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FEATURES OF SMALL BUSINESS DEVELOPMENT IN UKRAINE

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Abstract

The study is to show the main aspects of small business development in Ukraine. The features of business formation in the first years of independence have been observed, among which the power and business fusion, the use of political rent and so on. The features Ukrainian legislation which regulates the activities of small businesses were described, and the latest legislative changes aimed at simplifying these activities. It is suggested to improve the conditions of freelancers' activities due to introducing simplified requirements for documenting their work in Ukraine. Attention is paid to defend the interests of small businesses in Ukraine through their NGOs.

Key words

entrepreneurship, freelance, middle class, political rent, taxes.

1. Small businesses development – the condition of the middle class formation as a basis of stability of a state

Entrepreneurship is seen as a special activity for profit. It covers research, technical and commercial work. It possesses innovative approaches to economic decision-making, creative combination of financial resources, tangible and intangible resources, intellectual property for new products or services that are in demand. Employers care about increasing personal income through the use of the latest commercial technologies, production methods. They cover new areas of capital application, care about the most

efficient use of resources. Entrepreneurship is the force which accelerates the movement of economy through efficiency, rationalization and freshness. It creates innovative environment, destroys traditional structures and opens the way to transformation and growth of society, in particular – to expand the middle class and ensure its prosperity.

Activities of the middle class and social behavior of its representatives will determine the direction of the Ukrainian society. The formation and growth of the middle class in Ukraine is the need of time. From the social point of view, the middle class has the following characteristics: adequate income level, high level of education and skills, moderate political

conservatism, interest in maintaining social stability and marginal ideologies rejection, etc (Ляпін, 2009). In the developed countries, the middle class constitutes the majority of the population and is the main carrier of public interests and national culture (social values, norms, patterns of behavior, lifestyle, etc.). The middle class is a cultural integrator of a society and distributes the samples of their own culture to other segments of a society. There are no clear parameters that people belong to the middle class. About this group of people, they say, "The middle class – those who earn so much that can not think only about survival but about life". The Gorshenin Kyiv Institute of Management investigation showed that in Ukraine the middle class may include no more than 9% of the population, while in the West the middle class are 50–70% of the population (Зануда, 2007). The polls have shown that although only 5.8% of Ukrainians can afford significant costs and purchases of durable goods, but a significant number of respondents (44%) considered themselves to be of middle class. The researchers explain these results that the respondents do not want to classify themselves with the lower class (Кардаш, 2013). Academician Igor Yukhnovsky proved that with no legal provisions protecting the middle class the society is rolled down to so-called bimodal type, which is dominated by the poor, the middle is very small, and the bulk of the wealth is concentrated in a small number of rich (Чи можна..., 2008). Such a society is unstable, it has revolutionary sentiments, low motivation to achieve business success through legal difficulties for business development.

Western countries have come the evolutionary path of the middle class on the basis of business development. For example, in Poland the small business development provoked social and mental changes in Polish society, has helped to create a middle class, made it possible to experience the independence, autonomy from the government, big business and oligarchs. According to Rafal Sadowski, expert of the Centre for Eastern Studies (Poland), Ukraine has not recognized the urgent need to develop a small business. Therefore, we have some minor changes: licensing procedures reduction, canceled some licenses, but it is not enough (Потенціал малого..., 2015). The same view is shared by other experts. They believe that for Ukraine "the lack of improvement in the conditions for the development of small and medium-sized firms and the still insufficient deregulation of the economy are being the main problems" (Konończuk et al., 2015). However, a comprehensive initiative to support young entrepreneurs must become an effective instrument for the formation of a strong middle class.

A key role in the formation and development of entrepreneurship plays a business environment. Important factors that environment is legislation, human resources, availability of financial, commodity and energy resources, purchasing power and so on. In Ukraine, the conditions of business have been changing since the period of independence of the country in 1991.

