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STRENGTHENING THE FINANCIAL AND CREDIT SUPPORT TO SMALL BUSINESS DEVELOPMENT IN AN UNSTABLE UKRAINIAN ECONOMY

The article analyzes the main problems faced by small entrepreneurship in the conditions of a worsening business climate in Ukraine. It is proposed to establish an institutional framework for dialogue between the representatives of the associations of banks, non-bank institutions, business associations to facilitate SMEs' access to credit and financial services.

Keywords: small business, credit and financial mechanism, institutionalization, instability.

Today, small business undertakes many social and economic problem solving, provides the necessary mobility in the market, creating an in-depth specialization and extensive cooperation of production, which they cannot be highly effective without. However, a small business is very vulnerable in a volatile environment, its effective development in the economy, prone to crises, is impossible without the support of the state, in particular credit and financial.

The literature reviewed wide range of different mechanisms and tools of credit and financial support of promotion of entrepreneurship used in the world practice of state regulation [1; 2]. But, unfortunately, the current support is not effective, especially in the emergence of new risks in the course of business in Ukraine.

The purpose of the article – is to analyze the main problems faced by small businesses in the conditions of a significant deterioration in the business climate, and existing ways to improve the institutional provision of credit and financial mechanisms to support it.

It should be noted that the trends of stagnation of the domestic business sector, observed in recent years, both as a whole in Ukraine, and at the regional level, have reached a critical value today. There is also an economic decline of activity ratio (Fig. 1), which is calculated according to the formula $I - K_{st} / K_{reg}$, where K_{st} – the number of subjects who have stopped business activities, K_{reg} – the number of registered business entities.

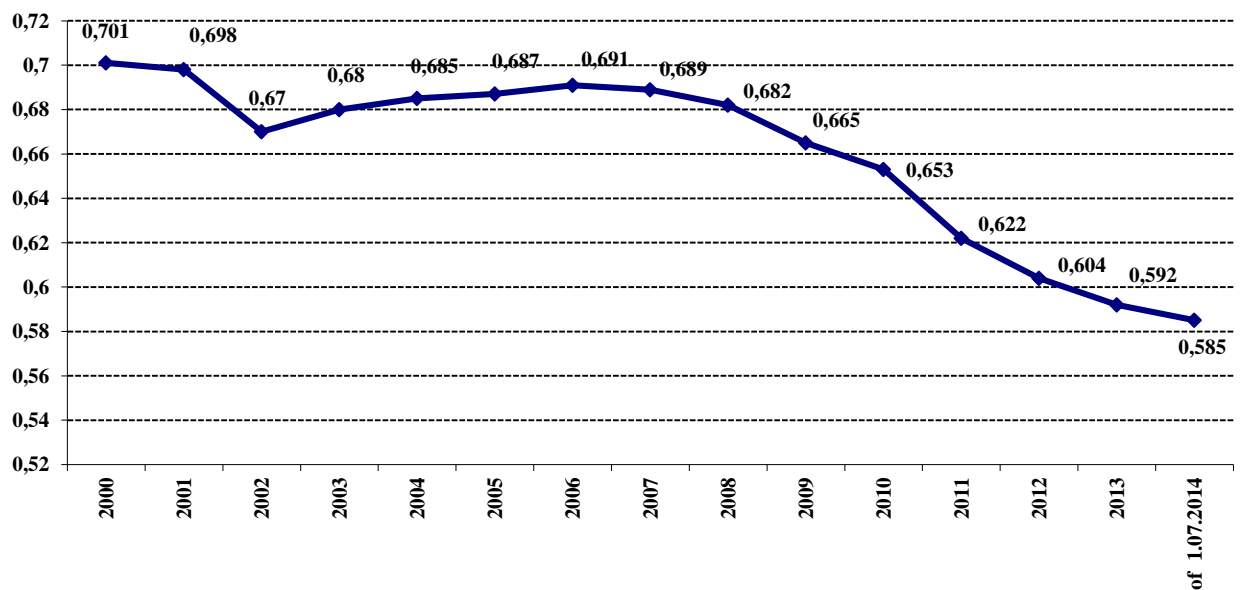


Fig. 1. Dynamics of the index of economic activity of business entities of entrepreneurship in the 2000–2014

