Linking competition policy with SME development in Ukraine

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Executive Summary

The debate on policy towards the development of small and medium-sized enterprises (SME) in Ukraine has resembled a black-and-white story for years. While many policy makers and experts completely neglect the SME sector, others exaggerate the importance of the sector. However, promoting small business for its own sake is the wrong approach. The relevance of SME can only be appreciated by considering their role in the economic system. Only few policy makers see that a viable SME sector is important for facilitating efficient competition and promoting progressive market dynamics in the entire private sector.

It is not a story in black and white, and also not a question of whether to focus on SME or on big companies. It is not important to have a big SME sector, neither. Important are the dynamics and interdependencies between SME and big incumbent companies. That should be the focus of economic policy. Therefore, an appropriate SME policy needs to be interlinked with competition policy.

Competition policy has gone through difficult times in Ukraine, too. There have been reforms with respect to competition legislation and to the Anti-Monopoly Committee of Ukraine (AMCU). However, a comprehensive and holistic strategy has been missing as well as the capacity building in institutions and authorities other than the AMCU.

The lack of a policy strategy towards competition and the missing links between SME policy and competition policy can lead to severe inefficiencies in the market system. Unreasonably low entry barriers for solo entrepreneurs and microbusinesses combined with growth barriers and the protection of big incumbent companies destroy incentives to innovate, create a class of chanceless low-income micro-entrepreneurs and contribute to economic stagnation.

Furthermore, neglecting the competition law enforcement within the SME sector facilitates the emergence of anti-competitive structures and dynamics that hinder innovative entrepreneurship even further.

In order to stop that vicious circle and instead take advantage of the synergies between SME policy and competition policy in Ukraine, we recommend the following steps:

- Formulate a comprehensive and holistic competition policy
- Link competition policy with SME policy
- Focus on growth-oriented and innovation-oriented SME
- Reform the entry barriers for solo entrepreneurs
- Improve methods and results of competition law enforcement in the SME sector
- Facilitate building Social Capital

Contents

1 Introduction

Both competition policy and SME policy have received insufficient attention in Ukraine for the last decades. SME policy is assigned to a small department within the Ministry of Economic Development and Trade which means that less than ten ministry officials deal with the development of two-thirds of the Ukrainian economy. Competition policy does not even have a department in any of the ministries. There has been established a state authority at least for the implementation of competition policy, namely the Anti-Monopoly Committee of Ukraine (AMCU), whilst there is still no such state authority like an SME Agency. Considering that the transformation process started already 26 ago, this situation is astonishing because in many industrial countries both competition policy and SME policy have top priority.

In Ukraine the policy dealing with issues of competition in the business sector is an eclectic patchwork of some legislation, some institutions, some juridical decisions and practice. There is no comprehensive holistic approach, not to speak of a strategy. During our research we found that there is often even no understanding of the benefits of competition. When there is no consensus on the need for efficient competition, a consistent policy can hardly be formulated. We think that this is a deficiency in the Ukrainian ongoing transformation process.

Appreciating the existence of at least some elements of competition policy in Ukraine we see that the important interdependencies between competition policy and the policy towards the development of small and medium-sized enterprises have not been acknowledged yet.

This paper aims at contributing to the public and political discussions by highlighting how both competition policy and SME policy are interlinked – and by providing some recommendations for policy formulation that could take advantage of such synergies.

2 Why competition and what kind of competition?

2.1 What is perfect competition?

One of the possible pitfalls in economic policy formulation is the misconception of the idea 'perfect competition'. 'Perfect competition' is an academic concept, developed in the 19^{th} century. It describes a theoretical situation where the supply side of the market consists of many players, each one of them being too small to have a significant influence on the market prices. The same goes for the demand side. The products that are produced and offered by the suppliers all have the same quality and features. Such a situation is 'perfect' only in the sense that it is perfect for mathematical analysis. One makes a severe mistake if one concludes that such a competition structure is perfect for companies, for employees, for the economy or for the society. None of the latter four is true. On the contrary, the implications of such a 'perfect' competitive structure are: zero profit margins for companies, high risk of insolvencies for companies, economic stagnation and zero innovation.

It is, therefore, the duty of each responsible company manager to steer his enterprise out of such fierce competition situations. A company's main essential objective is the avoidance of competition. There is a variety of strategies for companies of how to escape competition. The crucial point is that some of such competition escape strategies can harm both economy and society, whereas some strategies benefit the economy and society.

It may sound paradoxical that individual company managers, who try to avoid competition, unintentionally contribute to an economy's development. In fact, it is not paradoxical at all but the fundamental background for any modern competition policy, as we will explain in the following.

2.2 Fatal market dynamics: price dumping and ruinous competition

One strategy for companies in order to differentiate their offer from that of the competitors is lowering the price. This strategy is very tempting when product quality and features of all suppliers are identical from the point of view of the customers. A customer would, of course, choose the cheapest offer, when he or she cannot figure out any difference other than the price. The first supplier that lowers his price initiates a price war which will end in a situation, where all prices are so low, that no supplier can generate any profit. That sounds good for customers. The major challenge is to find the bottom line of the price war. What often happens is that some suppliers lower their prices too much, i.e. offer at prices below the costs. As a result, they do not get enough revenues from sales to pay all their expenses. This will inevitably result in insolvency in the long-term. Why should they do so? Two answers are possible:

One answer, which is especially true for many small companies and for founders in particular: they simply do not understand their long-term cost structure. They underestimate costs for reinvestments, costs for liquidity reserves, costs for marketing, costs for modernization, costs for compliance etc. This is due to a financial illiteracy and/or a lack of business knowledge and/or a lack of experience. That behavior is easy to observe in sectors with many self-employed, where many people actually want to perform a 'job' but not necessarily act as business managers. Let us take the hairdresser market as an example. Almost all owners of hairdresser shops are hairdressers themselves, who spend most time of their day with hairdressing. Managing takes place after closing the shop. What you can observe on that market: hairdressing is very cheap, profits and wages for employed hairdressers are very low, and permanently new hairdresser shops open and others disappear. Most hairdressers engage in a price competition because they cannot communicate other value propositions than to be cheap. And since many hairdressers underestimate their long-term cost structures, many businesses go bankrupt whilst at the same time many rookies start a hairdressing business for the same reason: they underestimate the long-term costs. You can observe such hairdressing market structures and dynamics in many countries all over the world. Similar mechanisms are common in the food service industry, the small retail sector, the freelancer market etc.

The second answer describes an even worse dynamic. Some companies that engage in a price war lower their prices below costs on purpose. Their long-term objective is to force their competitors into bankruptcy in order to get the entire market after all competitors have disappeared. It is gameplay like 'who gives up first'.