In the early years of independence of Ukraine business formation faced with a population unwillingness to take the initiative and be responsible for it. Lacking the pro-market political elite and "homo sovieticus" people dominated (Radchenko et al., 2014). At that time there were four types of entrepreneurs:

1. Entrepreneurs "of necessity" – people who were forced to engage in small business to survive. It was a numerous group of people, consisting of former employees of companies and research institutions that have become unemployed. The main scope of business activities was a petty trade.
2. "Red" entrepreneurs – former heads of state enterprises, Party and Komsomol organizations, new heads of government. Some have access to the means of production and used them for personal profit through formation of various co-operatives and joint stock companies. The latter used the opportunity to influence government in the privatization process, as concluding lucrative contracts, obtaining tax benefits. There was a merger of power and business: the authorities were businessmen, and government officials and their family members founded the company and bought shares.
3. Successful entrepreneurs – individuals who were able to quickly use blanks of Ukrainian legislation, business contacts, differences in exchange rates and the prices of products in the domestic and global markets. The main areas of business activity were financial, trade and mediation, exports and so on. This group of entrepreneurs could quickly accumulate capital.
4. "Criminal" entrepreneurs – came through the legalization of criminal capital. It had various sources. One of them – revenues from "services" that bandit formations gave the entrepreneurs which were not protected by law enforcement. Other – formation of various trust organizations that promised investors high profits, but in fact artificially bankrupted them and appropriated the borrowed funds.

In general, the formation of business in Ukraine began spontaneously, often illegally and through the blending of business with the government. You can not talk about the evolutionary development of

entrepreneurship, but about the accelerated one, accompanied by rapid enrichment of entrepreneurs, particularly through political rent. In Ukraine the situation is clearly evident when “governmental intervention in the economy assigns resource allocation power to bureaucracy, and therefore allows capturing political rents through corruption” (Lazarev, 2004, p. 11). The above circumstances have caused low orientation of Ukrainian entrepreneurs on production and new technologies, and low percentage of people who are of a middle class.

2. Features of legislation governing small business activity in Ukraine

The choice of legal form of business in Ukraine is very important issue before starting business. Rights of private entrepreneurs in Ukraine are almost the same as the rights of corporate entities, with some benefits and disadvantages in comparison with corporate entities. The law sets limit on the list of people who can conduct business. For example, the militaries, prosecutors, judges, officials of public authorities cannot be private entrepreneurs. And this prohibition applies to persons for which barred the court, or who have not withdrawn or not canceled for acquisitive crimes.

Legislation regulating business activity in Ukraine was undergoing many changes and additions. According to the Commercial Code small business include entities whose annual income does not exceed 10 million euros and the number of employees not exceed 50 persons. The composition of small business includes so-called micro. There we include entities in which the annual income does not exceed 2 million euros and the number of employees do not exceed 10 persons.

Significant opportunities for small businesses opened with the introduction and development of a simplified tax system. It was established by Presidential Decree of Ukraine back in 1998 and was reflected in the Tax Code, adopted in December 2010. Simplified tax system – a special tax collection mechanism, which states:

- replacement of the payment of certain taxes to pay a single tax;
- maintenance of simplified accounting and reporting.

Tax Code considered several groups of single tax payers, depending on the size of revenues, number of employees and economic activities. After 2015 it provided the activities of four groups of single tax payers:

1. Individual entrepreneurs who do not use hired labor of persons engaged exclusively in retail sales of goods from trading places in the markets or providing domestic services to the population, if the amount of income for the year does not exceed 300 thousand UAH. For this group of single tax payers, the village, town and city councils have a fixed rate within 10% of the minimum wage.
2. Individual entrepreneurs who provide various services to single taxpayers and for the public, engaged in the production or sale of goods, are active in the restaurant business if the number of people who are with them in employment is less than 10 persons, and the volume of income for the year does not exceed 1.5 million UAH. For this group of taxpayers, a single tax rate is fixed within 20% of the minimum wage.
3. Individual entrepreneurs and legal entities – entities in which the amount of income for the year exceeds 20 million UAH (after 2016 will be 5 million UAH). For this group of single tax payers, it is established a rate of 2% of income (after 2016 will be 3%) – in case of payment of value added tax or 4% of income (after 2016 will be 5%) – in the case of inclusion of VAT the single tax under the Tax Code.
4. Agricultural producers, whose share of agricultural commodity production for the previous financial year equals or exceeds 75%. For this group of single taxpayers, the tax rate is set for each hectare of agricultural land or water fund lands. Size rate (percentage of the tax base) depends on the category of land and their location according to the Tax Code.

