

INNOVATION INDUSTRY MARKET INFRASTRUCTURE IN UKRAINE

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Innovation Industry Overview

As a result of the implementation of economic reforms in Ukraine (i.e. privatization, transition from administrative-command system) the country is turning to the free entrepreneurship and free market system. This goal can be achieved by means of forming healthy business environment for the entrepreneurship development.

International history of the market economy development (particularly, with regard to SMEs and large business entities) is strongly correlated with the business development market infrastructure. In case of the venture capital industry, it is dependent on the development of the R&D sector, business incubators, science parks, venture capital sector, business networks, etc.

Innovation industry development as the priority of the State policy

In 2002, there were indications of changes in the policy-makers' and influential power groups' vision on economic policy. The economic stabilization and development policy, which was dominant during the last 10 years, is being gradually replaced with the innovation policy.

2002 was marked with an increase in the State's activities aimed at the innovation business development:

- ✓ (February 2002) Parliament passed the Law «On Special Regime For The Property of National Academy of Sciences of Ukraine»

- ✓ (March 2002) Parliament passed the amendment to the Law «On Special Regime for Investment and Innovational activities of TechnoParks» (this Law was passed in 1999). The number of technoparks was increased twofold to 8.

- ✓ (May 2002) Addressing the Parliament, the President of Ukraine promulgated «The Strategy of the Innovation Model of Ukraine's Development and Integration into EU».

- ✓ (July 2002) Administration of the President of Ukraine and State Agency on SME Development held a meeting «On SME Development of Ukraine».

The President adopted decision to pass from the Government to business incubators and other business support centers results of all R&D activities conducted during 1997-2000).

- ✓ (July 2002) Parliament passed the Law «On Innovation Activities».

This Law envisages a 50% reduction in VAT, corporate profit tax remission, and customs duties decrease for innovative projects and enterprises. It was planned that this Law would go into effect after 2003. To implement this Law, it was necessary to pass the Law on the innovative priorities and creation by the Government of a special State agency to execute these Laws.

- ✓ (Summer 2002) Establishment of the State Innovation Company of Ukraine (SICU)

It was created on the basis of the former State Innovation Fond and inherited its unreturned debts amounted to more than \$100m.

- ✓ (December 2002) Parliament passed changes to the Law «On Corporate Profit Tax»

By 2004, CPT rate will be decreased from 30 to 25 per cent; depreciation rates will be significantly increased.

Implementation of this policy is continuing in 2003:

- ✓ (January 2003) Parliament passed the Law «On Priority Areas of Innovation Activities»

According to this Law, 41 technological sectors, encompassing 8 strategic directions, have been given priority status in Ukraine and can use tax-free regime according to the Law «On Innovation Business».

- ✓ (February 2003) Administration of the President of Ukraine held at the Kiev Polytechnic Institute the conference «Implementation of Innovation Model in Ukraine»

It was declared that the Government policy will be aimed at decreasing main taxes for business (CPT to 20%, VAT – 15%). Also, the Government plans to implement the initiative of the SICU to create Ukrainian Bank for Reconstruction and Development.

The above trends in the government's policy corroborate the forecast made by the President of AVentures, Andriy Kolodyuk, in an article in the Mirror Weekly publication (Issue # 49, December 2001) that « within the next five years, the share of the hi-tech industries in Ukraine's GDP will significantly increase, taking the lead from the agricultural and industrial sectors».

Opportunity rich innovations supply

At present, the R&D sector of Ukraine is represented by 1,500 institutions with 75 scientists employed by each of them on average.

Most of these institutions belong to the National Academy of Science of Ukraine, Ministry of Industrial Policy, Ministry of Education and Science. Also, the R&D sector is developing at the leading Ukrainian higher education institutions. More than 300 of them have the highest state accreditation level.

