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FULL TITLE: THE ROLE OF GOVERNMENT IN PATH-DEPENDENT DEVELOPMENT OF SME SECTOR IN UKRAINE

Short title: **Government and SMEs in Ukraine**

Yuliya Shutyak, Didier Van Caillie

CEPE, HEC Management School, University of Liege

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Abstract

This paper studies evolution of governmental support for SME development from the times of *Perestroika* until 2013. Guided by institutional theory, the paper revises SME development in Ukraine and explains government actions through the prism of path dependence. The analysis is conducted within a matrix logic resuming the data by several periods of time corresponding to changes in the Ukrainian government and being juxtaposed to the main stages of the path dependence analytical framework. The study reveals main trends in governmental support for small business and main challenges remaining nowadays.

Key words: SMEs, government, policy, institutions, transition economies, Ukraine

1. Introduction

The small and medium enterprises (SME) sector is generally considered to be an important contributor to economic growth and competitiveness all over the world. Such importance of SMEs provoked emergence of a number of research papers covering various aspects of small business in different countries. Among them, a separate stand of literature is devoted to studies of SMEs in post-Soviet states (PSS). Indeed, after the collapse of the Soviet Union, SMEs played a crucial role in formation of the labour market and as a source of survival for a number of families in times of a deep crisis. SMEs serve as a supply base for needs of large companies, promote innovations, and contribute to an economic system and an individual sector restructuring and a wider social transformation (Doern 2009; Smallbone & Welter 2001; Smallbone & Welter 2008). Comparative and case studies, as well as surveys

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on business practices in small enterprises, have contributed significantly to understanding small-business practices in PSS (McMillan & Woodruff 2002; Klochko & Issakova 1996; Smallbone et al. 2010). At the same time, some issues still need to be revised, of which the role that the government plays in SME development remains a matter of dispute.

Because the government influences conditions where businesses of different size operate, the question of the role of government is actively discussed in academic literature on transition economies (Smallbone & Welter 2001; Welter & Smallbone 2011). This activity is very often disguised under such other topics as the role of the environment for SMEs or barriers to SME development (Manolova et al. 2008; Doern 2009; Smallbone & Welter 2012) or studies on SME policies (Bartlett 2001; King 2010; Minniti 2008). Simultaneously, some of these research results are not any more relevant for more recent years. In others, the methodological approaches have such limitations that prohibit a deep understanding of reasons for government decision making and underlying processes driving SME development.

For instance, narrowing a study on the role of government in exploring the perception of barriers to SME development does not allow being objective in research (Smallbone et al. 2010, p.655). Admitting the importance of the government in creating the institutional framework for entrepreneurship accentuates that this environment “*enables and/or constrains entrepreneurship.*” It means that the government actions may have both positive and negative effects. Moreover, perception of barriers does not necessarily mean that these barriers exist or really inhibit SME growth. A participant of such a survey could simply be involved in “barrier rhetoric” (Doern 2009) and, thus, biasing the research results. Doern (2009) therefore reveals a need for a more qualitative approach to understand better both the problem and context in which this problem has arisen.

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Further, concentrating on short periods of time, many studies lose sight of long-lasting processes. It becomes problematic when research focuses on development of institutions with time. That is why historical institutionalists argue that history matters (Steinmo 2008; Lindner & Rittberger 2003; Hay & Wincott 1998; Pierson 2000; North 1990). While contributing with new discoveries relevant to that specific moment, a short-term research neglects a role of history in emergence and evolution of studied phenomenon and processes that led to obtained outcomes. Historical approach is inevitable in this case. Otherwise, a researcher risks missing from his/her vision those crucial factors that determined historical development in a certain direction and linked separate periods into one chain.

The influence of the past is repeatedly admitted in research on SME development in PSS countries (Williams, Nadin, and Rodgers 2012; Smallbone and Welter 2001; Doern 2009; Fuxman 1997). Corruption, bureaucracy, and outdated economic practice are among those institutions that scholars acknowledged as disadvantageous heritage impeding business development. Not denying these problems, we would like to point out the absence of a structured research of path-dependent development of SMEs in transition economies. Such research requires regress in the past and rigorous analysis discovering time and sequence-dependent interrelations among various events that led to formation of the existing SME sector in PSS.

Therefore, this paper seeks critically to review the role of the Ukrainian government in SME sector development in Ukraine, starting from the period of *Perestroika* until 2013. It uses the concept of path dependence as an analytical tool of institutionalism theory to understand the behaviour of the government and decision-making reasons at different stages of small entrepreneurship development in the country. The focus only on one country in transition allows, on one hand, conducting a more comprehensive analysis. On the other

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hand, it provides insights for similar research for other post-Soviet states.

