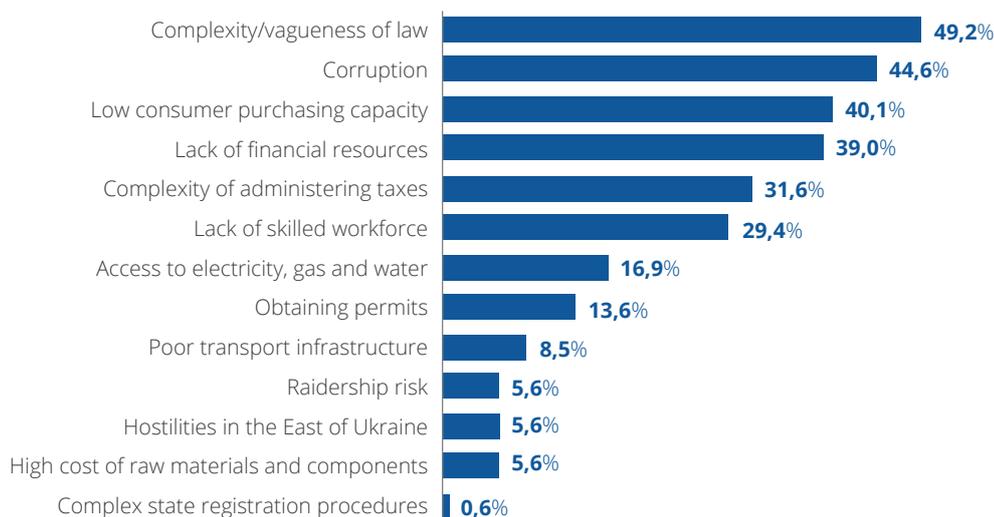
1.4. Assessment of business environment by SMEs¹³

Survey findings **on changes in the regulatory environment related to SMEs** recently conducted by the USAID Competitive Economy Program (USAID CEP) show that 42.6% of the respondents did not notice any significant changes. However, positive assessment of change in the regulatory environment was remarked by 33.3% (with a slight improvement stated by 29.6% and

a significant improvement by only 3.7% of the panelists). The overall negative marks are 16.7% (with a slight worsening stated by 7.4% and a major one — by 9.3% of the participants)¹⁴.

Below is the information on the biggest obstacles to doing business that surveyed SMEs have pointed out to (see Chart 2).

Chart 2. The biggest obstacles to doing business in 2019¹⁵



Source: State SME Policy Implementation Evaluation Report for Ukraine, USAID CEP 2019¹⁶

¹³ This section is based on the Report of State Policy for the Development of Small and Medium-Sized Entrepreneurship Implementation in Ukraine prepared at the request of the BOC by the USAID Competitive Economy Program.

¹⁴ State SME Policy Implementation Evaluation Report for Ukraine, USAID CEP 2019

¹⁵ The above list of obstacles emphasizes the paternalistic sentiment of society and the domination of the external locus of control over the internal. This indicates high expectations for the state and external factors, which should be uncharacteristic for the business community.

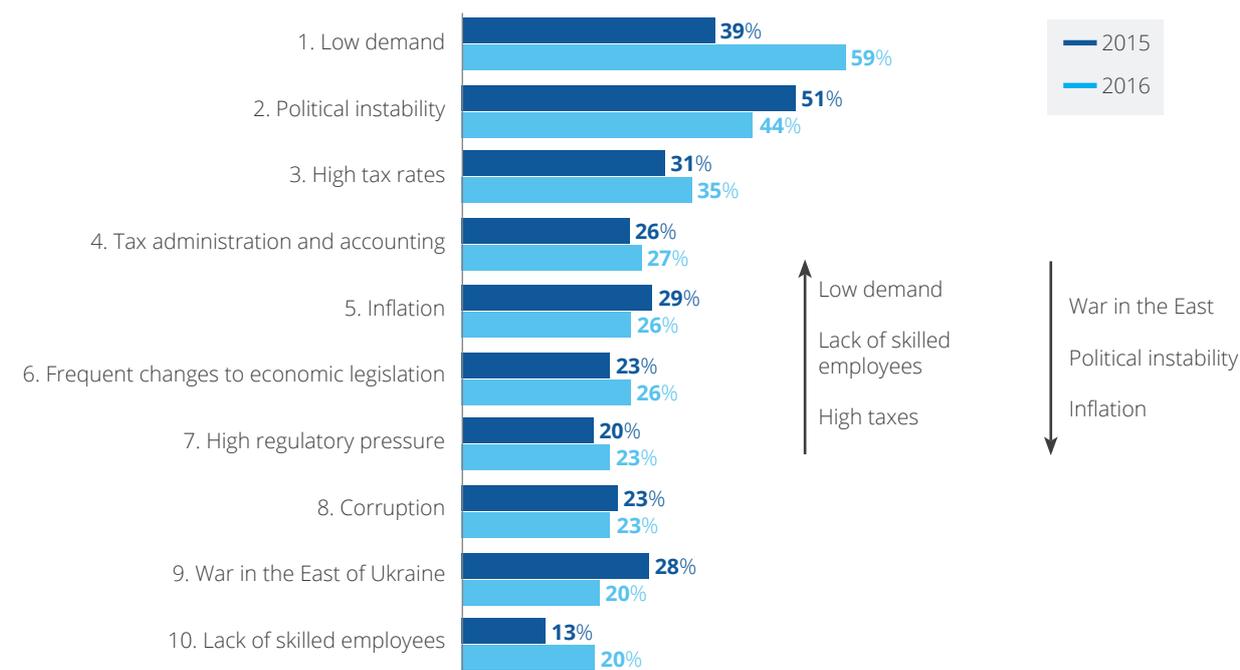
¹⁶ Quantitative data were collected by:

- Questionnaire of the focus group participants in 6 cities of Ukraine (Cherkasy, Odesa, Vinnytsia, Ivano-Frankivsk, Chernihiv and Zaporizhzhia). Focus groups discussions were held by the same scenario in all six cities. Selection of the focus group participants was carried out in partnership with regional state administrations and local business associations through a targeted sample that was most relevant to the research objectives and was able to gather a wide range of views from various SMEs' representatives.
- Filling in an online questionnaire distributed via social networks and among the USAID CEP partners.

A similar study of the Institute for Economic Research and Policy Consulting “Annual Business Climate Assessment 2016: National

and Regional Dimensions”¹⁷ yet two years ago revealed the relevance of these problems for SMEs (see Chart 3).

Chart 3. SME development barriers rating



Source: Annual Business Climate Assessment 2016: National and Regional Dimensions, USAID LEV 2016

The aforementioned survey has been conducted using different methodologies, which are obviously incomparable. However, creators of this report, being curious, decided to compare dynamics of certain parameters and highlighted the following notable changes:

- “War in the East of Ukraine” consistently reduces its impact on the work of SMEs (in 2015 — 28%; 2016 — 20%; 2019 — 5.6%);
- “Low consumer purchasing capacity / Low demand” shows a slow improvement (in 2015 — 39%; 2016 — 59%, 2019 — 40,1%);
- “Complexity of administering taxes / Tax administration and accounting” remains approximately at the same level (2015 — 26%; 2016 — 27%; 2019 — 31.6%);
- “Lack of skilled workforce / employees” shows the negative dynamics (2015 — 13%; 2016 — 20%; 2019 — 29,4%);
- “Corruption” is the indicator which impressed the BOC with its negative dynamics (2015 — 23%; 2016 — 23%; 2019 — 44,6%).

¹⁷ Prepared under the USAID LEV Program. Available at: http://www.ier.com.ua/sme_development/ABCA?pid=5789&fbclid=IwAR0OosBgk

When discussing the SMEs' issues, **actions of local authorities** take a separate place. In the process of decentralization, local authorities have been vested with broad regulatory powers. They also manage local movable and immovable property, land, natural resources, as well as control public utility companies. SMEs are directly affected by local authorities in terms of locating new facilities in their territories, approving local city planning documentation, public services planning and organization rules (including cleaning and sanitary conditions, market trade), sales of beer and alcoholic beverages, requirements to equipment of parking lots, etc.

Local authorities may arrange inspections on some issues related to services delivered by trade and catering enterprises, household services, transport, communication, in the field of control over compliance with labor law and workforce employed in private enterprises, as well as individuals using hired labor.

However, local authorities are not always able to properly exercise their delegated powers as the approach they apply often creates prerequisites for corruption, while actions of local inspectors are perceived as pressure on businesses which is fully reflected in the BOC's complaints statistics.

Examples of public authorities' malpractice in their interaction with SMEs based on the BOC's practice

EXAMPLE 1.

An individual entrepreneur sold by retail in her store. The entrepreneur addressed the BOC to complain about actions of one of the Settlement Councils in Kyivska Region and its chairman in connection with the creation of artificial obstacles to the complainant's business activities.

These obstacles consisted in putting cement blocks and vases, which blocked the street of public use, where the complainant's store was located, so that her main customers — car drivers were unable to get to the store. Despite an effective court decision, local self-government authorities dismantled the previous barriers and, at the same time, replaced them with another one — a metal lifting gate.

Unfortunately, even after the court had officially clarified the need to dismantle all the barriers, local authorities continued violating the complainant's rights.

EXAMPLE 2.

In June 2018, an enterprise from Odeska Region complained to the BOC about inaction of the State Architectural and Construction Inspectorate of Ukraine (SACI). Since April, the complainant has been trying to submit a notification on the start of a car wash construction to the SACI. He could not start the construction without having the document registered.

According to the procedure, the registration is performed automatically within 1 day. However, during a month the SACI has not been registering the notification. A month later, the SACI returned the documents and indicated reasons for the refusal: the applicant incorrectly wrote a word “pavilion”, without a letter “i”. In addition, although the city was indicated in the address, “Odeska Region” was missing. According to the complainant, an intermediary turned to him and offered “to speed up the process and solve the issue with the SACI”. Disagreeing to give bribes, the company addressed the BOC.

Considering the refusal of the SACI groundless, the BOC requested the inspectorate to register the complainant’s documents. As a result, with the assistance of the BOC, the company’s notification on the start of the construction process was registered.

EXAMPLE 3.

In September 2018, an individual entrepreneur, a pub owner in Kyivska Region, appealed to the BOC. The individual entrepreneur complained about actions of a tax authority. In August, the entrepreneur, being a single tax payer, applied to the tax authority for a license to sell cider. At first, the tax authority was continuously refusing to accept the Complainant’s documents, and then replied that in order to sell this beverage the Complainant should switch to the general taxation regime.

After a series of refusals, unscheduled tax audits and numerous complaints to a hotline of the State Fiscal Service of Ukraine (SFS), the entrepreneur, overwhelmed with a feeling of injustice, turned to the BOC for support. In the course of investigating the case circumstances and the relevant legislation, the BOC established that according to the Tax Code, single tax payers of group I-III, as the complainant was, can sell beer and jug wines. At the same time, selling cider (including perry) is possible only if the general taxation regime is chosen.

Having acknowledged the relevance of the entrepreneur’s arguments regarding legal regulation of selling such beverages, discerning disproportionate approach, the BOC raised this issue in its communication with the MinFin and the SFS. After several months of the BOC’s correspondence with the relevant authorities on this issue, the Tax Code was amended — since 2019 single tax payers of groups I-III have been enabled to obtain a license and sell cider and perry.

EXAMPLE 4.

The BOC received a complaint from an individual entrepreneur arguing that governmental agencies were unable to completely deregister her as an entrepreneur. As a result, she had a debt to the tax authority.

The entrepreneur decided to terminate her business activity and approached an administrative service center for this reason. The state registrar gave her a description of the submitted documents and assured that the termination of her business activity would be registered. However, the state registrar made a mistake — instead of performing “decision to terminate” and “termination” registration actions she performed only the first one. The termination of business activity remained “incomplete”. According to the law, every individual entrepreneur, even an inactive one, has to pay a single social contribution (SSC) from a minimal salary.

As a result, when 9 months later the entrepreneur found out (by post from the tax authority) that the termination of her business activity had not been registered, the SSC debt was already over UAH 6k. When she turned to the tax authority, they simply threw up their hands and explained they relied on the state register data, from where she had not been excluded yet. Therefore, the SSC would be being accrued further.

The entrepreneur came to the administrative services center to complete the liquidation process. The civil servant, who had made the mistake, no longer worked there by that time. Fortunately, her manager, realizing his responsibility, got down to correcting his colleague's failure. However, instead of performing the registration action on the date when the documents had been submitted, he performed it on the date when the error was detected.

As a result, the tax authority received a notice of liquidation and made sure it was right — the individual entrepreneur was registered for the past eight months and the SSC was accrued correctly. Accordingly, the SSC claim was sent to the enforcement service and the enforcement proceeding against the entrepreneur was initiated, as well as the respective fees were charged. Her bank accounts were blocked.

The complainant repeatedly turned to the tax authority but was told it was impossible to solve her problem due to the state register data. In addition, she repeatedly addressed her issue to the registration department requesting to correct the mistake in the register (change the termination date of her business activity to the correct one), but received replies with apologies for the inconvenience caused and explanations that correcting the date was technically impossible. Complaints against the registrar's actions to the Ministry of Justice of Ukraine were also to no avail — the complainant received formal replies stating that her complaints did not meet formal requirements (improperly certified copies, no confirmation of absent ongoing litigation).

The ex-businesswoman turned to the BOC at quite a late stage, when refusals had been received almost from everyone and there was little hope for a happy end. The BOC advised the Complainant to lodge a complaint to the territorial justice authority against the omission of the state registrar having made sure the complaint met all the formal requirements. Not long before that the registration department provided the complainant with another written reply explaining the impossibility of correcting errors in the register. Based on the receipt date of this reply, one was able to prove that the deadline for filing a complaint was not violated.

During the complaint consideration, the BOC was once again told it was technically impossible to correct the register error. They even referred to the corresponding letter of the technical administrator of the register. Therefore, the commission did not find it possible to correct the date of termination of business activity. However, the BOC's investigator managed to convince commission members that it could not be left just like that and, at least in the reasoning part of the commission's conclusion, it was necessary to establish the fact that the state registrar's actions were illegal and to penalize her.

Having obtained the commission's conclusion in which the facts of the state registrar's illicit actions and the incorrect date of termination were established, the investigator, jointly with the Complainant, arranged a meeting to convince tax officers to correct the information on the outstanding SSC. The dialogue was difficult at first. Following the communication, the tax authority, originally set to write another formal refusal to the entrepreneur, decided to address the territorial department of justice with an official request, asking to confirm the complainant's version of the real date when the business had been terminated. The BOC discussed this issue with the territorial department of justice, and after its reply the tax authority corrected the information on the allegedly existing nine-month-old SSC debt in the taxpayer's integrated card. Besides, at the BOC's request, the tax authority informed the state enforcement officer on withdrawal of the previously sent SSC claim. Based on this request, the enforcement proceeding was closed and the complainant's accounts were unblocked without the enforcement fees and costs charged.