However, not all businesses can be single tax. For example, it can not be single tax entities (legal entities and individual entrepreneurs) engaged in:

- organization of gambling, lotteries, tote boards;
- foreign currency exchange;
- production, export, import, sale of excisable products;
- mining, production, sale of precious metals and precious stones (excluding the production, delivery, sale of jewelery and household articles of precious metals, precious stones);
- production, realization of mineral resources, the realization of mineral resources other than local importance;
- activities of financial intermediation, except the business of insurance, carried out by insurance agents;
- activities of business management;
- activities to provide mail services (except courier activities) and communication;

- sales activities of art and antiques, the activities of the organization bidding (auction) products of art, collectibles or antiques;
- conducting of touring activities.

In spite of the single tax, businesses pay a single social contribution. Its size does not depend on revenues, but only – from the number of employees. Minimum amount of this contribution is 34.7% of the minimum wage in Ukraine of the current month (after 2016 will be 22%). Along with a decrease in the size of this contribution for individual entrepreneurs of the third and fourth groups the single tax rate rises. At the end of 2015 in Ukraine there was a wave of protests of agricultural producers, for which the single tax rate increases by 80% and abolished exemptions of VAT. To protect their interests, this group of entrepreneurs were even blocking roads in international traffic. Farmers unite in civic organizations and associations. For example, the Association “Land Union of Ukraine” has shown itself as experienced and professional organization in the field of land relations in Ukraine. It is engaged not only in spreading awareness on land issues, but also in regulatory activities. This Association grew convinced in its effectiveness while interacting with public authorities and NGOs, participating in the development of recommendations to legislation and regulations and promoting adoption thereof.

Since 2015 the Government introduced payment to the local budget the excise tax on the retail sale of excisable goods and simultaneously abolished the duty on the development of viticulture, horticulture and hop growing. Payers of this tax are business retailers who sell regardless of the forms of payment, including the pouring glasses in restaurants, cafes, bars and other catering establishments such excisable goods as: beer, alcoholic beverages, tobacco, gasoline, diesel fuel, liquefied gas, etc. Excise tax is paid to the local budgets of the administrative units in which businesses are situated. The tax is transferred to the budget within 10 calendar days after the tax return for the month. An entity retailer who sells excisable goods, including the places where the main place of residence is not registered must file tax returns to the regulatory agencies that serve territorial administrative units, which are selling items of such goods.

For a long time, it was difficult for Ukrainian entrepreneurs to terminate the business activities due to time-consuming procedures to close. In 2014 the relevant procedures were considerably simplified. In particular, it was introduced a radically altered order of termination of business for persons, which provided for the reduction of the termination term of individual entrepreneur to one day. It was also simplified

the procedure for termination of legal entities and given the opportunity to make changes to the data in the Unified State Register after the decision to terminate the legal person. For example, now it is not prohibited to provide a state registration of legal person founder (participant) which is a legal person on whom the decision to terminate his business was made.

In general, Ukrainian legislation regulating entrepreneurial activity is constantly changing. The post-Maidan Ukrainian government found itself forced to launch a comprehensive state reform process due to both the deep crisis in all the key areas of the state's operation and the enormous demand for change among the Ukrainian public (Konończuk et al., 2015). Some steps have already been done. In particular, it was performed a series of measures to deregulate business activities. For example, a number of simplified procedures for Architectural Control, they also reduced the number of state oversight, simplified procedures for the use of agricultural land. In 2014 at the initiative of the business environment the Business Ombudsman Council was created. It is an independent advisory body under the Cabinet of Ministers of Ukraine, which helps to create transparent conditions of business, preventing corruption in government (Business Ombudsman Council, 2015). In 2015, a system of electronic public procurement *ProZorro* appeared, an idea which originated among entrepreneurs and was supported by the government (ProZorro..., 2015). The corresponding changes are aimed at facilitating business and corruption reduction.

Despite a number of steps to improve legislation governing business activities, Ukraine is at the bottom of the list of countries of economic freedom. According to the web-resource *Index of Economic Freedom*, the rule of law is particularly weak. The investment regime remains closed, with foreign investment competing with large state-owned enterprises. A rigid labor market and bureaucratic business regulations inhibit the development of a dynamic private sector (Index of Economic Freedom, 2015). Therefore, it is necessary to carry out many activities to simplify the business environment.

3. Dynamics and geographic features of small business processes in Ukraine

Changes in business activity conditions caused that the number of small businesses in Ukraine also changed. Their number was affected in some regions by the fact of large industrial enterprises and educational and research institutions presence.