The remainder of the paper is presented as follows. First, we provide a brief description of the SME sector in Ukraine. We pay special attention to difficulties that may emerge while using official statistical data on the number of small-business entities. Second, we discuss the interplay between institutions, history, and government with relation to SME development. Based on theoretical propositions, we briefly explain our choice of research strategy, methods of data collection, and data analysis. Next, the analysis of the governmental influence on SME begins from the last years of the Soviet Ukraine, when prototypes of small business emerged as one of the achievements of *Perestroika*. Presenting in a narrative form the results of the analysis, we proceed period by period until 2013. The following discussions review the results of the analysis from a path dependence point of view and propose several ideas for further research and policy implications. Finally, the paper concludes with a summary of research and suggestions for a future research agenda.

2. The SME Sector in Ukraine

Smallbone and Welter (2001, 2008), the recognized specialists in entrepreneurship in transition economies, repeatedly characterise the development of entrepreneurship in Ukraine as slow and not sufficiently productive. Such vision of Ukrainian small and medium business is prevailing in research and various reports, with a few exceptions(OECD et al. 2012). Thus, citing the data from the State Office of Statistics in Ukraine, many specialists in small business argue that Ukrainian SMEs fall much below the European level by their number, employed persons, and turnover (Smallbone et al. 2010). Indeed, the overview of the literature on development of small business in Ukraine returns not a surprising mismatch of provided statistics and real situations in the country. The two main reasons for this

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discrepancy are disparity between official statistical data and the shadow economy.

Therefore, we argue that research on small business in Ukraine slightly underestimates the scale of this sector.

Today in Europe, an enterprise is “any entity engaged in an economic activity, irrespective of its legal form”(European Commission 2005). This definition means that individual entrepreneurs, family business entities, or any other organization involved in economic activity can be considered as an enterprise. Further, to assign an enterprise to the SME sector, two other criteria must be met: number of employees (up to 250) and sales volume (up to 50 million euro) or annual balance sheet total up to 43 million euro.

The classification is different in Ukraine. First, until 1998, Ukraine used an old classification of enterprises. In 1998, the criteria were changed: an enterprise was classified as small when the number of its employees did not exceed 50 persons and turnover did not exceed 1 million UAH. Later, the norm of turnover was changed three times, in 2000, in 2006, and 2012, and today equals 10 million euro for a small enterprise and between 10 and 50 million euro for medium enterprises. This norm is much higher than previous, but still much lower than the European norm.

Further, the confusion among terms “small business,” “small entrepreneurship,” and “small enterprise” causes inaccuracy in research. Speaking about SMEs in Ukraine, researchers rarely take into account a contribution of medium enterprises into the economy due to the lack of statistical data during a long period of time (Table 2). Moreover, two other groups can be considered, with caution, as components of small-business sector in Ukraine: individual entrepreneurs and cooperatives.

Ukraine is characterized by a high number of individual entrepreneurs who are seldom considered in research on Ukrainian SMEs, although included by the State Service of

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Statistics in total number of business entities representing small entrepreneurship. Thus, in 2012, the number of individual entrepreneurs constituted 1,234,831 or 78.2% of all small entrepreneurship entities (see Table 2). Along with SMEs-judicial entities, this number changes the profile of SME sector in Ukraine and raises significantly the rating of Ukraine among other European countries.

As for cooperatives, the number in 1997 consisted of 20,094 (including 3,000 producing cooperatives and 11,100 service cooperatives). Their total reached 34,164 in 2012. Cooperatives can be considered as a prototype of a small or medium enterprise and could be included in the total number of SMEs, with precaution due to their special judicial status and the fact that only producers' cooperatives are created with a purpose to gain profit (Law on Cooperation 2003, Article 2). Service cooperatives are allowed to provide services to external customers to the level not exceeding 20% of the whole volume of services.

Finally, one of the most influential factors is a shadow economy, which in Ukraine increased from 12% in 1989 to 48.9% in 1995 of GDP (Lackó 2000; Smallbone, Welter, Isakova, and Slonimski 2001; Williams, Nadin, and Rodgers 2012). Its share remains high until today: From the 1990s until now, a significant number of small businesses (including individual entrepreneurs) has been operating in the shadow. Reasons for that include, but are not limited to, need to survive, overcome bureaucracy, and avoid taxes both formal and informal (Williams et al. 2012). Nowadays, the shadow economy may provide excuses not so much for the number of SMEs but for their performance: a large number of employees work illegally or partially registered and the control over real turnover remains quite difficult.

