

**German Advisory Group**  
**Institute for Economic Research and Policy Consulting**

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## **Comments on the draft SME policy strategy**

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## **About the Institute for Economic Research and Policy Consulting**

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Institute for Economic Research and Policy Consulting (IER) is the leading Ukrainian analytical think tank focusing on economic research and policy advice. The IER was founded in October 1999 by top-ranking Ukrainian politicians and the German Advisory Group on Economic Reforms.

The mission of IER is to present an alternative point of view on key problems of social and economic development of Ukraine. In frame of the mission IER aims at providing top quality expertise in the field of economy and economic policy-making; acting as real leader of public opinion through organization of open public dialog; contributing to the development of economic and political sciences as well as promoting development of Ukrainian research community.

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## **About the German Advisory Group**

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The German Advisory Group on Economic Reforms, which has been active in Ukraine since 1994, advises the Ukrainian Government and other state authorities such as the National Bank of Ukraine on a wide range of economic policy issues and on financial sector development. Our analytical work is presented and discussed during regular meetings with high-level decision makers. The group is financed by the German Federal Ministry for Economic Affairs and Energy.

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## **1. Introduction**

As of June 2016, the Ministry of Economic Development and Trade of Ukraine has produced a draft of the document “Strategy for the development of small and medium-sized businesses in Ukraine for the period until 2020”.

The aim of the document is to act as a strategic framework for the future policy towards small and medium-sized enterprises in Ukraine.

The final version of the SME strategy will be approved by the Cabinet of Ministers of Ukraine and thereby transformed into a Resolution of the Cabinet of Ministers of Ukraine.

This policy briefing provides comments on the current draft of the SME strategy as of June 2016 with the aim to furtherly improve the strategy formation process.

## **2. Comments on the content and recommendations for improvement**

### 2.1 Reforming the regulation on private entrepreneurs

From our point of view, the list of identified problems is not complete.

We have identified at least one more major impediment of the SME sector development in Ukraine, which is the significant number of pseudo-self-employed and the massive misuse of the simplified taxation system “private entrepreneur” (so called “FOP”).

Ukraine has a system that aims to release single entrepreneurs from tax and administrative burden (“FOP”). The problem with that system is that it facilitates fictitious self-employment and tax fraud. There are many big companies that disguise themselves as networks of “FOPs” in order to evade taxes and undermine employee’s rights.

The problem is that such unfair competition puts the “normal” single entrepreneurs at a disadvantage and harms their development.

The task for the policy is to design a regulation system that facilitates small entrepreneurial activities but at the same time protects real entrepreneurs from the illegal competition of tax-fraud schemes.

### 2.2 Responsibility and accountability

The current draft states that the Ministry of Economic Development and Trade of Ukraine shall be responsible for the SME policy formation and controlling, while a state agency should be responsible for policy implementation. This is not according to international best practice.

International experience suggests that the responsibility and accountability of the SME policy should be with the entire government, i.e. the Cabinet of Ministers of Ukraine. SME policy should be a joint task of all line ministries and the implementation of SME policy should be a joint task of all authorities and state institutions. This is in line with the Small Business Act for Europe, especially the principle “think small first”.

The Ministries of Economy in Western countries usually fulfil a role of coordinating the SME policy formation and controlling, but are surely not the only responsible state bodies.

A SME agency could play an important role in the SME promotion, but only for parts of it. Usually the SME agency deals with the implementation of some of the support programs such as basic business training and alike. But issues related to deregulation, competition enhancement, innovation promotion, export promotion etc. are usually beyond the scope of a SME agency.

### 2.3 Academic entrepreneurship

#### *General Relevance for SME development*

Academic Entrepreneurship is a way of transferring knowledge and technology from science and higher education to the private business sector and, therefore, contributes to the innovativeness and competitiveness of small and medium-sized enterprises. Furthermore, the promotion of academic entrepreneurship is an adequate success of a policy towards the development of regional clusters and innovative milieus. That is why modern SME policy approaches include the promotion of Academic Entrepreneurship and so should Ukraine.

#### *Specific problem in Ukraine*

Academic Entrepreneurship is underdeveloped in Ukraine. There are many impediments for academic entrepreneurship. We want to highlight here only one of the problems and sketch out a solution approach that is very feasible.