EXAMPLE 5.

A private enterprise had a permit for pollutant emission into the air in 2008. Its validity expired in December 2013, that is why the company applied to the Ecology Department of the Kyiv City State Administration (KCSA) in advance in November to have the permit extended.

At the end of December 2013, the KCSA Ecology Department registered the company's report on pollutants emissions' inventory, but during 2014-2015, the KCSA Ecology Department made numerous remarks on the drawing up and content of the documents submitted for approval. The main reason for refusal was non-compliance of the documents substantiating emissions with the Regulation on General Document Formalization Requirements in which Emission Volumes are Substantiated to Obtain Permits for Enterprises, Institutions, Organizations, and Entrepreneurs Emitting Pollutants into the Air by Stationary Sources.

In view of the lack of progress and constructive communication with the authorities during two years, in August 2015, the company decided to seek help from the BOC.

Having examined the complaint, the BOC provided recommendations to the KCSA Department of Urban Improvement and Conservation and the Ministry of Ecology and Natural Resources of Ukraine regarding the subject matter. After several stages of communication, the complainant was eventually granted a permit with an unlimited term in June 2016 and an internal investigation in the corresponding KCSA department was conducted.

EXAMPLE 6.

In March 2014, Vinnytsia City Council Executive Committee approved a procedure for using municipal facilities for seasonal trade and fairs, which in fact introduced the need to obtain trade approvals, i.e. documents having signs of permits.

Following consideration of the complainant's applications, Vinnytsia City Prosecutor's Office (prior to cancellation of the general supervision function), addressed the Committee on bringing the said legal act in compliance with the current legislative requirements.

Due to the rejection of the Executive Committee to consider the prosecutor's application in October, a lawsuit was filed — Vinnytsia District Administrative Court dismissed the prosecutor's claims in November due to the fact that the disputed decision was found no longer valid according to the Executive Committee's decision dated November 6, 2014.

At the same time, in February 2015, the Executive Committee again decided on approval of the procedure for using facilities for trading activities in mobile objects of seasonal trade, seasonal trade points of sale and organization of fairs in the City of Vinnytsia. This decision introduced a similar obligation to obtain an approval for trade.

In the course of investigation, the BOC found out entering this procedure into force was contrary to provisions of the current Ukrainian legislation, which was also confirmed by the MinEconomy, SRS and the Ministry of Regional Development and Construction of Ukraine in reply to the BOC's requests.

As all available means to resolve the complaint were exhausted, the BOC discontinued the investigation. Meanwhile, it is still necessary to amend the current legislation to eliminate misreading and to clearly distinguish competences of state and self-government authorities in terms of legal regulation of the licensing business activity in trade.

EXAMPLE 7.

Under sale and purchase agreements, an individual entrepreneur imported road vehicles — a tractor truck and a semi-trailer. Subsequently, the vehicles were registered in the Unified State Register of the Ministry of Internal Affairs of Ukraine and were assigned to the name of an individual (citizen).

According to the tax administration, which carried out an unscheduled documentary onsite inspection of the individual entrepreneur related to the claimed budget VAT refund, the subject of ownership of the purchased vehicles is an individual (citizen), not the individual entrepreneur, who paid for their purchase, and, therefore, actually there was transfer of vehicles from the individual entrepreneur to the individual (although it was actually the same person). In view of the above, the controlling authority concluded that when purchasing vehicles, the individual entrepreneur was entitled to include the VAT amount from the cost of the vehicles in his tax credit, provided the tax invoice was properly drawn up and registered; the individual entrepreneur was obliged to accrue VAT liabilities and draw up a tax invoice on the date of acquiring the private ownership of the vehicles by the individual (citizen) and register within the deadlines specified in the Tax Code.

The individual entrepreneur appealed to the SFS against tax notifications-decisions that reduced budget refund and provided for penalties, and asked the BOC to support him during the administrative appeal.

The BOC drew the SFS's attention that in this case registration of the vehicles by the complainant as an individual entrepreneur for use in his economic activity was legitimate, carried out in accordance with the applicable requirements specifically for an individual, since the individual entrepreneur cannot be indicated as an owner in the vehicle registration certificate. At the same time, the registration of purchased vehicles by the individual (citizen) cannot in any way point out to the fact that the purchased vehicles were not used by the individual entrepreneur in his activity.

Moreover, during the tax inspection, inspecting officers did not question the circumstance of use of the abovementioned vehicles in the business activity, nor did they require any supporting documents. The BOC also noted that the complainant, acting as an individual entrepreneur, acquired the right of ownership of vehicles on a common basis, and their registration for the name of an individual (citizen) is not a right-making fact with which the law linked the transfer of the right to dispose (which is an integral feature of goods supply according to the Tax Code of Ukraine). In addition, the complainant, while acting as an individual (citizen) and an individual entrepreneur, albeit having different tax status, remains one and the same person.

As a result, the SFS took all the complainant's and BOC's arguments into account and cancelled tax notifications-decisions issued after the inspection.

Currently, the work of local authorities in the context of **predictability and reasonability of regulatory policy for SMEs** is somewhat broader **and** connected with the lack of an effective toolkit suspending or preventing local authorities from adopting legal acts violating entrepreneurs' rights enshrined in the national law¹⁸.

In addition, it is too difficult for local authorities to meet regulatory requirements for performing the so-called M-Test¹⁹. The

reason for that is the lack of knowledge, and often the disrespect (treating entrepreneurs as being inferior) for small businesses by authorities.

No single information source that would inform in a user-friendly and simple manner about legislative novelties (requirements and opportunities) often leads to mistakes and non-compliance of entrepreneurs or abuse of controlling authorities.

1.5. SME's development is a priority of the Ukrainian Government. SME Strategy

The Ukrainian Government set the SME's development as its priority as further formalized into the SME Strategy. To have the Strategy implemented, the CMU adopted the Action Plan, which is also backed by numerous domestic and international initiatives launched in recent years to improve the situation of SMEs in Ukraine.

- Within the framework of the study, the BOC held meetings with stakeholders and identified the following general remarks which may be appropriate to consider when preparing SME policy documents:
- Firstly, it is necessary to point out the large gap between micro-, small and medium-sized businesses in Ukraine, which is probably stipulated by the methodology for identifying a medium-sized entity in accordance with the Commercial Code of

Ukraine. This observation is important to consider in the context of public policy and planning of the appropriate SME development activities.

- Secondly, many BOC's stakeholders have noted the lack of a systemic dialogue between the Government and business organizations, namely SMEs', as well as the lack of regional involvement²⁰ when discussing the SME's development and support policies.
- Thirdly, the stakeholders noted the lack of interim reports on the implementation of the SME Strategy in public, the lack of correlation with other policy documents approved by the Government of Ukraine, and insufficient resources (funding) enabling the due and comprehensive implementation of the SME Strategy.

¹⁸ This issue has already been raised by the BOC in its Systemic Report "Challenges for Government and Business in Dealing with Local Government" (February 2017).

¹⁹ M-Test is a part of the Regulatory Impact Analysis (RIA) introduced by the Law "On Principles of State Regulatory Policy in the Sphere of Economic Activities" in 2004. M-Test is based on a methodology for calculating costs incurred by small business to implement a specific regulatory act. M-Test results allow substantiating options for mitigating the administrative burden on small businesses.

²⁰ Giving that the regional dimension is not the only dimension, it is recommended to allocate 14 extensions for segmentation to apply smart approaches to SME development (see Regional policy for smart growth of SMEs. Guide for Managing Authorities and bodies in charge of the development and implementation of Research and Innovation Strategies for Smart Specialisation).

Available at: https://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/sme_guide/sme_guide_en.pdf

Recommendations:

1) **The MinEconomy, other involved Central executive bodies (CEBs):**

- (i) To review the Action Plan to the SME Strategy and determine its relevance, priority and expediency;
- (ii) To approve an updated realistic action plan for the support and development of SME, taking into account the BOC's recommendations according to this report. The SME Action Plan should cover activities for all groups of entities (micro-, small and medium-sized businesses) and be backed by appropriate financial resources;
- (iii) The development of the updated action plan to the SME Strategy should be based on the participatory principle, in particular, all key stakeholders both from the state and the business community representing all groups of entrepreneurs should be involved in this process. The overall focus of this document should be on creating conditions for transforming small businesses into medium-sized enterprises, as well as for more rapidly growing small businesses, enterprises with export potential or enterprises with a significant innovation component.

2) **The MinEconomy, the SME Development Office and the Ministry of Digital Transformation (where applicable) :**

- (i) To develop the concept of creating information sharing and/or business consulting areas;
- (ii) To introduce the practice of informing SMEs of major changes in the legislation (for example, through publication at the SME Development Office's website) that directly set new requirements for micro- and small-sized businesses;
- (iii) To elaborate recommendations for self-government authorities on the unified presentation/ placement of business-relevant information on their websites.

3) **The SRS — to regularly hold awareness-raising activities among central and local authorities' officials, including:**

- (i) compliance with the requirements of the Law of Ukraine "On Principles of State Regulatory Policy in the Sphere of Business Activity" (preparation of RIA, disclosure of information, public discussions, establishment of a professional dialogue with relevant business associations);
- (ii) M-Test application. It may be expedient to modernize the methodology of this test, taking into account available information, current conditions, etc.

2 ANALYSIS OF COMPLAINTS LODGED BY INDIVIDUAL ENTREPRENEURS TO BOC

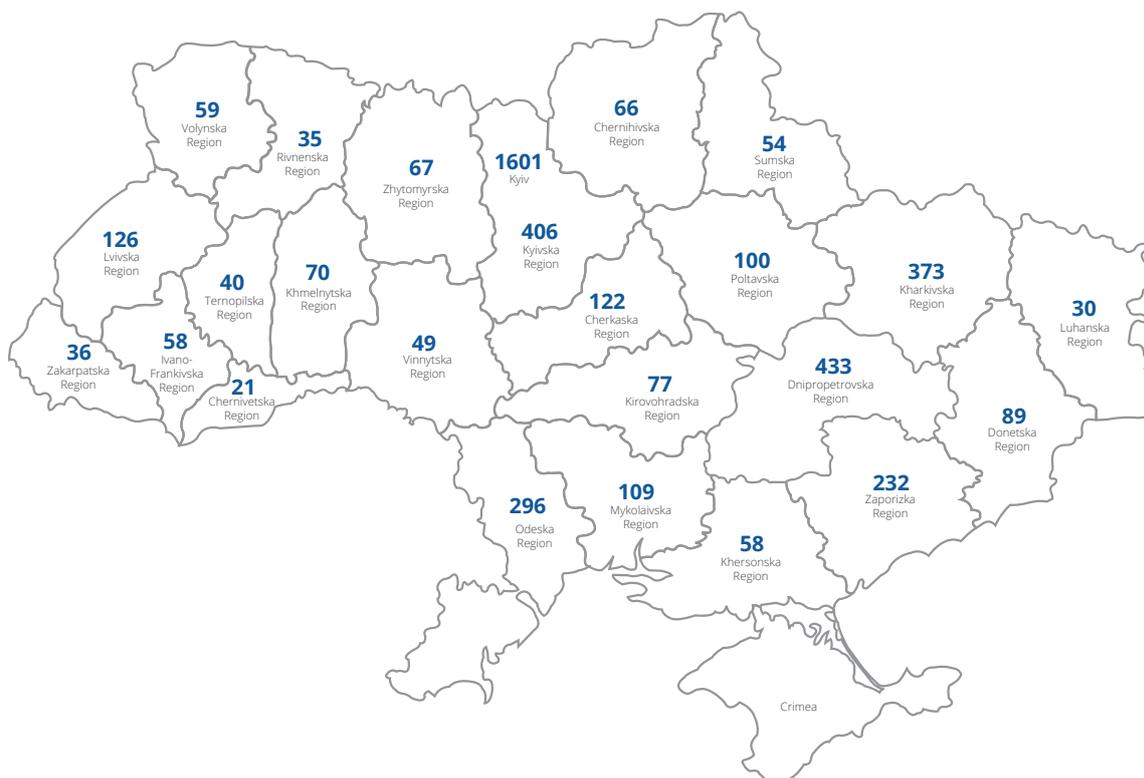
2.1. Overview of complaints received in 2015-2019

One of the BOC's key goals is to ensure effective communication of business with the Government, state and local self-government authorities. To this end, the BOC daily receives complaints about possible acts of corruption and/or other violations of legitimate interests

of business entities as a result of actions or omissions of authorities.

As of the end of 2019, the BOC received 6,528 complaints. According to the BOC's estimates, at least two thirds of these complaints were filed by SMEs.

Fig. 1. Geography of SMEs' complaints received by the BOC in 2015-2019



In our opinion, the information accumulated by the BOC during investigation of such complaints is of value for this report as it allows for the assessment and systematization of SMEs specific issues.

Fig. 2. Key issues raised by SMEs in their complaints to the BOC



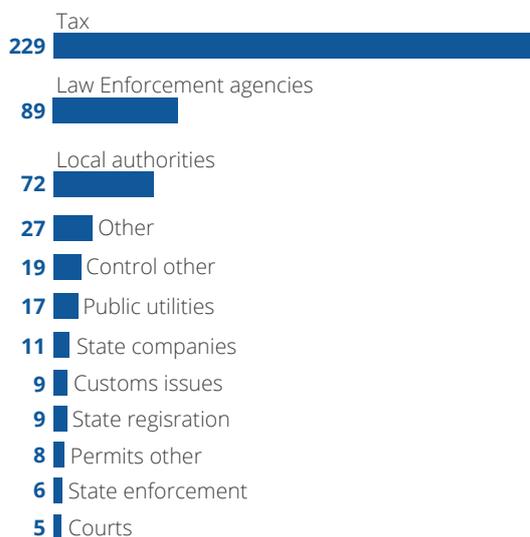
It should be noted the BOC accepts and investigates complaints from all entrepreneurs, without changing the approach depending on the size of their business or collecting information about their financial performance. In this regard, the BOC does not have the ability to accurately separate the SMEs' complaints from the general array of the complaints. In addition, SMEs are both micro- and much larger small and medium business entities. The issues faced by medium-sized business entities are in constant BOC's focus, since they comprise the majority among the complainants.

At the same time, problems of microenterprises are specific in view of factors such as (i) significantly fewer resources for administration of their activities and legal support; (ii) the extensive use of a simplified tax system; (iii) sometimes, prejudiced attitude to such entities by regulatory authorities as those involved in the "grey" economy.

When investigating complaints, the BOC distinguishes the complaints from legal entities and individual entrepreneurs. The vast majority of individual entrepreneurs are microentrepreneurs. Analysis of complaints submitted by individual entrepreneurs will help assess problems faced by the smallest businesses and identify common trends.

