

Chapter 6. Financing of innovative entrepreneurs

Ukraine has entrepreneurial talent and a relatively strong risk-taking attitude. These are major ingredients for any policy intervention seeking to promote innovative entrepreneurship. However, the survival rate of start-ups is very small in comparison to advanced countries. Effective policy actions that improve this rate would create employment, diversify the industrial structure and stimulate competition.

Comments: As mentioned in the introduction to Ch 6 recommendations, Ukraine demonstrates relatively widespread entrepreneurship. This is confirmed by the IMD WCY, in which the country ranks 39th out of 59 economies. In comparison, Russia ranks much lower in 55th place. This provides fertile ground on which to improve the environment in which entrepreneurs can set up companies. However, the difficulty in starting a company is also validated by the WCY where Ukraine ranks as low as 57th, just above Brazil and Venezuela. The author correctly focuses on the difficulties in financing start-ups and the necessity to improve the legal and regulatory environment (where Ukraine ranks 57th). For example, another indicator shows that financial regulation in Ukraine is not perceived by the business community as being sufficiently effective (ranking 55th). Lastly, Ukraine ranks very low in 56th position for “access to finance” compared to Turkey’s 12th position.

Consequently, with regard to the specific recommendations:

Recommendation 6.1:

Overall framework conditions have a strong influence on the development of start-ups and SMEs and as does the impact of other policy interventions. The authorities should carry out focused and sustained efforts in improving the legal and regulatory environment for these companies. Within this overall effort, the authorities could consider the following actions:

Rec 6.1:

- *Emphasise quick interventions with a large potential impact, including easing administrative regulations, rather than time-consuming legal reforms;*
- *The words “quick interventions” may be too vague. I would suggest “tailor legislation to support and encourage the ease of doing business”, then continue with examples such as reducing administrative burdens and red-tape, standardizing procedures and lowering the costs of doing business. Also, it’s not clear to me whether the focus is on the time element “quick” vs “time-consuming” or on the necessity for simplification to reduce the high levels of bureaucracy.*
- *Target female entrepreneurs, who are less likely to start a business but display high success rates;*
- *An excellent recommendation focusing on the need to promote more female entrepreneurship; therefore I would suggest changing the word “target” to “promote” and using the word “target” in providing a specific example, such as a communications campaign targeting female entrepreneurs.*

- *Reform company laws in line with international experiences, so it is easier for entrepreneurs and venture capital firms to set up business in Ukraine, reversing the observed trend to be established abroad (of setting up companies abroad); and*
- *“Reform company laws” gives the impression of wanting to change internal corporate laws, when I believe that the intention is for policy-makers to reform business legislation (correct?). Also “international experiences” is vague. Maybe replace “international best practices” with “Reform business legislation to facilitate the entry/exit of firms, support start-ups and encourage the development of venture capital firms”. (According to recommendations of World Bank study on Ukraine, p. 84).*
- *Document these actions in an annual report to track progress.*
- *Fine. May wish to add something about milestones or objectives (KPIs) to be reached (monitoring and evaluation process).*

Innovative companies and SMEs in general face particular difficulties when trying to raise finance, which remains a critical obstacle when starting a business. However, support programmes for SMEs are very limited and there are no public interventions targeting start-ups. Limited public resources and past unsuccessful attempts to stimulate innovation by offering financial incentives contribute to explaining the current absence of financial mechanisms to encourage the development of innovative enterprises.

Recommendation 6.2

Public support is necessary to address the financing problems of innovative companies. A new innovation fund, although limited in size, would have positive effects on facilitating the development of start-ups and help them to attract private financing. To increase the potential beneficial impact of this innovation fund, the authorities could consider the following principles and actions (goal of identifying genuine innovative projects)

- *The innovation fund should be initially of a limited size. Once it has a proven track record of successfully supporting innovative SMEs, resources could be increased. A fund that is **run well**, with stringent but transparent criteria to select companies, would attract a **good quality deal flow** and would also encourage private sector interest in the companies that are being financed;*
- *As innovation is always beset with risk, it is crucial that there is a tolerance for failure. Funding should be stable, preferably in the form of a contribution to the capital of the fund, so risks can be managed on a portfolio basis, without requiring a positive outcome for all projects financed; and*
- *Introduce some experimentation in funding possibilities: Some examples would be introducing counter-cyclical loans, which respond to economic cycles, deferring tax payments until a certain profit threshold or ROI is achieved; rolling over SMEs loans (e.g. as interest rates fall); risk-sharing in the form of joint control of the organization between the owner and investor (e.g. business angel), this contributes to diminishing the VC’s power over companies; and supporting the creation of risk capital funds (high risk/high potential with management guidance); and risk-sharing with the use of public funds.*

