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Investing in SMEs in the Eastern Partnership

Ukraine

COUNTRY REPORT
JUNE 2018

EaP | Eastern Partnership

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Introduction

The EU4Business Secretariat is proud to present the third Country Report prepared under this initiative, following the first in late 2016, and second May 2017 publication. Country Reports analyse the developments and achievements of the EU4Business initiative in each of the Eastern Partnership countries (EaP). They offer a review of the SME sector in the country, as well as of the economic and business environment in which enterprises operate. In addition, the 2018 Country Reports add two major new elements, namely the results of an SME survey and the outcome of round tables of EU4Business stakeholders carried out in each EaP country.

The national round tables were held between late February and early April 2018, and involved all the EU4Business stakeholders in each country, as you will see in Section 6 of the Report. The conclusions offer a unique perspective arrived at following a detailed joint consideration of all the EU4Business pillars and initiatives.

The results of the survey of SMEs benefiting from the EU4Business finance facility are presented in Section 5. They provide an overview of the impact of EU4Business, as perceived by the beneficiary enterprises themselves, at least a year after the lending operation has been completed.

We have also conducted a thorough analysis of some 150 documents and discussed these with a multitude of stakeholders to arrive at the impact assessment of the EU4Business portfolio, as presented in Section 3.

Finally, the two opening sections provide an economic overview by country and the state of affairs of the SME sector.

The EU4Business Secretariat has received tremendous research assistance from our country teams, based in the EY offices throughout the Eastern Partnership region, while the EU Delegations provided substantial support and data for the publication. DG NEAR was closely involved in report editing and verification. To all of them we extend our sincere thanks.

We anticipate that the materials presented here will support the reform discourse in each of the six countries, contributing to further enhancement of the SME climate and regulatory framework. The Secretariat looks forward to facilitating new national-level discussions on how further to improve effectiveness and delivery of EU support to the EaP's SME development and to work on new and innovative support instruments.

Boris Divjak, SME Expert
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SECTION 1:

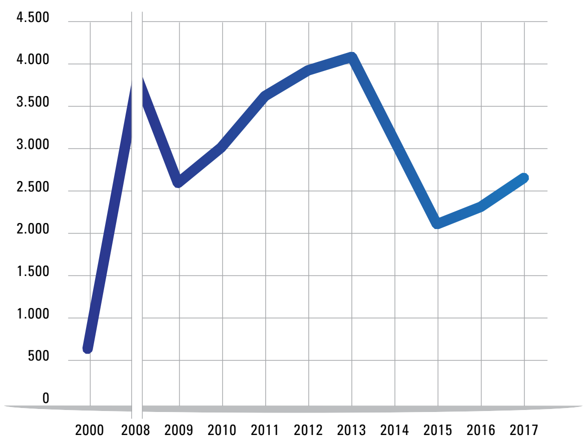
General economic overview of the country

1.1 Macroeconomic indicators

Ukraine has experienced acute political, security, and economic challenges during the past three years. Since the "Maidan" uprising in February 2014 that led to the ousting of the previous president, the country has witnessed several momentous events, including the outbreak of conflict in eastern Ukraine and presidential, parliamentary, and local elections. Key reforms undertaken since include: carrying out significant fiscal consolidation, simplifying business regulations, stabilizing and restructuring the banking sector, establishing anti-corruption agencies, etc., all the while contending with powerful vested interests that continue to oppose reforms [1].

Growth remains weak due to the key pending reforms needed to strengthen investor confidence. GDP grew by 2.5% in 2017 and 2.3% in 2016, a weak recovery since it follows a cumulative 16% contraction in 2014–15. The growth of fixed investment slowed in the second half of 2017, while foreign direct investment (FDI) remained weak at 2.1% of GDP in 2017 compared to 5% on average before the crisis. Investor confidence has been affected by the slow pace in adopting key reforms in light of macroeconomic vulnerabilities and uncertainty surrounding the 2019 elections.

Figure 1.1: Republic of Ukraine's GDP per capita (current US$)



Source: Macroeconomic indicators, World Bank

1 Adapted from the World Bank in Ukraine, http://www.worldbank.org/en/country/ukraine/overview

The fiscal deficit was within the target range in 2017 but spending growth, inflation, and the current account deficit (CAD) continued to be high. The fiscal deficit remained flat and on target at 2.4% of GDP in 2017. However, expenditures were up by 11.7% in real terms and reached 42.6% of GDP due to the increase in the minimum wage (resulting in higher wages for teachers, doctors, and civil servants) and higher spending on social programmes. This was balanced by strong revenue growth in 2017 that was driven by the payroll tax (20% in real terms due to the hike in wages), the value added tax (17% due to higher proceeds from imports), and the personal income tax (16%) [2].

Last year's moderate recovery, which followed the economy's return to growth in 2016, appears to have been sustained in the first quarter of 2018. Growth was again likely driven by robust domestic demand. Retail sales continued to expand in Q1, signalling healthy private consumption growth, which was bolstered by sustained wage growth throughout the quarter. Despite slowing in the first quarter, industrial production appears to have gotten some support from buoyant, albeit also moderating, export growth [3].

Financial sector weaknesses from the high number of nonperforming loans (55% of total loans), weak corporate governance of the dominant state-owned banks, and the weak financial position of the Deposit Guaranty Fund stand in the way of stimulating investment and growth [4].