The typology of the complaints lodged by individual entrepreneurs to the BOC is shown in Chart 4.

Chart 4. Typology of complaints of individual entrepreneurs to the BOC



As of the end of 2019, the BOC received 501 complaints from individual entrepreneurs (7.7 % of the total complaints received).

As can be seen from the chart above, individual entrepreneurs most often complain about tax authorities (46%), law enforcement agencies (18%) and local authorities (14%). The indicated complaints account for approximately 78% of the total number of appeals to the BOC during 2015-2019.

The majority of complaints against tax authorities relate to tax inspections (audits) and tax invoice suspension. As regards law enforcement agencies, individual entrepreneurs often complain about actions

of the National Police and the Prosecutor's Office related to criminal investigations.

Among the complaints related to local authorities the issues of granting various permits should be singled out.

Below are statistically the most common circumstances individual entrepreneurs have referred to when applying to the BOC. Our analysis showed that **over 40% of individual entrepreneurs' complaints refer to at least one of the circumstances listed below.**

2.2. Common trends of complaints on law enforcement agencies:

In 2016, the Financial Investigation Department of the STS started the criminal investigation based on the analytical note according to which an individual entrepreneur "A" performed economic transactions having signs of fictitiousness.

At the beginning of 2017, a search of the premises owned by the individual entrepreneur "A" was conducted, which resulted in the seizure of property (including the items not specified in the search order). The investigative judge refused to arrest such property. As of September 2017, the property has not been returned to the individual entrepreneur, the criminal investigation was not completed, no person was informed of being suspected.

Common issues mentioned in the complaints against law enforcement agencies are:

- initiating criminal proceedings against business entities without a clearly established fact of offense;
- seizure of property, documents and computer equipment hindering current business activities;
- impossibility to quickly return seized items and documents;
- unreasonably lengthy criminal investigation regarding alleged violations committed by an individual entrepreneur thereby causing business uncertainty;
- an inactive approach to investigation of criminal proceedings initiated at the request of an individual entrepreneur (where an entrepreneur is a victim).

2.3. Common complaints trends on tax invoice suspension:

An individual entrepreneur sent a tax invoice for registration and its registration was suspended. The Commission of the Regional Main Department of the SFS refused to register the said tax invoice, giving as a reason a failure to submit documents sufficient to establish reality of an economic transaction. The individual entrepreneur went to court, which obliged to register the tax invoice. The SFS authorities did not lodge an appeal, nor did they comply with the court decision in view of the intention to lodge an appeal soon.

Common trends of such complaints are as follows:

- tax invoice suspension reasons being unclear for a taxpayer;
- low efficiency of the procedure of "unblocking" tax invoices, the registration of which is suspended automatically, from the taxpayer's position;
- significant delays with execution of court decisions regarding tax authorities' obligations to register a tax invoice.

2.4. Common complaints trends on declaring a taxpayer as "risky":

An individual entrepreneur submitted several tax invoices for registration and they were suspended due to the fact that the regional Commission of the Main Department of the SFS declared the individual entrepreneur as a "risky taxpayer" (based on the available "tax information"). No clarification on the nature of the mentioned "tax information" was provided to the taxpayer by tax authorities. As a result, all subsequent tax invoices filed by the individual entrepreneur were not registered and the individual entrepreneur did not know which documents or explanations should be submitted to the tax authorities to be excluded from the list of risky taxpayers.

Common trends of such complaints are as follows:

- insufficient information provided to the entity on actual grounds for declaring the taxpayer as "risky";
- difficulty in obtaining information on the scope of required documents for exclusion from the list of risky taxpayers;
- there are cases of blocking the taxpayer's ability, who is considered risky, to submit any electronic documents to tax authorities (in fact, illegal termination of electronic document flow with reference to alleged technical errors).

It is also worth noting more general organizational problems making it difficult for individual entrepreneurs to protect their own interests:

- 1) Insufficient resources to engage high quality legal assistance. This leads to both erroneous non-compliance with current legislation and inability to apply effective remedies in the event of groundless allegations of violations.
- 2) Ineffective communication with tax authorities. A considerable number of diverse complaints, have one thing in common — tax authorities question the reality of individual

entrepreneur's economic transactions and respond with tax invoice suspension, blocking electronic document flow, initiating criminal investigation or charging additional tax liabilities without preliminary clarifying the details with the taxpayer. A small business entity is often unable to obtain prompt, specific and comprehensive information from tax authorities about the actual reason for suspicions mentioned above and about the actions required to prove the legality and reality of their activities and avert authorities' negative attention.

Recommendations:

- 1) The STS — to ensure that in case of tax invoice suspension or inclusion of a taxpayer in the list of risky taxpayers the respective entrepreneur receives information about the actual reasons/circumstances that led to such a decision. Such information should allow the taxpayer to understand which documents to submit or how to adjust his activity to achieve tax invoice registration or exclusion from the list of risky taxpayers²¹.
- 2) The STS's and the SCS's top management — to take organizational steps to ensure mandatory and prompt execution of court decisions by the subordinates and to bring them to disciplinary liability in case of delays.
- 3) Legally limit the period of investigators to keep original documents and other property seized during a search, not containing any trace of a crime, and also limit the period of criminalistic examinations within criminal proceedings²².

²¹ The CMU with its Resolution No. 1165 dated December 11, 2019 approved a new Procedure of tax invoice suspension (the Procedure comes into force on February 1, 2020). According to the mentioned document, a new form of a decision on declaring the taxpayer as "meeting the risky taxpayers' criteria" requires clarification of the tax information that led to such a decision. At the same time, the quality and completeness of the information actually mentioned in each document by the tax authorities' official is important from a practical standpoint.

²² This recommendation was set forth by the BOC in its Systemic Report "Abuse of Powers by the Law Enforcement Authorities in their Relations with Business" (January 2016). Available at: <https://boi.org.ua/publications/systemicreports/1121-sistemnij-zvt-zlovzhivannya-povnovazhennyami-z-bok/>

3 IMPROVING REGULATION IN LABOR DOMAIN

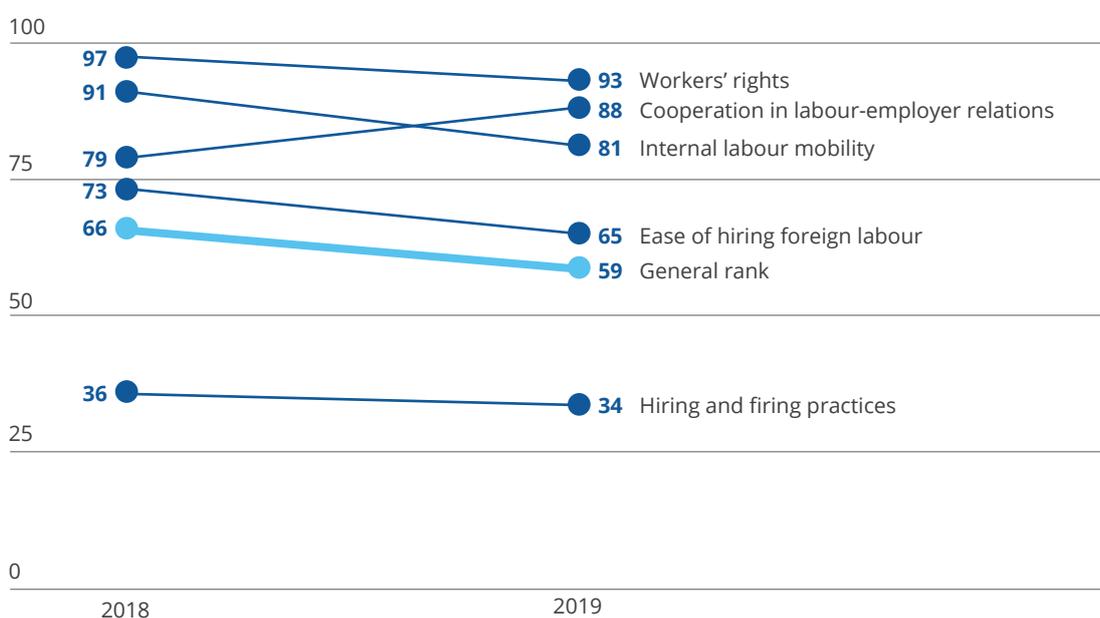
3.1. Issues faced by SMEs in labor-related regulatory domain

Analyzing the current state of the domestic labor market in general, we can refer to the Global Competitiveness Index including the Labor Market pillar. In particular, the latter evaluates such indicators as “Hiring and firing practices”, “Cooperation in labour-employer relations”²³,

“Internal labour mobility”, “Workers' rights” and “Ease of hiring foreign labour”.

Thus, according to the mentioned index the dynamics of Ukraine's position over the last two years can be presented as follows:

Chart 5. Ukraine's ranking and labor market indicators according to the Global Competitiveness Index 2018-2019



Source:
World Economic Forum²⁴

²³ Evaluated in the hypothetical interval from confrontation to cooperation

²⁴ Available at: http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf and <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

Compared to other participating countries without taking the “Workers’ rights” indicator into account, Ukraine’s position has improved slightly — from 66/140 in 2018 to 59/141 in 2019. It should be noted that there were no significant amendments to the Ukrainian legislation that would directly affect these indicators in the analyzed period.

In the already mentioned Bureaucracy Index survey conducted by EasyBusiness²⁵ in 2018, it is noted that small business in Ukraine plays a key role for the state economy, as it is an employment source for almost one third of Ukrainians — 27%. In turn, the smaller an enterprise is, the more costs it incurs in connection with regulatory and bureaucratic procedures. Instances of bureaucratic obstacles are most often stipulated with the need to comply with obsolete or complicated requirements.

The SME Strategy also highlights the problem of labor administration. In particular, the Government notes the complexity of the legal procedure of dismissal, which is a serious problem for SMEs, given the lack of human capital and the need to rapidly adapt to ever changing market conditions. However, the SME Strategy also notes that the effective legislation does not adequately

protect employees and punish employers for violations.

The BOC acknowledges that the burden of administering labor-related issues can be one of indirect causes of illegal (informal) employment and a significant level of shadow economy in the country, as emphasized in the recent Systemic Report “Business Focus on Labor-Related Issues”²⁶ published at the beginning of 2019.

The said report focused on the issues the BOC considered relevant for all entities, without singling out SMEs. At the same time, in the BOC’s view, the negative impact of the existing shortcomings of the legislation is mostly noticeable for SMEs — during discussions within focus groups and individual interviews, arranged by USAID CEP jointly with the BOC, in terms of the labor context, SMEs’ representatives mainly pointed out to the rigid legal model of “labor-employer” relations, as well as the complexity of administering labor and the current legal regulation of business inspections, which creates a risk of pressure.

On the whole, in the BOC’s opinion, the need for re-thinking the existing Labor Code, introducing modern labor law based on the freedom of employment agreement, reviewing penalties for labor-related violations is still of high relevance for the state.

²⁵ Available at: <https://bureaucracyindex.in.ua/>

²⁶ Available at: https://boi.org.ua/media/uploads/system_feb2019/4_2018_sytem_en.pdf

3.2. Labor documenting

Under circumstances of global digitalization, transition to electronic document flow and automation of processes related to human resources is deemed imminent. However, as regards human resources record management in Ukraine, the effective legislation provides for a unified approach to legal entities and individual entrepreneurs in case of hiring employees. Being considered an employer, legal entities and individual entrepreneurs shall comply with administering all labor-related documents in hardcopies, in particular, records on accrual and payment of wages to hired employees, registration log of orders, accounting log of employment books and attachments, list of used working time of employees, employees' personal data cards, vacation schedules of employees, their job descriptions, internal codes of conduct. Alongside this, the Commercial Code of Ukraine also provides for an enterprise's obligation to administer staffing table²⁷.

Unlike large businesses, SMEs, including individual entrepreneurs, nominally have less resources and expertise for administering labor issues but, as one can see, hiring procedures and ongoing activities require scrupulousness which might turn out to be excessive. Administering the mentioned documents namely in hardcopies should be gradually transformed into electronic administration of such issues.

A possible option is to give an employer a choice — either to draw up and maintain hardcopies of the labor-related documents or to launch an own e-database, which could contain information on employment-related documents.

One of the most discussed issues in this context is the use of the employment books. An initiative for legislative changes to cancel such employment books or to ensure that the employee's labor activities are electronically accounted has not been fully implemented so far. In view of business demand, the anticipated step in labor relations management may be digitizing of the employment books, which would also provide additional control by the state authorities over compliance with labor law regarding forgery of employment books and work records. In the present-day market environment, functions originally performed by the employment books seem to have lost their relevance over time.

Another issue, standing aside, is an initiative to prevent abuse and simplify the procedure of remuneration upon sick leave certificates which seems topical and relevant. On April 17, 2019, the Government adopted the Resolution on launching sick leave certificates e-register²⁸, and currently the development of information interaction between the state authorities is underway. Such an e-register should enable the system of interaction with a scheme "Employee — Medical Facility — Social Security Fund — Employer".

²⁷ Part 3 of Art. 64 of the Commercial Code of Ukraine

²⁸ CMU's Resolution No. 328 dated April 17, 2019.
Available at: <https://zakon.rada.gov.ua/laws/show/328-2019-%D0%BF> CMU's

3.3. Supervision (control) of SMEs' compliance with labor legislation

The regulatory framework for inspections conducted by the State Labor Service of Ukraine and executive bodies of city councils with the regional status and united territorial communities is relatively dispersed and formed up with both international and national legislation. In particular, at the time of preparation of this report, the issue was regulated by the International Labor Organization's (ILO) Labor Inspection (Agriculture) Convention No. 129, 1969²⁹ and Labor Inspection Convention No. 81, 1947³⁰, the Labor Code of Ukraine³¹, the Law of Ukraine "On Local Self-Government in Ukraine"³², the Law of Ukraine "On Basic Principles of State Supervision (Control) in the Sphere of Economic Activity" (Law No. 877), and the CMU's Resolution "Some Issues of Exercising State Supervision and Control over Compliance with Labor Legislation"³³.

From SMEs' representatives' standpoint, who certainly do not always possess proper legal knowledge or have in-house/hired lawyers,

it is relatively difficult to thoroughly sort out the issue of legal regulations of labor inspections by using their own resources, particularly when it comes to understanding and proper protection of their rights and interests when controlling authorities exercise their control (supervision) powers in violation of the procedure, for example by preventing such authorities from carrying out an inspection or demanding its termination. As the BOC's practice shows, this can lead to cases where entrepreneurs, who are convinced in their being right, decide not to allow labor inspectors to carry out an inspection, but eventually receive a relevant act on the impossibility to carry out an inspection with a significant fine, which have to be further challenged by administrative and/or judicial means. Moreover, if an appeal outcome is not in favor of the entrepreneur, the final fine may be unsustainable and result in a person's decision to discontinue the entrepreneurial activity at all.