To conclude, the SME sector in Ukraine is indeed characterised by insufficient performance, orientation on short-term investments in trade rather than in production, a high level of informal economy, and thus low social protection of people employed there (Lackó

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2000; Williams et al. 2012). In 2012, 28.7% of all SMEs-judicial entities and more than 50% of individual entrepreneurs were operating in retail and wholesale trade (State Statistics Service of Ukraine 2013) largely based on imported products from China, Turkey, Poland, and some other countries. Their number in the industry was relatively 9.2% and 5.6% with 6.7% turnover in total revenue of SMEs. For comparison, in neighbour Poland, a share of SMEs in industry rises beyond 10%, bringing 23% of total return (Central Statistical Office of Poland 2014). Simultaneously, the above-discussed factors that influence official statistics must be taken into account when analysing the SME sector in Ukraine. It becomes specifically important if someone looks at SMEs from both economic and political perspectives. Considering small and medium businesses as a future electorate having accumulated certain capital, the bargaining strength of this part of the population becomes even more evident due to shared interests and needs and a potential to influence governmental decision making.

3. Government, Institutions, and Path Dependence

Recent studies on entrepreneurship in transition countries reveal a strong connection between the pace of development of small business and an institutional environment where the business operates (Manolova et al. 2008; Welter & Smallbone 2011; Smallbone & Welter 2012). Institutions, as rules of the game, are incorporated in any society. And “in any context they represent both constraining and enabling forces with respect to entrepreneurship”(Smallbone & Welter 2012, p.216). However, in a transition period, they become even more important because the very transition concerns significant changes of formal and informal institutions.

The government plays a crucial role in institutional transformations as an actor

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empowered to change and develop the formal institutions while simultaneously influencing informal, directly or indirectly. The purpose of such transformation, according to McMillan and Woodruff, is “to set a stable platform for entrepreneurs’ self-help” (McMillan & Woodruff 2002, p.163). However, this is a desirable role of government but not necessarily coinciding with reality. First, as mentioned earlier, the dominating institutions can be unfavourable to entrepreneurship, as it was in the Soviet Union. Second, the government may not have intentions to support small business. Finally, even good intentions of the government may not always have a positive effect, leading instead to development of unproductive or even destructive entrepreneurship (Minniti 2008).

Indeed, institutions are difficult to change. North (1990) explains that while formal rules can be easy to change, informal social constraints remain. Similarly, Roland (2004) splits all institutions into “slow-moving,” to which he assigned culture with values and beliefs, and “fast-moving” as political institutions that he believes can change quickly. Slow-moving institutions need time to be changed. Fast-moving institutions can be changed overnight.

In this regard, probably one of the most well-known concepts that allows explaining the mechanism of institutional change is the concept of path dependence (Barnes et al. 2004; Pierson 2000; Prado & Trebilcock 2009). Being simultaneously inspiring and vague, the concept led to emergence of a number of papers where it was used in different ways. Despite such variety, several common features of this framework are discussed by researchers: antecedent conditions, critical junctures, institutional or structural persistence, reactive sequences, and increasing return (Prado & Trebilcock 2009; Mahoney 2001; Pierson 2000) that Mahoney (2001) transformed into the analytical framework presented on Figure 1.

Considering institutional change through the prism of path dependence, a better

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understanding of the self-reinforcing mechanism of institutions that increases the cost of changing them at later stages is possible (Prado & Trebilcock 2009). Uncovering underlying reasons of long-lasting processes, path dependence framework allows understanding the role of history and the need for an historical approach in research.

To summarise, the path dependence analytical approach is used in various research in economics and politics to understand both the process of development as well as dependence from a certain institution. Coming back to Ukraine, this is a post-Soviet state that inherited from the Soviet Union inefficient institutions impeding economic development. Among those institutions, William, Nadins, and Rodgers (2010) mention bureaucracy and corruption and Lacko discusses inherited inefficient production structures. These institutions are admitted to be “lock-ins” constraining entrepreneurship development and economic growth. In turn, SMEs themselves also had to come through trials of all stages of the path dependence chain to become a mature influential sector. Such consideration along with the above-discussed theory leads us to our main research question: How can path dependence analytical framework explain the role of the Ukrainian government in the path-dependent development of SME sector in Ukraine?

4. Analytical approach when institutions and history matters

Driven by institutional theory, this paper seeks to study the role of government in SME development in a transitional economy, using the concept of path dependence as an analytical framework. Path-dependence approach requires a return to the past and historical analysis of past events. While researching institutional environment and the government as an actor influencing this environment and other actors, historical approach is needed to understand long-term transformations and obtained outcomes.

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The chosen theoretical framework dictates the choice of data selection and data analysis methods. Despite an increasing popularity of quantitative methods in various fields of research, this study is qualitative and draws upon secondary data. Historical institutionalism, in particular the path dependence approach, assumes utilization of many data to analyse evolution of a phenomenon during a chosen period of time. Such data may be both quantitative and qualitative in nature. Not to be drawn in information, we will focus mostly on the regulatory pillar of the institutional environment (Scott 1995). This decision is made based on data available and scope of this paper. Further, drawing on suggestions of Smallbone and Welter (2001), development of the regulatory pillar will be studied within several dimensions: adoption of general regulatory basis for business development in the country, specific policies and programs for SME development, and development of institutions (organizations) aiming at implementing SME policies. Simultaneously, a general overview of macroeconomic conditions will be provided for separate periods of analysis.

