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## DIRECTIONS FOR IMPROVEMENT OF THE INSTITUTIONAL BASIS OF TRANSACTION COSTS MINIMIZATION OF BUSINESS ENTITIES IN UKRAINE

*The paper emphasizes the essential characteristics of the concept and justifies the need to improve the institutional environment of entrepreneurship at post-transformation and post-crisis stage of economic development of Ukraine. Gaps in Ukrainian institutional business environment are defined, including legislation, organization of government regulation of business, non-governmental institutional support for entrepreneurship. The purpose and sequence are validated as well as activities and instruments of public policies concerning the improvement of the institutional basis for transaction costs minimization of business entities.*

**Keywords:** entrepreneurship; transaction costs; institutional basis; business environment; government regulation; institutional support.

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## НАПРЯМИ ВДОСКОНАЛЕННЯ ІНСТИТУЦІОНАЛЬНОГО БАЗИСУ МІНІМІЗАЦІЇ ТРАНСАКЦІЙНИХ ВИТРАТ СУБ'ЄКТІВ ПІДПРИЄМНИЦТВА В УКРАЇНІ

*У статті наведено сутнісні характеристики поняття, а також обґрунтовано необхідність удосконалення інституціонального середовища підприємництва на посттрансформаційному та посткризовому етапі розвитку економіки України. Визначено недоліки сформованого в Україні інституціонального середовища бізнесу, зокрема, щодо законодавства, організації державного регулювання підприємництва, недержавної інституційної підтримки підприємницької діяльності. Обґрунтовано мету та послідовність, а також заходи і засоби державної політики вдосконалення інституціонального базису мінімізації трансакційних витрат суб'єктів підприємництва в Україні.*

**Ключові слова:** підприємництво; трансакційні витрати; інституціональний базис; середовище бізнесу; державне регулювання; інституційна підтримка.

*Рис. 1. Табл. 1. Літ. 14.*

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## НАПРАВЛЕНИЯ УСОВЕРШЕНСТВОВАНИЯ ИНСТИТУЦИОНАЛЬНОГО БАЗИСА МИНИМИЗАЦИИ ТРАНСАКЦИОННЫХ РАСХОДОВ СУБЪЕКТОВ ПРЕДПРИНИМАТЕЛЬСТВА В УКРАИНЕ

*В статье рассмотрены существенные характеристики понятия, а также обоснована необходимость усовершенствования институциональной среды предпринимательства на посттрансформационном и посткризисном этапе развития экономики Украины. Определены недостатки сформированной в Украине институциональной среды бизнеса, в частности относительно законодательства, организации системы государственного регулирования предпринимательства, негосударственной институциональной поддержки предпринимательской деятельности. Обоснованы цель и последовательность, а также мероприятия и средства государственной политики усовершенствования институционального базиса минимизации трансакционных расходов субъектов предпринимательства в Украине.*

**Ключевые слова:** предпринимательство; трансакционные расходы; институциональный базис; среда бизнеса; государственное регулирование; институциональная поддержка.

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**Problem statement.** Competitiveness of economic agents is the essential prerequisite for economic development of any country. However, changes in socio-psychological, organizational and professional, resource, financial and economic conditions for carrying out business activities, which are not supported by relevant institutional basis, led to the formation of poor economic and legal business environment in Ukraine with high level of not only production costs but also the interaction costs of economic agents. Insufficient level of market institutions development makes the problem of improving the institutional basis of effective transaction costs control of business entities actual, as well as the minimization of negative consequences of their interaction – shadowing and criminalization of the economy, corruption, lack of social, environmental and other components of socioeconomic security.

**Latest research and publications analysis.** Local and foreign scientists, such as S. Arkhieriiev (2000), S. Borsukova (2000), M. Mykhailovskyi (2010), D. North (2009), V. Novytskyi (2004), O. Shepelenko (2008), S. Suvorova (2006), A. Tkach (2007), O. Williamson (1975), A. Yakovlev (2000) and others, paid much attention to the problem of transaction costs control. The process of establishment and development of small and medium-sized enterprises are well described by Z. Varnalii (2005) and others.

**Unresolved issues.** The objective necessity for studying the transaction costs of business entities was proven at all stages of the evolution of the theories of institutional economics, transaction costs and entrepreneurialism. Attempts to consider company apart from its external environment objectively leads to incomplete and, as a consequence, false understanding of the nature of business entity operation and its economic efficiency, its behaviour regarding the conclusion and execution of contracts with other economic agents, external organizations and workers, particularly under the conditions of costly and incomplete information, decision rules, taking into account the effect of internal and external factors. D. North (2009), O. Williamson (1975) etc. laid the foundations for the conceptual framework and were improved with the development of new institutional economics and were adjusted to the conditions of transformational economy by S. Arkhieriiev (2000), O. Shepelenko (2008) etc.