Ukraine's economy therefore portrays a relatively volatile movement, but the return to growth from 2016 has been sustained. Although its GDP (in current US$) is far higher than of any other Eastern Partnership country, Ukraine has the second lowest GDP per capita, with only Moldova trailing somewhat behind. Its GDP growth is also meaningfully behind most others or the regional average. The inflation rate has also been the highest in the group ever since the 2014 events and it amounted to 14% in 2016.

2 Extracted from the World Bank in Ukraine, http://www.worldbank.org/en/country/ukraine/overview#3

3 Macroeconomic indicators from https://www.focus-economics.com/countries/ukraine

4 World Bank in Ukraine, ibid.

Exports of goods and services have also been on a steady decline since that time, although in absolute terms it still exports more than any other EaP country, which is outpaced by the volume of imports. Still, with nearly 50%, it has the second highest export volume as percentage of GDP, following Belarus. That has been a steady figure, despite the various turmoil, which goes to show that, in order to stimulate exports, different structural reforms are needed even more than the political environment. That invisible cap needs to be broken through improving the business environment. Due to the monetary tightening of the last few years, credit to the private sector has also been dropping steadily, but as a percentage of GDP it is still above the regional average with over 47% of GDP in 2016, according to the IMF, partly also because the lending interest rate is among the highest in the EaP region, although dropping continuously – 16.4% in 2017, according to the WB. There has been no major exchange rate and local currency fluctuation in the past two years, but the fluctuation was volatile the previous two, so a Euro is worth 30.4 Ukraine Hryvnia (UAH) in late-May 2018.

1.2 Trade volume with the EU – exports

The EU is the most important trading partner for Ukraine, accounting for most of its imports and exports, with a share of 41% in its total trade. In 2017 alone, Ukraine's exports to the EU amounted to € 15.1 billion, 40.5% of the total[5].

This country report focuses on selected trade categories and accounts are given in terms of their size and economic impact. It will focus on exports and effects both concerning the economy and job creation from these sectors[6]. The sectors identified have a comparatively high potential for growth based on full access to the internal market, and SMEs are especially active within them.

On average, in the six EaP countries, the economic effects of exports of these selected categories to the EU amount to 1.5% of GDP, and 1.3% of the total employment. The fraction of effect is larger in comparison in Ukraine with an impact on GDP of 1.9% and the same on total employment, exactly 1.3%. As reported, the EU is Ukraine's first trading partner and the total exports of goods to the EU between 2009 and 2015 amounted on average to € 80 billion p.a. Trade flows to the value of € 77 billion have been excluded from the analysis because they relate to large-scale activities (e.g., iron and steel).

5 European Commission, DG for Trade, (2018), 'European Union, Trade in goods with Ukraine 2017'.

6 Panteia, (2018), Study: Key sectors and BSOs - Step 1 selection of the sectors. Data on trade flows sourced from the International Trade Centre (ITC).

The remaining € 3 billion are regarded as relevant trade, 97% of which is categorised as belonging to potential growth categories, specifically for SMEs. The most significant categories are:

- Electrical machinery and equipment (categories in HS85).
- Animal and vegetable fats (categories in HS15).
- Wood and articles of wood (categories in HS44)[7].

Within the selected goods categories, exports to the EU had a particular impact in the categories of food and beverages, electrical machinery, and other manufacturing. The general direct impact on production amounts to € 3,063 million. These direct effects triggered a value added in these sectors which amounts to € 355 million and direct employment impact of 29,000 jobs.

The total economic impact on the Ukraine economy is larger than the direct effect because of spill-overs to other sectors of industry. The total effect on value added is € 1.3 billion, which is equivalent to saying that 2% of Ukraine GDP depends on exports of selected goods categories to the EU. Indirect effects are especially significant in trade and (financial intermediation and) business services. Regarding employment, in total 215,000 jobs (more than 1%) depend on the selected trade flows.

The significant categories which represent potential growth sectors for Ukraine will be described in more detail.

1.2.1 Electrical machinery and equipment category

The electrical machinery and equipment category is responsible for the export of a number of products in the EU markets. Products which are most commonly exported to the EU include automobile wire; consumer electronics; climate equipment, household and industrial pumps and engines; polypropylene pipes for heating and water supply; electrical heaters, etc.

In the first quarter of 2018, Ukraine exported almost 50% of machinery and equipment produced, with major European importers including Hungary, Germany and Poland. These products are mainly exported in the EU to large energy generating companies, mining corporations, communication companies, and car manufacturers.

This trade category is operated by approximately fifty specialised enterprises, which are mostly represented by large-scale companies, industrial groups and factories.

7 Data for the reference categories from: http://www.ukrstat.gov.ua/ under Volume of industrial products sold, by types of activity in January-April 2018

These producers are dependent on supplies of foreign industrial equipment and component and these enterprises are mostly direct exporters and active users of international exhibitions to promote their own products and establish partnerships.

1.2.2 Animal and vegetable fats

Vegetable and animal oils account for 10.9% of all Ukraine's exports. Despite fierce competition from European suppliers, Ukraine's growing potential of agribusiness chain development is very high as food processing companies will need to modernize their production. Harmonization of Ukrainian food safety legislation in compliance with EU norms, the requirement to implement Hazard Analysis and Critical Control Points (HACCP) by 2020, and expansion to foreign markets will increase demand for higher quality food processing and packaging materials. Ukrainian enterprises in the period of September 2016 - August 2017 exported 5.84 million tons of sunflower oil to 124 countries. Major exports markets in the EU include countries such as The Netherlands, Spain and Italy. These products are mainly imported by large scale companies: wholesalers, large producers or large-scale retailers.

