SME policy: Instruments and challenges

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Germany Advisory Group Ukraine

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Structure

1. Introduction
2. SME policy: Direct vs. indirect
3. Direct instruments: German experience and implications for Ukraine
4. Conclusions
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Introduction

- Ukrainian SME policy is mainly based on tax incentives
- Ukrainian Tax Code: Tax incentives, especially for small entreprises, are reduced
- Special focus: Small entrepreneurs under the simplified taxation scheme are most worried about impact of Tax Code.

- **Conclusion 1: New types of SME policy instruments need to be developed and implemented.**

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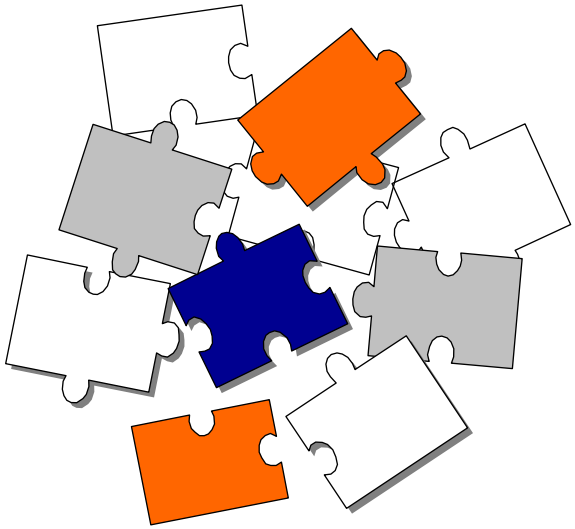
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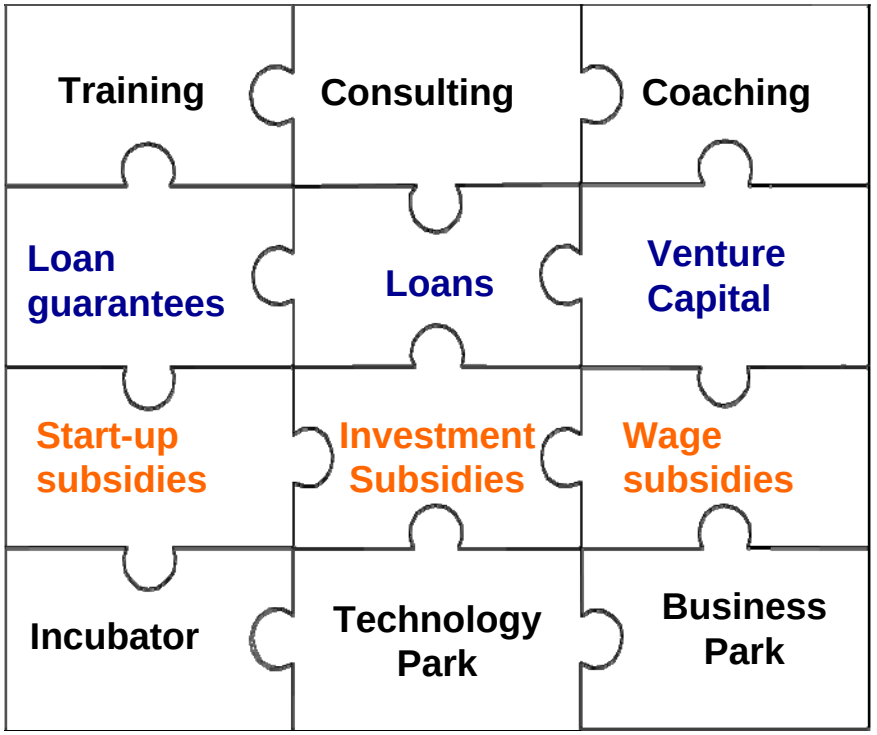
Direct SME policy

Definition	• Measures that provide individual support for founders, entrepreneurs and companies
Instruments (international best practice)	• Business development services • Access to finance: Subsidies, loans, loan guarantees, venture capital • Facilities and specific infrastructure
Experiences from Germany	• Approx.1,000 different policy programmes • Mixed experiences reg. efficiency and effectiveness of instruments -> Focus shift to innovative and growth-oriented SME -> Co-payment by companies required (up to 50%, depending on region and industry sector)
EU Policy	• Focus shift focus to innovative and growth-oriented SME
Opportunities for Ukraine	• Broad variety of best practice instruments • Experiences (positive and negative) from other countries: help to prevent making same mistakes again
Challenges for Ukraine	• High costs = negative impact on public finances in the short term • Danger of corruption, misuse and structural distorsions • Institutional capacity for implementation