However, it will never happen that a company gets all market shares in the end. There will be new entries, especially when market entry barriers are low, as it happens to be in many SME dominated industries. If you force your competitors into insolvency with your price dumping strategy, you will see newcomers on the market that offer at the same dumping price. So, in the end, you will drive yourself into insolvency. The final result is that all companies of a branch end up in bankruptcy and every new entry is doomed to go bankrupt right from the start-up phase. This is why such competition dynamics are called 'ruinous competition'.

What is the implication of ruinous competition for the economy? It comes with high social costs such as costs for unemployment benefits; it hinders economic development and it can bring about political pressure groups who lobby for state aids and subsidies.

2.3 Progressive market dynamics: innovation and 'fleeing companies'

Another strategy for companies in order to escape from competition is innovation. If a company identifies a customers' need that no one else has discovered before and finds a way to serve that need, that company would gain a monopoly position in its niche. A monopoly position allows for charging high prices, which is a prerequisite for high-profit margins.

Developing new production technology that enables to produce at lower costs is also an innovation. Producing at lower costs means that the company can actually offer at lower prices without risking long-term bankruptcy. And having a superior efficient production technology would push competitors that are too expensive out of the market in the long-term, resulting in a monopoly of the innovator. The innovator strategy is pricing out the competitors by improving the own cost structure, not just pricing out competitors by holding one's breath for some moments.

How to assess the competition escape by innovation from the perspective of society? The results of innovation competition are: new products with better features and better quality, lower prices for customers, technological progress, better positions on world markets. At the same time, jobs are safe and public revenues increase through taxes on income, taxes on corporate profits and dividend taxes. Therefore, the effects on the society and the economy’s development are great. Remember: They are unintended positive effects of the selfish behavior of companies that aim to escape from competition.

Let us make a thought experiment for a moment. Let us assume for a moment that all companies of an economy innovate and acquire a monopoly in their niche; a market structure that consists only of monopolies. Is that a good thing or bad thing? Dogmatists would scream: No, monopolies are bad for the economic system. But that is wrong as well because monopolists are not bad per se.

The answer lies in a dynamic perspective. What the society and the economy need is innovation. The prospect to reach a monopoly is the incentive that drives a company to innovate. Therefore, the key to a competition policy is to balance out incentives for companies and society's needs. In other words, the policy must enable companies to acquire a monopoly temporarily, but must not weaken the competitive pressure. What policy needs to facilitate is potential competition. No company should ever feel safe from competitors but instead should constantly innovate in order to be ahead of its actual and potential competitors. Companies that are permanently fleeing from competition by innovating are those who benefit the economy and society most. It does not matter whether or not any company has a monopoly on the market. That is only a snapshot. What matters is the question, whether or not this company feels the pressure that leads to effort towards innovation. To speak very frankly: A market structure full of monopolies is fine, as long as all monopolies feel haunted by potential competitors and therefore constantly innovate.

We will provide an example of an instrument of competition policy that promotes exactly the above-described market dynamics: Patents. A patent grants the patent holder a monopoly on the market for the patented technology or product. Companies invest in innovation with the prospect of getting a patent, which is a monopoly position in their market which in turn allows for high profits. The patent is the carrot. The stick is: patents often have a due date, they are temporary. Accordingly, the monopoly position of the patent holder is limited in time, which forces the patent holder to permanently invest time and money in research and development in order to file new patent applications in the future.

2.4 Anticompetitive behavior within markets

The third strategy of escaping competition is collusion. If I do not want to engage in a ruinous price war and am too lazy to innovate, I invite my competitors for smoking the peace pipe. We divide the market into territories and distribute the territories between ourselves, with the agreement that none of us interferes in someone else's market area. That would, in fact, grant monopoly positions to everyone. Think of territory not only as a geographical unit but also with respect to products, technologies, resources. The steel market is mine and you can have the agricultural market.

Another peace pipe strategy: All competitors make an agreement on the prices in a way that they decide about the market prices and everyone agrees to not lower his market offer below that commonly agreed price. That is called a price cartel. It has, for instance, been a common behavior until recently on the world oil market.

What are the implications of collusive behavior for the economy and society? It may sound quite cozy, but it results in economic stagnation, high prices for consumers, low and even decreasing product quality, zero innovation, slowly but constantly decreasing wages. Admittedly, it will result in some degree of short-term job safety, decent (although decreasing) tax revenues and a short-term social stability. An economy that tolerates cartel-like structures would be one with slowly but constantly decreasing living standards, moving the world ranking lists quietly down step by step each year. The biggest problem is that such an economy would not be able to cope with demographic changes, with disrupt technology changes or other external shocks.

2.5 Anticompetitive behavior from outside the markets

That is the dark version of the collusion strategy. Instead of eliminating competition by collusive 'peace' agreements, I try to eliminate the competitors with non-market methods. I lobby for laws that secure me a monopoly position by simply forbidding competitors to operate. There are obvious versions of such laws like the 'law on natural monopolies', which has such a cynic name. But there are thousands of more or less subtle ways to use policy, authorities and the law system to push competitors out of the market or at least harm them.

Even worse, some people commit crimes like blackmailing, bribery and physical violence in order to harm competitors. Unfortunately, the latter mentioned criminal behavior is still quite common in Ukraine and many other countries around the world.

2.6 Straightforward implications for competition policy?

The implications for competition policy are not straightforward as the simplified explanations may suggest, without one exemption: It should go without saying that the nation's legal and judicial system should make it totally impossible to regard crime as an option for business purpose.

But for all the other strategies which companies are tempted to pursue it is very complex and difficult to formulate an appropriate policy: Do I aim at helping companies to avoid the trap of ruinous competition? Do I allow some limitation of competition dynamics in order to promote an infant industry or an underdeveloped region? Do I even protect some specific companies with special laws and policies, e.g. to gain a world market advantage? No easy and quick solutions are available. We will provide some specific recommendations for formulating competition policy in Ukraine later in this paper.

3 Competition policy and SME policy hand in hand

In what ways do both of the fields of policy, the competition policy and the SME policy, depend on each other?

3.1 Competition policy as a prerequisite for SME Policy

First of all, an efficient competitive market system provides the fruitful ground for SME development because of the low transaction costs.

Transaction costs are low when all market players use only price and innovation strategies to compete because then no one needs bribes, protection money or lobbying expenses in order to thrive his/her business. Transaction costs are especially low when you can rely on your business partners' commitment because that decreases your risks and thus decreases the costs of hedging the risks. For the same reason transaction costs are low when you can rely on the fairness and justice of the legal system and administrative procedures.