Among the problems for the development of Academic Entrepreneurship is an inefficient structure of the support infrastructure. There are several science parks, business incubators and similar institutions in some of the Ukrainian higher education and state research institutions, but none of them has sufficient resources and sufficient capacity on their own. The cooperation of those institutions is currently limited. As a result, they cannot make use of potential economies of scales and positive learning curves effects.

#### *Policy approach*

Create several central virtual science parks for Ukraine. The central virtual science parks shall facilitate the cooperation of existing science parks and all other initiatives of scientific research institutions and higher education institutions towards promoting and supporting academic entrepreneurship. Duties of the central virtual science parks include:

- Coordinating exchange of knowledge, experience and best practice
- Expert pooling
- Facilitating a network of supporters and mentors from the private sector, from politics and from civil society
- Incubating services for spinoff projects

#### *Expected Outcome / Indicators*

- Number of supported spinoff and startup projects: XX
- Number of academic spinoffs that entered the market: YY
- Number of academic startups that entered the market: ZZ

#### *Expected Impact*

- a) Increasing the efficiency of the support infrastructure for Academic Entrepreneurship
- b) Increasing the number of spinouts and startups from Science and Higher Education
- c) Facilitating the emergence of an ecosystem of high-tech startups in Ukraine.

#### *Examples from international best practice*

See publication: 15 Years of EXIST "University-based start-up programmes", Fraunhofer-Institut für System- und Innovationsforschung ISI, [http://www.exist.de/SharedDocs/Downloads/EN/15-years-EXIST-University-based-start-up-programmes.pdf?\\_\\_blob=publicationFile](http://www.exist.de/SharedDocs/Downloads/EN/15-years-EXIST-University-based-start-up-programmes.pdf?__blob=publicationFile).

Consider especially pages 8-9.

## 2.4 Contentual consistency

The following highlights some of the inconsistencies that are most prominent from our perspective.

- Under the section *“building of strong institutional capacity of the state in the field of development and support of SMEs”* is stated a paragraph on *“international and national business associations”* (p. 5): The instrumental relation remains unclear, providing that business associations are no state institutions.
- Under the section *“building of strong institutional capacity of the state in the field of development and support of SMEs.”* is stated: *“international organizations and technical assistance projects - funding and implementation of projects and assistance programs under this strategy”* (p. 5): This is something beyond the scope of the Ukrainian government, although it is a nice-to-have. In other words, the Cabinet of Ministers cannot decide upon whether any international organization provides funding. The government could deploy resources for fundraising activities, though.
- Action *“creation of an Agency for small and medium enterprises”* (pp. 5-6): It is not clear, what problem should be addressed with the creation of such an agency. Such a SME agency is an international best practice instrument, but the fit to the specific situation in Ukraine remains unclear.
- Action *“creation of the office of the newest technologies”* (p. 6): It is not clear, what problem shall be addressed with the creation of such an office and to what objective’s achievement that office shall contribute.
- Create *“industrial parks for small and medium enterprises, which would have all necessary conditions for the fast launch of business start-ups in manufacturing, logistics, service spheres.”*(p. 6): Again, it is unclear, what problem and what strategic objective shall be addressed. In the current document, this action is under the section *“Building of strong institutional capacity of the State in the field of development and support of SMEs.”* Does that mean, such industrial parks should be state-owned and state-run institutions?

Maybe, Industrial parks are meant be an action for the problem *“insufficient SMEs support infrastructure”*, which belongs to another group of problems. However, an industrial park is not the best instrument for addressing a lack of support infrastructure, but for addressing a lack of “real” infrastructure, such as land plot, energy supply, water supply etc. Above all, there is nothing stated about a lack of premises or facilities in the problem section.

- Create *“Entrepreneurial labs - local small space sites for micro-businesses in the service sector and information technology”* (p. 6): The same is to say here as for the industrial parks.
- *“Creation of a unified information resource for entrepreneurs”* (p. 6): Again, it is unclear, what problem should be addressed. It is not stated before, that the SME sector in Ukraine lacks information.
- *“Development and implementation of a national strategy for waste management, which will create circular economy markets open to SMEs”* (p. 9): There is no clear relation of that action to any of the problems stated in the first section. Furthermore, this points to a very specific niche issue. The relation between waste management and SME development remains unclear. Is a lobby or pressure group here trying to influence the policy?
- Success indicator *“Reduction of employment in the informal sector is from 4.5 million people to 3.0 million people in 2020.”* (p. 11): There is no clear relation to any of the stated problems nor strategic objectives.