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Integration of direct SME policy instruments in Germany

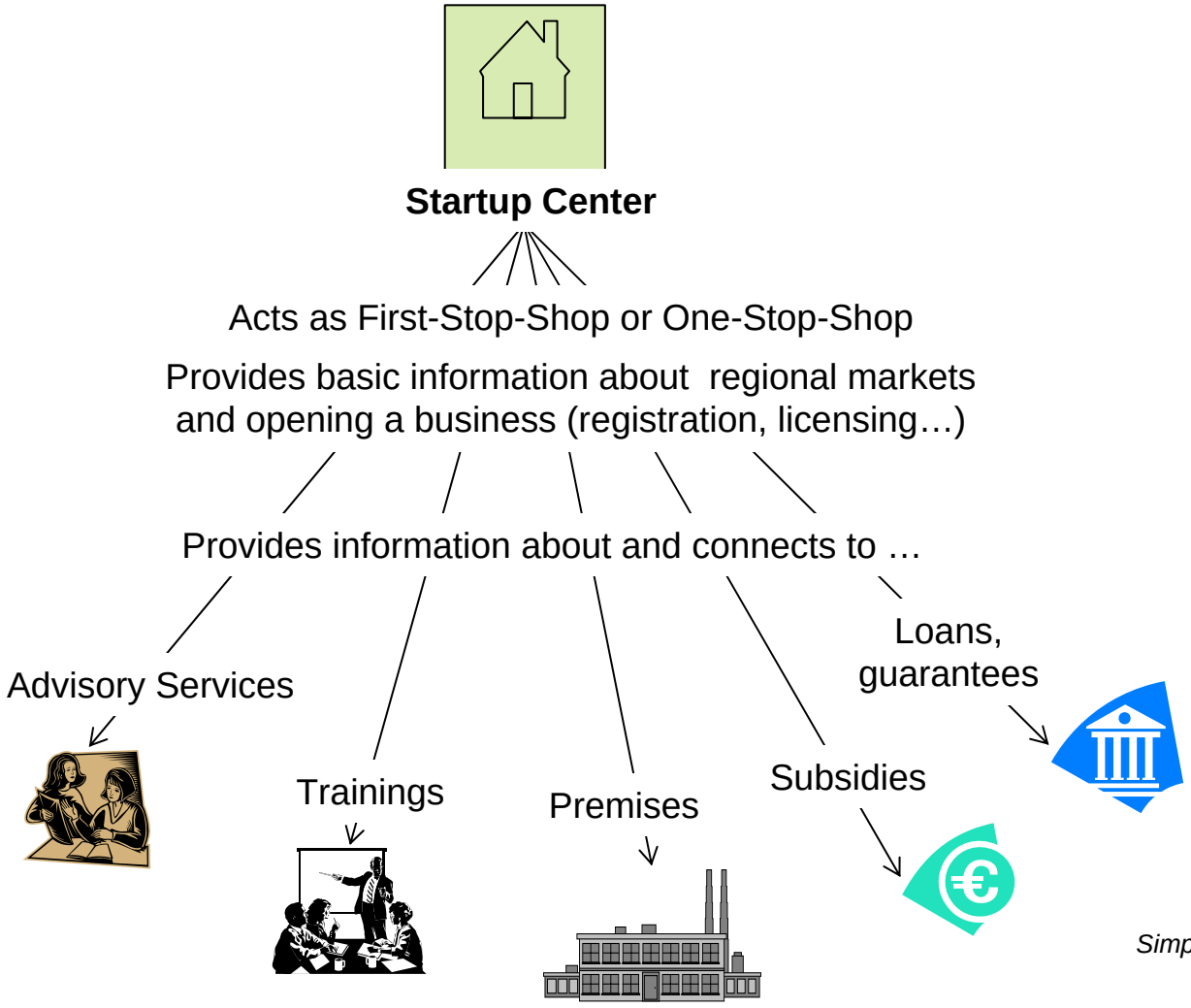




Direct instruments are more and more integrated, but there are still approx. 1,000 different policy programmes in Germany (for specific target groups, regions, industries, growth stages etc.), resulting in some overlap and inefficiency

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Entrepreneur‘s point of view



Simplified diagram

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Concrete example: Unemployed person wants to open a small business