More than 70,000 doctors of sciences are currently working in Ukraine. At the same time more than 1 million students are currently studying in Ukrainian higher education institutions. More than 30% of Ukrainian active population already holds a higher education diploma. And this is one of the reasons why, after liberalization of regulatory and fiscal policy for entrepreneurship and SME development in Ukraine during last three years, the number of private enterprises grew to 1.8 million (whereas 1.5 million of them are represented by private entrepreneurs, which constitutes 6% of the active age population).

Ukrainian R&D specialists are widely recognized all around the world. About 80% of R&D institutions possess international competitiveness as they are participating in international projects. Within the framework of the NATO scientific program (1999-2000), Ukrainian scientists were ranked second for the number of grants awarded among the countries of the Euro-Atlantic partnership. Official statistics of 1999-2001 indicate an average annual growth of the Ukrainian R&D export by more than 30%. 2002 is expected to yield similar results. Turnover of this sector has exceeded \$140m.

Last year, it was internationally recognized that Ukraine had enormous human capital in IT sector – the 4th place after USA, India and Russia according to BrainBench, Inc. «Global IT Q1 Report».

Most of science, R&D infrastructure and educated human capital are concentrated in 5 Ukrainian regions: Kiev, Kharkiv, Dnipropetrovsk, Donbass, Lviv. Here one can expect, with a great degree of probability, an appearance of the Ukrainian hi-tech «venture stars» and breakthrough projects. According to Kiev City Administration estimations, only in Kiev more than 20,000 innovative SME are active.

Low competitiveness of Ukrainian technology SMEs

It is well known that SMEs are the driving force of the innovation development. However, 80% of them are not able to survive due to insufficient business practice, access to seed capital, lack of managerial expertise and insufficient marketing information. The above challenges have become the starting point for the practice of business incubation.

According to the Ukrainian statistics, number of active entrepreneurs is growing:

- ✓ The present number of private entrepreneurs & enterprises currently amounts to 1.8 mln. And 1.5 mln of them are private entrepreneurs, which means 6% of active age population. 260,000 of 1.8 mln are SME's, which constitute about 30% of all the enterprises in Ukraine.

Level of education of the Ukrainian population and work force is high:

- ✓ literacy rate – 98%, high-education graduates – more 30% of population of active age, plus more than 300,000 annually, number of doctors – more than 70,000, number of universities – 318, around 1,500 R&D organizations with 120 researches on average.

The Ukrainian economy level of globalization/integration in international market is increasing:

- ✓ 43th place in the rankings of globalization (Russia possesses the 45th place), more of 50% of GDP is generated by export and import;

- ✓ Volume of R&D activities amounted to \$430m in comparison with last year's \$373m, which constitutes a growth of 15%. The sector of science and technology-based services displays an impressive growth of 77% (from \$31.8m to \$57m);

Expansion of the Ukrainian hi-tech export:

- ✓ The amount of innovation products shipped has increased by nearly 50% (from \$0.7bn in 2000 to \$1.6bn in 2002), most of which are representing the military sector.

Increased demand for the Ukrainian R&D:

- ✓ The structure of cash flows for the R&D activities is experiencing a steady shift towards foreign funds. The growth of export is continuously exceeding the growth of revenues from Ukrainian clients and constitutes 30% per year.

At the same time, the share of competitive hi-tech SMEs in the Ukrainian export is very low. The share of technology in Ukrainian export is approximately 10%, which amounts to \$1.7bn, but the share of SMEs in technology-based exports is only 3% or \$55m.

Challenges to Hi-tech SMEs

The typical place of introduction of innovation into the market is SME. There are no sound feasibility studies on the Ukrainian technology SME practices and their business environment. Based on the analysis of different general feasibility studies on entrepreneurship development in Ukraine and AVentures business incubating experience, we believe that technology SMEs, in order for them to be successful, need to resolve the following issues and challenges that don't pertain to other SME types:

- ✓ to have much higher management skills;
- ✓ to collect and to make correct analysis of specific scientific & marketing data (not only on local market, which is needed for some low-tech start-up projects, but also on international