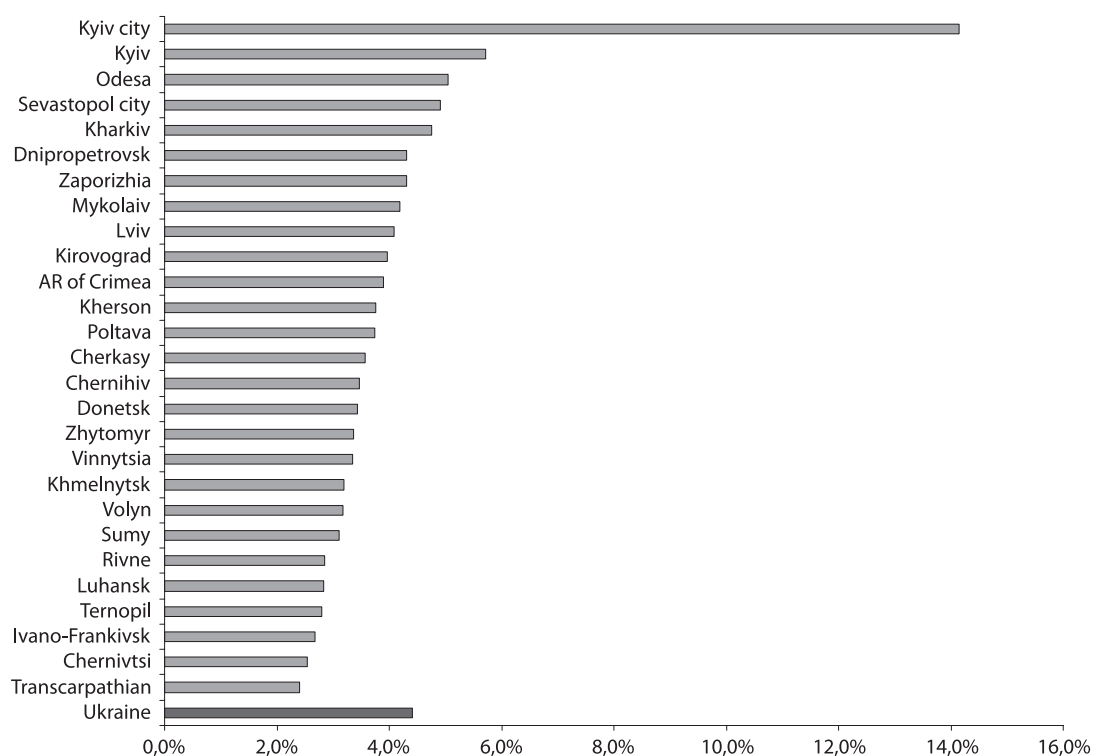


Fig. 1. The percentage of persons employed in small business in the total population in the regions of Ukraine and in cities of Kyiv and Sevastopol

Source: calculated according to: Діяльність суб'єктів..., 2015.

Tab. 1. Number of workers employed in small businesses in Ukraine

Type of economic activity	Number of employees, thsd.				
	2010	2011	2012	2013	2014
Agriculture, forestry and fisheries	263	233,4	258,3	276,6	296,8
Industry	554,4	513,7	509,8	514,1	456,5
Building	302	259,2	241,4	...p	...p
Wholesale and retail trade; repair of motor vehicles and motorcycles	2258,5	1990,7	1838,6	1814,8	1763,9
Transportation, storage, postal and courier activities	302,5	264,1	258,4	256,1	254,4
The temporary arrangement of catering	182,8	178	190,8	194,5	156,6
Information and Telecommunications	130,1	129,8	141,9	159	182,1
Financial and insurance activities	36,1	31,7	27,9	...p	...p
Real estate	187	177,3	216,2	218,3	204,7
Professional, scientific and technical activities	257,6	226,2	213,4	216,1	218,4
Activities in administrative and support services	181,2	163,5	144,4	145,6	134,1
Education	28,3	25,1	22,6	23,9	22,7
Health care and social assistance	54,3	58,5	60	59,8	57
Arts, sports, entertainment and recreation	24,1	23,3	23,8	...p	25,2
Providing other services	196,7	167,5	137,7	...p	...p
Total	4958,6	4442	4285,2	4291,2	4115,2

p – extracted data to enforce the Law of Ukraine "On State Statistics" on privacy

Source: Діяльність суб'єктів..., 2015.