Low transaction costs are the basis for small and medium-sized enterprises, whilst high transaction costs form market entry barriers because they raise the minimum efficient size. In other words, big companies can afford to employ an army of world-class lawyers because big companies can allocate such overhead costs among a big sales volume and thus diminish the effect on average product unit costs.

Therefore, a policy that ensures a functioning competition on - and only on - market areas creates the preconditions for SME development.

A competition protection policy must prevent that companies pursue strategies other than innovation and price competition.

Building strong institutions such as an anti-monopoly authority is usually one part of such a competition protection policy. However, building Social Capital is the even more important political challenge. To use a metaphor: A football game requires that all football players agree to the game rules and intrinsically adhere to that rules. If they do not and instead all football players permanently try to foul and cheat, you would need two dozens of referees as wells as surveillance cameras all over the playground. And even a hundred referees cannot assure a fair game, they can just assure punishment for unfair play afterwards.

If we turn the same argument around, it would sound even more provocative. If Social Capital and an efficient competitive market system promote the development of SME, then vice versa low Social Capital and inefficient market systems would facilitate highly concentrated oligopolistic market structures. In that perspective, ‘oligarchs’ are not the cause of the systematic problems, they are one of the logical consequences. If I cannot rely on the ethics and moral of my business partners and neither on the fairness and integrity of institutions – I would rather grow big and gather market power and influence in order to defend my business and assure its viability.

3.2 SME policy as the prerequisite for competition policy

As explained above, most benefits for the economy and the society emerge from innovation competition. If all companies succeed in fleeing from competition by innovating and occupying their own market niche, the final result would be a completely monopolistic market. That will actually never happen, simply because all companies never will succeed in their innovation efforts. But let us assume it here for the sake of sharpening the argument. These monopoly positions would not cause problems as long as the competitive pressure is high enough to force the same companies to permanently innovate. The question is the following: Who will ensure the competitive pressure? This is where SME play an essential role in the market system. New market entries and ambitious growth-oriented SME put high pressure on the incumbent firms. And even nascent-entrepreneurs who 'only' think about starting a business put pressure on incumbent companies. As soon as it becomes visible that some incumbent company earns a good profit in its market niche, followers try to enter the very same market niche. These potential competitors are a permanent threat. The only efficient strategy for defending the market niche is to discourage potential newcomers by increasing the innovative advantage. The innovation leader must continuously invest in his research and development, because when he gets too lazy, the competition will be there. SME and start-ups create major pressure. From that perspective, it is not important to have a lot of start-ups but rather to have the potential and credible threat that the start-ups could easily emerge to exploit the laziness of incumbent companies.

Therefore, an SME policy that ensures low barriers for start-ups is a pre-requisite for facilitating innovation competition. The same holds true for an SME policy that eliminates growth barriers. Market entry barriers and growth barriers are created by administrative burden, restrictive licensing, bad infrastructure, bad availability of financial capital etc. All that has already been discussed in our 2014 report.

Making it easy to start and grow a business makes it difficult for incumbent firms to relax and exploit their positions. Making it easy to found and grow a business is competition policy because it creates potential competition.

Again, it is not the point to have many start-ups and SME. The point is that incumbent and big firms feel threatened enough to constantly innovate. Consequently, a fierce or even ruinous competition among SME can be counterproductive for the fitness of the economy, if the fierce competition prevents the small companies to grow to a size that is sufficient to pose a threat to a big incumbent. It creates little benefit for the economy and society when small companies push each other out of the market whilst big companies feel safe from challengers.

3.3 Balancing competition and SME promotion

Some approaches suggest that economic policy for some purposes should temporarily limit competition among companies in order to achieve more efficiency and benefits for the society in the long-run. Infant industry development promotion is an example of such a policy: protecting the infant industry from world market competition, giving it an advantage with state subsidies and allowing a certain degree of agreements between companies – then called cooperation, of course – are typical instruments of infant industry development that would be regarded as anticompetitive elsewhere. The discussion with respect to infant industry support is controversial. Some experts argue that it is impossible to identify such industries that have the potential to reach 'adult' status. While not everyone agrees with this position, it is clear that the steel industry, coal mining as well as many other industries in Ukraine are definitely not infant industries (in the 21st century). Therefore, the infant industry promotion policy will not work as an excuse for the state protection of monopolized heavy industries in Ukraine.

Furthermore, when a market tends towards ruinous competition, it might be wise to limit the competitive pressure, too.

However, the competition policy and the SME policy must be consistent.

Consistent economic policy releases the competitive pressure for premature industries, markets and underdeveloped regions with the objective to promote their maturing; and afterward increases the competitive pressure on the mature industries, markets and regions with the objective to achieve the best results for the society. SME promotion is one crucial means for policy makers to either release or enhance the competitive pressure. It cannot be stressed enough: The dynamics between the SME and big incumbent companies are most crucial. One of the widespread misconceptions: SME are often seen as being adorable for their own sake. Instead they should be seen as what they are: a necessity for ensuring the fitness of the economy.

On the contrary, an inconsistent economic policy would be promoting start-ups and at the same time protect incumbent companies and tolerate collusion among incumbent companies. One result of such an inconsistent policy would be: too many founders, solo entrepreneurs and micro-businesses that all have very limited chances to grow. And those chanceless solo entrepreneurs and micro businesses are the Achilles heel of the economy because they are most vulnerable, prone to economic crises and generate low income.

The other result of contradicting SME policy and competition policy would be: solo entrepreneurs compete with solo entrepreneurs, small companies compete with small companies, medium-sized companies compete with medium-sized companies and no one challenges the big incumbent companies. Put on the top collusive behavior of the big companies, and then you have safe big monopolists in the most attractive industries and ruinous competition between the SME in those markets that are not interesting for the big companies.

To sum up: competition policy and SME policy must be balanced. Hindering SME development is bad policy, but encouraging people to start businesses can be bad policy, too, depending on the conditions, structures and dynamics of the markets.

4 Innovation competition not welcome?

4.1 Fractal patterns

‘Dethroning Ukraine’s Oligarchs: A How to Guide’, was an article of the foreignpolicy.com magazine[1], one example of a variety of similar recent articles. ‘Deoligarchization’ is nowadays one of the keywords in Ukraine. Much is written about the billionaire ‘oligarchs’ in Ukraine.

What is irritating is that those articles apparently base on the silent underlying assumption that ‘oligarchs' are at the top, on the ‘throne' of the business and society structure, and ‘dethroning' them - a one-digit number of people - would solve the major problems of the country.