²⁹ Available at: https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_INSTRUMENT_ID:312274

³⁰ Available at: https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:C081

³¹ Available at: <https://zakon.rada.gov.ua/laws/show/322-08>

³² Available at: <https://zakon.rada.gov.ua/laws/show/280/97-%D0%B2%D1%80>

³³ The Resolution dated August 21, 2019 No. 823 approved the Procedure for exercising state control of compliance with labor legislation and the Procedure for exercising state supervision of compliance with labor legislation. Available at: <https://zakon.rada.gov.ua/laws/show/823-2019-%D0%BF>

In fact, this Resolution replaced the previous CMU's Resolution No. 295 dated April 26, 2017 "Some Issues of Implementation of Article 259 of the Labor Code of Ukraine and Article 34 of the Law of Ukraine" On Local Self-Government in Ukraine ", which, at the time of preparation of this report, was declared invalid by the Sixth Administrative Court of Appeal in Case No. 826/8917/17. The grounds for declaring it invalid from a formal point of view were violation of the procedure for adopting a regulatory act, and from the actual one — extension of the mentioned ILO's Conventions' norms to those business inspections which they are not applicable to, as well as conferring state supervision (control) powers on officials of executive bodies of city councils with the regional status and united territorial communities in violation of the requirements of Law No. 877. At the same time, in the BOC's opinion, the adoption of the new Resolution No. 823 has not finally resolved the respective legal gaps, which had served the basis for the court to declare the Resolution No. 295 invalid.

Recommendations:

The CMU jointly with the corresponding CEBs:

- 1)** To qualitatively review and initiate amendments to the legislation by providing flexible forms of work organization and regime, including part-time employment, working in shifts, work time logging, weekends and holidays, remote work, etc.
- 2)** To take appropriate steps to simplify the labor-related document flow and transform it into electronic format.
- 3)** As regards the supervision (control) of employers' compliance with the labor legislation — to take steps aimed at careful harmonization of the procedure, grounds, methods and forms of inspections, powers of the corresponding authorities, particularly with the ILO Conventions and requirements of the Law No. 877.
- 4)** As regards the proportionality of employer's liability for violations of the labor legislation — to review sizes of fines, taking into account the nature, degree of offenses committed and an employer's degree of guilt, and to provide for the possibility of applying warnings for minor or first-time offenses and/or granting employers a grace period for their elimination without an obligation to pay respective fines.

4 PROMOTING SMES' EXPORT ACTIVITIES AND INTERNATIONALIZATION

The SME Strategy sets three objectives within the direction of promoting SMEs' export activities and internationalization. These objectives conceptually embody ideas from the Law of Ukraine "On Development and State Support of Small and Medium-Sized Entrepreneurship in Ukraine"³⁴, as well as the Association Agreement, and reduce to following:

- 1) Creating favorable export conditions;
- 2) Introducing training programs and information dissemination³⁵, and
- 3) Approximating national legislation to the EU acquis and standards.

As can be seen from the Action Plan for the Strategy Implementation approved by the CMU³⁶, it does not contain direct measures for export-related objectives and, respectively, indicators, terms and authorities in charge. Instead, the annex to this Action Plan contains a reference that SMEs' internationalization and export promotion are in fact being covered by the

Export Strategy 2017-2021³⁷ and the Strategy for Development of Technical Regulation System for the Period Up to 2020 (Technical Regulation Strategy)³⁸ in their respective parts. Subsequently, the implementation of these objectives is being monitored separately and outside the monitoring of the SME Strategy's implementation.

The Export Strategy's main goal is Ukraine's transition to export of science-based and innovative products for the sustainable development and successful external markets entry, mainly based on improving competitiveness of the Ukrainian SMEs, which directly correlates to the 6th Direction of the SME Strategy — "Improving Competitiveness and Innovation Potential of SME".

It should be noted that although the Export Strategy is aimed at improving activity for all sectors of the economy, the Government has singled out the most promising economy sectors for further elaboration and approval of sector and cross-sector export strategies

³⁴ Available at: <https://zakon.rada.gov.ua/laws/main/4618-17>

³⁵ It should be noted that this objective, in fact, coincides with another one from the 4th Direction - as regards the development of entrepreneurial skills, activation of SMEs' study process to achieve the respective knowledge and skills related to export activities.

³⁶ Approved with the CMU's Resolution dated May 10, 2018 No. 292-r. Available at: <https://zakon.rada.gov.ua/laws/main/1017-2017-%D1%80>

³⁷ Approved with the CMU's Resolution dated December 27, 2017 No. 1017-r. Available at: <https://zakon.rada.gov.ua/laws/main/1017-2017-%D1%80>

³⁸ Relates to approximation of regulatory norms, including technical regulations and standards. This Strategy was approved with the CMU's Resolution dated August 19, 2015 No. 844. Available at: <https://zakon.rada.gov.ua/laws/main/844-2015-%D1%80>

Both the SME Strategy and the Export Strategy recognize the need to implement the Technical Regulation Strategy aimed at modernizing the Ukrainian economy and promoting competitiveness of Ukrainian producers by gradually integrating with the EU market and overcoming technical barriers to trade. Improving the level of quality, safety and technological friendliness of products is expected to increase export volume to the EU market under the same conditions as for the Member States' manufacturers. The Action Plan for implementation of the Technical Regulation Strategy envisages harmonization of legal acts, technical regulations and standards with the EU, as well as institutional strengthening of bodies in the sphere of technical regulation and state market supervision.

and promoting such industries' products abroad. One of the sector selection criteria was the SMEs' potential to develop. Such an approach was applied to move away from the existing trend of erroneous focusing on large enterprises' segment³⁹.

In view of the aforementioned and in order to substantively analyze this area, achievements and further necessary measures, the BOC decided to go beyond SME Strategy to focus on certain key aspects of the Export Strategy and to articulate recommendations for further development in the context of export activities performed specifically by SMEs.

4.1. Monitoring of the export progress

Thus, to evaluate the effectiveness of its implementation, the Export Strategy provides for indicators, taking 2016 as a starting point to indicative positions at the end of the Strategy's implementation, i.e., until 2021. Hence, during the Export Strategy's elaboration it was planned to:

- Achieve annual growth of goods and services export volumes from USD 45.1bn by 10%;
- Increase export share of goods produced with high- and medium-level technologies from 17.3% to 27% of the total export share over five years;
- Enter top 50 countries according to the Enabling Trade Index⁴⁰ and the Global Entrepreneurship Index^{41, 42} as of 2021.

A set of initiatives and measures taken during the recent years has somehow or other led to the increase of export volumes from Ukraine. According to statistical information provided by the MinEconomy, export of goods and services

increased by 8.6% in 2018 compared to 2017, amounting to USD 57.1bn, of which USD 47.3bn is export of goods only. In the first half of 2019 alone, the volume amounted to USD 29.5bn, which is 5.9% more as compared to the same period of exported goods and services in 2018. Overall, during 9 months of 2019, goods and services volume, when compared to 9 months of 2018, increased by USD 2986.2mn (7.1%) and totaled USD 44.8bn⁴³. The statistics currently show that overall growth rate is almost in line with the benchmarks set in the Export Strategy.

It is worth noting that the main trading partners of Ukraine with a large margin are the EU countries, which jointly imported 42.6% of the volume of the goods exported from Ukraine in 2018 and 32.9% — of services.

In the context of groups of exported goods, the MinEconomy's data show steady increase in volumes driven with significant increase in export supply. Compared to 2017, in 2018

³⁹ At the time of preparation of this report, the second stage of the Export Strategy's development was underway, namely the development and approval of the sector and cross-sector strategies and their formalization in the relevant CMU's resolutions. Sector directions include information and communication technology (ICT), creative industries (including light industry, fashion and design industry services (graphic, industrial and interior design), audiovisual services and other artistic/cultural manifestations), tourism, aircraft repair and maintenance, aerospace products, spare parts and components, mechanical engineering, food and processing industries. Later, the list of cross-sector development strategies was formed up and it will address skills development, investments for export, provision of trade information and promotion, as well as transportation and trade facilitation.

⁴⁰ Managed by the World Economic Forum

⁴¹ Managed by the Global Entrepreneurship and Development Institute

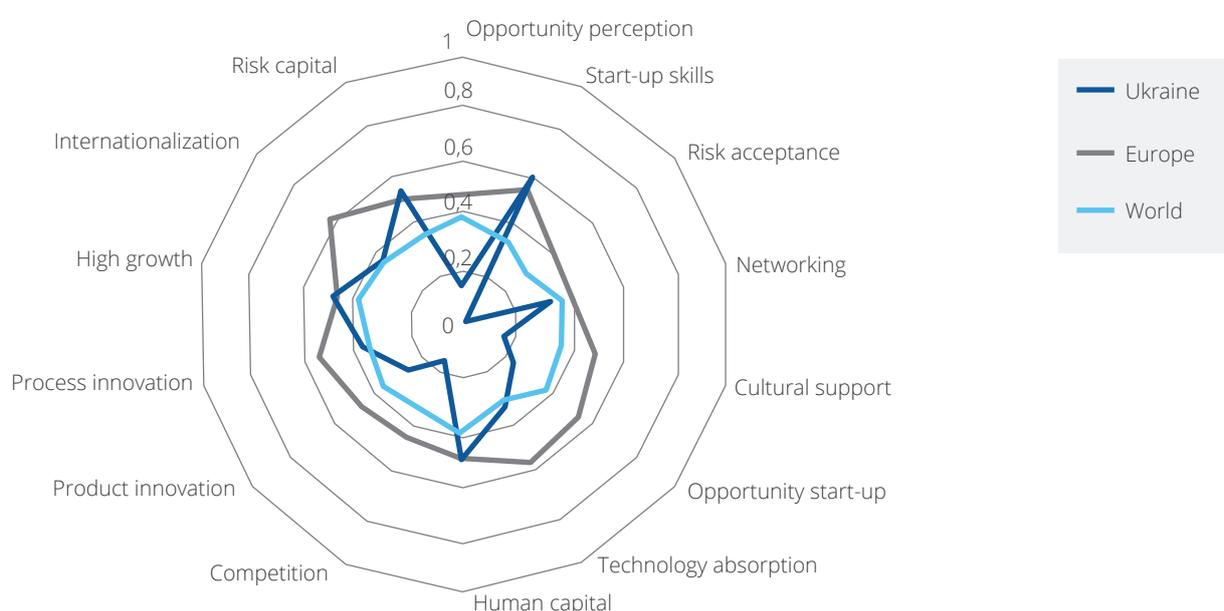
⁴² In 2016, Ukraine was ranked 95th and 66th respectively

⁴³ Available at: <http://www.me.gov.ua/Documents/List?lang=uk-UA&id=e3c3c882-4b68-4f23-8e25-388526eb71c3&tag=TendentsiiEksportulnInfografika-eksport->

export of products increased, including high-tech, in the field of mechanical engineering (+8.3%; +USD 420.8mn) and in chemical and related industries (+15.5%; +USD 344.0mn), however, it would be premature to speak on the expected high- and medium-tech products export level, in view of the deadlines for the implementation and the lack of clear mid-term monitoring and public reporting.

With regard to tracking Ukraine's positions in the mentioned world rankings, it should be noted that the Enabling Trade Index has not been updated since 2016, while in the Global Entrepreneurship Index 2017 Ukraine retained the 66th position (out of 137 participating countries; 33rd position out of 41 in the European Region).

Chart 6. Ukraine's indicators according to the Global Entrepreneurship Index 2017



Opportunity perception	0,13
Start-up skills	0,60
Risk acceptance	0,01
Networking	0,33
Cultural support	0,16
Opportunity start-up	0,23
Technology absorption	0,36
Human capital	0,50
Competition	0,16
Product innovation	0,26
Process innovation	0,38
High growth	0,48
Internationalization	0,38
Risk capital	0,55

Thus, according to the analysis of the situation in the Global Entrepreneurship Index Report 2017, it was recorded that by internationalization index, Ukraine ranked average compared to other countries-participants, while as regards the components on risk acceptance, new opportunity perception, competitiveness and product innovation, it was far behind average positions in the world. Ukraine's compliance with the European average level matched only in the components related to risk and human capital, start-up skills and growth rate.

Source: GEDI; Global Entrepreneurship Index 2017

Chart 7. Ukraine's indicators according to the Global Entrepreneurship Index 2018



Source:

GED; Global Entrepreneurship Index 2018

According to this report in 2018, Ukraine lost its position in the entrepreneurship ranking for six positions, having been ranked 73rd with weak and strong areas remaining unchanged. Thus, Ukraine got the lowest score again on the components of risk acceptance, competitiveness, opportunity perception, and cultural support, while the highest scores were received for components related to startup skills, risk capital formation and technology attraction.

In the BOC's view, the monitoring of Ukraine's position in these two mentioned indexes in the context of the implementation of the Export Strategy does not give a solid picture of the

world perception of the country's position in the specified area, in particular, given that one of them — the Enabling Trade Index — is not regular.

For the purpose of analyzing dynamics change, the BOC also paid attention to a trading across borders indicator within annual Doing Business reports. Thus, in 2016 being the basis for the Export Strategy's evaluation, Ukraine was ranked 109th out of 189 countries covered by this indicator, when calculating which such components as documentary and border compliance, as well as transportation were taken into account⁴⁴ and were recorded in monetary and time dimensions.

⁴⁴ Since 2017, the transportation component has been excluded from the calculation.

Although the quantitative indicators of the components did not change in 2017, Ukraine's overall position dropped to 115th out of 190 participating countries. A similar situation was in the report of 2018, where Ukraine was ranked 119th.

At the same time, according to the Doing Business reports in 2019 and 2020, Ukraine's position in trading across borders improved rapidly to 78th and then to 74th position respectively.

Chart 8. Ukraine's rating and cross-border trade indicators according to Doing Business rating in 2016-2020



Source: World Bank Group

Although, as noted above, the Export Strategy is based on enhancing the competitiveness of Ukrainian SMEs for transition to the global level of exporting high-tech innovative products, the BOC can state selected indicators for evaluating the effectiveness of the Export Strategy's implementation (total export volumes, high-tech exports and positions in the international ratings) are not directly correlated with the SMEs' export activity.

As regards SMEs' export volumes, statistics were not made public by the MinEconomy⁴⁵. In turn, the StateStat tracks exports from Ukraine only by the criteria of importing countries, number of employees⁴⁶, types of business activities and regions.

The Export Strategy and the Action Plan for its implementation put a special emphasis on SMEs only in the context of actions related to

⁴⁵ At the same time, at the SME Forum arranged on December 11, 2019, the head of the SME Development Office published information about the share of exports in SMEs: microenterprises - 3%, small enterprises - 6%, medium-sized enterprises - 16%.