The largest exports in this category include vertically integrated agricultural companies but some of the processors purchase raw materials from small farmers. The sector is heavily dependent on supplies of imported agricultural machinery and raw materials, such as seed material, crop-protection agents and fertilizers, but Ukraine has an abundance of domestic raw materials.

SMEs produce animal and vegetable fats only for the domestic market. However, with the growth of the number of people who support the trend towards a healthy lifestyle, a new perspective export niche for SMEs has emerged. Production of cold pressed oil from pumpkin, hemp, and flax is becoming a promising industry. The global demand for this product is significantly higher than the supply, and the prices are 10 times higher than traditional sunflower oil, which also opens the way for SME processors to export.

1.2.3 Wood and wood items

The last category which has a good potential for growth in Ukraine is wood and wood items. The sector is dependent on supplies of foreign production equipment but at the same time Ukraine has an abundance of domestic raw materials. In fact, over the past 10 years the volume of logging in Ukraine has increased by 6 million m3 to reach 22 million m3. Approximately 90% of the forest area of Ukraine has logging potential. Ukraine has excellent conditions for growing forests and is rightfully among the six European countries with the largest wood reserves. The total growth of forests is estimated at 35 million m3 or about 4 m3 per 1 ha, placing Ukraine in line with Sweden and Finland by forest productivity.

Representatives of the Ukrainian wood-working industry include many SMEs, dominated by individual entrepreneurs and small enterprises operating under preferential taxation treatment. Production is concentrated in the border areas. In some of them (Zhytomyrska, Volynska, Sumska areas), a significant contribution to production is made by the enterprises of the State Forest Agency of Ukraine.

Most companies that sell wood products to the EU are direct exporters and have direct supply contracts with EU customers. There are several basic types of sales: a) long-term direct contracts signed with woodworkers and investors with a 1-3 year history of trade relations with state forest structures; b) periodic electronic bidding, with the submission of proposals in closed envelopes, for all those wishing to purchase wood; c) retail trade of harvested wood; d) auctions for the sale of large-sized assortments of valuable species. The sector's clients in the EU are mainly SMEs like Uniles, Bioenergy, Averman, Ligo, Pallet Timber and others. There are, however, also major players like Holzindustrie Schweighofer and Erdert Zrt., who import wood products from Ukraine.

1.3 Business climate

Positioned 76th on a global scale, the Republic of Ukraine trails well behind the other five EaP countries in the Doing Business rankings of the WB by the ease and costs of business regulations. Despite some improvements in the past year, Ukraine compares to the European and CIS laggards rather than the dynamic environments such as that in Georgia (9th) or Belarus (38th). However, the business climate has steadily been improving over since the 2014 events, according to the indicator. Of the various topics that Doing Business covers, Ukraine is most advanced with getting credit procedures and dealing with construction permits (29th and 35th position globally, respectively), while lagging behind with resolving insolvency, where it is ranked 149th of 190 countries ranked.

Corruption is a critical bottleneck for a greater investment volume, as shown by Transparency International's Corruption Perception Index, where Ukraine, despite improving in the past 3-4 years from 25 to 30 (100 being best and 1 worst), was still 130th out of 180 countries on a global scale in 2017.

"Efforts to establish an independent anti-corruption court were also delayed despite pressure from international and national stakeholders.

While an independent anti-corruption court is urgently needed, an independent judiciary is similarly important. Without this, civil liberties and freedom of the press remain challenging. A legal system that is independent of political influence is a prerequisite for safeguarding the rights of all citizens, including those pushing anti-corruption reforms," finds Transparency International [8].

Ukraine has a range of BSOs that actively engage in monitoring of the business environment, reporting on it and discussing progress with the public sector. Besides the official Chamber of Commerce, there are several other associations, including the foreign chambers and associations, such as American, British and European. Business Support Offices and Centres, that grew out of the EBRD and EU projects respectively, supporting SMEs through technical assistance, also play a role as a conduit for business environment improvement and propose improvements to the authorities. Even though the chambers typically work with larger companies, all of the identified associations actively support SME development and promote policies aimed at their strengthening.

Textbox 1:
SME Development Framework until 2020

The Cabinet of Ministers adopted in May 2017 the Strategy for SME Development in Ukraine until 2020 – in place largely due to FORBIZ support. This development framework largely calls on better coordination among various authorities and levels of government that cover SME operations and it has led to the more recent adoption of the Action Plan by the Cabinet of Ministers, alongside establishment of the SME Development Office that oversees its implementation. Both documents acknowledge various regulatory deficiencies and set the reform path to their resolution:

- Creating a favourable environment for SME development;
- Improving access to finance for SMEs;
- Simplifying Tax Administration for SMEs;
- Promoting Entrepreneurial Culture and Developing Entrepreneurial Skills;
- Promoting SME Export / Internationalisation;
- Improving competitiveness and developing the innovation potential of SMEs.

Several bilateral projects are aimed exactly at that: working with associations of SMEs to increase their visibility and lobbying capacities, so they can engage directly with the authorities in promoting a sounder investment climate. Some of these associations are sectoral, the others geographic, while a few try to gather youth, 'green' producers, women entrepreneurs etc. as membership-based associations living increasingly of their own income or fees and in turn providing members with a voice that actively advocates the conditions for their improved performance. All of these endeavours are rather long term, as their capacity building may take years.