The picture of the throne is quite a good metaphor actually, because it unveils the oxymoron. In a feudal system, the king or queen on the throne is the top of a consistent multi-level hierarchical system of subservience, dependence, and shelter. In a system with a throne on the top, you would expect many smaller thrones below the high throne (dukes, barons, noblemen etc.). So why would someone assume that in a system with ‘oligarchs’ on the thrones, the ‘oligarchs’ exist only at the top? It is not more compelling to assume that the entire society has a system that facilitates the rise of such phenomenon that are named under the term ‘oligarch’. To put it even more frankly: is it not more conclusive to expect ‘oligarchs’ on all levels?

We do not want to engage here into the discussion of defining the term ‘oligarch'. It would be a very difficult discussion that depends very much on people's attitudes, society values and the political and legal system. Instead, we want in the following to shed some light on structures that exist in the sector of small and medium-sized businesses and the readers can draw their own conclusions.

4.2 Case study: The coffee car market in Kyiv

Across Kyiv city, you can see coffee cars everywhere. Coffee cars are tiny trucks that contain a coffee machine in their load space. They park on boardwalks or parking places and a man or woman sells Cappuccino, Latte Macchiato, Espresso etc. in paper cups right from the load space to pedestrians. During our fact-finding missions, we had the opportunity to visit several of those coffee cars in different districts of Kyiv. The quality of the drinks is actually quite nice and prices are quite affordable although not cheap. We have never seen any of the coffee car sellers using a cash register, we have never received a fiscal receipt[2] and we have not seen any seller making notes about sales numbers either.

There are three possible explanations for that behavior: First, the coffee car sellers have photographic memories and in the evening note all sales of the day in their books. Second,

[1] http://foreignpolicy.com/2016/06/13/dethroning-ukraines-oligarchs-a-how-to-guide/

[2] We have not asked for one, though.

they are involved in some kind of fiscal evasion. Third, they all are so-called FOPs[3] (self-employed solo entrepreneurs, that are not obliged to keep sales records[4]). The first explanation is unlikely. The second explanation is dicarded. The only explanation left is that they are all small entrepreneurs. Indeed, the coffee car business phenomenon in Kyiv, as well as in many cities of Ukraine, on first sight looks like a perfect opportunity for small business founders: the market entry barriers are low since investment costs are limited, it does not require much of managerial skills, market networks, client base etc. and there is customer demand for it, obviously. Therefore, you would expect that the coffee car market is an atomistic market close to the above sketched 'perfect competition' with fierce price competition, leading to low prices for customers and small profits for the coffee car drivers.

Our research revealed a different structure. Apparently, the supply side is highly concentrated, the thousands of coffee cars belong to a one-digit number of enterprise networks. This is illogical because concentration processes emerge in cases when the business model has a minimum efficient size. However, the coffee car business model per se has no significant minimum efficient size. There might be some scale economies with respect to purchasing ingredients, or decreasing average producing costs because of shared administrative costs. But such small average cost effects would expect companies with a size of up to ten coffee cars or so. Having a hundred coffee cars should make no significant difference in average costs compared to having ten coffee cars.

Consequently, other factors behind the curtains seem to influence the market structure. As a matter of fact, we have no data to prove the picture as sketched in the following and none of our (more than a dozen) interviewees agreed to be cited in our report on this issue. Therefore, let us make the thought experiment and analyze a 'fictitious' situation in the following:

Most of the coffee car sellers are not solo-entrepreneurs, but in fact employed, so to say pseudo self-employed. The coffee car sellers do neither possess their car nor do they make self-responsible decisions regarding product range, price model, location, opening hours etc.

Even worse, the locations of the coffee cars belong to a big system of divided market areas. When a new entry wants to park a coffee car at promising locations, he/she gets bullied by other coffee car sellers or someone else. Officially, coffee cars need a permission of the Kyiv city administration for parking at a certain location. In reality, such an official permission or document would not be of any help if the coffee car newbie infringes someone's market territory. On the other hand, there are many coffee cars without any official permission that apparently are tolerated if not protected by some authority staff member.

How to assess such a 'fictitious' situation from the perspective of economic policy? If coffee car 'dukes' divide the city into exclusive market areas, then this will be anticompetitive behavior. Hundreds of solo entrepreneurs that coordinate their product range and prices through any kind of organization are a cartel, which is an anticompetitive organization, too. Pseudo self-employment is a matter of tax evasion. 'Krijshas' for special selling areas would

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[3] FOP means *fizhychna osoba pidpryemets*, which translates literally like physical person entrepreneur.

[4] In fact, the FOP status allows business up to legally defined turnover limits. Thus the FOPs must keep records to prove that they comply with the legislation.

be a matter of corruption and political power abuse. Bullying new market entries would be a matter of using criminal methods.

We cannot see any difference between this ‘fictitious' coffee car market and the accusations that journalists, oppositional politicians, and international competition experts raise against the practices of some of the big so-called ‘oligarchs'. It is ‘just' minor scale, it is regional and it is ‘just' coffee. It is not steel, coal-mining nor electricity power and does therefore not receive as much attention.

4.3 Case study: Restaurant market

We have our business lunch in one of Kyiv’s restaurant chains. After lunch, we receive three fiscal receipts: one for food, one for alcoholic drinks and one for non-alcoholic drinks. The fiscal receipt for food is issued by the restaurant, and the fiscal receipts for drinks are issued by two different FOPs. It is very obvious, that these two FOPs are pseudo self-employed. Apparently, the restaurant manager misuses their identities in order to avoid social taxes, avoid value added tax and avoid corporate income tax.

It requires tremendous fantasy to assume that this is not a tax-avoidance scheme, but let’s do so for a hypothetic quick analysis. Let us instead assume, that we can here see a kind of shop-in-shop concept for drinks and the two FOPs are actually entrepreneurs. Add the fact, that all restaurants of this specific restaurant chain have the same standardized menu with exactly the same drink offer range and identical prices for all drinks across Kyiv. This means, that all shop-in-shop drink entrepreneurs use the organization of the restaurant chain to collude and agree on product ranges and prices, which would be a cartel. Either way, such a structure is anticompetitive.

Using FOPs as pseudo-employees might not be forbidden in all cases in Ukraine, but the crucial point is not whether it is illegal tax evasion or legal tax optimization. The crucial point is that a huge network of firms and solo entrepreneurs is used to disguise ownership, organizational structure, and revenue streams. Such schemes are used in Ukraine not only by restaurants but also by retail chains, fitness club chains, IT businesses etc.

Such company networks are anticompetitive structures with the aim to deceive authorities, business partners as well as customers and to gain an unfair advantage over actual and potential competitors.

If tolerating such structures, why pointing at the big oligarch firm networks?