- *Given the limited resources available and the need to enhance the credibility of interventions in this area, it would be useful to engage international know-how in the administration of the fund. An option would be that the set-up of the fund is carried out under a **twining** agreement with a well-established European funding organisation. **For example, the European Investment Bank and European Investment Fund have lending and investment programs that benefit small businesses.***

Ukraine has an emerging venture capital scene, which indicates the presence of entrepreneurial opportunities in the country. While this form of financing caters only for the financial needs of a small fraction of innovative SMEs, it is an important ingredient of the innovation system. However, the development of the venture capital industry requires the presence of other financial intermediaries and business services and a continued stream of opportunities that could be financed, **e.g. Combine loan guarantees with consultancy services. Additionally, measures should be undertaken to encourage venture capital support at earlier stages of a firm's development.**

Recommendation 6.3

The authorities could provide further impetus to the development of the venture capital industry in Ukraine by considering the following actions:

- ***Paying continued attention (Continue to pay attention)** to the improvement of framework conditions for SMEs in order to increase potential investment opportunities;*
- ***Engage the private sector in public technology programmes via public-private partnerships or consultation**, so venture capitalists can have better information on possible commercialization possibilities; and*
- ***Encourage the emergence of business angel financing as a way to explore small scale opportunities that can later be developed further by venture capital firms. This could be done through support to (by supporting) the formation of business angels networks and the creation of platforms for communication with research organisations and universities. Additional actors would improve the overall access to finance and expand the diffusion of financing instruments.***
- **Improve the financing environment for entrepreneurs and SMEs by encouraging the following:**
 - **A forum or round-table that brings together bankers and small business organizations to identify and reduce the barriers to finance.**
 - **Linkages with the EU's Competitiveness and Innovation Programme (CIP), which provides financial instruments (equity finance, loan guarantees) to small businesses.**
 - **Peer-to-peer" lending (P2P)¹ or corporate venture capital where established larger firms take equity stakes in new innovative firms.**

¹ The practice of lending money to previously unrelated individuals or "peers" without the intermediation of traditional financial institutions (banks). It takes place on online lending platforms that are provided by peer-to-peer lending companies on their websites and is facilitated by credit checking tools of varying complexity. Most peer-to-peer loans are unsecured personal loans, i.e. they are made to an individual rather than a company and borrowers do not provide collateral as a protection to the lender against default.

- Support involvement of private actors (e.g. professionals in the fields of private equity, corporate law, tax, banking and audit) to provide information to entrepreneurs and SMEs about the various financial actors and instruments available and legislation concerning their business activities. For example,
 - A communications platform (website) dedicated to entrepreneurs/innovators (e.g. Kauffman Foundation, Le Reseau (CH) – non-profit to Promote innovation and facilitate entrepreneurship in Switzerland by providing members’ expertise and proposing changes in legal and administrative processes.
 - Formation of networks between

Overall, since I understand that a large share of financing of SMEs takes place within the company, this implies that more needs to be done to further develop efficient financial markets, which offer a large portfolio of financing opportunities and financial instruments, while at the same time create incentives to facilitate the access to finance for entrepreneurs and SMEs at earlier stages of development. (“causal link between a high level of financial development and the degree of innovative development”, p. 78).

Chapter 7. Innovation and international economic integration

Access to international knowledge plays a critical role in modernizing the Ukrainian economy. External markets can provide critical demand for innovative Ukrainian companies. Facilitating participation in the global networks through which information flows and ensuring that researchers, students and companies have full access to the mechanisms of international cooperation helps create the framework conditions for innovation to flourish.

Recommendation 7.1

Ukraine has a well educated population, but continued improvement of human capital and the ability to retain local talent are ongoing challenges. The authorities could consider a number of actions to foster these aims, including:

- ~~Building on existing initiatives, introducing new~~ *Continue to strengthen measures that facilitate the international mobility of graduate students, young researchers and educators. These could include taking advantage of existing EU programmes, developing new forms of cooperation through regional integration initiatives and establishing mechanisms of collaboration with the private sector through shared sponsorships and corporate-sponsored scholarships;*
 - *Developing R&D programmes and encouraging spin-offs, including with the participation of foreign partners and private investors, to create long run employment opportunities for returning students and researchers; and*
 - *Introducing appropriate mechanisms for (Improve the process of) attracting foreign experts and leading scholars through facilitated immigration policies and work permits,*
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to work with Ukrainian partners especially on projects of high priority for the country (national projects). OR...