8 https://www.transparency.org/news/feature/europe_and_central_asia_more_civil_engagement

SECTION 2:

Share of SMEs in the economy

As of the end of 2016, there were about 305,598 SMEs in Ukraine, a marked increase compared to the previous year. These SMEs contributed significantly to job positions in Ukraine with a total of 4,214,500 employees in 2016. Small enterprises employed almost 38% of SMEs' employees in 2016, while medium-sized enterprises employed a total of 2,622,800 people, which represents 45.2% of all enterprises operating. As of December 2016, SMEs had a turnover of UAH 3,846,080 representing 61.7% of the total turnover of all registered enterprises.

Both small enterprises and medium-sized enterprises engage in wholesale and retail trade, as well as repair of motor vehicles and motorcycles. Sectors that are only covered by small enterprises include agriculture, forestry and fishing. On the other hand, medium-sized enterprises are also engaged in the extractive and processing industry, electricity, and gas and water supply.

In 2016, political instability was no longer the biggest challenge for SMEs in Ukraine; instead, poor demand became their main worry. Only 10% of SMEs in the Ukraine so far have engaged in import or export operations but more than half of operating SMEs have a strategy for development or at least a business plan. See Table 2.1: Ukraine's SME statistics as of 31 December 2016[9].

It is interesting to note that SMEs do not hire an equal number of men and women. Namely, the official statistics suggest that 3/4 of SME employees are men, while only 1/4 of them are women[10].

9 Source: State Statistic Service of Ukraine

10 Ibid.

Table 2.1: Ukraine's SME statistics as of 31 December 2016

Indicator	Measure-ment units	Small-sized business	Medium-sized business
Number of enterprises	quantity	291,154	14,832
Share among total number of registered enterprises	%	95.0	4.8
Activity type		Engaged in wholesale and retail trade, repair of motor vehicles and motorcycles, agriculture, forestry and fishing	Engaged in extractive and processing industry, electricity, gas and water supply, wholesale and retail trade, repair of motor vehicles and motorcycles
Employees		1,591,700 people work at the small enterprises. The major part is occupied in wholesale trade – 350,500 employees – and 280,600 are engaged in industry	2,622,800 people work at the medium enterprises, that is 45.2% of the total. There are 1,117,800 people employed in industry, and 359,000 are employed in agriculture
Turnover	UAH million	1,177,385.2	2,668,695.7
% from total turnover of all registered enterprises	%	18.9	42.8

SECTION 3:

Overview of the EU4Business portfolio in Ukraine

The EU4Business umbrella initiative supported a total of 21 projects in Ukraine since its inception. In the period 2009-2017, a total of 4 projects were completed, while 17 are still running. Within the four objective areas that the projects covered, 10 were established to Improve the access to finance, 4 to Strengthen the policy and regulatory framework, 4 to Improve knowledge base and business skills, and 3 projects to Improve access to markets.

The table illustrates the distribution of projects in the different support areas, and which of those are ongoing and which are completed.

Table 3.1: EU4Business project portfolio

	PROJECTS in UKRAINE			
Area of support	A: Improving Access to Finance	B: Strengthening policy and regulatory framework	C: Improving knowledge base and business skills	D: Improving access to markets
Ongoing projects	10	3	3	1
Closed projects	0	1	1	2
Total projects	10	4	4	3

Source: EU4Business database

The EU contributed approximately € 150,000,000 for ongoing projects, with most of the financial support targeting improving access to finance, followed by projects strengthening policy and regulatory framework.

With regard to projects that have now been completed, the EU contribution has been of approximately € 5,800,000 with predominant support for projects improving knowledge base and business skills, and improving access to markets.

The EU4Business initiative and the projects implemented through it have a significant impact on enterprises and for the provision of employment. The table below summarises these key impacts in terms of enterprises supported, the number of enterprises that received loans, the total value of the loans provided via the programmes, and the number of jobs created, supported and sustained through programme support: between 2009 and 2017, EU4Business supported 660 enterprises, 1,043 enterprises received loans for a total value of € 188,810,961 and through these 5,887 new jobs were created.

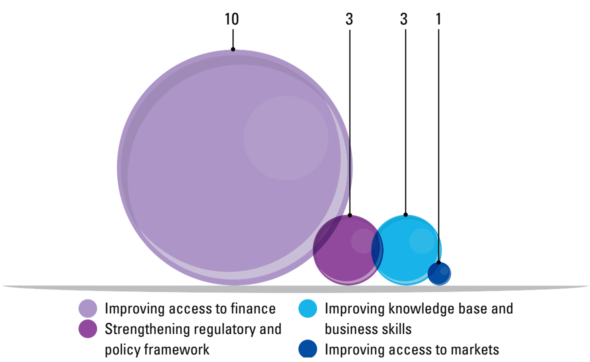
Table 3.2: EU4Business impact in Ukraine

Impacts of EU4Busines support	2009-2015	2016-2017	2009-2017
Number of enterprises supported with advisory services	306	354	660
Number of enterprises which received loans	557	486	1,043
Total value of loans disbursed (Euro)	103,921,541	84,889,419	188,810,961
Number of new jobs created	1,865	4,022	5,887
Number of jobs supported and sustained (advisory and financial projects)	20,318	8,722	29,040

Source: EU4Business database

The EU contributed approximately € 150,000,000 for The success of EU4Business in improving access to finance for SMEs can be illustrated with ample success stories where loans have spurred SME growth, such as the case of Tetiana Yaremchuk, whose SME obtained funding from a local bank under the EU4Business EFSE programme [11].