4.4 Case study: Advertising in Kyiv

Across Kyiv city, you can see advertising billboards and signboards everywhere. From the perspective of aesthetics, this is quite annoying sometimes, because it sometimes spoils the panoramic view on Kyiv. Some officials of the Kyiv City State Administration (KCSA) admitted that the uncontrolled growth of advertising billboards and signboards is seen as a problem by parts of the KSCA. The latter statement is irritating because the KCSA is responsible for planning and regulating advertisement in public spaces by issuing permissions and charging fees. Apparently, different interest groups clash within the same administration.

At the same time, many entrepreneurs and managers of SME complain that their applications for a permission to place advertisement have not been processed for years by the KSCA. Additionally, the KSCA has piled up more than 1,800 undealt applications for renewals of the permissions since 2011, which the KSCA has not answered yet. The KSCA has neither rejected nor approved those applications, it has simply not responded. This is in contrast to the law that requires a response within 15 days.

Apparently, some other companies receive such a permission for placing advertisements on billboards and signboards immediately.

And even worse, some companies must pay for advertising in the public space whilst others do not have to. There are prominent examples of huge mega-billboards that are used by one company free of charge.

How does this fit together: on the one hand the pile of unprocessed applications and on the other hand the annoying growing mass of billboards (300 new billboards per month)?

According to insiders, quite a lot of companies place their advertisements illegally. Insiders claim that many illegal advertisements are tolerated by some of the authority staff members of the KSCA. They allude to corruption schemes in this matter.

How does this affect the efficiency of competition? It creates barriers for new (honest) market entries and protects incumbent companies that were able to acquire a permission using fair or unfair methods. It hinders fast-growing SME to attract the attention of potential customers. It hinders the allocation of public advertising space to the most efficient use and therefore disturbs dynamics.

4.5 Interim conclusions

As a result of our research, which had comprised a variety of case studies and interviews, we conclude that innovation competition plays a smaller role in the Ukrainian SME sector than it does in SME sectors of many other industrial countries. Ukrainian market players often pursue competition limitation strategies. This is no accusation because the definitions of what kind of behavior can be called collusion depend very much on the legal system. What is illegal collusion in one country might be legal in another. However, it can be observed that many Ukrainian market players tend to try to avoid competition with agreements instead of innovating. Unfortunately, non-market competition limitation strategies are very common in Ukraine, too. This goes for SME as it does for big companies.

Competition limitation strategies are usually only possible with a backup of a dense network of policy makers and authority staff members that use their influence on law-making and administrative actions to support the interests of specific companies.

This does not mean that we deny the existence of innovative companies, innovative industries, and markets in Ukraine. However, innovation competition seems to be rather the exception than the standard in Ukraine.

4.6 Statistical evidence

So far we have provided some anecdotal illustrations. We now want to highlight some statistical macroeconomic indicators and test whether our assumptions about the competitive dynamics in Ukraine are reflected in data.

A current AMCU report provides evidence on the assumption of low competition intensity and highly concentrated markets[5]:

- Only 42.7% of the Ukrainian markets can be classified as competitive markets, which means that more than half of the Ukrainian economy is not competitive. The share of competitive markets has even decreased by eleven percentage points since 2001.
- Almost one-third of the markets shows signs of individual domination.[6] This is a dramatic increase compared to 2001 when it was approx. one fifth.
- One-sixth of all markets are oligopolistic markets or show signs of collective dominance.[7] This is an increase of nearly 50% since 2001.
- One tenth of all markets are classified as purely monopolized markets, i.e. the market share of the largest player accounts for over 90 percent.

The Global Competitiveness Report 2016-2017 shows a similar picture: The competition efficiency of Ukraine is ocuppies rank 118 out of 138 countries.[8]

According to our assumptions, we further expect low innovation dynamics in Ukraine. The statistical macroeconomic data support the assumption of low innovation activity from both the input and the output perspective.

Expenditure on research and development as a share of GDP (R&D intensity) is very low in Ukraine. In 2015, in Ukraine, the R&D intensity declined to 0.61%, including 0.21% of government expenditures, which is the lowest level since 1991.[9]

This is dramatically lower than the EU average of R&D intensity - which was 2.03% in 2013 - and other countries in the world (South Korea 4.15% , Japan 3.47%, USA 2.81%).[10]

Applying the EU's Methodology of the Community Innovation Surveys, the share of innovative enterprises in Ukraine was only 14.6% in the period 2012-2014[11]. This is a

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[5] www.amc.gov.ua/amku/doccatalog/document?id=122547&schema=main

[6] Individual domination is here defined as follows: the share of the largest player is more than 35 percent.

[7] Oligopolistic markets are here defined as follows: The market share of the three largest players exceed 50 percent.

[8] http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=UKR

[9] Year 2015: Economic Summary for Ukraine, http://www.ier.com.ua/files//Regular_products/Economic_Summary/ES_2015_en.pdf

[10] http://ec.europa.eu/eurostat/documents/2995521/7092226/9-30112015-AP-EN.pdf/29eeaa3d-29c8-496d-9302-77056be6d586

[11] http://www.ukrstat.gov.ua/druk/publicat/kat_u/2016/zb/09/zb_nayka_15.zip

decrease of 40% as compared to the period 2010-2012[12]. In contrast, the share of innovative enterprises in the EU was on average 48.9% in the period 2010-2012 (Germany 66.9%). [13]

The output perspective reveals few innovation results and thus supports the assumption of low innovation activity, too. Ukraine has weak positions in the world markets as a result of outdated products. And because only a few Ukrainian products are highly demanded in the world, the share of sophisticated products of export of Ukraine is very low. Commodities and preproduction make up the largest share of exports.[14] Only 3% of Ukrainian exports are classified as high-tech products, which is significantly below-average. The share of high-tech products in world trade is approx. of 10%. Taking into account that one third of Ukrainian high-tech exports consists of heavy industry aerospace products, the export share of all other high-tech products is only 2%.[15]

4.7 Deeper problems: about Social Capital and institutions

The discussion in Ukraine about competition law and strong competition institutions in general and the AMCU in particular is important, but at the same time somewhat misguiding because it neglects one of the core problems.

To blame the absence of strong competition authorities for anticompetitive structures is a bit like blaming the absence of Aspirin for having a headache.

Why don't you murder your neighbor? Because it is forbidden by law? Because homicide is prosecuted by the police and authorities? Those are probably (hopefully) not the reasons. The reason is: because it is a generally accepted moral rule. It is how we are brought up. 'You do not do so such things'. The ethics are imprinted deep down in our conscience and if they are violated, we feel a 'bad conscience'. Laws are the written manifestation of ethics and the police exist, in this case, to punish those exceptional people who for some reason do not have the inner ethics that prevent them from committing homicide. So why does a restaurant manager exploit his personnel by forcing it into FOP-based tax avoidance schemes? Because such schemes are not prosecuted by authority?