⁴⁶ The groups are divided into entities employing up to 9 persons, from 10 to 49 persons, from 50 to 249 persons, as well as individual entrepreneurs. This approach does not fully comply with the criteria set forth for SMEs in the Commercial Code of Ukraine.

promoting entrepreneurial activity, improving management skills among employees of existing enterprises and ensuring the education system meets the needs of enterprises, particularly small and medium ones.

The BOC also noted that non-governmental organizations such as chambers of commerce, business associations, industry associations and others play an important role in promoting

export opportunities of SMEs in Ukraine. In particular, the Ukrainian Chamber of Commerce and Industry uses a wide range of tools and methods for this purpose: from representing the Ukrainian SMEs' interests in most international, regional and national organizations and business associations in the world to providing a wide range of versatile services for entrepreneurs.

4.2. Export Promotion Office

Prior to the approval of the Export Strategy, the MinEconomy initiated the establishment of the Export Promotion Office (hereinafter in this section — the Office) as a consultative and advisory body. Plenty of tasks in the Export Strategy are somehow or other imply the active involvement of the Office and are reduced to providing consulting, information, analytical and training services to exporters, including potential ones. In addition, the Office supports, organizes and coordinates trade missions to promote export activities outside Ukraine, international exhibitions and fairs.

One of the Export Strategy's goals was to strengthen the institutional capacity of the Office and to expand its functionality, which was finally implemented with the adoption of the Order No. 864 dated June 23, 2018 by the MinEconomy, which formalized the Office as a state institution. The transition period for the Office in this role was completed at the end of 2018.

The proper functioning of the Office is one of the key aspects for both the implementation of the Export Strategy's objectives and, in general, for the support of business with a separate accent on SMEs in terms of their export activities.

The MinEconomy surveyed businesses on the state support of export⁴⁷ in terms of evaluating the awareness level, where 145 companies participated, of which 73% were SMEs' representatives from 23 regions. Thus, a half of the respondents said they had obtained export support services and international trade information, but it had not been sufficient, one-third stressed they had not received it at all, while full information on available governmental support had only been available to one-tenth of the respondents.

In addition, the survey revealed that after e-mails and social media newsletters, a website of the Office⁴⁸ ranks third as a source of available governmental support, as well as analytical data on potential export markets and opportunities for improving skills required for export activities. In addition, the vast majority of participants noted that the Office's services were very useful indeed.

Among the problems preventing SMEs from entering foreign markets, participants of the focus groups⁴⁹ remarked, among other things, lack of knowledge and experience, difficulty in communication with external partners, undergoing certification procedures and being unaware of opportunities to participate in

⁴⁷ Available at: <http://www.me.gov.ua/Documents/Download?id=7e4f5b61-6f5f-4cac-83de-8159f04c8116>

⁴⁸ Available at: <https://epo.org.ua/>

⁴⁹ Arranged within the research of the USAID CEP

foreign exhibitions and procurements. Those participants of the focus groups, who had the opportunity to cooperate with the Office, highly appreciated its activity level and confirmed that this resource effectively addressed issues faced by SMEs in the course of export

activities. In particular, in addition to consulting and analytical directions, the Office efficiently works as an educational platform, a platform for finding partners, and facilitates a dialogue between businesses, the Government and an expert community.

4.3. Export Credit Agency

On December 20, 2016, the Law of Ukraine “On Providing Large-Scale Export Expansion of Goods (Works, Services) Originating from Ukraine through Insurance, Guarantees and Cheapening of Export Credits”⁵⁰ (hereinafter in this section — the Law) was adopted. In particular, the Law envisaged the establishment of the Export Credit Agency (ECA) by the CMU to facilitate export of Ukrainian goods and services and to promote domestic producers’ competitiveness through insurance, reinsurance, guarantee and partial interest rate compensation for export credits.

The said Law tasked the CMU, within six months of its entry into force, to establish the ECA, which, however, happened only on February 7, 2018, with the adoption of the Resolution No. 65 “The Issue of Establishing the Export Credit Agency”⁵¹. In turn, its registration as a legal entity (a private joint-

stock company) took place on November 23, 2018.

The delay in creating and launching the ECA was also reflected in the Export Strategy, which aimed to establish the ECA by the 3rd quarter and to launch operations in the 4th quarter of 2018. Although the adjusted deadline under the Export Strategy to create the ECA was met, at the time of preparation of this report, the ECA has not actually started to operate, in particular, in view of the need to adapt the legal framework.

According to the USAID CEP survey, one of the biggest challenges for entering foreign markets is poor financial capacity. In turn, introducing a real and affordable system to guarantee SMEs’ export transactions would contribute to solving the issue.

⁵⁰ Available at: <https://zakon.rada.gov.ua/laws/show/1792-19>

⁵¹ Available at: <http://zakon.rada.gov.ua/laws/show/65-2018-%D0%BE>

4.4. Foreign institutions' support

Since 1990s, bodies performing a representative and protective role in foreign jurisdictions for domestic entities, involved in foreign economic activity, have taken various forms, with different subordination and capacity — in different periods, trade representative offices, trade and economic missions and economic departments within foreign diplomatic institutions have been functioning.

The latest significant institutional change was formalized in 2010, when it was decided to liquidate trade and economic missions under foreign diplomatic institutions of Ukraine and to create economic departments within diplomatic offices.⁵² However, as evidenced in practice, this decision failed to provide effective and sustainable support to Ukrainian businesses abroad, including exporters, which explains intentions of the Ukrainian Government to find and approve a new format for such bodies during the recent years.

In this aspect, it was also indicative for the BOC that the SMEs' representatives participating in the focus groups⁵³ complained about the lack of the state protection for domestic producers, referring to insufficient support from the Ministry of Foreign Affairs (MFA), the MinEconomy, embassies, etc.

The Action Plan to the Export Strategy fairly did not ignore the need to improve coordination and interaction among the network of institutions, which assist exporters and support business and trade, in particular, by means of strengthening the economic departments within diplomatic offices of Ukraine abroad. Such an improvement was

expected to be implemented by the 2nd quarter of 2018.

The anticipated result was the development, adoption and implementation of the CMU's Resolution "On Implementation of the Pilot Project on Representing Economic Interests of Ukraine Abroad by Strengthening Economic Departments under Diplomatic Institutions of Ukraine", which, however, was not eventually achieved.

When reporting on the Export Strategy's implementation, the MinEconomy informs about alteration of fulfillment of the said task, namely by establishing trade representative offices of Ukraine abroad.

In June 2018, amendments to the Law of Ukraine "On Foreign Economic Activity"⁵⁴ introduced organizational framework for the establishment of the trade representative offices — the CMU was empowered to coordinate the work of such representative offices, to appoint their heads⁵⁵, as well as to coordinate the appointment of CEBs' employees responsible for trade, economic and sectoral cooperation, for positions in foreign diplomatic institutions of Ukraine⁵⁶.

Moreover, in recent years, the State Budget assigns the MinEconomy with a funding item for the trade representative offices abroad amounting to UAH 28,251.8k in 2019 and UAH 25,637.0k in 2020.

At the time of preparation of this report, pilot projects to launch institutions in one form or other, which would provide economic

⁵² It was implemented by the Presidential Decree No. 522/2010 dated April 8, 2010. Available at: <https://zakon.rada.gov.ua/laws/show/522/2010>

⁵³ Arranged by the USAID CEP

⁵⁴ The Law No. 2449-VIII dated June 7, 2018 sets out the third paragraph of part 2 of Art. 9 in the new wording. Available at: <https://zakon.rada.gov.ua/laws/show/2449-19#n377>

⁵⁵ Upon a proposal of the MinEconomy approved with the MFA

⁵⁶ Upon a proposal of CEBs approved with the MFA

support for Ukrainian business in foreign jurisdictions, have not been implemented yet. The respective processes are ongoing. At the same time, in this context, in the BOC's view, it is of utmost importance for the

Government to allocate sufficient resources to such institutions in order to enable them to regularly, qualitatively and promptly handle requests related to business needs abroad, including those submitted by SMEs.

4.5. Single export web portal

In addition to creating the infrastructure of institutions aimed at supporting and promoting domestic export, the Export Strategy provides for the development and operation of a single web portal for exporters, including representatives of the prioritized sectors.

The relevance of this task was confirmed by the business itself during the research of the USAID CEP. The entrepreneurs emphasized the need for an independent source with detailed consolidated information on rules and requirements valid in foreign markets. Currently, SMEs confirm there is a significant burden which consists in the need to spend a lot of resources to collect and to analyze the information required to commence and carry out export more or less steadily.

The Action Plan to the Export Strategy provided for the launch of the single export web portal in mid-2018, but the said deadline was not complied with.

In July 2019, the MinEconomy and the Office announced a tender for the development of the National export web Portal⁵⁷ designed on the "single window" basis with the information, being updated regularly. Preliminary, the portal is expected to post information on

foreign markets, conditions for access thereto and respective regulations, search tools for potential counterparties (buyers)⁵⁸, and other export-related opportunities and services for businesses.

It is worth noting that the Action Plan to the Export Strategy also contains a task related to awareness-raising among Ukrainian enterprises regarding current and planned support and development projects in the sphere of innovations, listing of research and development programs, a catalog of innovative and high-tech products and their manufacturers in Ukraine, as well as effective mechanisms for promoting innovation. This information should be posted at the export web portal.

At the same time, within the monitoring of the Export Strategy's implementation, in this part the MinEconomy reports⁵⁹ that the said task is completed, referring to an information bulletin "Innovative Developments of Universities and Scientific Institutions of the Ministry of Education and Science of Ukraine"⁶⁰, posted at a website of the Ministry of Education and Science of Ukraine. In the BOC's view, it's too early to consider this task as a completed one, and further measures are required.

⁵⁷ The project is implemented with financial support of the German Government through the German Society for International Cooperation (Deutsche Gesellschaft für Internationale Zusammenarbeit - GIZ).

⁵⁸ This is also envisaged by other measures under the Action Plan to the Export Strategy, which provides for the need to facilitate the establishment and development of direct business relationships between exporting enterprises and foreign partners.

⁵⁹ Available at: <http://www.me.gov.ua/Documents/Download?id=3df335e5-93a4-44d3-8a3f-d0af15941098>

⁶⁰ Available at: <https://mon.gov.ua/storage/app/media/nauka/nauka-v-universitetax/rozrobkiuniv-monu.pdf>

4.6. Certification of origin of goods

Nowadays customs authorities issue EUR.1 movement (origin) certificates for goods originating from Ukraine to the EU and EFTA countries (Switzerland, Iceland, Norway, Liechtenstein), Montenegro⁶¹. Such certificates shall be issued in case of necessity to present them when importing into the customs territory of the EU and EFTA countries, Montenegro as evidence that goods of Ukrainian origin meet the requirements of the rules for determining preferential origin when applying preferential import duty rates.

In order to obtain a EUR.1 certificate, an exporter or an authorized representative may submit documents to the customs division, either hardcopies or electronic ones. Once the submitted documents are processed, a certificate is issued to the exporter free of charge and as soon as possible (no more than eight working hours after the application is registered).

The Chambers of Commerce in Ukraine also support the export of Ukrainian products by determining the country of goods origin, registration and verification of certificates of origin of various forms — general form (all

countries), form ST-1 (CIS countries), form A (USA, Japan), form EUR-1M (Republic of Macedonia), preferred certificate form for the United Mexican States. Currently, the Chambers determine and verify the origin in most export cases of Ukrainian goods (except where the customs authorities issue EUR-1 certificates), which is more than 70% of Ukrainian export.

At the same time, one can apply for the certificate in any chamber in the territory of Ukraine, both at the direct request of the customer and by electronic means⁶². Upon confirmation of the origin of Ukraine, the certificate is issued in 2.5 hours, the maximum term is 3 working days.

The Chamber of Commerce of Ukraine applies best practices in the implementation of electronic certification and works closely with the International Chamber of Commerce and European chambers. As of today, the issue of recognition of electronic certificates by the customs authorities of the countries across the world, which still require confirmation of the goods origin from Ukraine by the certified original document, is being solved.

⁶¹ The Procedure for Filling in and Issuance of the EUR.1 Movement (Origin) Certificate by the Customs, approved with the Order of the MiniFin No. 950 dated November 20, 2017. Available at: <https://zakon.rada.gov.ua/laws/show/z1563-17>

⁶² By email or at the link <https://apply.ucci.org.ua/ua>

Recommendations:

- 1)** Since the progress tracking of the tasks related to SMEs' export promotion and their internationalization is not provided in the SME Strategy, whereas clear quantitative and qualitative indicators namely of SMEs' export activities are not provided in the Export Strategy, the BOC finds it necessary to recommend the MinEconomy, when determining further steps aimed at developing exports, to provide indicators that would allow to monitor changes specifically for SMEs and, when analyzing statistical data, to separate the influence of implemented tasks from the indicators of large enterprises.
- 2)** The CMU — to continue providing the Export Promotion Office with appropriate resources, expanding support services according to the Export Strategy and SMEs' demand, and disseminating information about the Office's capabilities among SMEs' representatives⁶³.
- 3)** To ensure transparent and efficient functioning of the ECA in accordance with the best international practices. When taking final legislative steps to launch the ECA, it is recommended that the CMU, the MinFin and the MinEconomy carry out additional analysis of:
 - a)** the level of the ECA's capitalization and state support, so that the institution could cover as many businesses as possible, including SMEs, and make their own functionality more accessible and
 - b)** the support areas outlined in Art. 8 of the Law, first of all in the context of their consistency with the identified priority sectors of the Export Strategy.
- 4)** The MinEconomy and the MFA — to finally approve and implement the creation of a fully operational structure of foreign (trade representative) offices provided with sufficient resources and functionality to effectively support domestic businesses, including SMEs, with the gradual expansion of the geographical presence of such offices. In this context, it is deemed appropriate to ensure close co-operation of foreign agencies with the Export Promotion Office when processing requests, particularly those submitted by SMEs.
- 5)** The MinEconomy, jointly with the Export Promotion Office - to take steps to launch the National export web portal, its proper and regular filling with useful and accessible information for active and potential exporters, as well as introduce a separate section dedicated to promotion and using innovation opportunities by exporters, as set forth in the Action Plan to the Export Strategy.

⁶³ This recommendation is also in line with the OECD recommendation issued to the Government in the framework of independent Monitoring of the SME Strategy implementation in Ukraine.

5 INCREASING SMES' ACCESS TO FINANCE

5.1. Increasing SMEs' access to finance is an important direction of the SME Strategy

In many countries with the established rule of law and favorable entrepreneurship regulatory environment, access to financial resources remains the next important factor for the SMEs' sustainable development and capacity-building. That is obviously why the expansion of the SMEs' access to finance has been identified as another important direction of the Strategy.