Index of the Business expectations of enterprises in Ukraine for the second quarter of 2014 fell to the lowest crisis level, from 2009 onwards. Respondents of the quarterly survey of the National Bank of Ukraine¹ emphasize factors that are currently substantially worsening the business climate:

- instability of the political situation;
- high prices for energy and raw materials;
- growing inflation;
- an urgent need for loans;
- reduction in demand;
- criminalization and raiding.

According to experts, the negative trends in the development of business in Ukraine is primarily caused by objective reasons such as reducing the capacity of the domestic market and of the consumer purchasing power; low levels of property and proprietary rights protection, due to activities related to the illegal seizure of enterprises; imperfection of the current corporate and criminal law and the judicial system related to raiding control [3]. According to the Ukrainian union of industrialists and entrepreneurs, there are nearly 35-50 specialized raider groups in Ukraine consisting of experienced lawyers and economists. The number of raider attacks exceeds more that 3,000 per year and their impact is more than 90%. Losses from raider attacks are estimated annually by 3-5 billion dollars [5].

It should be said of the strengthening of geopolitical risks to domestic business connected with the signing of the Association Agreement between Ukraine and the European Union (hereinafter – EU), which provides for a transition to European quality standards and as a consequence, an increasing in domestic business spending on their implementation. In addition, in recent times the level of uncertainty of the regulatory field of

¹ *Dilovi ochikuvanya pidpryemstv Ukrainy. I kv. 2014 roku.* [Business expectations of enterprises. QII 2014]. – Issue N 2(34). – K.: NBU, 2014, available at: <http://www.bank.gov.ua/doccatalog/document?id=8804911>

doing business is being increased as a result of radical and unpredictable changes in the current legislation. A huge number of new legislative acts with regulatory signs are often accepted without prior discussion in relevant committees of the Verkhovna Rada of Ukraine, the public debate in the industry associations and business circles, clear mechanisms and financial support of their implementation. Thus, the protection, preservation and support of small and medium business sector development are in today's complex social and economic climate very important and urgent task for the state.

International experience offers many institutional tools and mechanisms to support and maintain small and medium business in unstable conditions, among which a system of financial and credit support mechanisms, comes first [1; 2]. The components that provide to small business access to sourcing are as follows:

- development and implementation of the loan guarantee program (allocation of investment risks between public and private capital);
- development and implementation of highly dynamic and cost-effective microfinance system;
- implementation of leasing operations to a small business, the development of credit cooperation, budget support of small businesses;
- interest rate subsidization on loans by commercial organizations granted to small businesses;
- the provision of soft loans for small businesses through system of small business support and specialized banks funds.

The effective functioning of such system is only possible on condition of formation of adequate institutional environment of credit and financial small business support provided by major group institutions that regulate the market small business funding: financing systems, tax institutions, legal institutions, and others.

Thus, by the institutional environment of financial support and lending to small businesses is meant a stable system of economic, legal, financial, social and organizational conditions that ensure optimal functioning of processes of credit support to small businesses and the commercialization of the final results.

In order to improve the efficiency of small and medium business support mechanisms it is needed to form an integral structure of the existing institutions of the state that would help to achieve a system cumulative effect of the financial investments of the state, based on optimal coordination and integration of economic interests of entrepreneurs, government, local communities and the population.

The system of financial mechanisms of small business development in Ukraine consists of the budget, taxation and credit mechanisms, as well as of a self-financing mechanism. The development of small business and its relationship with the institutional structure is provided by the influence of internal and external factors. In Ukraine, the main institutions focused on providing financial services to small business are as follows: commercial banks, state institutions of small business financial support, joint investment institutions, leasing and factoring companies, microfinance institutions (credit unions, pawn shops, etc.), insurance companies, private pension funds and the like.