1. Startup Center: All information about process of opening a business and about support offers
2. Basic entrepreneurial training: How to write a business plan?
3. Assessment Center: Is the business concept profitable? Is the person competent to run the business?
4. Coaching / consulting for completing the business plan
5. Register the business
6. Receive startup subsidies (degressive)
7. Coaching for young companies (50% of the coaching must be paid by the company itself)

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Indirect SME policy

Definition	• Measures that aim to improve general conditions for the development of the SME sector – Improvement of business climate and framework conditions – Fostering entrepreneurial interest and talent – Building a positive image of entrepreneurship
Instruments (international best practice)	• Improvement of regulatory and administrative framework • Enable employment flexibility through easing labour market regulation • Information dissemination and image campaigns • Entrepreneurship education
Experiences from Germany	• Positive exp. with simplified accounting and tax calculation • Positive exp. with exempting small enterpr. from dismissal protection law • Positive exp. with entrepreneurship education and image campaigns
EU Policy	• Highest priority on EU policy agenda: “Small Business Act”
Opportunities for Ukraine	• High impact on SME development • No economic and structural distortions • No major losses in public revenues (medium- and long-term)
Challenges for Ukraine	• Implementation, enforcement, monitoring and adjustment of reforms

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Comparison direct vs. indirect SME policy

- **Conclusion 2: Indirect SME policy is generally applicable to Ukraine**, because it is
  - **Cheap**: Requires lower levels of public expenditures
  - **Easy**: Low danger of corruption and misuse and thus easy to control and monitor

- **Conclusion 3: Direct SME policy might be partially useful to Ukraine,** because it is
  - **Fast:** Effects can bee seen immediatly

    (Especially considering the situation of small entrepreneurs affected by Tax Code)

In the following we focus on direct SME policy as this was the request of the Ministry of Finance

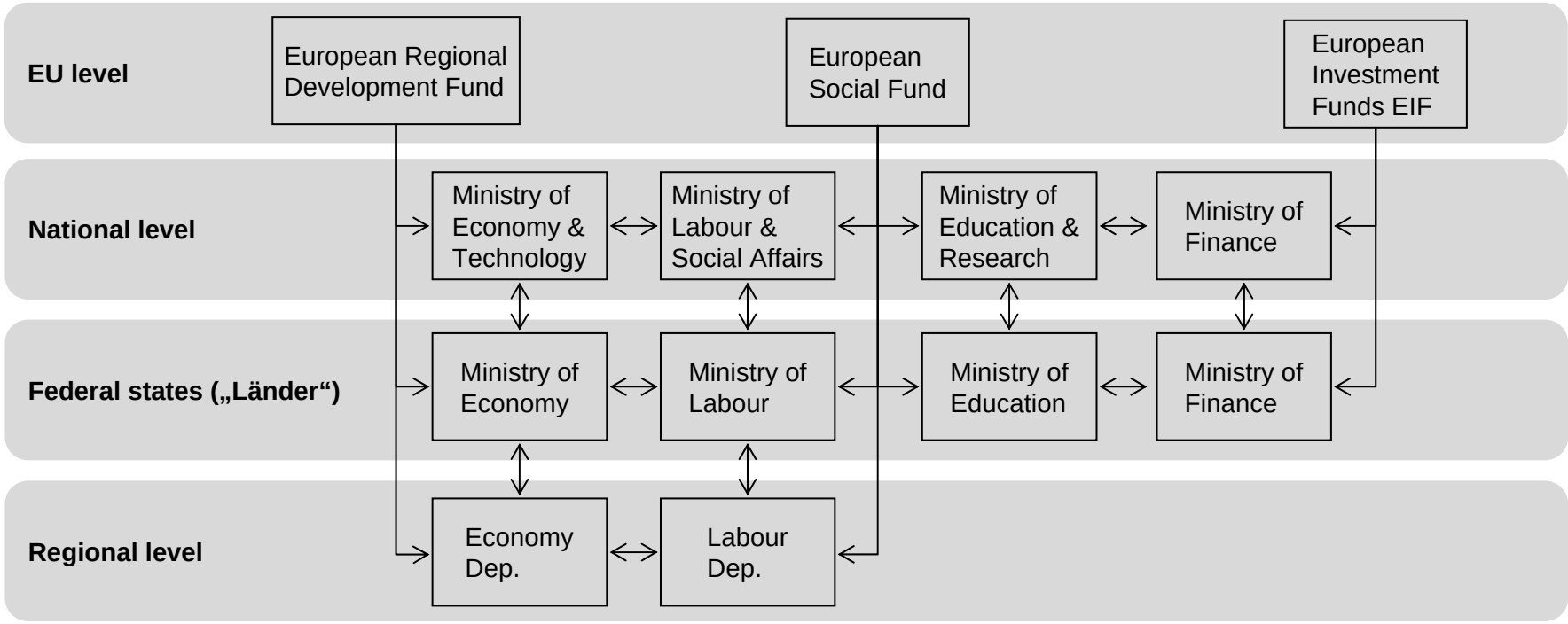
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SME policy formulation in Germany