A crucial condition for availability of external financing for SMEs is standards of credit application approval by financial institutions, i.e. requirements for borrowers and mortgage. Another important factor affecting finance availability and crediting demand from borrowers is real interest rates in the banking system.

In the market economy, the government cannot directly influence requirements for borrowers and interest rates by administrative measures. Any directive decrease in the interest rate from the market equilibrium will result in demand for credit resources exceeding supply and will lead to the deficit of financial resources available in the system, which subsequently

increases inequality of business opportunities and stimulates corrupt and non-competitive practices. Similarly, the administrative lowering of borrower requirements distorts risks assessment by financial institutions, leads to deterioration in the quality of credit portfolios and imbalances in economy.

Similarly, an independent banking regulator moving away from the inflation targeting regime⁶⁴ for crediting stimulating purpose, for example, by unreasonably lowering the discount rate, will lead to negative macroeconomic consequences, namely economy overheating and inflation rising above acceptable levels.

Hence, in its strategy, the government is limited to policy instruments impacting the cost of capital and risk acceptance by financial institutions, contributing to confidence among market participants and symmetrical and extensive access to information both on the demand and supply sides. However, the state can facilitate targeted crediting for SMEs by budget funding and joint programs with donors and international financial institutions.

5.2. Activities (measures) envisaged in the SME Strategy

The Strategy adopted by the CMU included a wide range of activities aimed at supporting SMEs' crediting by commercial banks and non-banking institutions, loans guarantee schemes, developing such instruments as factoring and promissory notes, creating favorable regulatory

environment for venture capital investors, non-formal investors (business angels), a voluntary pooling of funds for financing a business venture (crowdfunding); export financing, insurance and provision of guarantees; introducing a unified register of credit history for corporate clients,

⁶⁴ The National Bank Board's approval of "The Basic Principles of Monetary Policy for 2017 and the Medium-Term Prospect" in December 2016 de jure entrenched inflation targeting as a monetary policy regime in Ukraine.

international financial reporting standards for SMEs and creating conditions for deposits security.

It should be noted that the Strategy did not contain measurable targets and performance indicators related to access to finance.

The Action Plan to the SME Strategy Action, approved by the CMU in May 2018, contains four objectives to improve access to finance:

- enhance SMEs' financing by commercial banks through introduction of new loan guarantee schemes and promotion of a partial loan guarantee project through GUF (German-Ukrainian Fund);
- intensification of using promissory notes;
- intensification of financing by non-banking financial institutions;
- use of factoring services.

The declared indicators of the implementation are actually the facts of their completion — approval of relevant draft laws and educational activities, introduction of credit schemes. At the time of writing this report, these tasks have not been completed⁶⁵.

According to data collected from interviewed entrepreneurs and their representatives

within focus groups in six cities of Ukraine⁶⁶, over 95% of entrepreneurs did not attempt to obtain financial resources using such financial instruments as promissory notes, factoring, and even leasing.

Some of the tasks under the SME Strategy are also covered by other documents⁶⁷:

1. Regarding the creation of conditions for ensuring the security of deposits through banking sector regulation, reducing information asymmetry through introduction of credit histories, and leasing services development — by a Comprehensive Program for the Development of the Financial Sector of Ukraine up to 2020, approved by the NBU Board with the Resolution dated June 18, 2015;
2. Regarding the use of venture capital opportunities⁶⁸ and voluntary pooling of resources for funding projects (crowdfunding) — by the Government Priority Action Plan for 2018, pursuant to the Government Mid-Term Priority Action Plan for 2020⁶⁹;
3. Regarding export financing, insurance, guarantees — by the Export Strategy of Ukraine for 2017-2021.

⁶⁵ A draft concept for a partial loan guarantee and a pilot project were developed, however the implementation was postponed due to changes in the GUF's Supervisory Board. The Action Plan under the Comprehensive Program for the Development of the Ukrainian Financial Sector up to 2020, which would include measures to promote the use of promissory notes, is under development. The Draft Law No. 9078 on Amendments to Certain Legislative Acts of Ukraine on Credit Unions Activities was withdrawn from the Parliamentary Committee on Financial Policy on August 29, 2019. The Draft Law on Amendments to the Civil Code of Ukraine on Financial Services, as set out in the Factoring Services Action Plan, has not been developed yet.

⁶⁶ USAID CEP survey

⁶⁷ Annex to the CMU's Order No. 292-p dated May 10, 2018

⁶⁸ Venture capital investments are high-risk investments in small startup companies with great growth potential, usually in equity, or a share in property.

⁶⁹ Approved with the CMU's Order dated April 3, 2017 No. 275-r

On January 14, 2020, the Verkhovna Rada adopted the Law “On Amendments to the Law of Ukraine “On the State Budget of Ukraine for 2020” Concerning Ensuring the Functioning of Entrepreneurship Development Fund”.

This Law provides for expenditures for financing the Entrepreneurship Development Fund (EDF) amounting to UAH 2bn through

increasing the State Budget Special Fund receipts from early repayment of promissory notes of the Deposit Guarantee Fund.

Under the mentioned EDF financing, it is proposed to allocate UAH 1.5bn for a partial interest rate refund⁷⁰ and UAH 0.5bn — for providing partial guarantees of obligation fulfillment on loans of partner banks.

Recommendation:

To review and evaluate the relevance of unimplemented activities outlined in the Action Plan for the implementation of the SME Strategy, prioritize activities that may have a fast and significant effect on the SMEs’ access to finance and to stop implementing ineffective measures.

5.3. Current state and dynamics of access to finance for SMEs

Neither the Strategy nor the Action Plan for its implementation contain measurable targets that could assess the effectiveness of the Strategy and its implementation specifically in terms of improving the SMEs’ access to finance. Therefore, for interim

assessment of the strategy effectiveness in the first approximation, we may use absolute figures the volume of loans granted to SMEs and correlate them with the GDP of Ukraine for macroeconomic trends to be taken into account.

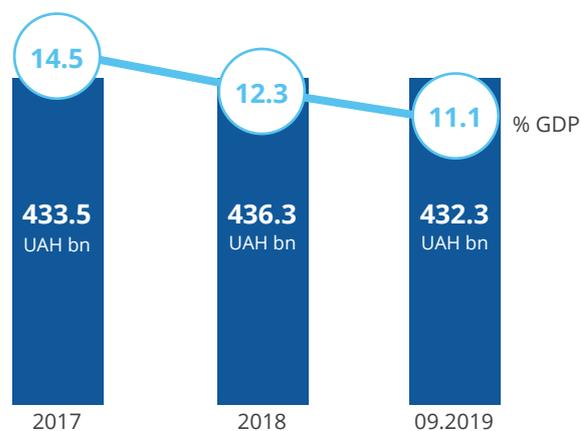
⁷⁰ So-called “5-7-9%” Program. As reported, the rate will depend on the size and the type of business: 5% p.a. — if the revenue is below UAH 25mn and 2 working places are created at least; 7% p.a. — for the business with the revenue below UAH 25mn, which does not create new jobs, but the rate decreases per 0.5% for each new employee; 9% p.a. — for the business with the revenue below UAH 50mn. More details at: <http://smeprogram.guf.gov.ua>

Data published by the NBU and the MinEconomy show the retention of loan volumes granted to micro-, small and medium-sized enterprises in absolute figures at around UAH 430bn, which, compared to economy growth, is reflected in the decrease in SME to GDP ratio loans amount from 14.5% to 11.1% for the period from 2017 to September 2019. However, to get an objective picture of loan volumes granted to SMEs only, it is also necessary to consider the share of the loan portfolio granted to counterparties affiliated with business groups.

Since September 2019, the NBU has started publishing statistics on loans to large, medium-sized, small and microenterprises — legal entities, considering characteristics of their membership in a particular business group. The NBU substantiated expansion of statistics on SMEs' crediting by a large number of borrowers formally being small enterprises, but are actually part of much larger business groups.

Indeed, as of the end of October 2019, SMEs' loans accounted for 56.1% of the corporate sector's total loan portfolio, of which medium — 24.7%, small — 9.8%, micro — 21.7%. However, loans to counterparties being part of a business group in SMEs made up 79.1%. Rates on loans to affiliated business groups are typically lower. Interestingly, loans for individual entrepreneurs are granted mainly to counterparties unaffiliated with business groups (86.1%)⁷¹.

Chart 9. Volume of loans granted to SMEs



Source: NBU statistics, Ministry of Economy

Thus, overall statistics show stagnation in SME lending over the last three years, despite the growth of the Ukrainian economy. This indicates there are no significant changes that could improve the SME's access to finance as of the time of this report preparation.

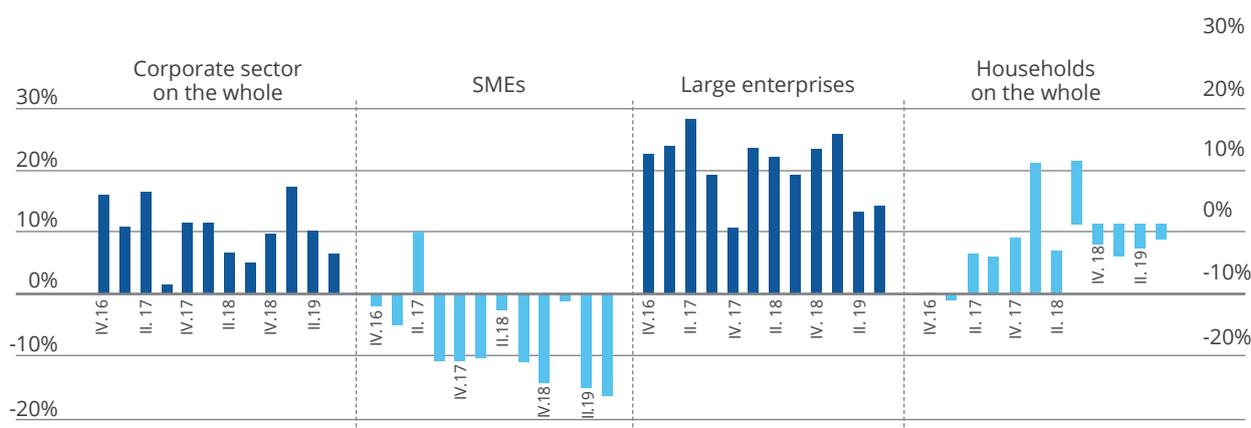
Analyzed data also supports the assertion that volume estimates and segmentation of such crediting are significantly distorted, taking into account the loans granted to counterparties affiliated with business groups.

⁷¹ Available at: <https://bank.gov.ua/statistic/sector-financial/data-sector-financial>

Steady lending volumes for SMEs coupled with economic growth lead to deleveraging, i.e. reduction in debt burden in this economy segment. This assumption is well illustrated by the results of the NBU's survey on the bank

lending conditions for the 4th quarter of 2019⁷². SMEs lending level was considered low or average by 90% of respondents and the balance of responses was record low for the entire monitoring period.

Chart 10. Current debt burden assessment level (balance of responses of respondents with high/low crediting level assessment of the respective sector, a negative indicator indicates prevalence of low ratings, % of respondents)



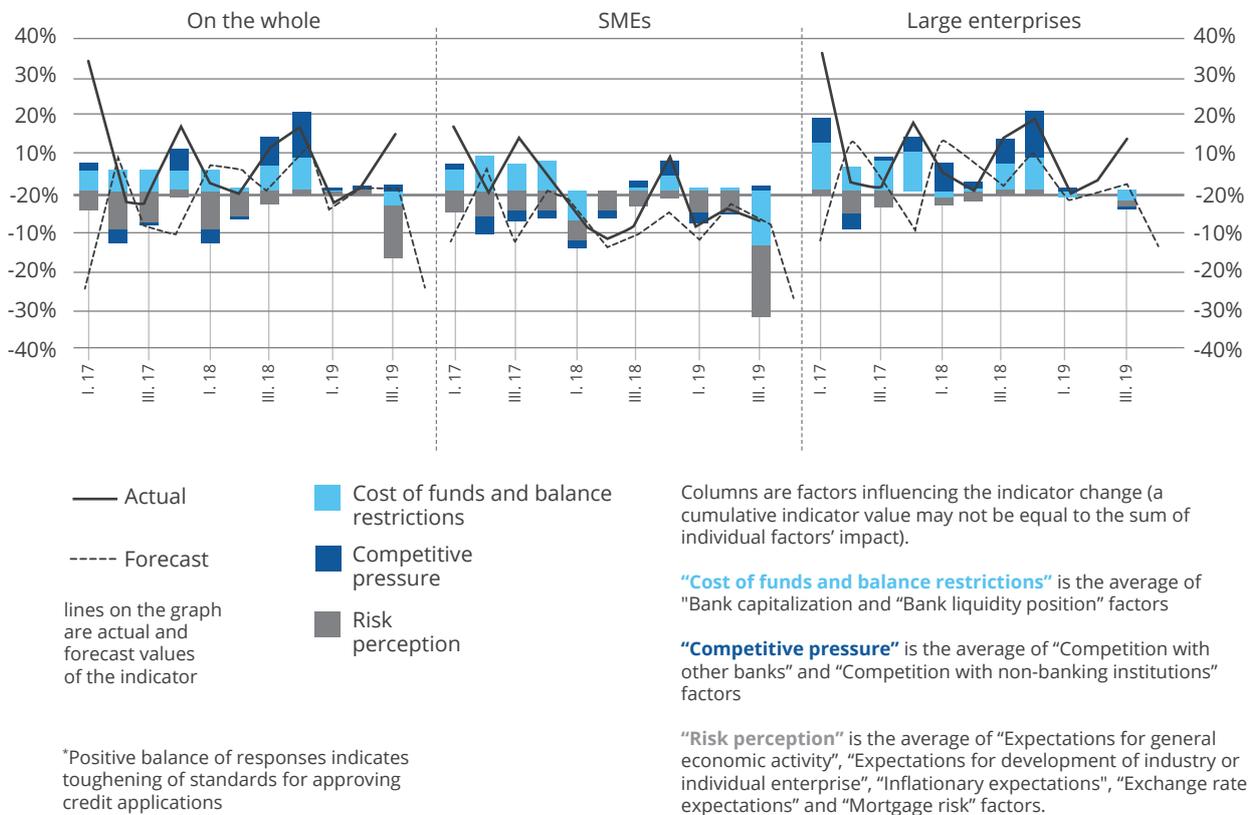
Source: Bank Lending Survey, Q4 2019, NBU

It should be noted SMEs' low level of debt burden speaks for the good financial health of this segment of entrepreneurship and significant potential for the development through leveraging financial resources, which can be implemented provided real access to finance is improved.

Also noteworthy is lowering of SMEs' credit applications approval standards, i.e., less requirements to a borrower in the 3rd quarter of 2019 by the overwhelming majority of banking institutions primarily driven by competitive pressure and increased liquidity in the banking system.