The primary sources of data are academic literature, analytical reports, legal and regulatory documents, official statistical data, reports on policy implementation, information from official websites of governmental bodies, and organizations responsible for implementation of SME policies in Ukraine. General inductive approach is used as the data analysis method. It is “carried out through multiple readings and interpretations of the raw data, the inductive component” (Thomas 2006, p.239). Drawing upon earlier studies allows reducing a volume of data, presenting it in a convenient form, and drawing verifiable conclusions (Thomas 2006).

We begin with the last years of the Soviet Ukraine, specifically from 1986. Further, the findings are grouped by periods corresponding to changes of presidents in independent Ukraine from 1991 to 2013. Such periodization is chosen based on suggestions of the

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institutional theory that argue for the importance of power in analysis of actors' behaviour and their influence on development of an institution, especially during a time of reactions and counter reactions (Mahoney, 2001). Simultaneously, these periods are juxtaposed to the stages of path dependence framework. The description of findings is followed by discussions of the obtained results and the chosen analytical framework.

5. Findings

5.1. Antecedent Conditions: Formation of Entrepreneurship in the Soviet Ukraine

With regard to entrepreneurship in Ukraine, the period of *Perestroika* (1985-1991) can be considered as a starting point or antecedent condition. It is true that the SME sector was underdeveloped in the Soviet Ukraine (Smallbone et al. 2010). However, a number of studies and thorough familiarization with Soviet laws point out recognition of the importance of small enterprises as far back as the late 1980s, shortly before acknowledging Ukrainian independence (see Table 3). Thus, a splash of entrepreneurship in the Soviet Union followed the adoption of the Law on Individual Labour Activity (1996) and the Law on Cooperation in the USSR (1988) (Table 3). In Ukraine, individual employment grew from 79,100 in 1987 to 118,600 in 1990. The number of cooperatives in Ukraine acknowledged by the government as "the main element of national economic complex" (Law on Cooperation in the USSR 1988), also grew rapidly from 529 in 1987 to 34,823 entities at the end of 1991 (Slider 1991). Cooperative employment, considered "honorary, prestigious and in every possible way is supported by the state" (Law on Cooperation in the USSR 1988), advanced by more than 36.5 times from 1988 to 1991 and significantly exceeded individual employment (Kuznetsova 1991; Nuti 1991; Plokker 1990; Slider 1991). These new-for-socialist-economy forms of economic entities were very similar to small private enterprises because they had a

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significant level of economic freedom from the government (Slider 1991).

Although, these laws are considered sometimes as “a political gesture” rather than a real commitment of central government (Smallbone and Welter 2001), they allowed for business development at the local level. Specifically, development of cooperatives and individual labour activity, together with other economic innovations, led to a revival of trade during the late 1980s and early 1990s. It was then that several leading retail and wholesale open markets in Ukraine were founded.

In June 1989, the Soviet government approved the Regulations on the Organization of Activity of Small Enterprises. Hereon, the Union of Small State Enterprises in the USSR was founded. Later, the Law on Enterprises in the USSR (1990) officially employed the term “small enterprise.” In the Decree on Measures for Establishment and Development of Small Enterprises (1990), the government considered small enterprises those able to facilitate structural reformation of economy, provide freedom of choice and additional work places, and ensure fast cost recovery and response to changes in customs demands on an operational basis (Decree on Measures 1990). It acknowledged that the development of small enterprises had to facilitate the rapid market saturation, tackling industry and regional monopoly, development of competition, implementation of new technologies, and growth of export potential. New legislation guaranteed equal rights of enterprises of different forms of ownership (Law on Enterprises 1990), secured tax exemptions, and allowed accelerated amortization for this sector (Decree on Measures 1990). There were even more important changes. First, the Law on Enterprises in USSR (1990) provided an enterprise freedom in its economic activity, including a free choice of business partners and foreign economic activity. Second, this law defined a possibility to establish enterprises based on individual or family property. It was a start for development of private enterprises-judicial entities and

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accumulation of initial capital.

Later, the Union of Leaseholders and Entrepreneurs of Ukraine and the Union of Small Enterprises of the Ukrainian SSR were founded in Kyiv in 1990. The first organization was established to support self-organization of entrepreneurs and establishment of social partnerships among the government, trade unions, and entrepreneurs. In turn, the Union of Small Enterprises pursued a goal to support gradual development of SMEs and their cooperation for improvement of provision of goods and services and elimination of monopoly. Later, both organizations played an important role in the improvement of the business environment in the independent Ukraine, and now they remain as significant contributors to the development of favourable regulatory policy in the SME sector.