It should be noted that the network of financial and credit institutions in Ukraine is emerging, which is manifested in their unsteady distribution and lack of development, the frequent crises that shake the country's financial system, as well as in a limited set of services provided to customers, and significant amounts of "shadow" lending. In general, such situation has an extremely negative impact on the development of domestic entrepreneurship. Performance analysis of financial and credit institutions in the financial services market confirmed that stagnation is being in this area over the last 5 years. Thus,

according to the National Commission for State Regulation of Financial Services Markets, in 2013 (compared with 2009) the number of credit unions decreased by 17%, credit union members – by 55%, leasing companies – by 84%, assets of credit unions – by 38%. During this period only the number of pawnshops has increased (by 29%), and this shows that the people and businesses really need the borrowed funds.

Development of business risk insurance system in Ukraine also did not reach the proper level. Thus, according to the National Commission for State Regulation of Financial Services Markets in late 2013 financial risk insurance extent in the net premium structure amounted to 2401,3 million UAH (11.1%) (at the end of 2012 – 2.0984 billion USD, or 10.3%) and credit insurance extent amounted to 684 million UAH (3%). According to NBU, for 11 months of 2014 the number of banks decreased by 15 units in Ukraine, 25 more banks is being in the process of liquidation. As of 01.12.2014, 165 banks have been functioning in Ukraine, including 51 banks with the participation of foreign capital. Foreign equity of banks reached 32.2%. Total assets of banks increased by 3% and amounted to 1.31727 trillion UAH, but the losses were equal to 22.419 billion UAH. Meanwhile, as shown in the statistics of the World Bank data, the level of a network of commercial banks development in Ukraine is being still significantly lower the European (Fig. 2).