Since the small business includes entities in which the annual income does not exceed 10 million euros, their number is affected by the change rate of the Ukrainian hryvnia. The dynamics of small business in

Ukraine is presented by quantitative and qualitative indicators. Some statistical information about the activities of business entities is hidden because of its confidentiality.

Tab. 2. Relative number of individual entrepreneurs in the regions of Ukraine

№	Region	Number of individual entrepreneurs for 10 thousand of population		Growth (decrease) rate for the period, %
		on 01.01.14	on 01.01.15	
1	AR of Crimea	733	733	0
2	Vinnitsia	670	593	-11,49
3	Volyn	526	440	-16,24
4	Dnipropetrovsk	664	571	-13,99
5	Donetsk	548	406	-25,79
6	Zhytomyr	589	491	-16,6
7	Transcarpathian	475	413	-12,94
8	Zaporizhia	713	581	-18,5
9	Ivano-Frankivsk	510	424	-16,78
10	Kyiv	739	656	-11,24
11	Kirovograd	489	412	-15,81
12	Luhansk	714	623	-12,73
13	Lviv	798	757	-5,12
14	Mykolaiv	694	531	-23,49
15	Odesa	859	726	-15,5
16	Poltava	605	496	-18,03
17	Rivne	448	378	-15,67
18	Sumy	562	480	-14,57
19	Ternopil	541	465	-14,03
20	Kharkiv	828	757	-8,59
21	Kherson	686	578	-15,74
22	Khmelnitsk	524	423	-19,26
23	Cherkasy	485	416	-14,1
24	Chernivtsi	788	713	-9,6
25	Chernihiv	483	387	-19,86
26	Kyiv city	918	851	-7,33
27	Sevastopol city	898	893	-0,57
Total		667	579	-13,25

Source: Реєстраційні дані..., 2015.

Small business is unevenly distributed in the regions of Ukraine. We calculated the percentage of people who are employed in small business in the total population in the regions of Ukraine, Autonomous Republic of Crimea, cities of Kyiv and Sevastopol. Data are taken on the results of 2013, to have information before the time of annexation of the AR of Crimea and temporary occupation of parts of Donetsk and Lugansk regions by the Russian Federation. The calculation results are shown in Fig. 1.

The obvious leader in percentage of persons employed in small business in the total population is the capital of Ukraine. Partially, this high figure can be explained by the fact that Kyiv actually resides more people than registered: many people rented housing, but they are not registered; that is why the

“day” Kyiv population is much higher than its official number. In addition, the said percentage is affected by the fact that in Kyiv are recorded a lot of small businesses that operate in other areas.

After 2014 the percentage of people who are employed in small businesses significantly reduced, in the total population in Donetsk (from 3.4% to 1.3%) and Luhansk (from 2.8% to 0.7%). This can be explained by the fact that a large number of enterprises were liquidated or re-registered in other regions of Ukraine. In general, in Ukraine the number of employed in small business decreased from 2.011 mln persons in 2013 to 1.687 mln persons in 2014 (ie 16%).

The spread of small business in various economic activities is shown according to data of the number

of workers employed (Table 1). Number of employees is determined on the basis of full-time, freelance and unpaid (owners, founders and members of their families) employees.

Some small businesses are registered to reduce taxes of large firms. In fact, the number of independent small businesses is less than recorded.

A relatively large percentage of persons employed in small business in the total population is in the areas with a strong industrial and scientific base: Kyiv, Odesa, Kharkiv, Dnipropetrovsk, Zaporizhia, Mykolaiv and in Sevastopol. The reasons for the uneven spread of small business may be the different possibilities of access to financial resources and government contracts, various capacity markets for products of local manufacturers, different levels of competition from foreign companies, the willingness of the population to entrepreneurship. The latter factor can be judged by the proliferation of individual entrepreneurs in the regions of Ukraine. Table 2 shows the State Registration Service of Ukraine data: the relative number of individual entrepreneurs (for 10 thousand of population). According to these data, the activity of individual entrepreneurs is most common in the following regions of Ukraine: Sevastopol, Kyiv city, Lviv, Kharkiv, Odesa, Chernivtsi regions and the AR of Crimea.