But, firstly, relevant institutional reforms in Ukraine have not been implemented; secondly, complex post-crisis conditions of commercial activities require the action of somewhat different (than in classical economics) institutes and institutions; thirdly, the level of business security of entrepreneurship in Ukraine is extremely low. These features require justification of new, more effective elements of institutional basis to eliminate the transaction costs of domestic business representatives.

**The goal of this research** is to substantiate the ways to improve the institutional basis for transaction costs minimization for business entities in Ukraine.

**Key research findings.** The problem of transaction costs of business entities in Ukraine is a system-wide; therefore, its solution cannot be achieved through heavy but scattered measures. The cornerstone of good government policies in this area is its institutional support, a set of formal and informal laws, rules and principles, as well as institutions, focused on effective management and reduction of transaction costs for business entities. Actually, institutional support is the basis that helps to make informed decisions on logical and sequential process of public policies implementation.

The conclusion naturally follows that a certain configuration of institutional support for business sector development in Ukraine is already built. At the same time excessively high level of transaction costs of business entities, one of the most important factors of low business security of entrepreneurship in our country, is the evidence of its incompleteness and irrationality. Hence, the critically low position of Ukraine in international rankings regarding favorable business and investment environment.

The volume and the level of transaction costs of business entities in Ukraine is significant. This is proved by the results of studies by the recognized international economic organizations (World Bank, International Finance Organization, Freedomhouse, Global index competitiveness, Heritage foundation, Transparency International etc.) and expert surveys of Ukrainian small and medium-sized enterprises, which point out at organizational complexity and high costs of clearance of such procedures as enterprise closure; purchase/sale of enterprise; obtaining permits, approvals, patents and licenses; obtaining state (municipal) property, land and other resources in use; receiving government contracts.

So, despite the adoption of a range of laws and regulatory acts in the field of business entities activity regulation during 1991–2014, real simplification of licensing procedures in Ukraine did not happen. According to the results of the expert survey, standards and specifications are compulsory for the production of 41% of all enterprises, and in the industrial sector – for 67% of enterprises. In general, business entities in Ukraine, which were receiving permission, passing inspections and procedures of technical regulation, lost 10.2 bln USD due to this (Figure 1).

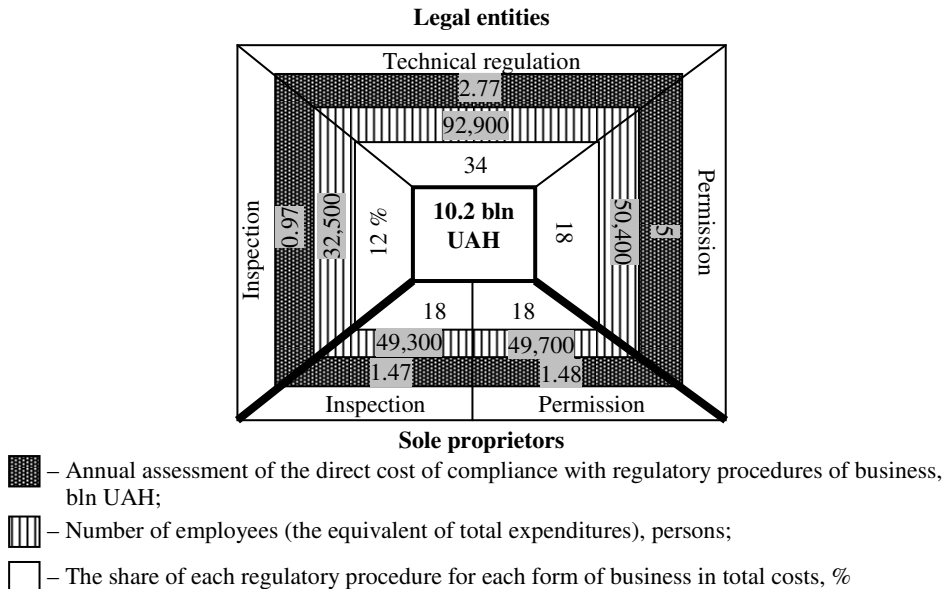


Figure 1. Level and volumes of transaction costs to observe procedures by economic entities in Ukraine in 2013, based on the expert poll

Using the tools of regression analysis for the period from 1996 to 2013 in domestic economy brings us to the suggestion that the following quality factors of business

environment, which are especially sensitive for business sector and have negative impact on gross domestic product, should be noted: favorableness of business registration (the regression coefficient is -0.63); taxation (0.54); property registration (-0.12); international trade (0.43) (Table 1).