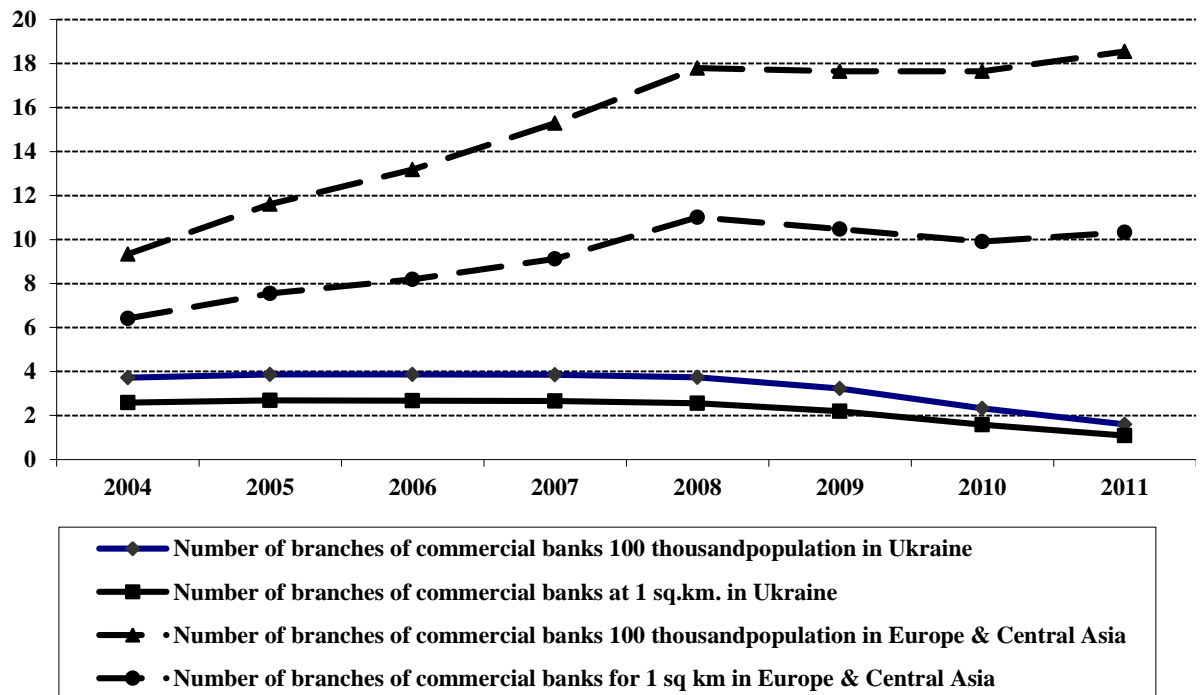


Fig. 2. The evolution of the level of development of a network of commercial banks of Ukraine and the countries of Europe and Central Asia

That is why the main source of investment of small enterprises, like all business entities, according to the State Statistics Service of Ukraine, are being own funds: the average for Ukraine – 59.2%, loans and other external loans – 17.5%, funds from the state budget and local budgets – respectively 6.3 % and 3.2%. The share of bank financing of small and medium-sized enterprises is nearly 5% of the total loan amount [5].

The factors complicating access to bank lending are the following: high interest rates on loans, significant fluctuations in the hryvnia exchange rate against other currencies,

excessive demands on the value of collateral and so on. This state of affairs is explained by the insufficient development of the financial services market in Ukraine, fragmentation of existing system of financial arrangements and the imperfection of the institutional environment. Thus, according to the Index of Financial Development 2012, presented at the World Economic Forum, Ukraine ranked the 59th position among 62 countries, worsening their position since 2011 by 5 points, and by the level of institutional environment – the 60th place.

In 2014, due to political and economic instability conditions lending to small and medium-sized businesses deteriorated. This business lending market is in a recession. According to the estimates of the Independent Association of Ukrainian banks, when at the end of 2013 from 180 banks only 40 banks provided services to small and medium businesses, at the end of the first quarter of 2014 they remained around 20 banks, with 72% of all credits belong to main 10 banks [6]. Most banks – leaders in the market of financial services for entrepreneurs ("Ukreximbank", "Oschadbank", "UkrGasbank", "UkrSibbank", "Credit Agricole") have continued lend small businesses, but with more stringent requirements for hypothecation value, terms in the market, and so on, as well as increased interest lending rates (on average 22-26% per annum). The fact that the NBU discount rate increased almost twice (from 6.5% to 14%) can also affect the cost of credit.

It should be noted that there is no integral system of financial and credit support to small businesses formed in Ukraine as an integral part of the mechanism of state economy regulation based on a single legal and organizational and methodological basis with strict government monitoring and regulation. Today we can only talk about the presence of certain elements of public financial support for small businesses that are not organized in a system. There is a disparate set of financial institutions operating on the market, offering a variety of credit services to small businesses. In addition, there is a gap between the commercial level of the system, including banks with sufficient financial resources, that are not ready to fully assume the credit risks of small businesses and non-profit level, represented by the credit unions, leasing companies and funds to support small businesses, experiencing an acute shortage of resources and found themselves in a situation of non-optimal control.

Another big problem is the lack of adequate institutional, legal and contractual forms suitable for use in credit risk-sharing schemes (guarantee funds, credit derivatives, credit insurance pools, and so on). Particularly relevant reduction of these risks becomes in the case of lending newly established and microenterprises. This problem cannot be solved without state participation. In addition, there is no legal framework of microcredit as an effective source of financing for small and micro businesses in Ukraine (including entrepreneurs- individuals). As international experience shows, microfinance is the system of more equitable access to financial services for those groups of the population and entrepreneurs that drop out of the credit system today. In addition, it gives the opportunity to bring to some extent money, held by the citizens into circulation. According to the estimates of the NBU chairman, total outflow of resources from the banking system since the beginning of 2014 has already exceeded 100 billion UAH [7].