- *Attracting the world's leading scientific competences to Ukrainian universities by offering grants earmarked for integrating internationally renowned academics into university research labs;*
- *Encouraging and facilitating tertiary educational exchanges such as Erasmus Mundus by finalizing the standardization of the educational system in accordance with the Bologna Process (mutual recognition of diplomas, credits, etc.).*
- *Sending personnel for advanced technical training to countries and companies with specific expertise or technological leadership.*

Participation in global innovation networks and regional partnerships are important to have access to the knowledge necessary to advance the country's competitive position and ensure the relevance of domestic efforts. Ukrainian scientists are increasingly engaged in various research collaboration initiatives within bilateral, regional and international frameworks. However, the potential for collaboration has yet to be fully realized due to bottlenecks in existing capacity regarding skills and access to information.

Recommendation 7.2

International cooperation in science can be encouraged by strengthening coordination mechanisms and the circulation of information. Engaging in these exchanges requires specific linguistic and managerial skills that can be developed through appropriate training. Building on current efforts, the Ukrainian authorities could consider measures to:

- *Develop Internet-based platforms to enhance skills in international research collaboration, including managerial and administrative aspects related to grant applications, research collaboration and commercialization of research projects;*
- *Support and expand existing services ~~and establish new ones~~ to improve access to international science publications, and to provide foreign language translation and other assistance with research articles and manuscripts for publication in international academic journals, as well as developing English skills among the scientific community; and*
- *Introduce a web portal to facilitate access by the R&D community to scientific, technical and educational information as well as to communicate international opportunities for exchange and cooperation.*
- *Promote the emergence of a network of private business and non-profit NGOs to provide training services in preparation for grants and fellowship competitions and legal, managerial and administrative aspects of international collaboration.*
- *Develop cooperation agreements with foreign investors to encourage the transfer of international best practices, management training and technical skills.*
- *Enhance the existing legal and regulatory framework to promote innovation and facilitate international cooperation and innovation linkages (improve the investment climate by reducing administrative barriers; encourage technology transfer by providing*

tax-based incentives and ensuring IPR protection; encourage immigration of skilled workers, facilitate student mobility, etc.).

Ukraine has a favourable geographic location and well developed cultural and economic relations with CIS countries. This creates a significant potential for cooperation opportunities, which could be exploited more fully. Despite a raft of ongoing initiatives, there remains scope for actions to provide a more solid institutional basis for common projects in various fields.

Recommendation 7.3

The authorities should build on existing initiatives and common traditions to derive greater benefits from bilateral and regional economic cooperation in areas related to innovation, including through a number of possible actions such as:

- *Strengthening R&D and S&T links with similar programmes in the CIS, and champion those programmes and projects where Ukrainian institutions and scientists have potential to become regional leaders and centres of excellence;*
- *Facilitating the integration of the emerging innovation infrastructure into various regional and international networks in the CIS, EU and BSEC; and*
- *Promoting the establishment of joint educational and training programmes in the field of higher education by establishing dual diploma/degree programmes or joint graduate programmes with major international universities.*
- *Initiating a cross-border innovation ecosystem within the CIS region based on bilateral and multilateral collaborations and public-private partnerships to encourage knowledge transfer and innovation linkages. OR...*
- *Developing regional innovation clusters, bringing together appropriate infrastructure and closely located and interlinked companies, R&D organizations, and universities (to ensure positive externalities to the overall innovation ecosystem of the region).The authorities can also support and encourage university-industry cooperative ventures.*
- *Facilitate the spill-over effects of R&D by encouraging regional networks of university laboratories, research incubators and technoparks and develop multi-stakeholder forums for interaction and cooperation.*

International visibility of innovation efforts is important to attract the interest of foreign partners and engage them in domestic initiatives. However, this requires coordinated efforts that present a coherent view of public programmes and allow synergies.

Recommendation 7.4

The authorities should build on the growing network of cooperation with international partners to ensure increased recognition of the potential for cooperation by implementing new measures that could include:

- *Identifying or developing a single national flagship project that would be promoted internationally, as a rallying point and catalyst for the interest of foreign partners;*
- *Improving coordination between different R&D and innovation programmes, identifying elements that would benefit from international cooperation, so these can be communicated in a consistent **and unified** way to foreign partners; and*
- *Developing a **communications** strategy for the promotion of national goals **and a national branding campaign to promote Ukraine as an attractive investment location. Priorities should be established among key partners to define the specific role that international cooperation should play in the achievement of these goals.***
- *Supporting national delegations comprising multiple stakeholders (public officials, business leaders, scientists and academics) to visit European and Asian countries to develop commercial, R&D and S&T partnerships as well as educational and knowledge linkages.*
- *Implement a monitoring and evaluation system to provide an informed assessment of the impact of integration initiatives.*