**Table 1. Relationship between the volume of business activity and components of the business environment quality index in Ukraine, 1996–2013, based on the results of regressive analysis conducted by author with the use of software Statistica**

Index	Beta-coefficient	Standard deviation Beta	B-coefficient	Standard deviation B	t(16)	Level of statistical uncertainty
Intercept term			-18.8037	5.358726	-3.50898	0.003165
Business registration	-0.633175	0.241594	-0.0004	0.034108	-0.01314	0.089689
Property registration	-0.124090	0.264653	-0.0175	0.037360	-0.46888	0.045899
Crediting	0.376281	0.245818	0.0556	0.036311	1.53073	0.146651
Taxation	-0.541497	0.232922	-0.0055	0.030993	-0.17816	0.060983
International trade	-0.428546	0.268776	-0.0494	0.030975	-1.59444	0.131688
Contract performance security	0.037667	0.252432	0.1058	0.049682	2.12995	0.050142

Thus, the volume of transaction costs of business entities in Ukraine is significant. The important characteristics of business environment are their sources. The consequence of these trends is the slowdown in the development of business sector and economic growth. To correct this situation it is necessary to identify the deficiencies and implement the activities focused on improving the institutional basis for business entities in Ukraine, in particular regarding such components as legislation and government support programs, state and public institutions, technical regulation of business, property rights and data protection.

The system problem here is low level of business security of entrepreneurship, which leads to a substantial decrease in GDP, decreased innovative and investment activity, poor scientific, technical and technological potential, failure in important cooperation, weakening of public regulation, loss of capacity to prevent conflicts and financial crises, increase of financial and credit risks, reproduction processes slowdown and structural deformation of the economy, low value added, enhanced dependence of the national economy on external markets, increasing share of foreign capital in strategic types of economic activities and shadowing of national economy.

Characteristics of domestic institutional basis for commercial activities, which has to be improved, should be presented in terms of legislation and institutional support and coordination of activities. When speaking about legislation, the concept, functions, principles of formation and development of entrepreneurship are defined by the Commercial Code of Ukraine, which came into legal force in 2004. This legal document defines the concept of enterprise and business entity, organizational and legal forms and types of enterprises. It is obvious that, as the economy and economic entities develop, provisions of the fundamental regulatory act on economic activity should be developed, clarified and improved too. In particular, category "entrepreneurship" should be clarified, not only as a kind of activity, but also as a sector of national economy. The criteria for classification and taxation of small, medium and large enterprises should also be adjusted. However, despite this, the role of the

considered code is difficult to underestimate, because it defines the framework conditions for running business in our country and is the basis for the development of other legal acts.

The Law of Ukraine "On State Support of Small Business" as of 19.10.2000 # 2063-III is the basic one regarding state regulation of small business development. However, this legal act is full of defects, besides, there are no provisions in it regarding the protection of small business from transaction costs. In particular, this law defines the criteria, status and basis for the activities of small businesses, regulates the conduct of various types of business activities, provides the programme for the development of this sector as it defines the principles and the procedure for adoption and implementation of national, regional and local programs to support small businesses. It is the latter ones that play an important role in the implementation of state policy regarding the analyzed sector of the economy.

Therefore, legislation stipulates that a national small business support program is an action plan to implement the state policy of its development. It plays the role of a consolidating mechanism for implementing the policy, in which central government and local authorities may take part, as well as business associations, business infrastructure entities (business centres, business incubators, consulting, leasing and other institutions). It is carried out through the Law of Ukraine "On the National Program of small business promotion in Ukraine" (21.12.2000, #2157-III).

The purpose of this program is to create proper conditions for the realization of the constitutional right to run a business, as well as improving the welfare of Ukrainian citizens by engaging population in such activities, but its provisions no longer reflect the actual state and the conditions of business environment, do not contain mechanisms and instruments of business entities' protection from actual and potential institutional risks and threats, including those caused by government-business relations.

Critical evaluation of the list of the main directions of the program document on the development of small business in Ukraine leads to the conclusion that the measures, planned and implemented, do not correlate with dominant economic problems and obstacles which business entities face, containing also different types of transaction costs.