As international experience shows, an important area of revitalization of bank lending to small and medium-sized businesses is to create a flexible system of guarantees that would make it possible to lend in this sector of the economy. This guarantee will be provided, firstly, by the banks themselves - by introducing the sale of guarantees as a form of capital investment for profit and by other relevant agencies such as specialized funds or other small business support institutions, secondly, by state and municipal authorities. It concerns those small and medium-sized enterprises that operate in socially important sectors of the economy, are involved in the implementation of government orders and carrying out

activities in the framework of regional programs of socio-economic development of territories Especially perspective for credit support of small business activities should be considered _ guarantee funds, which can assume the part of commercial banks' risks of lending small businesses from its own resources.

It should be noted that the Cabinet of Ministers of Ukraine in early 2010 adopted a resolution according to which the state budget of Ukraine is necessary to provide funds for credit support to small and medium-sized enterprises in the amount of 0.15% of budget revenues, but not less than 200 million UAH – to support the activities of guarantee funds and 100 million UAH – for lending to projects of small and medium-sized businesses. At the same time, none of the laws on the state budget of Ukraine during the 2010-2014 the allocation of funds for such purposes was foreseen.

The relevant law of Ukraine noted that the main focus of the development of small business is the "financial and credit support of small business" the main types of which are:

- partial compensation of interest rates on loans provided for projects of small and medium-sized businesses;
- partial compensation of payments of leasing and factoring as well as the use of guarantees;
- granting of guarantees for loans of small entities and medium-sized businesses;
- granting loans for opening and running a business introduction of new technologies;
- reimbursement of expenses for the development of cooperation between small and medium-sized businesses and large enterprises;
- financial support for energy-saving and environmentally friendly technologies.

However, due to limited or complete lack of budget funding, none of the programs for the implementation of these types of state credit and financial support for small businesses has not been implemented in full. Thus in the state budget of Ukraine for 2014 [10] funding for small business micro-credit programs have been canceled, and funding of the National Promotion Program of small business development has been reduced by half (from 2,672,800,000 UAH in 2013 to 1,336,400,000 UAH). The State Service of Ukraine for Regulatory Policy and Entrepreneurship Development which was created as one of the main state institutions supporting entrepreneurship development for 2014 was in a state of reorganization. Draft Law of Ukraine "On the State Program of development of small and medium enterprises in the years 2014-2024" developed by by this service and registered in the Verkhovna Rada of Ukraine (the register Number 4003 from 01.21.2014) was recalled. Conceptual guidance for the development of new programs and support of domestic business has not been presented yet. Thus, we can conclude the existence of a specific institutional vacuum in this area.

The signing and implementation of the Association Agreement between Ukraine and the European Union [8] also bear the new risks to small and medium-sized businesses. They occur due to the fact that this agreement substantially changes the regulatory environment on the "issues such as competition policy, government aid, public procurement sanitary and phyto-sanitary measures, technical regulations, intellectual property rights protection, and sustainable development" [9]. However, the assessment of the regulatory impact of this legal instrument, in particular, "the calculation of the expected costs and benefits of economic entities, citizens and the state as a result of the regulatory act", has not been implemented. Since Ukraine undertakes to implement more than 300 EU regulations, there should be at least 300 such assessments for each group of standards for the business groups_, which they will relate. Only in this case we can talk about the level of risk to be faced by the domestic business in connection with the implementation of the agreement.