⁷² The survey was conducted among credit managers of 50 banks. All the respondents provided their answers, their share in the banking system total assets volume is 99%. Findings available at: <https://bank.gov.ua/news/all/banki-pokraschili-ochikuvannya-kredituvannya-biznesu--opituvannya-pro-umovi-bankivskogo-kredituvannya>

Chart 11. Change in credit applications approval standards (balance of responses)



Source: Bank Lending Survey, Q4 2019, NBU

Such changes to the key crediting availability factor can, in the short- and mid-term run,

revitalize SMEs' lending and lead to an increase in this sector's credit portfolio.

5.4. SMEs' awareness of funding opportunities

SMEs' representatives interviewed during the USAID CEP survey pointed out to the lack of information on targeted programs to improve the SMEs' access to finance. Over 3/4 of the respondents did not attempt to obtain financial

resources through international technical assistance projects, international financial institutions and grant programs. However, 41.2% of the surveyed companies applied for and received commercial credit (see the Table below).

Table 2. Attempts to obtain financial resources in 2017-2019 from certain sources/using financial instruments, % of responses

Funding Sources		Hard to answer	Made attempts and received financial resources	Attempts were made, financial resources could not be obtained	No attempts were made
State budget funds, N = 49		6.1%	12.2%	6.1%	75.5%
Local budget funds, N = 52		3.8%	17.3%	11.5%	67.3%
International technical assistance programs/projects, N = 51		5.9%	11.8%	11.8%	70.6%
EU Grant Programs (COSME, Horizon 2020, etc.), N = 50		4.0%	8.0%	10.0%	78.0%
International financial institutions (European Bank for Reconstruction and Development, International Finance Corporation, European Investment Bank, etc.), N = 51		3.9%	5.9%	9.8%	80.4%
Commercial banks, N = 51		3.9%	41.2%	9.8%	45.1%
Placement of securities on the stock market, N = 49		6.1%			93.9%
Use of financial instruments such as:	promissory note, N = 43	7.0%	4.7%		88.4%
	factoring, N = 43	7.0%			93.0%
	leasing, N = 43	4.7%	4.7%		90.7%
Venture funds, N = 49	8.2%	2.0%	2.0%	87.8%	87.8%
Institutional investors (investment funds and companies), N = 50	8.0%	6.0%	2.0%	84.0%	84.0%

Source: State SME Policy Implementation Evaluation Report for Ukraine, USAID CEP 2019

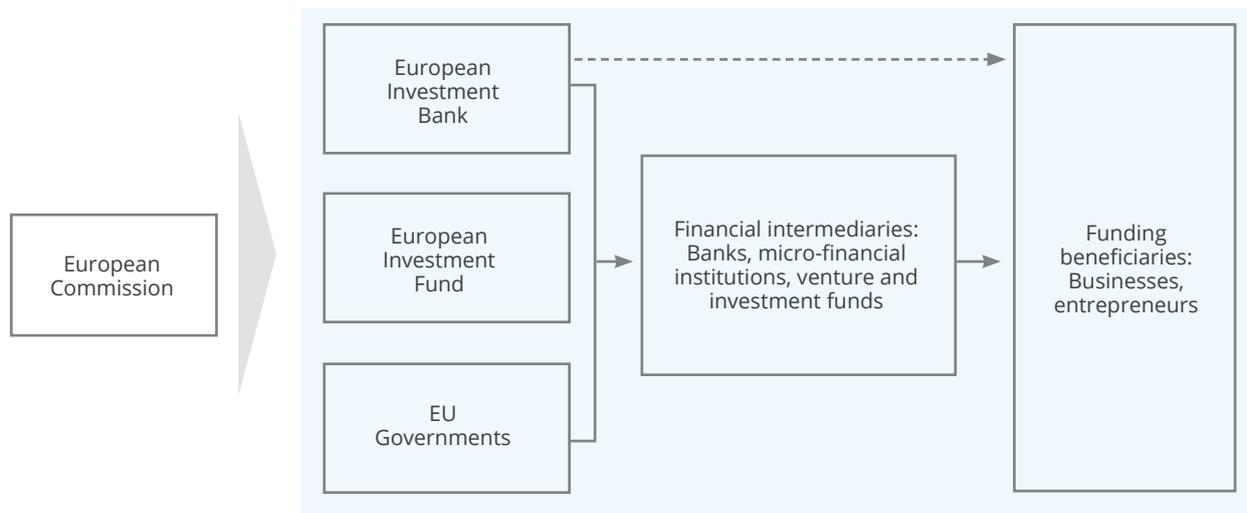
At the same time, according to the BOC's research, up to 50 SME support programs are currently run by international donors in partnership with Ukrainian banking institutions, investment funds and governmental agencies.

The main funding sources are the EBRD, the European Investment Bank, the European Investment Fund, the German Development Bank (KfW), GUF, IFC. The programs include granting targeted loans to SMEs for social,

energy-efficient, environmental projects, grants for exchange of experience and entrepreneurial competences development.

In the EU there is a separate official portal www.access2finance.eu containing detailed up-to-date information on all European programs for improving the SME's access to finance at all levels, as well as financial institutions via which these programs are implemented.

Chart 12. EU support scheme for entrepreneurs via local financial institutions



Source: Portal access2finance.eu at official EU portal europa.eu

Instead, the portal for entrepreneurs of the MinEconomy www.sme.gov.ua can perform a similar function of the official portal — the single point of contact that would aggregate information on access to finance, grants and training programs for SMEs.

As of today, the portal already contains relevant sections on banking, budgetary and donor support programs for SMEs, but they include incomplete information so far.

During surveying⁷³ and interviewing entrepreneurs, the BOC also discovered that significant constraints, in entrepreneurs' opinion, are SMEs' activities not being

transparent enough, thus complicating loan applications assessment by financial institutions, doubts about the entrepreneurs' ability to prepare compelling business plans, the need to prepare a lot of documents to obtain a loan and lengthy decision-making process.

At the same time, the prospects of obtaining loan financing stimulates transparency in business and facilitates unshadowing SMEs.

The BOC also got this information confirmed in interviews with several mid-level executives from corporate banking institutions and SMEs in particular.

⁷³ USAID CEP survey

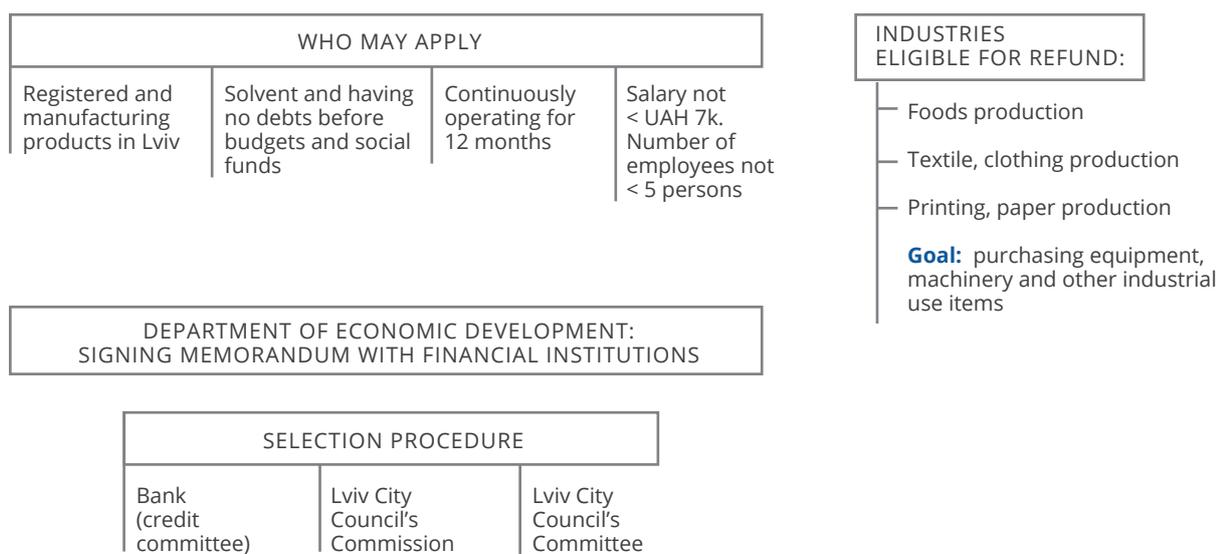
5.5. Regional programs supporting SMEs' access to finance through example of Lviv City

In 2019, the Lviv City Council launched a financial and credit support program for small and medium-sized businesses. The regulation for a partial loan interest refund for business entities was approved by the Lviv City Council in April 2019.

According to its terms and conditions, solvent food, light industry and printing companies registered and continuously operating for at least

12 months in Lviv and having no debts to budgets are entitled for interest refund amounting to the NBU interest rate. Refunds may be granted for loans to purchase machinery and equipment and other fixed assets for industrial purposes for the amount from UAH 200k to UAH 1mn up to 36 months and at least 30% of own funds share. UAH 3mn budget funds were allocated for the loan interest refund till the end of the year:

Fig. 3. Regulation on partial loan interest refund for business entities in Lviv City



Source: Portal of Lviv City Council city-adm.lviv.ua

However, despite attractive conditions, as of mid-December 2019, only one borrower took the advantage of this offer within the framework

of the GUF small and medium-sized businesses support program⁷⁴.

⁷⁴ Available at: <https://minfin.com.ua/en/2019/11/18/39755898/>

Recommendations:

1. To consider creating a section dedicated to the SMEs' access to finance at government-based web resources, for instance the SME Development Office's portal sme.gov.ua. To provide aggregation of up-to-date information on funding programs and grants, relevant educational programs for SMEs.
2. To provide quality information and training materials on access to finance and general financial literacy, including preparing SMEs for obtaining bank financing and preparing loan applications. Make this resource widely known to the target audience.
3. To initiate training programs for SMEs aimed at improving access to finance through technical assistance programs. Consider regular conducting of such programs on the ongoing basis with budget and/or donor funding, for example, through regional business support centers.

To avoid a formalized approach to implementing such programs (for example, when performance is assessed based on the fact of the training itself), introduce measurable and focused key performance indicators, such as quantitative indicators of the SMEs' participation, the number of SMEs that have tried to or received funding after participation in training programs, and others.

4. To analyze the implementation of financial and credit regional business support programs at the expense of budgetary funds that have been active since 2018, in terms of their effectiveness and to develop an optimal approach to providing financial and credit support for business entities.
5. To consider introducing criteria for participation in concessional lending programs according to the state policy priorities, such as:
 - assistance in adapting to the corresponding EU standards;
 - enterprises/projects founded by employees dismissed over the last year;
 - enterprises registered in regions with high unemployment rate and/or low economic activity (the so-called "depressed regions").

6 ENHANCING COMPETITIVENESS AND INNOVATION POTENTIAL OF SMES

Innovative products development is named as one of the key drivers of recent rapid expansion for startup and scaleup⁷⁵ firms in the EU. Being innovative is also identified among the key factors increasing the likelihood that SME will export goods or services, thus reaching out to global markets with opportunities for growth.

Therefore, promoting all forms of innovation in business processes and products, as well as enhancing skills among SMEs' employees are to become one of the guiding policymaking principles.

To identify key areas, the improvement of which might have the largest impact on innovations in the Ukrainian SME's environment and relate to measures, provided by the Strategy, we have reached out to prominent innovative/startup investors, managers and experts, and analyzed available surveys, benchmarks and indexes.

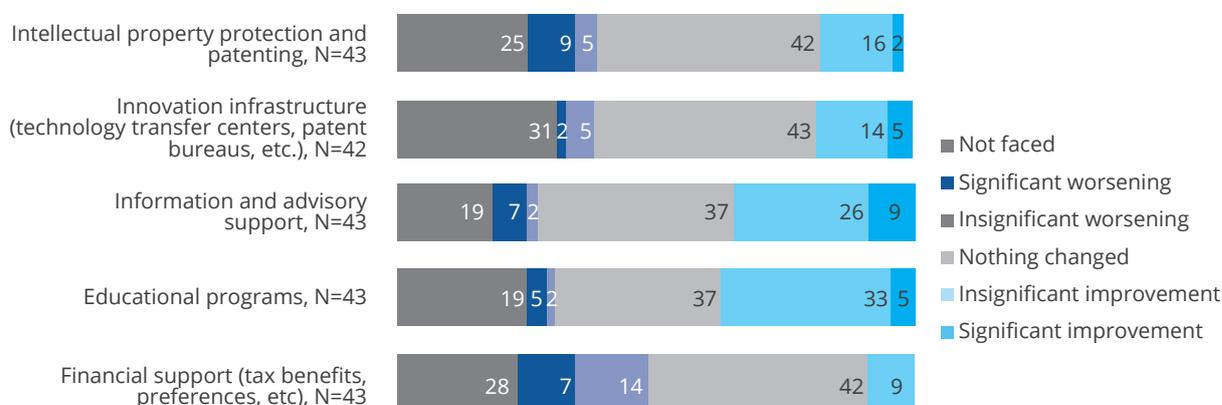
Interviews with market participants and experts have revealed that major factors restraining growth of the innovative business in Ukraine are intellectual property

protection, protection of ownership, judicial independence and efficiency of the judicial system and a legal framework in settling disputes. In the course of interviews several managers and owners have stated that these factors lead to insecurity and make innovative businesses register their key assets, intellectual rights and patents overseas, e.g. in the US or the EU.

These observations are supported by the latest measurements of the Global Competitiveness Index, in which judicial independence criteria ranked Ukraine 117th out of 140 countries, intellectual property protection criteria put Ukraine to 114th place, property rights — 129th and efficiency of legal framework in challenging regulations 107th.

Illustrative in this case is the EIC Accelerator data hub map, which shows a striking difference in the number of supported Horizon 2020 projects in Ukraine compared to other countries in which the program operates⁷⁶. Ukraine is involved in only 10 projects (for comparison, Lithuania is involved in 27 projects, Poland in 98, and Turkey in 46). The BOC was unable to study the causes

Chart 13. Changes in innovation support and/or technology implementation over the last three years (2017-2019), % of responses



Source: State SME Policy Implementation Evaluation Report for Ukraine, USAID CEP 2019

⁷⁵ Firms with a three year-average growth rate in employment of at least 10%

⁷⁶ See <https://sme.easme-web.eu>

of such indicators in depth — the difficulty of doing business, the SMEs' lack of awareness of the program or the program's inconsistency with the realities of Ukraine.

In general, these observations also correlate with the USAID CEP findings:

Response statistics indicate a significant improvement in factors such as educational programs, information and advisory support. At the same time, there is a worsening situation with the "financial support" factor, as well as a slight positive balance of responses, or stagnation in factors related to intellectual property protection, patenting and innovation infrastructure.