Moreover, the domestic public policy on the development of medium and large enterprises or securing the growth of sole proprietors to legal entities or small business entities to the medium ones is not planned at all, which is an additional argument for changing the principles of government regulation in the analyzed area on the basis of problem-target base where an important place is given to the consideration of the scope, level and implementation of measures aimed primarily at reducing transaction costs for small and medium-sized enterprises.

In general, it should be stated that Ukrainian legislation is not a sufficient institutional base for effective management with low level of interaction costs of small and medium-sized enterprises. The main legal act regarding small business sector is the Law of Ukraine "On the development and government support of small and medium-sized enterprises in Ukraine" (22.03.2012, # 4618-VI) and it has no direct effect, only creating a legal framework for the development of other legal acts. It is supplemented, clarified and corrected with subordinate legislation. As a result, institutional support

for business regulation has become an extensive and multilevel structure, inconsistent and chaotic thus that requiring reforms, simplification and harmonization of legal mechanisms. There is a demand for unification of legal regulation of business sector and maintenance of its stability in the future as an important principle of further development of these entities. It is important that the provisions of this legal act take into account the interaction cost (with formal and informal restrictions) of small and medium-sized enterprises with each other, with the government, other economic agents in the process of transferring ownership of assets, goods and services; access to information, economic resources and markets, market infrastructure, special rights and types of activities; property rights protection; management and use of business relationship management structures under the conditions of imperfect institutional support.

It should be noted that the aspect of institutional support, as the second component of the characteristics of national institutional basis of commercial and economic activity, is also insufficient. Thus, the relevant government body, that has to regulate the organization and management of financial and economic activities of business entities in Ukraine, is State Regulatory Service of Ukraine, which is responsible for legal regulation of enterprise development, project preparation and implementation of programs to support entrepreneurship, including cooperation with the State Property Fund of Ukraine, the Ukrainian Business Fund, ministries and other government bodies. However, the potential of this institution is somewhat limited. First, final decisions on policy measures and the extent of financing are made by the Cabinet of Ministers of Ukraine or other relevant ministries and agencies; secondly, in recent years, the quantity of local offices of the committee, operating in each region, is significantly reduced. It would therefore be wiser to increase their number, not only in regions, but also at all administration agencies, to extend the capacities and to concentrate activities on solving the problems of business cooperation with external institutions, first of all, with licensing and supervising authorities. Moreover, offices of the State Regulatory Service of Ukraine form the institutional component of the state policy in the area of reducing transaction costs for business in Ukraine. They should bear the responsibility for monitoring qualitative and quantitative characteristics of economic and legal environment of entrepreneurship, as well as the development of a network of institutions to promote financial and economic activities.

It should be added that an important role is given to NGO support and their promotion of small and medium-sized enterprises development. Non-governmental organizations and business associations (including sectoral, regional, territorial and other) were first created in the 1990s to cope with this problem in Ukraine and its regions. The activities of these institutions have significantly influenced on the reduction of administrative barriers and improved access of small and medium-size enterprises to economic resources. However, it is obvious that this important part of business support infrastructure currently does not carry out its tasks properly, in particular, because of total lack of support from regional and local governments.

More opportunities and empowerment of such organizations would significantly reduce transaction costs for business entities in Ukraine. In particular, we are talking about bringing representatives of business associations to decision-making of local governments committees, control over the activities of licensing and conciliation structures, adding more opportunities for information dissemination etc.

Despite the objective relevance, the importance of particular actions differs, as well as the priorities in their implementation. First of all, it is necessary to unify majority of provisions in national legislation which appear in various legal acts but together form the institutional framework for management of small and medium-sized enterprises. To do this, a single, unified regulatory act has to be adopted, which will clearly define the criteria for classification of business entities to micro, small and medium-sized; criteria and features of simplified and preferential taxation and accounting; relationship of small and medium-sized enterprises with state administrative and regulatory agencies (including the responsibility of the latter for transaction costs); mechanisms of the state policy in the area of property rights protection and development of institutional infrastructure for entrepreneurship).

The expediency of the adoption of a single, unified regulatory act is based on the experience of developed countries (Small Businesses Act in the US; unified EU legislation concerning business sector etc.). It will help not only to identify, but also legally prescribe the goals of transaction costs management system in our country.