To resume, this period of time served as probationary with regard to small business. The government used the cut-and-try method to begin to build a regulatory pillar of institutional environment that would be favourable to private initiative. Individual employment and cooperatives served prototypes of small business. The last years of *Perestroika* allowed the most entrepreneurial persons to taste economic freedom and learn self-sufficiency and autonomy. Simultaneously, institutions of the Soviet economic system did not allow quick and full development of the SME sector. Along with a proclamation of freedom in decision making, the government retained most enterprises as state property. In other words, the country reached a crossroads where the choice must be made between administrative and market economy and the level of state control over economic processes.

5.2. Critical Juncture and Institutional Persistence: First Years of Ukrainian Independence during the Period of 1991-1994

The beginning of the 1990s was marked by an important event: the decision to build a

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market economy in Ukraine. After the adoption of the Declaration on State Sovereignty of Ukraine in mid-1990, the Ukrainian Republic immediately proclaimed its economic independence. Among principles of such independence, the government defined the principle of ownership, full economic independence, and freedom of entrepreneurship of all judicial and physical entities.

The government made an important decision with regard to small and medium entrepreneurship. First, it was a period of launching small privatization. Further, going beyond new legislative initiatives, it started institutional transformations in the SME sector (see Table 3). The newly established bodies had sought to provide state support and coordination of development of entrepreneurship, including small business, and create favourable conditions for small and medium entrepreneurship.

However, along with these positive changes in Ukrainian regulatory policy, radical economic reforms lingered. Trying to build new institutions, the government remained committed to its previous policy course. Although the Communist Party was prohibited, the communist past of the politicians manifested itself in non-professional economic decisions based on previous knowledge, a certain level of conservatism, and fear to lose the support of the people (Mikhalchenko & Andrushchenko 2012). In the end, the government failed to control the overall condition that led to the economic and financial crisis of 1992–1993, when inflation accelerated from 390.0% in 1991 to 2,095.0% in 1992 and picked up speed in 1993, reaching 10,255.0% (Fuxman 1997). The difficult economic situation in the country had a negative influence on the political situation; one government changed to another without enough time to do anything. The difficult economic situation further provoked a deeper political instability.

Despite promises to support entrepreneurs, the government failed to protect small

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businesses from the growing criminal pressure (Volkov 1999; Kuzio 2014). Enterprises had to pay high taxes, both official and unofficial. Moreover, this small business partially consisted of those who accumulated their capital by crooked means (Mikhalchenko & Andrushchenko 2012; Fuxman 1997; Kuzio 2014). No talks were possible about fair competition and a well-structured SME sector at that time. A more appropriate word to characterise a prevailing economic and political situation is the word “disorder,” despite of governmental efforts to control this situation (Mikhalchenko & Andrushchenko 2012). And probably the most valuable contribution that the government made in SME development during these first years of independence was the choice of market as a future model of the national economy.

The end of this period can be characterised by two parallel processes: persistence of entrepreneurship and beginning of first counter reactions. Thus, the number of SMEs doubled during 1991-1994 (see Table 1). The small entrepreneurship reproduced despite undeveloped institutional framework and absence of direct support. In parallel, discontent of representatives of large businesses was growing, leading to counter reactions organized by those who sought to reconstruct at least partially the communist ideals of the past associated with stability, employment, good salaries, and material equality.

5.3. Reactive sequences and final outcomes

5.3.1. The end of small privatization and simplified taxation during 1994-1999

This period is interesting for our analysis because it represents an attempt at resistance to the politics led by the previous government. The results of elections demonstrated preferences of the people. This choice on the presidential elections was given to Leonid Kuchma – a former director of a large enterprise and supported during his elections by so-

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called “red directors” – former communists occupying posts of directors of large industrial enterprises (Mikhalchenko & Andrushchenko 2012). Simultaneously, in 1994 the Communist Party of Ukraine, after its rebirth in 1993, got one fifth of the positions in the elections to the Verkhovna Rada, the legislative body of Ukraine. However, in 1993, communists claimed against “a restoration of capitalism,” characterising the government politics as “imposing with any possible means rip-off psychology of private interest, bourgeois individualism” (Communist Party of Ukraine 1993). To a certain extent, such appeal can be understood as counter reactions to those forms of entrepreneurship that dominated at that time and were characterised by Fuxman (1997) as a “mafia style capitalism.”