It should be noted that SMEs and providers of donor and information support do not have a single, universally accepted definition of what "innovation" is. Therefore, many non-innovative companies apply to programs that do not fit their profile and, after being selected, create negative information

background. At the same time, some companies are not aware of the innovative nature of their business and they are losing the opportunity for support.

Also, innovative companies do not have a "single point of contact" with information about support programs, which is particularly noticeable given the language restriction that prevents some entrepreneurs from finding relevant information in other languages or applying for SME support/funding programs.

The survey⁷⁷ also revealed inadequate copyright protection and imperfection of the national patent protection system, as well as non-harmonization of the national patent legislation with the relevant EU standards, hinder SMEs' innovation activities in Ukraine.

The topic of access to finance for SMEs including startups and the vast majority of innovative enterprises is covered in detail in the *Increasing SMEs' access to finance* chapter.

6.1. Intellectual property protection

The state of things around intellectual property protection, patenting and innovation infrastructure is extremely burdensome for SMEs and independent startups which cannot afford significant legal costs and do not have strong established business processes, dealing with legal protection of firm's assets.

The Global Competitiveness Index 2018 has two pillars, attributed to Innovation Ecosystem — Business dynamism and Innovation capacity, with 18 components therein. While some of those components scores are relatively high (e.g. cost of starting a business (18th/140), time to start a business (37th/140) and attitudes towards entrepreneurial risk (17th/140), most of the components leave room for improvement.

Among those indicators depending on quality of regulations and state policies are insolvency recovery rate and insolvency regulatory framework (129th and 93rd places respectively), state of cluster development (106th) and diversity of workforce (62nd).

It should be noted, that availability of qualified workforce was also mentioned as a limiting factor by the interviewed participants and it is a European-wide problem. As of 2018, all the EU Member States have established measures to help SMEs with their employee training, providing access to business advisory/ support services, as well as supporting the development of their RD&I competencies. Most EU Member States also have a well-developed and accessible network of training

⁷⁷ USAID CEP survey

providers and mechanisms to support the commercialization of scientific and research results.

Another notable issue is weak participation of SMEs in the policymaking process. While large companies can leverage their spending on governmental relations and make impact via business associations and industry-specific organizations, SMEs have much less instruments to provide feedback and communicate their needs to policymakers. Moreover, the BOC's practice shows that SMEs often lack knowledge about the existing channels of communication and policymaking process.

There is actually no platform for business to communicate with the Ukrainian Government at the national level. The Council of

Entrepreneurs under the CMU, set up as a permanent consultative and advisory body, has never convened in the last few years. The lack of institutionalized forms of interaction between businesses and the Government does not contribute to the state policy predictability and openness.

The Strategy addresses these issues mostly in the section 6, including measures for provision of consulting services to SMEs, especially in rural areas, strengthening institutional capacity of unions and organizations of entrepreneurs, intensifying transition of research and scientific achievements to entrepreneurs and active participation in respective international programs, such as COSME 2014-2020, Horizon 2020, Enterprise Europe Network, etc.

Recommendations:

1. To enhance the implementation of measures aimed at strengthening the institutional capacity of business associations (business support organizations), in particular, the implementation of a relevant Program developed during the SME Strategy's implementation. Prioritize measures within the Program designed to support the competitiveness and SMEs' interests presentation and communication.
2. To prioritize the implementation of the Innovation Strategy for the period up to 2030⁷⁸ aimed at enhancing copyright, improving the national patent protection system and harmonizing the national patent law with the relevant EU standards, in particular:
 - approximate technical regulation, standards, and conformity assessment;
 - normatively regulate the process of transferring intellectual property objects;
 - introduce state support for patenting of intellectual property of Ukrainian innovators abroad through co-financing, etc.⁷⁹

⁷⁸ Approved by the CMU on July 10, 2019. Available at: <https://zakon.rada.gov.ua/laws/show/526-2019-%D1%80>

⁷⁹ See the Innovation Activities Development Strategy for the Period Up to 2030

7 COMPLIANCE CAPACITY BUILDING AND AWARENESS RAISING OF BUSINESS INTEGRITY AMONG SMES

7.1. Current state

As outlined in the previous sections of this report, the SMEs' complaints are an important part of all complaints to the BOC. The specifics of the received complaints indicate that malpractice towards SMEs is mainly caused by:

- (i) excessively bureaucratic nature of processes applied by governmental agencies or local self-government authorities. This includes submission of information on administrative services or regulatory requirements in a complicated form for SMEs. It is noticeable that in the USAID CEP survey the panelists stated that it was hard for them to find the information they needed at some governmental agencies' websites, especially local ones, as well as noted that such information is structured and presented in different sections and different ways.
- (ii) failure of SMEs themselves to comply with specific formal requirements (e.g., lack of supporting documents for certain transactions), which caused not only SMEs' vulnerability to public authorities' malpractice, but also increased the likelihood of classification as risky entities; or
- (iii) lack of knowledge of SMEs in building an effective dialogue to restore violated rights (e.g., poor awareness of the administrative appeal terms, failure to meet formal requirements for documenting complaints to supervisory authorities). At the same time, when investigating malpractice in the context of complaints received from SMEs, the BOC

often sees that the lack of legal awareness of SMEs leads to both a breach of current legislation due to negligence and impossibility to effectively apply remedies.

In particular, the BOC notes that apart from access to relevant compliance practices and awareness raising of business integrity, SMEs often lack financial and/or human resources. Following analysis of complaints concerning regulatory relations, the BOC concludes that it stems from the development of regulatory standards without considering specific nature of certain types of enterprises, in particular SMEs, in Ukraine. In this regard, some of the requirements for developing compliance are disproportionately burdensome especially for SMEs (it is particularly relevant for individual entrepreneurs with hired employees being overloaded with formalization of employees' relations and reporting). In addition, the results of the aforementioned survey⁸⁰ also reaffirmed the formalism of state authorities in complying with the Law of Ukraine "On Principles of State Regulatory Policy in Economic Activity", particularly as regards the transparent development of regulatory norms and taking public opinion into account. It is due to both the lack of competence the officials of local self-government authorities have and, sometimes, the conscious unwillingness to comply with the requirements of the law.

According to international researches,⁸¹ under these circumstances micro- and small businesses are particularly on the verge of moving away from compliance culture and consequently are at higher risks of doing business and becoming less competitive.

⁸⁰ USAID CEP survey

⁸¹ Available at: <https://publications.europa.eu/uk/publication-detail/-/publication/2c74690f-9aa0-11e6-9bca-01aa75ed71a1/language-en/format-PDF/source-98115285>

Therefore, considering the importance of developing compliance culture from the point of effective interaction of SMEs with the state and local self-government authorities, as well as improving legal awareness and protection of SMEs, and, at the same time increasing the investment attractiveness before creditors, the BOC decided to focus on certain recommendations required for compliance capacity building by SMEs and raising their awareness of these issues.

The BOC notes that an important step towards addressing SMEs' problems has already been taken in 2018 with the establishment of the SME Development Office. The latter aims to consolidate information on SMEs, provide practical advice and support to SMEs. In addition, during preparation of this report, the BOC communicated with NGOs and international organizations' representatives which monitor the reform implementation in Ukraine, and they noted that the Government is already implementing many programs to increase transparency and facilitate access to information for SMEs and, as a result, create more favorable environment for SMEs. In particular, according to the OECD estimates,⁸² a number of public awareness and support activities have been held in 16 cities of Ukraine, while creation of SME's support centers to train SMEs, has been scheduled for the 4th quarter of 2019.

In the BOC's view, it is important to ensure practical nature of compliance seminars for SMEs (illustrated with specific compliance practices). Among other things, to ensure a lasting result, it is expedient to introduce measurable and focused key performance indicators (e.g., indicators of quantitative participation of SMEs, number of SMEs that have introduced or are in progress of implementing a compliance system in accordance with the minimum standard

developed). Such an approach would create further best practices to draw up a minimum compliance and business integrity standard (guidelines) for SMEs.

The BOC notes that the development of a minimum compliance and business integrity standard (guidelines) meets expectations of SMEs, who welcome the adoption of a unified guidance or clarifications. Thus, according to survey findings⁸³, making step-by-step instructions with detailed information on the procedure for performing certain actions, issuing/obtaining permits (for example, as applied by state information service — Start Business Challenge), check lists, guidebooks and other relevant information (e.g., dissemination of legally approved frequently requested information) publicly available through a single point of reference are very much welcomed. This should give impetus to wider application of self-assessment of risks and compliance level by SMEs. Based on the BOC's experience in monitoring the implementation of recommendations provided in the course of other systemic reports it could be concluded that such guidance and support should be tailored to the needs of different SME's groups and developed in close collaboration with businesses.

In this context, the BOC identified that currently there is a wide range of initiatives aimed at creating enabling environment for SMEs. However, the platform that would focus specifically on compliance-building for SMEs has not been determined yet. At the same time, it should be noted that collective actions in the private sector aimed at building compliance and business integrity have already been formed in Ukraine. For example, in 2017, with the support of the OECD, EBRD, BOC, Ukrainian and foreign companies, the Ukrainian Network of Integrity and Compliance (UNIC) was launched⁸⁴.

⁸² Presentation of the Monitoring of SME Strategy implementation for 2020 by Ukraine, prepared by the OECD Working Group No. 2 of November 7, 2019. For example, the OECD experts note a partial progress in meeting the targets set by the Action Plan for the implementation of SME Strategy in Ukraine for the period up to 2020.

⁸³ USAID CEP survey

⁸⁴ The goal of the Ukrainian Network of Integrity and Compliance is to introduce a common standard of business integrity and to provide comprehensive support to companies in implementing that standard in their day-to-day operations to further certify compliance with independent experts. For more information about the-Ukrainian Network of Integrity and Compliance, please go to: <https://unic.org.ua/>

Therefore, in the BOC's opinion, it would be appropriate for the MinEconomy to coordinate the development of a compliance platform for SMEs based on collective actions already launched to effectively overcome compliance risks faced by SMEs. This will help to consolidate efforts and industry-specific expert analysis of collective actions in the private sector. Such an approach will, among other things, strengthen the dialogue with large companies to encourage their suppliers (mostly represented by SMEs) to implement compliance practices based on the developed minimum compliance and business integrity standard (guidelines) for SMEs.

Finally, the development of the SMEs' compliance is particularly important in the context of prioritizing support for SMEs in the

public policy framework through proactive consideration of SMEs' efforts to implement effective compliance and conformity systems by regulatory authorities at early stages of law-making.⁸⁵ SMEs' representatives themselves, who the BOC met during preparation of this report, rightly remarked that, despite all the importance of this issue, as of today, the state has not developed a unified approach to encourage SMEs to incorporate compliance systems in their activities⁸⁶.

Given the importance of building a transparent system and introducing business integrity culture among SMEs, below are the BOC's recommendations, which should be considered to be only the minimum prerequisite for achieving the said objective.

⁸⁵ The expediency and timeliness of SMEs' active involvement in compliance is confirmed, in particular, by the 2030 Agenda and the UN Sustainable Development Goals, which encourage States to integrate SMEs into their national policies of responsible business. In turn, the "Think Small First" principle also calls for simplification of newly designed legislation, administrative rules and procedures to be easily applied by SMEs. For instance, in Germany all new legislation is subject to the 'SME test', and is evaluated in terms of its administrative capacities, budgetary constraints and potential impact on SMEs. Additionally, in Denmark and Sweden, consultation with the private sector is encouraged through the Burden Hunt Programs, which engage civil servants in developing smart regulation that can reduce red tape. According to the OECD study, this principle began being applied in Ukraine in 2017 by the State Regulatory Service by revising regulatory acts in 5 key sectors of the economy. Thus, in accordance with that principle, 1,298 regulatory acts were revised in 2018.

⁸⁶ For example, in the BOC's view, as set forth in the Systemic Report "Combating Raidership: Current State and Recommendations", it is advisable for the state to evaluate possibility to recognize and encourage companies' efforts to implement effective compliance and conformity systems in the field of business integrity. Thus, for example, G20 members have undertaken to support active involvement of companies by providing positive recognition of effective anti-corruption and compliance systems through regulatory entrenching opportunities and mechanisms for reducing fines. For more information, please go to: <https://boi.org.ua/publications/systemicreports/1134-systemic-report-combatting-raidership-current-stat/>

Recommendations:

The BOC has singled out several blocks of recommendations for:

- (i) building the SME Development Office capacity to extend application of compliance practices among SMEs;
- (ii) developing a unified approach how to encourage SMEs to implement a compliance system in their activities;
- (iii) implementing communication initiatives to improve understanding and compliance practices application. Therefore, the BOC recommends the following:

regarding the SME Development Office compliance practices capacity building

- 1) the MinEconomy to promote further enhancing of the SME Development Office institutional capacity;

regarding developing a unified approach to how to encourage SMEs to implement a compliance system in their activities

- 2) The MinEconomy, jointly with the SME Development Office — to encourage the development of partnership with collective actions in the private sector (e.g., Ukrainian Network of Integrity and Compliance) for creating a single mentorship platform to advise on compliance and business integrity for SMEs.
- 3) The MinEconomy and the SME Development Office — to strengthen the educational capacity of the created platform aimed at raising companies' awareness of international compliance standards and their implementation by the private sector, by holding country-wide events and creating a resource guide/program with success stories for SMEs' representatives, etc.
- 4) The MinEconomy and the SME Development Office — to develop a practical compliance workshops program by engaging various stakeholders, including those in the regions, to increase overall business awareness about business integrity practices, as well as further joint development of a common minimum compliance standard (guidelines) with further SMEs' support in implementing compliance practices.
- 5) The MinEconomy — to initiate developing a minimum standard (guidelines) on business integrity tailored to SMEs' compliance needs. The implementation of such a standard should lay down the necessary foundation for determining the compliance culture sustainability in Ukraine, in particular, by introducing company certification provided that they have more sophisticated and well-established compliance programs. Following the introduction of the standard with the stakeholders' involvement, study legislation to simplify regulation for SMEs applying the compliance standard.

Recommendations:

regarding launching of communication initiatives to improve the level of understanding and application of compliance practices

- 6) The SME Development Office, the MinEconomy and other CEBs and local governmental authorities — to properly and timely complete implementation of activities envisaged by the SME Strategy in terms of training, education aimed at developing competencies/skills and awareness-raising of SMEs in the field of business integrity.
- 7) The MinEconomy, other CEBs, regional administrations and the KCSA — to continue maintaining an active dialogue and holding specialized forums for SMEs. At the same time, it is advisable for these entities to analyze the current state and expand preparation of step-by-step instructions with detailed information on key business processes required to start or liquidate certain types of business and to uniquely present/post information on their websites. Additionally, such information should be accompanied by interactive self-testing tools for SMEs so that they can independently check their compliance level.



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