The next logical step of the state policy in this sphere should be the improvement of legislation on agents with whom business entities enter into economic and business relations. The biggest share of transaction costs of small and medium-sized enterprises in Ukraine is the result of relations with state administrative and regulatory authorities, especially in such key areas as the set up and closure of enterprise, purchase (sale) of enterprise, obtaining permits, licenses, patents, use or acquisition of public (municipal) property, resources, land, public order, competitive environment.

In this context it should be mentioned that the ease of starting and closing business is of great importance in motivating people to run business, because the affects its expenditure side. Ukrainian authorities made an attempt to simplify the procedure of business entities registration but only partially.

There is every reason to believe that it is time to improve national legislation in part which concerns enterprise closure. First of all, simplification of the procedure is needed in accordance with best practices of developed countries. The main direction here should be to separate the conditions for enterprise closure due to financial condition (bankruptcy) and for those economic agents that want to go out of business for other reasons. In particular, the declarative principle of closure should be introduced for the latter.

Significant transaction costs of business entities in Ukraine lead to the lack of business sale and purchase market. The stock market is too poor, making it impossible to even monitor the status of Ukrainian enterprises capitalization. The real market value of enterprises' assets often exceeds the authorized capital by more than 1000 times. Therefore, the sale of such company or its assets forms a significant segment of shadow economy, thus creating unequal conditions of management with respect to lawful economic agents and leading to a loss of significant amounts of funds for state and local budgets. One way to solve the problem is to introduce legislative initiatives to stimulate the development of Ukrainian stock exchange and stock trading, increase the number and the share of SME sector, listed at stock exchange, impose restrictions on transferring the share of the authorized capital of companies at the value less than the expert judgement.

Permits, licenses and patents remain the most problematic issue when speaking about transaction costs of business entities in Ukraine. It would be therefore wiser to include the following measures, aimed at improving the national system of permits: increased control and responsibility of regulatory authorities officials; revision of the existing licenses and permits in all areas of economic activity; enhancement of efficiency of local permitting authorities' functioning (in particular, increasing permit specialization; differentiation of permits applications (projects) regarding the facilitation of the procedure and timing of permits reconciliation for small enterprises; permitting approval of applications by default; introduction of preliminary written estimation of the set of documents, submitted for approval, by a licensing authority official); establishing the institution to control and monitor the operation of the licensing system.

Similar problems occur in public procurement. Here we need to mention such negative moments as the lack of transparency and monopolization. This does not only increase the transaction costs of business, but also leads to poor quality of services in public sector. It is obvious that increase of public and business sector awareness on the list and range of public procurement is a solution to most problems in this area.

Ukrainian legislation on competitive environment should be also improved. The key problems in this area are monopolization of markets and certain types of economic activities, unfair competition, poor protection of property rights and the existence of a significant informal sector. These problems create additional difficulties for small and medium-sized enterprises in Ukraine, the removal of which requires adequate funding, that again leads to transaction costs increase.

Improvement of legislation on the protection of property rights and information is the logical third step of the state policy in the field of improving institutional support in reducing transaction costs of business entities in Ukraine. This will ensure costs reduction on ownership transfer and overcoming informational non-transparency for small and medium-sized enterprises.

At the same time the fourth stage should include the development of institutions and business infrastructure to reduce transaction costs. In particular, reducing costs caused by informational non-transparency should be the primary goal. The idea is that the search for promising market niches, foreign markets, and consequently, an increase in activity of Ukrainian small and medium-sized enterprises is significantly limited due to the lack of activity (and in some cases – high prices for services) of infrastructural institutions that provide services in the fields of marketing, consulting, management etc. High prices for these services often become a serious obstruction for business entities. Therefore, regional and local authorities should use the positive experience of other countries in this area, concerning partial compensation of expenses or other forms of state financial and credit support.

**Conclusions.** The basis for good government policy on minimization of transaction costs of business entities is its institutional support – the system of formal and informal laws, rules and principles, as well as institutions focused on effective management and reduction of transaction costs of business entities. This is the basis for making relevant decisions on logical and consistent implementation of public policy.



Appropriate actions should be taken to ensure a systematic state policy on improvement of institutional support to reduce transaction costs of business entities in Ukraine. The key goal is the creation of favorable business environment and minimization of transaction costs including: 1) definition of objectives, operational goals and structure of transaction costs management system; 2) improved regulatory framework for transaction costs minimization; 3) lowering costs of ownership transfer and expenditures to overcome informational non-transparency; 4) strengthening the infrastructural support of state policy on transaction costs reduction.

Further research in this area should concern the improvement of methodology for assessment of public policies efficiency on minimization of transaction costs of business entities.

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