Figure 3.1 Ongoing projects by objective



Source: EU4Business database

11 For the related success story, please refer to page 9.

UKRAINE:
Tetiana Yaremchuk – from local bakery to European export

“As I was looking for money, I found that the Ukrainian ProCredit Bank was lending to Ukrainian SMEs under the EU4Business programme. I took out an unsecured loan to replenish the working capital. I received it quickly and without any red tape, and I was treated with respect.”

Tetiana Yaremchuk has gone from a small bakery to a major pasta production plant. She received loans from ProCredit Bank, a Ukrainian partner of the European Fund for South East Europe (EFSE) financed under the EU4Business programme, that has allowed her to grow and target the European export market.

SECTION 4:

Donor support to the SME sector in the country – looking beyond EU4Business

Net official development assistance received by Ukraine in 2016 amounted to 56% of what all EaP countries got combined, a ratio that has been sustained since 2014. This is equally true of the EU4Business share of the projects as well as of all others.

18 large foreign funded projects have been identified in Ukraine and despite being large in size, multimillion in EUR, they largely award grants to the final beneficiaries. Besides the EU, the largest bilateral donors are the USA through several agencies, Canada, Norway, EU member states individually, such as Germany, etc. Many are channelled through Ukrainian public agencies: ministries and other national-level agencies. However, increasingly so, regional governments within Ukraine are coming in to subsidise a portion of the interest of SME loans, therefore acting as donors themselves. This is particularly true of larger and economically more powerful cities, such as the capital Kyiv, etc.

These projects often act through business associations, NGOs, consultancies, academic institutions etc. to disburse aid, whereas subsidies to bank loans clearly follow predetermined arrangements with commercial banks and fund a portion of the loan costs. Grant programmes largely look at increasing the value added to SMEs in the strategic sectors, particularly agribusiness, but also targeting certain niches with high growth potential: export-oriented industries, youth entrepreneurs, value chain development, innovation etc. They rarely distort other market strengthening efforts and are mostly aimed at boosting business capacities, educating and training (vocational, specialised, introduction of new technologies), enabling the target audience to add value or engage in a new production niche or activity, developing intermediaries and consultants who can then work with the ultimate beneficiaries or enabling access to such consultants and know-how, or engaging with special groups such as women entrepreneurs or individuals with special needs to encourage their market entry, including internally displaced persons from Ukraine's East. Loans made available to rural communities, farmers, and agribusinesses are the largest share of all the access to finance support made available through local banks and other quasi-financial institutions. They are often combined with other instruments, such as guarantees, consultancy assistance and access to knowledge and markets etc.

Comparing these interventions to the suggested gap assessment as portrayed by the national round table and other analyses deployed by the EU4Business Secretariat, the main needs are being met. The key issue is speed of implementation and disbursement of aid, which in turn depends on the speed of reforms and the local absorption capacity. Levelling the playfield for SMEs and ending the monopolies and privileges for large state-owned companies and some politically connected entities will allow for a much faster engagement with entrepreneurs and higher economic growth with a more even spread of benefits. There is an enormous production and exporting potential within the agricultural sector alone, although there is a notable rise of the ICT and high-tech sectors that find a much faster way to the foreign markets, given no physical transportation needed most of the time.

A range of instruments is needed for this development: from the actual funds to support business development, to specialised training and business handholding in form of know-how and consultancy work, etc. There is a shortage of guarantee funds, particularly as many of the entrepreneurs are young with little starting capital, etc. These can complement a range of other opportunities that could be used hand in hand. Enabling easier access to the EU market through business matching, participation in fairs and accessing specialised online facilities might be a relatively small investment yielding comparatively high growth. DCFTA is still a vague concept in the eyes of most SMEs and it will take time and considerable resources to spread the message of the intended benefits and then to prepare the sector to adjust to the standards required by the DCFTA. Finding an appropriate outreach to the regions beyond Kyiv and the more developed Western part of the country will be a challenge that will require trusted partners locally in the medium to long run. Therefore, coordination with the other donors who focus on enabling Ukrainian SMEs to export will determine which gaps need to be filled in the matrix of industries/sectors and regions at any given time.

SECTION 5:

SME survey results

Thirty SME-beneficiaries of the financial products of EU4Business were surveyed in Ukraine in the period March-April 2018[12]; 82% of those were limited liability companies, while the rest were cooperatives and individual entrepreneurs. Statistically, the most represented sector was agribusiness with 62%, followed by manufacturing with 28%, and retail with 10%. The vast majority of SMEs have been in operation for a long time prior to taking the loan: 62% between 11 and 25 years, 10% even more, and 28% up to 10 years, while the employee size also varies – 50% of them have less than 10 staff and it goes up to 50 staff, with one company even up to 250. All these respondents borrowed in 2016 through EBRD and KfW run projects.