The generally accepted moral rules that determine personal ethics are part of the Social Capital. This includes the sum of all 'You do not do such things'. Strong Social Capital is the fruitful ground for any business activity. If business partners can rely on each other because everyone acts according to ethical rules such as 'You do not do such things like betraying your business partner', then making contracts is very easy. Economists use the term transaction costs. Transaction costs are low in societies that possess a high level of Social Capital. Transaction costs include for instance the costs of enforcing contracts. The costs of

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[12] http://www.ukrstat.gov.ua/druk/publicat/kat_u/2014/zb/09/zb_nayk_13.zip

[13] http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Share_of_innovative_enterprises_by_main_type_of_innovation,_2010%E2%80%9312_(%C2%B9)_(%25_of_all_enterprises)_YB15.png

[14] http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2016/05/PB_10_2016_en.pdf

[15] http://4liberty.eu/export-benchmarks-for-ukraine-what-are-we-striving-for/

enforcing contracts can be decreased by an efficient and just law system, but that is not the major driver. The average costs of enforcing contracts are low if betrayal is the exception. In this case each company can get an affordable insurance that covers the costs of lawsuits etc. So the risks are not only low but can even be hedged, which in turn further decreases transaction costs.

This does by no means mean that competition institutions are unnecessary. What we are claiming is that institutions are one element, but they are doomed to be inefficient by default without the underlying Social Capital.

It is simply not possible to investigate every single occurrence of anticompetitive behavior when it is widespread on all economic levels.

4.8 It is not capitalism

What we addressed so far may sound like a provocation to many readers: Bullying, power abuse, corruption, fraud etc. During debates people often say: ‘That is what capitalism is like’. However, it is a mistake to blame the capitalist system for such problems as described briefly in this paper.

There might be problems with the capitalistic system, but many of the major problems that Ukraine faces nowadays are neither results of capitalism nor integrated parts of a capitalistic system.

There are different types of capitalistic concepts. Some of the concepts rely on the principle ‘survival of the fittest’; other concepts focus on balancing interests and so on.

Common features of all concepts of capitalism are: a generally accepted and enforced set of rules and an appropriate underlying Social Capital. None of the concepts of capitalism tolerates or promotes crime, illegal activities, fraud, bullying, cartels or political power abuse. Of course, such things occur everywhere but the crucial question is: Are they the exception or the standard? In economic theory as well as in the practice of functioning capitalistic economies, anticompetitive behavior and non-market competition limitation strategies are the enemies of efficiency and wealth creation.

To say it frankly, capitalism cannot be blamed here.

5 Recommendations

Quite a few projects of international development partnerships currently deal with issues of competition policy in Ukraine. These projects focus on specific legislation or building capacity for specific institutions such as the AMCU. Such reform projects cannot be praised highly enough. Ukraine is ranked almost the last, number 129 out of 138 countries, in the Global Competitiveness Report 2016-2017 with respect to their institutions[16], which underlines the importance of such projects. We do not aim at contributing to those discussions about details because we see the necessity of supporting a debate about general principles of competition policy in Ukraine. In the following we present some recommendations based on our own findings and on international experience.

5.1 A comprehensive approach to competition policy

First of all, Ukraine needs a doctrine of competition policy. What model is most appropriate and most desirable for Ukraine? In the previous chapter we have stressed the doctrine of potential competition and innovation competition. Other doctrines and international experience are available, such as: competition as a means vs. competition for its own sake, preventing market power at all costs vs. a laissez-faire approach towards the market structure etc.

The competition legislation in Ukraine is largely aligned with EU standards and international best practice. The implementation of the DCFTA competition chapter will bring further progress in reforming the legislation and institution.[17]

However, a comprehensive competition policy involves more than competition law.

Ukraine, therefore, needs a competition policy strategy. The EU and international standards leave much space for defining specific policy. Regional economic development policy, international trade policy, environmental policy, education policy etc. have an impact on competition on home markets.

To give an example in frank words: when education and the science system cannot keep up with the latest technology progress, entire industries and markets will disappear in Ukraine, no matter how modern the competition law is. In contrast, having good human and technology resources and facing highly concentrated world markets would suggest to temporarily limit the competition on home markets in order to reach momentum on the world markets. This could be done without violating the DCFTA and EU standards in competition law.

Take the policy towards the Clean Technology industry in Germany as an example. In order to support the development of that industry, the competition had been influenced by the state - without violating established competition law – using measures like state aid, state

[16] http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=UKR

[17] Deepening EU-Ukrainian Relations What, why and how? Centre for European Policy Studies and Institute for Economic Research and Policy Consulting. Edited by Emerson/Movchan. 2016.

price interventions, tolerating and even promoting cooperation of companies, obligations to contract etc. However, it has been temporarily and for a purpose: pursuing the objective of becoming the world market leader in Clean Technologies. Additionally, very important, all other policy areas have been aligned: the education policy assures the education of specialized workforce for the Clean Technology sector, the science ministry finances corresponding research projects, regional development policies ensure preferred access to state aid for Clean Technology companies in their region and so on. Above all, the SME policy has been aligned with it, too (for a similar example see Box 1).

As the reader might have noticed, we are no ideologists who reject any state intervention in principle. The point is that the Ukrainian policy towards issues of competition and the Ukrainian state interventions in industries and markets appear being not strategic, but ad-hoc, erratic and incoherent or to accommodate vested interests. On the one hand municipal services such as waste management, electricity supply etc. get privatized. On the other hand, some outdated industries receive subsidies. There seems to be neither any doctrine nor a holistic long-term strategy.

The drafting, impact assessment and implementation of competition policy should be a joint task of all line ministries. One of the existing ministries should be responsible for orchestrating the competition policy, but there should be departments or at least experts in all line Ministries dealing with issues of competition policy.

Thirdly, Ukraine needs a good competition policy implementation and efficient institutions. The Ukrainian competition law is quite modern. However, are the courts and judges capable of applying and enforcing that law? The blueprint of the AMCU is quite modern as well. However, is assigning a single responsible institution appropriate for Ukraine, considering the special circumstances inherent in the business/political environment? Independence and integrity of institutions have been difficult to realize in Ukraine until now. Maybe it would be better to establish a system of checks and balances and assign several organizations and/or specialized prosecutors and specialized courts?

5.2 Link competition policy with SME policy

As we already said, low market entry barriers and low growth barriers for SME create competitive pressure on incumbent firms that should lead to innovation and benefits for the society. At the same time, when market entry barriers are too low, too many founders start a business. As sketched above, inexperienced entrepreneurs with insufficient managerial skills and insufficient financial literacy often tend to price dumping behavior, ruining themselves and others and causing costs to the society. It is, therefore, essential to balance measures and instruments influencing competition and SME development.