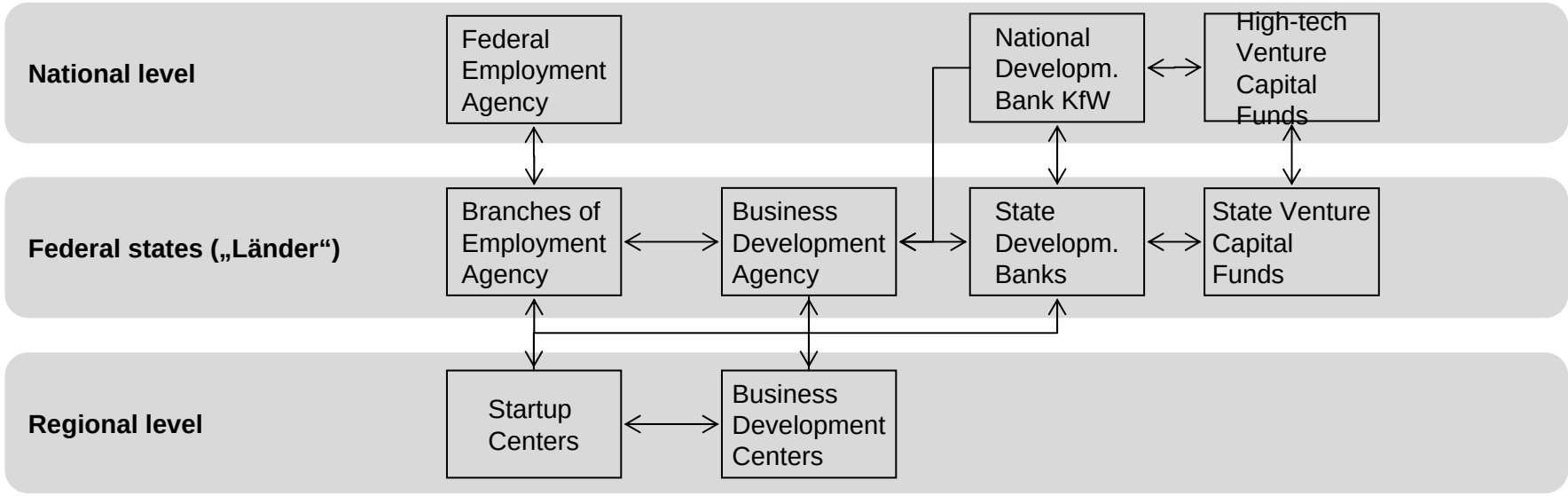


Simplified diagram

- In Germany: SME policy formulation is a joint task of relevant policy making institutions at national level, federal state level and regional level
- Policy makers at different levels can develop instruments. This is due to the EU principle of subsidiarity; as a result there are approx. 1,000 SME policy programmes in Germany
- Instruments are aligned to European SME policy guidelines and are co-financed by European funds

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SME policy implementation in Germany



Simplified diagram

- SME policy makers appoint specialised institutions to implement the instruments
- Institutions are required to coordinate their actions with each other
- For the implementation of Startup Centers and Business Development Centers, the policy makers offer tenders; private companies, state agencies, non-profit-organisations and state-owned enterprises can apply
- Tenders are renewed after some years; in that way, policy makers intend to foster competition between potential institutions and thus to continuously improve effectiveness and efficiency

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Business development services

Objectives	• Support founders and manager-owners with building up knowledge and skills
Instruments (Germany)	• Startup Center, Business Development Center • Basic entrepreneurial training • Training in business planning and business administration • Counselling and advisory services, coaching • Conditions: Co-payment by the company (up to 50%)
Opportunities for Ukraine	• Positive impact on human capital stock • Very flexible instrument • Best practice experiences available
Challenges for Ukraine	• Some danger of corruption and misuse (higher for consulting, lower for training) • Institution that manage and monitor the programmes? • Availability of skilled and experienced trainers/consultants/coaches?