It is possible to give an example of a rough calculation. According to European standards, the number of small and medium enterprises in 2012 amounted to 1,599,429 (99.96%) in Ukraine; 1235192 of them – are entrepreneurs- individuals, 344048 – small enterprises, 20189 – medium enterprises. Development, implementation and maintenance of procedures based on HACCP principles (Hazard Analysis and Critical Control Points), and obtaining the relevant quality certificates (ISO 9001, ISO 22000 and others.) by the representatives of international companies in Ukraine, specialized in management systems is estimated at 5000-25,000 dollars depending on the size and complexity of the processes. So, if we augment 344048 enterprises by at least 10 000 USD, then it will be needed nearly 3.4 billion USD for the acquisition of only one of the necessary certificates for small business in Ukraine. It should be noted that the Ukrainian laboratories have not acceded to the International Organization of weights and measures yet, so their certificates, which are a bit cheaper, can cause doubt at an international level. In addition to these certificates, there are also certification programs for farmers, for example, Global G.A.P. (Good Agricultural Practice) (reference 1, adopted by the EU in 1995). Meanwhile, the average annual income of a small business in 2012 amounted to only 5.3 thousand Euro. It is estimated that only 15% of enterprises in our country have one of these certificates [10]. Ukraine occupies 25th place in Europe and 51th place in the world by number of certified quality management systems. At the beginning of September 2012 only 7,100 certificates for quality management system has been registered in the State Register of Ukraine. And this is a significant barrier to the active export business enterprises, in particular small ones. Unfortunately, funding for any national adaptation programs of small business to the agreement, the budget in 2014 has not foreseen.

With the increase in social and economic, regulatory and geopolitical risks of doing business in Ukraine there is a problem of protection of domestic business in the institutional space, which, as noted earlier, has a certain “vacuum”. However, the launch of creative interactions in the system "business - authority - society" is hampered by the problem of subjectivity, in other words, the absence of at least one of the parties of the collective entity that represents the interests of one group or another and is able to participate in the process of developing rules and monitor their implementation. Therefore it is necessary to consider the establishment under the State Service of Ukraine for Regulatory Policy and Entrepreneurship Development of the department to protect the rights of all small enterprises in the country, such as the US Small Business Administration (Fig. 3).