### 3. Comments on the methodology and recommendations for improvement

The draft SME strategy shows not enough consistency between

- The underlying principles as stated on pp. 1-2
- The identified problems to be solved (p. 2)
- The strategic objectives (p. 3)
- Actions and instruments, named “main stages and directions of strategy implementation” (pp. 3-9)
- Expected results (p. 9)
- Success indicators, named “the criteria for the results’ achievement” (p. 10)

The document provides

- 10 guiding principles,
- 14 major problems that form 3 groups of problems
- 11 strategic objectives that form 3 groups of objectives
- 16 actions and instruments
- 14 expected results
- 7 success indicators

A consistent approach would be as in the following:

For each of the identified problems -> one strategic objective -> at least one action to solve the problem respectively achieve the objective -> one expected result -> at least one success indicator that can measure the expected result.

Providing the list of 14 major problems is acknowledged and finalized, it should like that:

- 14 major problems
- 14 strategic objectives
- 14 (or more) actions and instruments
- 14 expected results
- 14 (or more) success indicators

### **Example 1**

The current draft deals with the firstly named problem as follows.

- Problem 1.1: *“Entrepreneurship has no broad public support”*
- Strategic objective 1.1: *“Positioning of entrepreneurship as the basis for economic development of Ukrainian society”*
- Action: No corresponding action that addresses the stated problem
- Expected result: *“Entrepreneurship is the basis of economic growth”*
- Success indicator: No corresponding indicator that measures the achievement

There might be a (not obvious) relation between the problem and the objective. There is a clear consistency between the objective and the expected result. However, there are no actions assigned to the objective and the achievement will not be measured.

### **Example 2**

The current draft deals with the fourthly named problem as follows.

- Problem “No. 1.4”: *“Limited access of small and medium enterprises to financial, property and natural resources”*
- Strategic objective “No. 1.3”: *“Ensuring SME access to financial, property, natural resources”*
- Action “No. III.2” : *“Access to finance”*
- Expected result “No. 4”: *“SMEs have broad access to the necessary financial, property and natural resources”*
- Success indicator: No corresponding indicator that measures the achievement

In this case, there are clear one-to-one relations between problem, goal, action and expected result, but the order is confusing. Additionally, the success indicator is missing.

Furthermore, according to international best practice, it is common to divide expected results into two categories: expected outcome and expected impact. Outcome is the direct result of the actions and can be measured by indicators. Impact is the long-term effect on the economy that contributes to achieving the strategic goals. Impact is often difficult to measure.

One can regard strategic goals and expected impact as belonging to a highly aggregated perspective, whilst actions, instruments and expected outcome are specific, concrete plans and figures.

The following illustrates how to formulate a strategy more consistently.

### ***Proposal for improving example 2***

The example 2 could look like this:

- Problem No. 1.4: Restricted access of small and medium enterprises to financial resources
- Strategic objective No. 1.4: Improving SME's access to financial resources
  - Actions addressing strategic objective No. 1.4
    - Action No. 1.4.1: Establishing a loan guarantee fund
    - Action No. 1.4.2: ...
  - Expected outcomes
    - Expected outcome of action No. 1.4.1:  
XX bn HRW SME loans backed up by the loan guarantee fund, in year 20YY
    - Expected outcome of action No. 1.4.2: ...
- Expected impact referring to strategic objective No. 1.4: Access of SME to credit finance has improved
- Indicators for measuring the impact:
  - Growth rate of SME bank loans
  - Survey data
  - ...

We recommend dealing with all issues accordingly. This would increase the coherence of the document and would reveal missing pieces like missing indicators, would reveal instruments that are insufficient to solve the problems etc.

In the best case, there would be even coherence with the 10 guiding principles stated on page 1, which are derived from the Small Business Act of the EU. Such a consistency with the Small Business Act would make the document even more comprehensible.

Consequently, we recommend the following structure:

- 10 guiding principles of SME policy in Ukraine, according to Small Business Act of EU
- 10 major current problems of SME in Ukraine, one problem for each of the domains of the guiding principles
- 10 strategic objectives, each objective relates to one problem and thus to one domain of the principles
- at least 10 actions, each action unambiguously related to one of the strategic objectives, ordering should be accordingly
- at least 10 expected outcomes, each action should have one expected outcome
- 10 expected impacts, one impact for each of the strategic objectives