SME policy measures and instruments and competition policy measures and instruments should be specifically designed for targeting specific industries and regions, taking into account conditions such as technology and world market dynamics.

5.3 Do not support all SME, support challengers

This recommendation is an implication from the recommendation above (5.2). In order to take full advantage of the function of SME as a competitive pressure for big incumbent firms, it would be consistent to focus SME promotion on those SME that do indeed challenge big incumbent firms. Therefore, the recommendation is to focus support on growth-oriented and innovation-oriented SME. Big companies will never feel any pressure from micro retail businesses or from any FOP. On the contrary, ambitious technology-based up-climbers are more likely to emerge as potential competitors for the big incumbent.

It is difficult to identify the challengers because you need criteria and sophisticated methods for assessing the growth-orientation and the innovative potential. However, there is international best practice available.

The German SME policy had moved to that approach more than 10 years ago after it became evident that intensive support is more efficient than extensive support. Many other countries pursue that approach, too. The Korean government, for instance, has invested heavily specifically in the promotion of technology-based start-ups in the last years. The objective of that public undertaking is to reduce the dependence of the Korean economy on the big conglomerates, the so-called chaebols. (For another example see Box 1.)

Box 1: High-Tech Strategy of the German Federal Government

This case study serves as an example for all three of the above recommendations (sections 5.1, 5.2., 5.3).

"The new High-Tech Strategy – Innovations for Germany" is a governmental program as of 2014. It is the continuation of similar strategies of the German federal government, starting in 2006.

It is a good example of a comprehensive holistic approach that links competition policy, industrial policy, education policy, research policy, SME policy and many others to one joint strategy, as recommended in section 5.1. Accordingly, eleven of the fourteen federal ministries cooperate in this strategy, among which the Ministry of Economic Affairs and Energy, the Ministry of Education and Research, the Ministry of Labor and Social Affairs and the Ministry of Transport and Digital Infrastructure possess major roles.

The main objective of the program is to secure a leading position of German companies in future world markets. Thus, it is a comprehensive competition strategy that links competition on world markets with home markets' competition.

The linking between competition policy and SME policy as recommended in section 5.2 is done in several ways.

Firstly, growth barriers for SME in predefined focus markets shall be decreased. Among the growth barriers is the access to innovation finance. SME in the focus markets receive preferential access to state support in finance. On the one hand, such state financial support compensates for the liability of smallness and newness, creating a level-playing field for SME and big companies within the same market. On the other hand, SME in the focus markets are treated preferentially to SME in other markets. That influences the results of competition and creates desired distortions. Obviously, the dynamics between

SME and big companies within one market are appreciated more than the competition within the SME sector, which corresponds to our recommendation 5.3.

Secondly, networks, clusters, and cooperation between SME and big companies in the focus markets are not only allowed, but even supported by subsidies. Such cooperation, mainly with the focus on research and development, is by no means an anticompetitive organization, but it is a suitable instrument to limit the competitive pressure on home markets in the short-term.

Thirdly, state procurement plays a major role. State institutions dedicate parts of their budget for products and services of the focus markets. The state thus increases the demand for those products and services that are supported by the High-Tech Strategy. The state supports the innovation input and at the same time acts as a customer for the innovation output (push and pull mechanism). Since the entire public procurement in Germany on regional levels facilitates the access of SME to public tenders, SME profit a lot from that program.

Fourthly, SME in the focus markets have prior access to state subsidies, especially for research and development projects. “In this light, government research and innovation funding is giving special priority to enlarging the group of innovative, strongly growing SME, via suitable measures.”[18]

Sixthly, a variety of state programs that are components of the High-Tech Strategy aim at increasing the number of start-ups in the focus markets. Those start-up promotion programs include subsidies, financial support and non-financial support such as training and consulting.

Accompanying, the government funds special university research projects in the focus areas, funds special education programs for assuring the supply of skilled personnel for technical and innovation-oriented jobs in the focus markets, promises to reform the legislation with respect to technical norms in the focus markets etc.

The High-Tech-Strategy as of 2014 contains quite a lot of focus markets and quite a lot of measures and programs. When adopting such an approach to Ukraine, we recommend reducing the number of focus markets, taking into account the much smaller state budget of Ukraine.

[18] https://www.bmbf.de/pub/HTS_Broschuere_eng.pdf

5.4 Reform the entry barriers for solo entrepreneurs

This recommendation is also an implication from recommendation 5.2. When market entry barriers are too low, this leads to an inefficient self-selection mechanism of founders and entrepreneurs. Markets with very low entry barriers attract biased want-to-be entrepreneurs that, due to their lack of knowledge about long-term cost-based calculation, regard the market prices as interesting. On the other hand, educated nascent entrepreneurs are discouraged, because market prices are too low for establishing a long-term viable business.

The Simplified System of Taxation, Accounting and Reporting (or Simplified Tax System STS) for solo entrepreneurs – so-called and earlier mentioned FOPs – in Ukraine decreases the market entry barriers enormously. At the same time, the STS forms a growth barrier, because transforming an FOP business into a proper corporation requires enormous resources. Apart from the widespread misuse of the FOP legislation for income tax evasion, social tax evasion, value added tax evasion and labor law circumvention[19] – which are enough reasons to reform this regulation – it is a threat to the efficiency of competition. Unskilled and short-sighted FOPs destroy markets with dumping prices. Every market theory suggests, that if solo entrepreneurs base their price calculation on long-term cost structures, they could never be cheaper than the wages and salaries of employees. FOPs would not be used as surrogates for employment to such an extent in Ukraine if they all calculated their fees according to long-term business requirements.

In 2011, a reform on the STS was, unfortunately, stopped by protests of FOPs. Admittedly, the reform was half-hearted. However, instead of trying to improve the reform details, some politicians agitated the masses with misguiding arguments. One of the major arguments then was: 'Big oligarchs still have all opportunities to minimize their tax burden by using tax havens; and the 'small' people shall give up their tax privileges. That is not fair. We want to reform the tax regulation for the big first.' Did any FOP ever compete with one of the 'oligarchs'? FOPs are pushed into a ruinous fatal fierce competition with each other and with employees. Reforming the STS and FOP regulation would help to establish efficient markets that provide attractive profits for the real entrepreneurs and job opportunities for those who are not really entrepreneurial. It would improve the situation in the sectors that are currently FOP-based.

The current STS and FOP regulation should be replaced by an appropriate system of accounting and reporting requirements that results in a small administrative burden for solo entrepreneurs and microbusiness but at the same time requires some financial literacy and business knowledge. In that way, pseudo self-employment becomes unappealing which shall lead to a reduction of misuse and dumping-price competition.