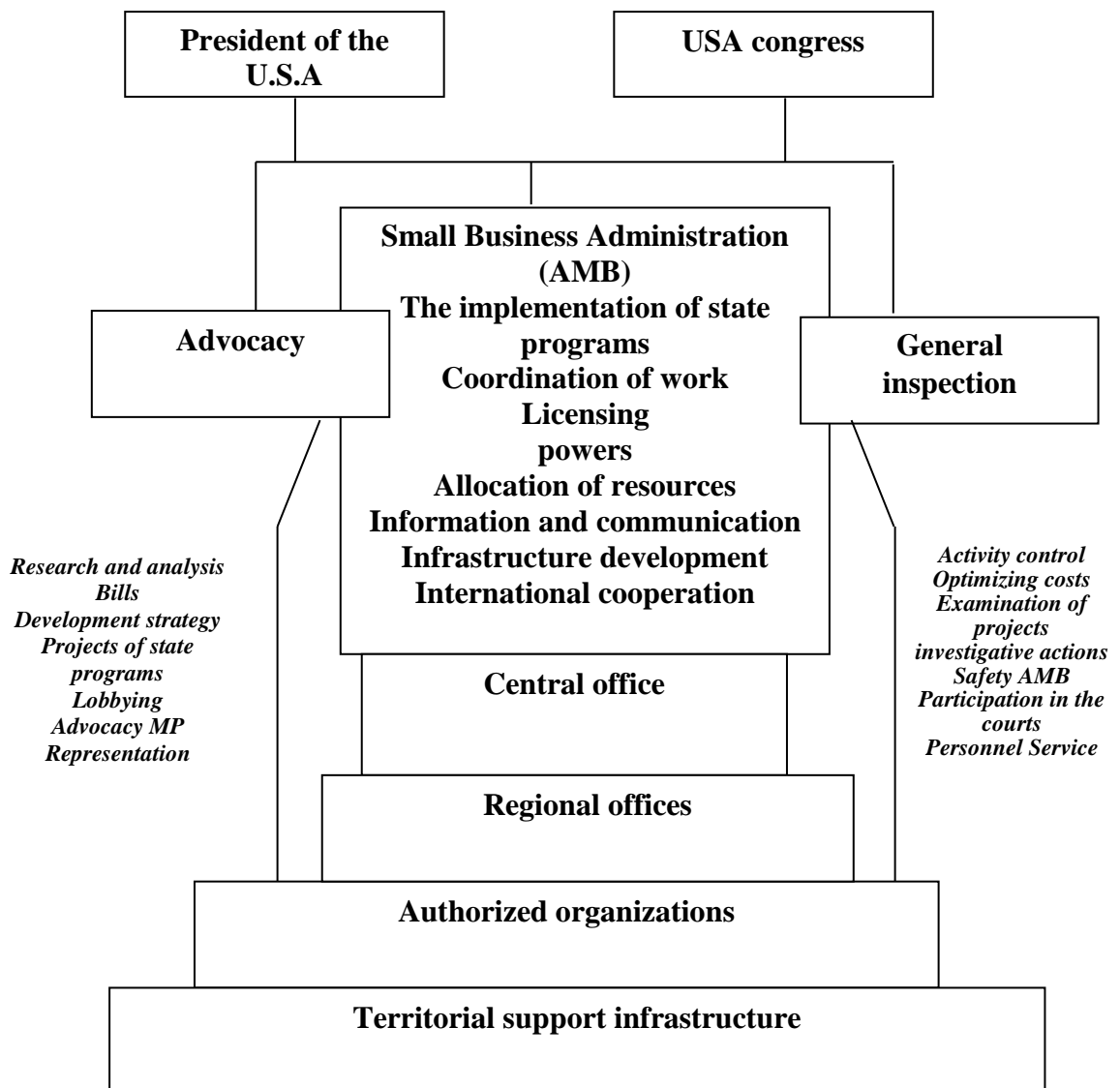


Fig. 3 The institutional structure of state support of small business in the United States

Such compartment should have a powerful informational and analytical unit and the corresponding legal service, which would have the power to represent the interests of small businesses in the Verkhovna Rada, the Cabinet of Ministers, the relevant committees and in all government departments, regional administrations and courts of all jurisdictions. This institution should be formed on the basis of attracting a wide range of representatives of business associations, business organizations and public associations.

Abstracts

Thus, at the present stage to provide small business development with the financing the priority mission of the state and society is to form an integral multicomponent system of credit and financial support for small businesses, which should be based on an integrated approach that includes:

- infrastructure formation of the system;
- creation of a single legal and organizational and methodological

- base for the development of venture capital, guarantee funds and other alternative financing mechanisms;
- providing continuous monitoring of the main problems, conditions and factors of development of domestic small business.

The set of disparate financial institutions, offering small various credit services to enterprises can be regarded as a system only if it is established the institutional framework for the establishment of sustainable financial relationships between its structural elements aimed at providing rational redistribution, accumulation and attraction of financial resources in view of the functioning of the domestic small business.

Priority measures in this direction, allowing implementing European standards, in our opinion, are the following:

1. Creation of an institutional platform for dialogue between representatives of the banks' associations, non-bank institutions, business associations and business regarding easy access for small and medium-sized businesses to credit and financial services.
2. Development of a comprehensive program relating to the work of the banking system, with the participation of government in the formation of investment resources of small and medium-sized businesses, and identifying sources of necessary funds that would make it possible to outline the objectives, principles and mechanisms of reforming the system of bank lending in this area.
3. Creating an open framework for the use of information support of the entrepreneurs on obtaining loans, tenders, tender guarantees, insurance and so on.
4. Investigation of export-oriented small and medium-sized businesses with a view to the implementation of the Association Agreement between Ukraine and the EU, analysis of their capabilities and needs, calculating the economic costs of housekeeping and determining the level of the regulatory burden on their activities.

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