Such political changes had indisputable influence on small business. As institutionalists underline, personal interests and distribution of power play an important role in institutional development, especially during periods of reactions and counter reactions. At that time, the small and medium entrepreneurship did not become a strong enough force to rely on heavily during elections. Therefore, the presidential election campaign was oriented toward representatives of large state enterprises, army, workers, and peasants, rather than small business that could not compete with other social groups. Besides, the future president before elections was a president of the Ukrainian League of Industrialists and Entrepreneurs, where the dominating actors were large enterprises (Kuzio 2014; Mikhalchenko & Andrushchenko 2012).

The pre-election program of Leonid Kuchma demonstrates the attitude toward small business at those times as from the side of this political force as well as from the electorate in general. After the elections, all efforts of the ruling classes were directed toward advantageous privatization of state enterprises by inside loyal people and concentration of capital in industrial and financial groups. The period was marked by economists and

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politicians as a beginning of development of an oligarchy and intensification of corruption in Ukraine (Mikhalchenko & Andrushchenko 2012).

Simultaneously, the government tried to please everyone. It provided certain results that were advantageous to both large and small businesses. Thus, from 1995 to 1999, the new Ukrainian government reached a certain level of stabilization of its financial system, completed small privatization in 1996, and introduced the Ukrainian national currency, the hryvnia. Simultaneously, remaining financial and economic problems impeded development of a banking system in the country. Short and long-term bank loans were practically unavailable to SMEs and entrepreneurs ran businesses at their own risk.

The government also took several steps toward SMEs by adopting several policy and regulatory documents (Table 3). Because the tax problem remained the highest priority for small businesses at those times (Smallbone & Welter 2001), the most important governmental intervention was the introduction of a simplified system of taxation, accounting, and reporting for subjects of small entrepreneurship in 1998.

Organizational framework also underwent changes. The State Committee of Ukraine for Support to Small Enterprises and Entrepreneurship was replaced by a similar body, first within the Ministry of Economy of Ukraine and later by the State Committee for Regulatory Policy and Entrepreneurship. Other institutions were complemented by new organizations. Thus, the state enterprise Derzhzovnishinform was founded to monitor the foreign goods markets in 1996. In addition, in 1997, the government adopted the law establishing a basis for the existence of chambers of commerce and industry in Ukraine.

Despite a remaining difficult economic situation, bureaucracy, corruption, undeveloped infrastructure, and other barriers existed for SMEs (Smallbone & Welter 2001; Volkov 1999), this sector was growing. According to official statistics, in 1995 only the

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number of small enterprises reached 96,000 (see Table 1). By the end of 2000, this figure doubled to more than 200,000 small enterprises.

5.3.2. Beginning a New Millennium: 1999–2004

This was a period of continuing reactions and counter reactions. The beginning of this period was a logical continuation of the previous one as a result of the election win by the same political forces who were governing the previous period of time. The same president representing large business and the Communist Party dominating in the Parliament managed to secure the legal power. However, the small-business sector, as we mentioned above, was different: its number increasingly became an important force that had to be taken into consideration by ruling politicians. Therefore, the politics of the government during this period was more concentrated on direct SME laws and programs than ever before.

The beginning of a new millennium was marked by the adoption of the Law on State Support for Small Entrepreneurship (2000). The new law defined the legislative base of state support to small business to tackle crises in the country and develop conditions for effective market reforms in Ukraine. The same law developed a base for another initiative, the Law on the National Programme for Support of Development of Small Entrepreneurship (2000). The development of this program facilitated governmental support to SMEs on the regional level, where regional authorities introduced regional development programs of the SME sector.

A desire of the Ukrainian government to join the European market became another influential factor that facilitated development of the SME sector in Ukraine. In his annual message, the President defined market transformation and integration of Ukraine into the EU among strategic priorities of the country (Kuchma 2002). In response to that expressed by the Ukrainian government orientation toward the EU and also within the framework of its

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neighbourhood programs, the European Commission provided additional support for the development of the SME sector in Ukraine.

Calls of the time and international institutions also facilitated adoption of a new Economic Code of Ukraine (2003). It allowed harmonization of legislative and regulatory documents in the business sphere that was the second high priority of SMEs defined in the study of Smallbone and Welter (2001). It was the first step toward unification of the definition of micro, small, and medium enterprises.

Very similar to the previous periods, this period was marked by a growth in number of small enterprises and number of those employed in small enterprises. Simultaneously, the officially reported contribution of small enterprises in total sale volumes remained low and even decreased. Discontent of entrepreneurs and the population in whole was growing. Entrepreneurs suffered from corruption, shortcomings of the judicial system, tax administration, and customs service. The first attempt to stand against the ruling elite was the election win of opposition political block “Nasha Ukraina” in the Parliamentary elections in 2002, although communists once again gained a high portion of mandates. This growing discontent has led in result to a stronger reaction — the Orange Revolution in 2004, so much supported by matured small and medium entrepreneurs in western and central Ukraine (Lanovyi 2013).