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Facilities & specific infrastructure

Objectives	• Provide basic infrastructure for start-ups and young companies • Foster specific industries • Promote innovation
Instruments (Germany)	• Incubator • Business park, science park, technology park
Opportunities for Ukraine	• Very powerful instruments for innovation policy
Challenges for Ukraine	• Availability of innovative business concepts? (definition of innovation applicable for Ukraine?) • High costs, especially high sunk costs = negative impact on public finances in the short term • Danger of corruption and misuse • Danger of structural distortions • Mixed experiences from other transition countries

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Investment subsidies

Objectives	• Increase real capital stock • Overcome financing shortages • Promote specific industries

Instruments (Germany)	• Grants for investments
	  • Investment amount at least 30,000 €,
	  • Long-term investments only (machinery etc.)
	  • Up to 50% of investment, share depends on industry sector & region
	• Grants for wages of newly created jobs that are bound to the investment
	  • Wages at least 25,000 €/year
	  • Up to 50% grant for two years
	  • Jobs must remain at least for 5 years

Opportunities for Ukraine	• Positive impact on investment climate • Renew and expand investment stock and production capacity
Challenges for Ukraine	• Danger of corruption and misuse • Danger of structural distorsions • Negative impact on public expenditures

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Start-up subsidies

Objectives	• Increase quantity and quality of start-ups

Instruments (Germany)	• Grants for unemployed people that start a business
	  • Up to 24,000 € per person + up to 5,000 € for equipment
	  • Precondition: Long-term profitable business concept
	• Grants for start-ups from universities
	  • Up to 30,000 € per person + up to 23,000 € grants for equipment and coaching
	  • Precondition: Highly innovative business concept

Opportunities for Ukraine	• Positive impact on investment climate and entrepreneurial spirit • Promote structural change
Challenges for Ukraine	• Availability of long-term profitable start-up business concepts? • Availability of highly innovative business concepts? (definition of innovation applicable for Ukraine?) • Institutional: Assessment of business concepts requires sophisticated skills and long-term experiences; such competencies must be build up • Danger of corruption and misuse • Danger of structural distorsions • Negative impact on public finances in the short term

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Loans

Objectives	• Overcome financing shortages

Instruments (Germany)	• Loans with lower interest rates and/or lower level of collateral
	• Preconditions
	  • Used for long-term investments (machinery etc.)
	  • Long-term profitable business concept
	• Funding: Budget + EU funds + ERP Assets
	• Implementation: Development banks (national development bank KfW and 16 state development banks) in coop. with commercial banks

Opportunities for Ukraine	• Positive impact on investment climate • Renew and expand real capital stock and production capacity • Overcome credit crunch
Challenges for Ukraine	• Institution that carry out programme? (No development bank in Ukraine) • Selection criteria? • Monitoring and risk management requires sophisticated skills and long-term experiences; such competencies must be build up • Insolvency law and collection of debts? How preventing fraudulent insolvency?

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Loan guarantee schemes

Objectives	• Overcome financing shortages
Instruments (Germany)	• Guarantees as substitute for collateral, used for loans of commercial banks, up to 90% of credit volume are guaranteed by state institutions • Funding: Budget + EU funds • Implementation: Development banks (national development bank KfW and 16 specialised guarantee banks) in coop. with commercial banks
Opportunities for Ukraine	• Overcome credit crunch • Positive impact on business climate • Positive impact on SME growth and development • Best practice experience from other countries available
Challenges for Ukraine	• Institution that carry out programme? • Selection criteria? • Monitoring and risk management? • How preventing corruption and misuse? • Insolvency law and collection of debts? How preventing fraudulent insolvency?

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Conclusions

- Ukraine needs to develop and implement new types of SME policy instruments
- Indirect SME policy instruments are generally recommendable, because they entail low impact on public fincances and little danger of structural distorsion, corruption and misuse
- Direct SME policy instruments are partially recommendable in order to respond to current situation of small entrepreneurs. Possible instruments:
  - Training: Impact of new Tax Code on business models
  - Training: Accounting and compliance to Tax Code
  - Advisory and counselling service for entrepreneurs that need to change legal form
  - Coaching for entrepreneurs that have fears
  - Startup Center for new entrepreneurs

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Steps for developing and implementing effective and efficient direct SME policy instruments

- Analysing specific current problems (and fears) of entrepreneurs in Ukraine, identifying target groups with specific needs
- Designing specific instruments for target groups
- Create or select institutions that implement the instruments, prevent misuse and corruption
- Coordination of institutions and authorities that are involved on national, oblast and local level
- Monitoring implementation progress
- Analysing impact regularly, adjusting the instruments accordingly

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