Admittedly, it would not change the privileges of the big, what might be regarded as unfair. However, rejecting an improvement for me with the argument that others profit even more, is economically illogical. It is instead an argument based on envy, which leads us directly to the next two recommendations.

[19] See for instance http://4liberty.eu/any-change-in-the-role-of-ukrainian-small-business/

5.5 Competition policy is more than deoligarchization

Pointing fingers at the ‘oligarchs’ bears the danger of distraction from other severe problems. It should be investigated whether ‘oligarchs’ use anticompetitive and/or illegal methods, and it should be prosecuted if necessary, no doubt. However, there are many inefficiencies and dysfunctionalities in markets that are not controlled by big ‘oligarchs’. This is especially the case for some SME dominated markets. For instance, we have seen no evidence that any of the big names interfere in those markets we have briefly described in our case studies in chapter 3.

Competition policy must not neglect all those other markets and the competition authorities must not overlook the anticompetitive structures and dynamics in the smaller markets. This includes disclosing firm networks that disguise company size, ownership and revenue streams. Further, as long as the FOP regulation is not reformed, the FOPs must be treated like real entrepreneurs which means they are subject to the same competition regulation such as prohibition of collusion.

It also includes the investigation and prosecution of cases when companies make use of political influence and corrupt authority staff members to harm competitors, in large-scale businesses as well as in small-scale local operations. A company that belongs to a mayor’s family, for instance, and that engages in public procurement of the very same mayor’s city administration, creates a conflict of interest and should be investigated.

However, market surveillance and prosecuting anticompetitive behavior is difficult - if not impossible - when anticompetitive behavior is widespread, which leads us to the last and most relevant recommendation.

5.6 Facilitate building Social Capital

Economic markets need preconditions that they are not able to produce by themselves. Every economic market needs trust in order to function efficiently. Economic transactions are impossible without trust because contracts are never complete. However, markets cannot produce trust themselves. Trust is Social Capital of a society. Social Capital cannot be produced by economic entities; it needs to be created outside the market mechanism. Social Capital is mainly created by the civil society.

The Ukrainian economy suffers from a lack of trust in general. This leads to the above mentioned high transaction costs which cause competition limitations. Even worse, some economic transactions are impossible because of the lack of trust. That is why blackmailing and bribery are very commonly used as means to enforce economic contracts in Ukraine. There is an interdependency between the low Social Capital and the spread of corruption: because of low trust and a lack of common norms people use corruption to facilitate transactions, and because of the extensive corruption, trust and common norms and thus Social Capital deteriorate. Legislation and institutions can support the creation oftrust, but they cannot substitute Social Capital.

The best competition policy and the best SME policy for Ukraine are to promote the creation of Social Capital which can be done by promoting the development of a vivid and authentic civil society. The civil society includes not only business associations, but also non-governmental organizations, non-profit organizations and foundations in the fields of education, science and research, culture and media, sports, leisure activities, health, environmental protection etc. An authentic civil society can contribute to creating trust, common norms, and networks that facilitate controlling corruption, monitoring and assisting the implementation of laws and rules impartially. Further, an authentic civil society helps to advocate for public goods, to achieve political compromises, to protect liberties, as wells as to promote the rule of law.

Box 2: Civil society in Germany and Ukraine

There are 616,000 non-profit organizations (NPO) in Germany that belong to the third sector. The terms 'third sector' and 'civil society' are mostly used synonymously in Germany. 17.5 m people are engaged in the non-profit sector in Germany. That is more than one-fifth of the entire population and more than one third of the working population. 2.3 m people have a regular job in the third sector, which is almost 6% of Germany's workforce.[20]

The competition in Germany's business sector is very efficient and the transaction costs are low in international comparison. Of course, Germany has a high standard of competition legislation and very efficient competition authorities. However, having a highly developed civil society and having an efficient competitive market system is no coincidence. Quite the opposite is true: the civil society contributes to building Social Capital, including general trust, which decreases transaction costs.

Ukraine has about 14,000 non-governmental organizations (NGO) that have at least one staff member. Further, Ukraine has approx. 50,000 active NGO with no staff.[21] The methodologies for counting the numbers of NPO in Germany and the numbers of NGO in Ukraine might differ. However, the numbers illustrate that there are huge differences, taking into account that Ukraine's population is more than half as big as that of Germany. Additionally, some say that many of the officially registered NGO in Ukraine seem to be puppet organizations of industrial-financial groups or fictitious NGO under the control of companies, ministries or politicians.[22] Such organizations will, of course, not contribute to building Social Capital but rather destroy it.

Some reform steps have been taken already in Ukraine, such as the presidential decree 68/2016 (‚On the promotion of civil society in Ukraine'), but there is still a long road to go.

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[20] Krimmer/Priemer: ZiviZ Survey 2012. ZiviZ – Zivilgesellschaft in Zahlen. 2013.

[21] http://bunews.com.ua/society/item/ukrainian-ngo-sector-civil-society-still-20-years-behind-the-west-despite-maidan-role

[22] http://ukrainianweek.com/Society/46723

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Epilog

This publication is the third of a series concerning the topic 'SME as an Engine for Economic Growth – Towards A Modern SME Policy‘.

The series is a joint undertaking of the Friedrich Naumann Foundation for Freedom and Berlin Economics as well as the Institute for Economic Research and Policy Consulting.

The motivation and contribution of the Friedrich Naumann Foundation for Freedom is based on the FNF 2014-2016 project objective for Ukraine “to identify the major SME needs in Ukraine and propose appropriately targeted measures to improve the SME framework, thus expanding liberal policy approaches, identifying obstacles and initiating learning processes and social change to facilitate economic activity”. The objective is to support the policy reform processes with realistic and specific recommendations for improving the framework for SME development in the short term and promoting competition within the Ukrainian economy in the long run. This should be achieved through personal consultations with relevant decision-makers, national experts, representatives of civil society (business associations) and international organizations, as well as by collecting comprehensive and reliable data.

Berlin Economics is a company that has advised the Ukrainian Government and other public authorities such as the National Bank of Ukraine on a wide range of economic policy issues and on financial sector development for many years. Its analytical work is presented and discussed during regular meetings with high-level decision makers.

Certain aspects of SME development policies have already been addressed by the Friedrich Naumann Foundation for Freedom and Berlin Economics in the past.

Whilst the first joint publication sketched out the principles of a comprehensive and holistic SME development policy, the last year’s joint work shed light on a specific part of SME development, namely Academic Entrepreneurship, that has been almost neglected in Ukraine so far. Consequently, our papers and specific recommendations do not primarily address policy makers of Ukraine, but those that ideally influence policy making – i.e. practitioners and experts, politicians and other representatives of civil society.