Reducing the number of individuals in all regions of Ukraine in 2014 is due to the general economic downturn and the military conflict in the east and the reduction of trade ties with Russia. Import and export with the country declined for two years, about three times (Russia and Ukraine..., 2015). In addition, many individual entrepreneurs benefited introduced in 2014 a simplification of the termination of business activities. The numbers of Crimean individual entrepreneurs have not changed, because for the termination of their businesses they need to apply what entrepreneurs from Autonomous Republic of Crimea and Sevastopol can not do because of the annexation of the territory by the Russian Federation.

4. Freelance development in Ukraine

Expanding economic ties between countries, mobility of people and development of information technologies contribute to the spread of a particular type of enterprise – freelancing. Freelancer – a professional who performs tasks for different customers without conclusion of labor contracts with them. Freelance has a number of advantages both for employees and for employers. Freelancer can choose the order, work at a convenient time and in

a convenient location, such as at home. This is especially important for those who care for children or sick relatives and for disabled persons for whom it is a hard task to go to work. Freelance can be combined with the main work for additional earnings. For freelance employer the advantage is in that there is no need to equip workplaces for employees moreover they are able to choose the best deals offered by various freelancers. Freelance today has no geographical limitations, you can place orders and execute remotely, including via the Internet. These circumstances led to rapid growth of freelance in Ukraine and in the world as a whole.

In August 2015, *Financial Times* published that up to 2014 there were recorded 120 thousand Ukrainian freelancers, they executed 40 thousand contracts and earned 61 million dollars. (fourth in the world according to online platforms Upwork) (New world of..., 2015). Ukraine lost to India, USA and the Philippines. Following the results of 2014 Ukraine retains market leadership of freelance programming, executing third orders, attributable to Eastern Europe (Зюзін, 2015). Approximately half of the orders were from freelancers living in Kyiv, Kharkiv and Zaporizhia (Ящишина, 2015). In terms of earnings freelancers in the IT field significantly differ in different regions of Ukraine (Fig. 2).

Freelance in Ukraine is developing steadily, but somewhat spontaneously. It is important to develop the appropriate legal support. While Ukrainian legislation related to business in the form of freelancing is imperfect. In particular, for taxes we need to fill a number of documents both a freelancer and employer. Moreover, a freelancer who requires from an employer documents provided by law (including acts of performed works), is less likely to get the order than the one who does not put such demands. Analysis of Internet forums where Ukrainian freelancers communicate shows that many of them do not pay taxes and take risk of being punished by fiscal authorities. They are willing to pay taxes if the procedure has been simplified. Some freelancers in Ukraine decorate their activity as individual entrepreneurs. However, in this case, they face a number of difficulties associated with full documentation filling of each order.

Ukraine has implemented some measures to ease freelancers' activities. In particular, in 2015 the National Bank of Ukraine has simplified the procedure of cooperation of Ukrainian freelancers who work through the Internet, with its foreign customers, canceled the contracts and acts of performed works for freelancers' work exports. Now, it is enough to show an invoice, which will serve as a proof of