Ukraine has the highest level of awareness of the origins of funding, with 69% of respondents knowing that the funds originate from the EU4Business programme or from the EU. All of them learned about the funding opportunity from the bank from which they borrowed. Borrowing in local currency through EU4Business is indeed paying off (see the example of Andriy Soroka, who received a local currency loan for his farming business under the EU4Business SME Finance Facility Phase II programme[13]), as 83% of respondents have borrowed in UAH – the highest rate in EaP – and all but one firm received the full amount applied for. 59% of the respondents believe the terms and conditions were better than the otherwise market terms (38% see them as being no different and only one respondent as being worse).

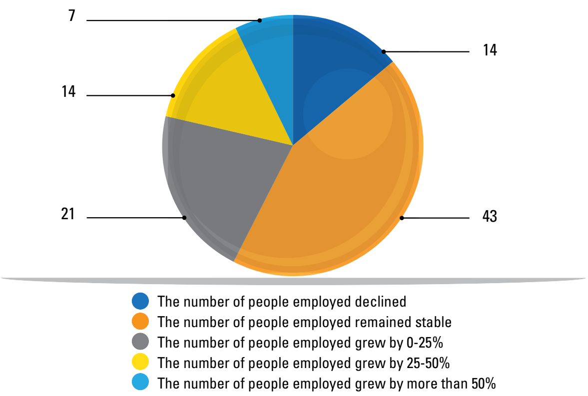
In the case of Ukraine, 52% of respondents needed the funds for equipment purchase, and a further 33% for less precise needs such as business expansion or working capital. Only one borrower used the funds to finance their start-up.

12 A total of 130 SMEs were surveyed in five countries of EaP (Armenia, Belarus, Georgia, Moldova, Ukraine): 30 companies in the three countries with DCFTA status and 20 in the other two. Initially, the key implementers provided twice as many SMEs, from which firms were contacted until the target number of interviews has been completed. The firms were chosen randomly, but a precondition was that they had taken an EU4Business financed loan at least one year before the beneficiaries' lists were prepared. In the countries where different projects were being run, the SMEs approached were from a proportional mix of such projects (provided via EBRD, EIB and KfW).

13 For the related success story, please refer to page 13

However, as a result of this operation, the majority did not feel the need to increase the size of their staff and some possibly became more tech savvy and even cut some staff. Interestingly, 88% of the respondents acknowledge that women represented up to 15% of the new employees, and only one company hired more than 50% women among the new staff. The loan itself has not influenced the number of employees for 65% (comparable to the 43 + 14% in the chart below of those who did not increase employment), while for the others it was somewhat or rather critical in generating jobs.

Figure 5.1: Impact of loan on employment



Source: EU4Business database

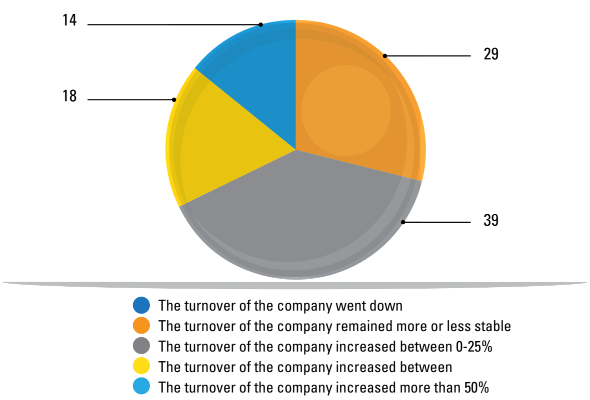
As many as 83% of the SMEs in the survey do not export abroad, and of those which do, they trade equally with the EU and Russia (a third of exporters each), while the other third splits equally between the rest of the EaP block and the Asian economies. Two-thirds of exporters generated less than 10% of their turnover in foreign markets, and only one company exports the majority of its products. This goes to confirm that these EU4Business borrowers were certainly not export-inclined and that the programme overall has a long way to go in generating and supporting exporting capacities among SMEs in Ukraine, a field still dominated by large state-owned companies.

Only a third of the interviewed exporters saw export levels rise up to 25% since they engaged with EU4Business, with one firm that actually started exporting for the first time as a direct result of the financial package from EU4Business. For all the others, export levels remained unchanged. This is why the 84% majority of the surveyed exporters indeed see the loan as less relevant for their exports, as other market factors were perceived more important. When asked what would it take to increase their exports to the EU, a third said they would need support in finding the trading partners, while the rest cite complicated border procedures to export, or unawareness and lack of knowledge of the standards (specifically phytosanitary), all being a part of the business environment reform endeavours.

If they would borrow again, most are looking to boost their working capital. Jointly next in line are equipment and more investment in knowledge. For that, the majority of businesses would turn to the commercial banks or non-bank institutions, where they are seeking loans under favourable conditions, primarily meaning lower interest rates than presently available. 37% is looking to use the owner's own funds for business expansion.

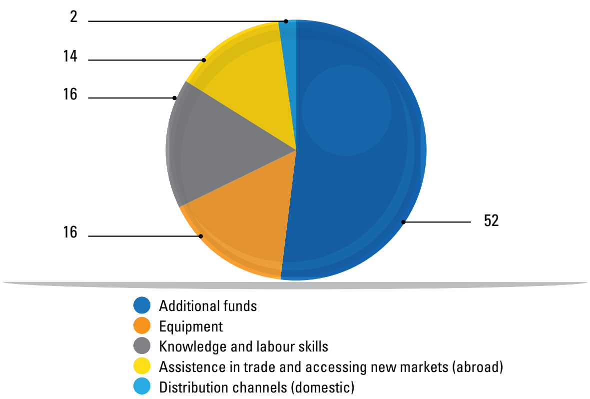
39% of the companies saw their turnover increase by up to 25%, and 32% even more than that, as the chart below details. 14% of respondents said that the loan was crucial to increase turnover, 69% important and only 17% of companies found that the loan did not significantly interplay with their turnover.