5.3.3. Ups and Downs of Small-Business Sector after the Orange Revolution: 2005–2009

In 2005, a new president directed his attention to liberalization and support to SMEs. However, not all problems, such as political instability, are able to be solved with new legislative and regulatory initiatives. Along with a new president, the country received a new government. Inheriting traditions established by his predecessors, the government changed

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almost every year, which also had a negative influence on the business environment. After the celebration of victory against oligarchy, Ukrainian society plunged into disappointment, provoked to a great extent by inability of the government to stabilize a political situation and solve such problems as corruption. (Mikhalchenko & Andrushchenko 2012).

During that period of time, the Ukrainian government continued implementation of SME programmes of the previous government. In line with that, international initiatives play a no less important role in Ukrainian SME development. Thus, the European Charter for Small Enterprises (European Commission 2000), joined by the Ukrainian government in 2008, specifies the main direction of governmental support for SMEs that generally fits Ukrainian SMEs needs.

The growing number of individual entrepreneurs and cooperatives demonstrated certain improvements. Simultaneously, the sales volume of SMEs went down slightly. Remaining political instability, tax pressure, corruption, and informal practices (World Bank Group 2013) provoked the disappointment of the people. This disappointment led to the revenge of the political party of Yanukovich, representing oligarchy and large business, mostly from eastern and southern Ukraine (Mikhalchenko & Andrushchenko 2012).

5.3.4. Decline of the Ukrainian SME Sector during 2010–2013

Despite a new government built from descendants from the Donbass region, representing interests of large industrial enterprises, it has also underlined the importance of the SME sector for the state economy and promised its full support to small business. However, as we will see further, many promises remained just promises, which became traditional in Ukrainian politics.

The new government has also underlined the importance of the SME sector for the

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state economy and promised to improve tax legislation, but its real intentions were toughening fiscal policy. The following adoption of a new Tax Code (2010) caused mass protest of enterprises; first of all, small business. A new Customs Code (2011) also provoked discontent of small and medium business as a document that gave advantages to large enterprises (Anon 2011). The government, in fear of a new Orange revolution, had to introduce changes in these laws and adopt new initiatives for small business.

Notwithstanding the importance of the new initiatives, some had a populist character. In other words, they remained on the paper only and were not implemented in practice (Mikhalchenko & Andrushchenko 2012). This government lost support of the people, including small and medium entrepreneurs, even faster than did the previous one. Worsening of the economic and political situation in the country provokes a decrease in a number of SMEs, individual entrepreneurs, and cooperatives. Despite some improvements of business climate in comparison with the previous period, specifically decrease of procedures to start business and simplification of procedures to get construction permit and property registration (Doing Business in Ukraine, 2004-2014), something was unacceptable by entrepreneurs. *Forbes* characterised Ukraine at that time as “one step forward, two steps back” (Soldak 2012). Corruption remained and strengthened.

6. Discussions of the findings

The study reveals that the role that the government played in developing the SME sector in Ukraine was ambivalent. This ambivalence is doubly manifested: simultaneous support and impediment of SME growth and orientation on the future while being anchored in the past. Indeed, as demonstrated in previous research (Smallbone & Welter 2001; World Bank Group 2013) and supported by this study, the government in Ukraine took certain

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important steps toward establishment of entrepreneurship in the country. At the same time, SME development in Ukraine was unfolding in parallel with other competing path-dependent processes that impeded SME development (Kuzio 2014; Williams et al. 2012; Mikhalchenko & Andrushchenko 2012). While entrepreneurship tried to persist over time, old institutions resisted change. This conflict remains today and the government attempting to balance between two sides very often stands for old institutions.

Simultaneously, the approach used in this paper allows obtaining a wider and more comprehensive understanding of the role the government played in SME development. The path-dependence framework allows seeing that the actions of the government with regard to SME development depended to a great extent on the stage of such development. The analysis underlines the importance of the period of Perestroika, neglected by many scientists, for further development of the institution of entrepreneurship in Ukraine. During several years before the collapse of the Soviet Union, the government created antecedent conditions that opened several options for the future: coming back to a prohibition of entrepreneurship, status quo with individual employment and cooperatives, and further liberalization. The period of antecedent conditions is marked by adoption of fundamentals for entrepreneurship laws and constant experiments with regulation of taxes, licenses, registration issues, etc.

During the following critical juncture period, the government made its choice among available options in favour of further development of small business in the country. “Once a particular option is selected, it becomes progressively more difficult to return to the initial point ...” (Mahoney, 2001, p. 113), which especially became obvious with a growing number of private SMEs at that time. New legislation facilitated private entrepreneurship and, closed to a certain extent, an option of reversion to state ownership and state administration of SMEs. At that time, the role of government had been changing from experimentalist to

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creator, with small difference on practice between two, however.