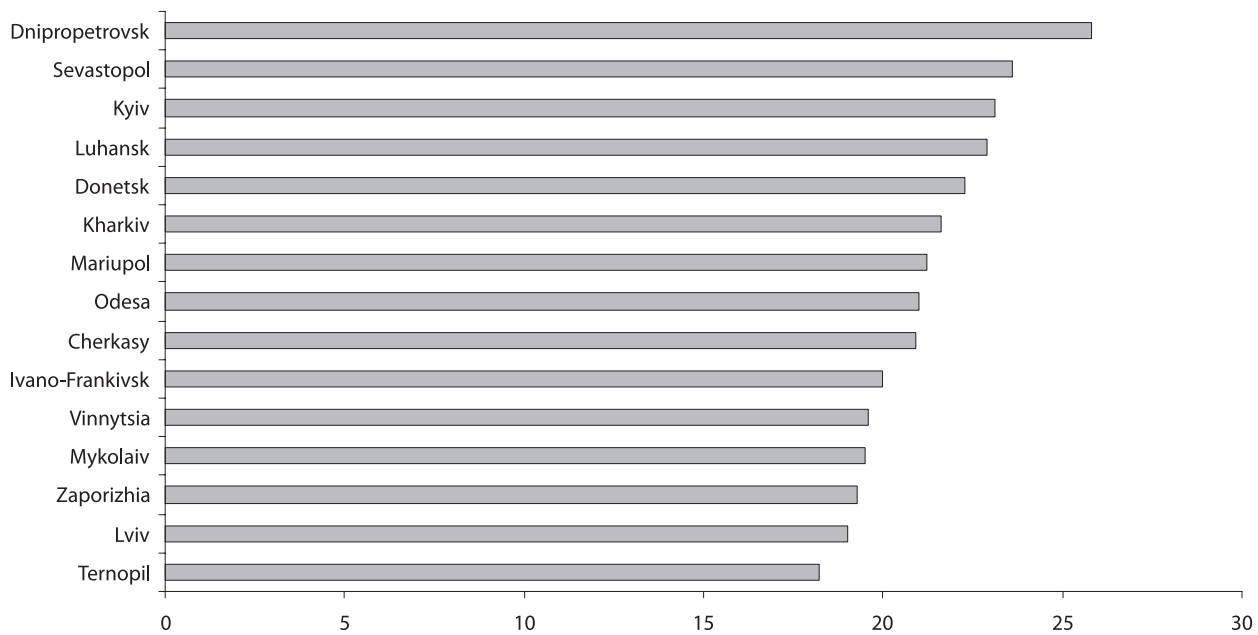


Fig. 2. Average earnings of ukrainian freelancers working in the IT field (dollars per hour in 2013)

Source: Stats oDesk, 2014.

completed work and will help to get the earned money quickly.

Some help for business development in the form of freelancing, is also provided by local authorities. For example, in Lviv they established a business incubator "Startup Depot", for which the City Council has given a room. "Startup Depot" – is a business incubator for IT projects and place of consultation and cooperation for entrepreneurs, designers and other creative people (Startup Depot..., no data). Entrepreneurship in Information Technology has prospects in Ukraine, because here we have a high level of training.

To simplify the business environment appropriate for freelancers it is needed to change the requirements for taxes payment. For example, payment of the single social tax could provide only for those months when a freelance has provided the related services.

To defend their interests, entrepreneurs of Ukraine formed a number of public organizations (NGO). It is advisable to create such civic organizations specifically to defend the interests of freelancers.

5. Summary

The society is the more stable, the more powerful is its middle class. An important condition of the middle class formation is the development of entrepreneurship. A vivid example is Poland, where the small business development led to social and mental

changes in the society, it helped to create a middle class, it gave him an opportunity to feel the confidence and independence from the government, big business and oligarchs. In Ukraine, it began spontaneously, forming entrepreneurship, using the imperfections of the law. There was a merger of power and business: government officials and their family members founded the companies, using access resources through the political rent. There was no evolution of business but rapid development, accompanied by rapid enrichment of entrepreneurs and low orientation of Ukrainian entrepreneurs on production and new technologies. To form a strong middle class, it is necessary to improve legislation and develop infrastructure to promote small business.

The benefits of acting as the private entrepreneur in Ukraine are:

- rather simple procedure of state registration (the procedure of registration is similar to corporate entity, but less complicated);
- rather favorable tax regime (especially single tax);
- he may transact business directly as entrepreneur with or without the involvement of hired labor.
- The main barriers for small business development in Ukraine are:
 - bureaucratic business regulations;
 - high level of corruption;
 - low level of willingness of the population to entrepreneurship;
 - frequent changes of legislation.

In Ukraine, there have been some positive changes in the laws regulating the business. For example,

a simplified procedure for business activities termination for individual entrepreneurs now it takes only one day, reduced the number of state oversight, simplified the set of procedures of architectural control. A single social tax paid by employers will be significantly reduced in Ukraine. For freelancers who perform work for foreign clients the paper filling work is simplified as well as the documentation of their relationship and the procedure for obtaining payment for works through banks. The electronic public procurement system is established; it helps to attract businesses to fulfill government orders. However, we need some further steps to promote the development of small business. In particular, it is appropriate to simplify the working conditions for freelancers, so that it would be not beneficial to conceal earnings. Many of them are willing to pay taxes if the procedure will not hinder their competitiveness in the market. To defend their interests, entrepreneurs, including freelancers need to develop a network of NGOs.

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