Figure 5.2: Impact of loan on turnover

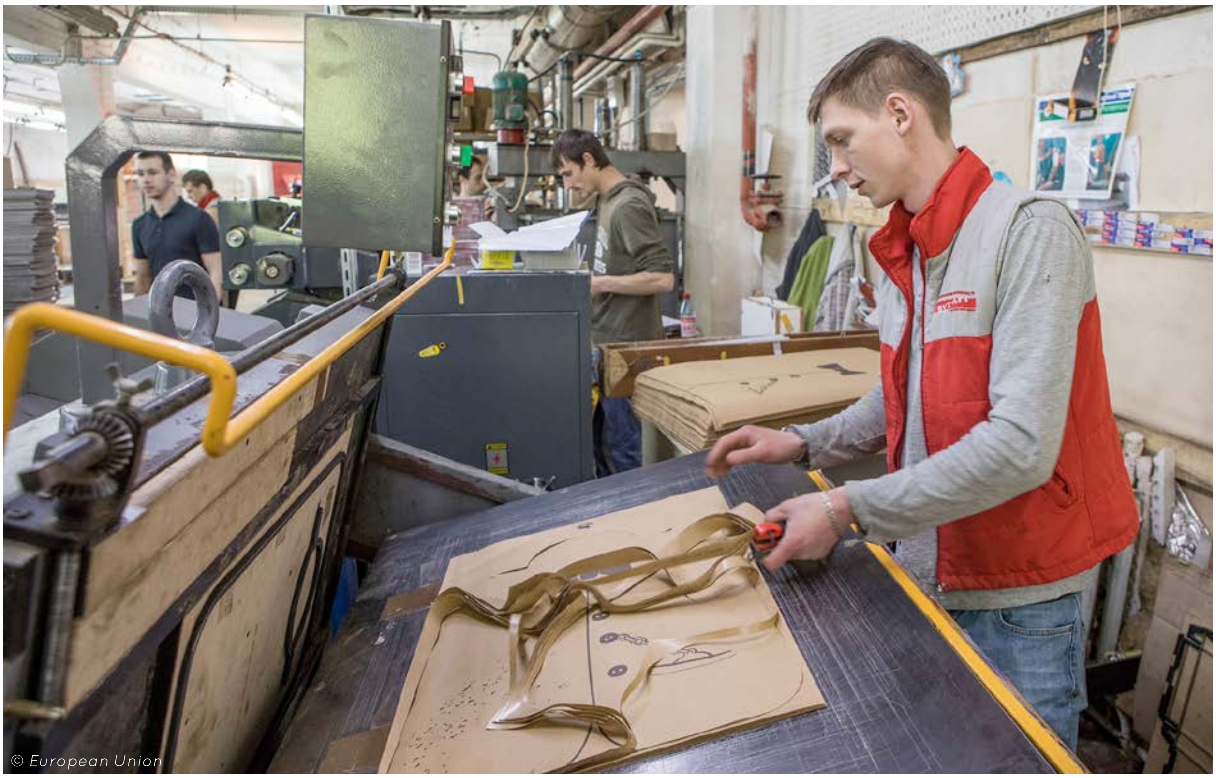


Source: EU4Business database

Figure 5.3: Company's current needs



Source: EU4Business database



UKRAINE:
Andriy Soroka – building up his farm, thanks to EU4Business

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We became a participant in this project for the first time, but we already feel its advantages. A low interest rate on the loan will allow us to modernise the business by building new premises, improving the working conditions of our employees and raising wages.

Andriy Soroka started out with a small plot, but over the years he has built up his farm to more than 300 hectares and become an independent producer. Now, with the help of the EU4Business SME Finance Facility and the German State Development Bank KfW, he has been able to take out a local currency loan from Kredobank in Ukraine to invest in further modernisation and infrastructure.

Success stories:
SME Finance Facility
Phase II (KfW)

SECTION 6:

Highlights of the round table discussion

The round table held in Kyiv on 26 March 2018 resulted in a dynamic discussion, during which 44 EU4Business stakeholders present in Ukraine highlighted the important achievements of the EU4Business initiative[14].

An overwhelming conclusion of the meeting was that the EU4Business initiative helps remove the obstacles encountered by SMEs by providing tailored funding, support and training that helps small businesses reach their potential. Lending in local currency was found to be particularly important. It was noted that the EU4Business initiative ensures cooperation among different market players in Ukraine, such as the local authorities, banks, regional NGOs, businesses, etc. An important result of EU4Business activity in Ukraine is that many local authorities were mobilized under the umbrella of EU4Business activity: Ministry of Economic Development and Trade, a lot of initiatives and programmes, that have an exceptional importance in terms of SME support efficiency. A number of key points have been identified for a possible follow-up as ways to further strengthen the impact of EU4Business. They follow the logic of the four pillars of EU4Business.