Similarly, further periods of structural persistence and reactive sequences demanded from the government a slight change of role, playing both a developer and a manager of the SME sector. As this study demonstrates, Ukrainian SMEs became strong enough to survive even without direct government support for them due to “increasing returns” (Pierson 2000) from a newly established institution of entrepreneurship. Therefore, along with development of the SME sector and growth of its economic and political power, the government had to pay more attention to specific laws, programs, and supporting organizations.

Regarding the outcomes and a relative equilibrium, "One size does not fit all" (Prado & Trebilcock 2009). There are always those who benefit from new institutional arrangements and those who oppose a change due to continuing benefits from the old institutional framework and absence of return from new institutions (Mahoney 2001; North 1990; Prado & Trebilcock 2009). The conflict of interests arises. On one hand, there are still those who struggle against private property and entrepreneurship in Ukraine (Mikhalchenko & Andrushchenko 2012). On the other hand, the SME sector in Ukraine today serves as an obvious outcome of two decades of development and survival of entrepreneurship. In the future, those institutions will have advantages that will be supported by the powerful elite.

Simultaneously, in the course of analysis, several problematic issues emerge. The first concerns the analytical power of the path-dependence concept. The analytical framework of Mahoney (2001) allows emphasizing separate periods of SME development in Ukraine and, thus, understanding better actions of the government during each of those periods. However, the somewhat vague character of the concept of path dependence gives freedom to a researcher in defining which period to consider as antecedent conditions, critical juncture, structural persistence, or reactive sequence, and defining these timeframes.

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Further, some stages are not easy to separate by time as they presented on Figure 1 (Mahoney, 2001). For instance, Mahoney (2001) defines reactive sequences as “chains of temporally ordered and causally connected events” (p. 115). However, if to consider development of SMEs in Ukraine, the main contradiction between large industrial enterprises and newly established small businesses was not resolved and continued influencing governmental decisions with regard to SMEs within each period of time. Personal relations of some important politicians and political parties with large enterprises only strengthen this conflict. Herein, the path-dependence approach allows us to see both in parallel rather than sequentially: lock-ins of command and administrative economy (bureaucracy, corruption, large-scale industrial structures) and newly evolving institutions of market economy.

The last and probably the most important consideration is predicting the power of path dependence approach and policy implications of our findings. History repeats itself. This is the main reason why someone should take it into consideration. The current situation in Ukraine, with Maidan and the war in Donbass, may change a lot. A new government is under pressure and is forced to make more radical decisions toward abolishment of old inefficient institutions. It is time now to choose among available options. In case of success of such endeavor, this period may become a critical juncture in the next cycle of historical development of the country.

Simultaneously, absence of significant measures toward elimination of corruption may lead to a new counter reaction, redistribution of resources and power, and unchanging position of SMEs until a new wave of entrepreneurs’ reactions, even stronger than previous. Today, Ukrainian society wants to see quick changes that are possible with “fast-moving” rather than “slow-moving” (Sturm et al. 2000; Barnes et al. 2004). However, looking back on the economic past of Ukraine and underlying reasons of insufficient support of SMEs in

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Ukraine, these are “slow-moving” beliefs, habits, and economic structure that must be changed to achieve desirable results.

7. Conclusions

This paper critically reviews the role of the state in establishment and development of small business in Ukraine during the period of independence. Guided by institutional theory, the paper presents a structured overview of the development of SMEs in Ukraine under the rule of different governments and discussions of the findings based on suggestions of the path-dependence framework. As distinct from previous research, such approach enables seeing not so much temporal conditions in which SMEs in Ukraine operate but rather roots and consequences of long-lasting processes influencing the whole development path.

The establishment of a SME sector in Ukraine experienced a snowball effect when positive changes in macro environment, legislative and regulatory base, and organizational framework were superimposed by each government. Notwithstanding these improvements, outdated path-dependent institutions did not allow implementation of SME development policies and programs to the full extent. Moreover, a simultaneous support for large businesses, especially in those industries where small business can also be competitive, demonstrate that the government continued to play a double game seeking opportunities for realization of personal interests and risk to continue the same game in the future.

Despite some limitations of qualitative approach used in this paper, it allows simultaneously to study complex phenomena in depth. It allows us to understand the issues at hand and highlight those phenomena that still need to be researched. Thus, this qualitative paper reveals the type of fertile territory for researchers from different disciplines interested

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in development of small business in countries in transition. Focusing on the regulatory pillar of the institutional environment, we left more detailed exploration of normative and cognitive dimensions for future research that may require different research designs and methods.

Additional comparative study would bring light on the interplay among institutional development, entrepreneurship, and political forces in the country. We only slightly touched the role of different political parties and the political elite in Ukraine. Simultaneously, we find this aspect as important, to be reconsidered in detail, to understand the conflict of interests and its influence on business development in the country.

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