6.1 Access to finance

The ability to borrow in local currency was a big achievement of EU4Business, because most Ukrainian SMEs now survive only due to their low leverage and UAH denominated loans. The cost of borrowing remains high, which limits SMEs' ability to take loans, particularly for long-term investments. SMEs in Ukraine appear to be well informed about EU4Business projects on access to finance, according to the banks involved in the programmes.

14 The national round tables were held in the capitals of all six EaP countries between late February and early April 2017, and engaged all the EU4Business stakeholders in each country: the EU Delegations, the IFIs involved, national counterpart- SME agencies and Ministries of Economy, commercial banks involved, business associations, key implementers and any other related party, totalling between 25 and 45 persons per round table. The discussions focused on the ongoing achievements across all four pillars of EU4Business, but the content was tailored to the priorities of each country. The discussants were specifically guided to address the forthcoming challenges anticipated and to propose solutions for the way forward.

Many SME representatives come to the Bank by themselves and ask for financing under the EU4Business programmes. Still, only a few partner banks are available in smaller cities, but there are a lot of SMEs in such cities. Thus, efforts to reach more distant entrepreneurs in smaller cities are especially important.

All programmes and tools that provide a lower cost of funding and financing offer a large benefit to the development of SMEs, because the current average financing rate is 17%, and very few businesses have such a rate of return. Some bank estimates speak of up to 90% of borrowing going towards working capital, and only 10% for the actual investment. Even so, the banks observe a significant increase in investment demand from SMEs. There is also a significant demand for guarantees, much above what is currently available through the EU4Business and other programmes.

- Final beneficiaries always want interest rates to drop further, with the loan maturity increasing marginally (engagement over a longer period). However, decrease of interest rates should be considered with caution, as subsidised instruments can become market distorting and create wrong incentives. Money should not be borrowed because it is cheap but because there is an investment decision, while competition among banks should remain healthy.
- Working capital is a very urgent need of SMEs and the access to finance programmes should not be limited to investment financing only.
- Expanding the collaboration with the Oblasts interested in subsidising some of the interest rate on loans in order to enable more SMEs to borrow (based on the Kyiv city model).
- Financing could be combined with a risk sharing facility as a synthetic tool, because SMEs' access to finance is limited due to an absence of collateral. A guarantee instrument that will allow SMEs to access financing, or programmes where the state provides guarantees to complement access to finance for SMEs, are much needed.

6.2 Access to skills and knowledge

Labour productivity in Ukraine is relatively low as compared to European countries (an average Ukrainian SME employs more people than a comparable European firm), partly due to low labour productivity, and partly because of the business culture with no outsourcing. Thus, there are companies that fall under the EU definition of SMEs in terms of turnover, but which are large on the labour side. On the other hand, an SME with up to EUR 50 million turnover in Ukraine is considered large. While this is a consideration from the EU4Business eligibility criteria, it is also important to increase productivity and lower the costs of production/service.

The Business Support Centres initiative works with various institutions, and other partners in different regions in Ukraine. Their operational advantage is that they can adjust faster to the specific strengths and weaknesses of each region of Ukraine and operate in different business environments. Efforts channelled through the local staff and analysts who perform on-site analysis and engage with the client, as well as through regional business support centres appear very popular. They are seen as trust and confidence building by the clients.

- The very dynamic yet still unstable Ukrainian market requires a flexible approach in strategy development. Planning of technical support needs much flexibility in order to meet the changing dynamics, and companies profit most from direct support and working hand-in-hand.
- SMEs need access to available opportunities for technical assistance that may also lead to access to finance, incl. what conditions they need to fulfil. The Ministry of Economic Development and Trade is currently building an SME portal where they plan to collect and share information on all available programmes and opportunities as a one-stop info shop, to which the others can provide inputs as well.
- More support might be needed for SME support centres; outreach to SMEs explaining the potential benefits of working with the support centres is beneficial and the related programme under the auspices of the EU Delegation would address that.

6.3 Access to markets

The DCFTA has brought many benefits in accessing the EU market but also additional challenges for Ukrainian SMEs to stay competitive there. Various related skills are needed and their own linkages and clustering would be beneficial to strengthen collaboration horizontally and vertically.

- Exchange of experience and ideas: it helps to leverage individual work with what can be done collectively, as well as to ensure that no overlaps and replications exist and that all important areas are covered. Some emphasis is on young entrepreneurs and their immersion in European businesses to learn directly from the EU markets.
- SME peer-to-peer mentoring: many companies have already been successful participating in EU4Business programmes, and they have knowledge to share. This can be used as peer-to-peer mentoring for members of a cluster or supply chain.

6.4 Business regulation

FORBIZ is a flagship project that has been successfully streamlining business regulation through the Better Regulation Delivery Office set up at the government level, and it continues to simplify the investment climate, thus also promoting such reforms across the EaP, as countries learn from one another. Over 700 outdated regulations have been removed since 2016, profiting businesses across selected industries and some market-wide.

- FORBIZ work will continue until March 2019, with impact on SMEs being well measured and presented. Studies into the priority markets may show lessons learned for all economic subjects across other sectors.
- An SME development office is being set up with FORBIZ support to start implementation of the recently adopted SME action plan and coordinate practical support programmes for SMEs across the country.
- Protection of property rights needs additional research and application in Ukraine as it advances the DCFTA, and seeks to collaborate more closely with EU business entities.

Participants of the round table concluded that some continuation of this very first such gathering of all the stakeholders involved in the EU4Business is highly desirable.

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