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SMALL BUSINESS AND CORRUPTION: PECULIARITIES OF THE INTERACTION

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Small business is an important factor of socio-economic development. It creates new jobs, supplies the market with necessary goods and services, and provides a significant share of the added value and GDP of the country. At the same time, small business has essential features that form a specific operating environment: high sensitivity to state regulation, limited access to resources, dynamism of decision-making, the need to accept institutional norms of behavior, etc. They provide the ground for the spread of corruption in society. Modern scientific publications mostly refer to corruption as a factor that restrains development, but not everything is so clear-cut. Depending on the state of the economy and the institutional environment, corruption can act as a factor contributing to the country's development. Our goal was to reveal the specifics of the relationship between corruption and the functioning of small businesses in Ukraine. A comparison of Ukraine and seven neighboring countries showed that the level of corruption negatively affects development indicators. The relatively high spread of corruption in the country is due to the incentives created for small businesses by the current economic policy of the state. The situation is supported by favorable informal institutions that have been formed during the last decades. Although the empirical analysis did not show a high level of dependence between the variables, the qualitative assessment made it possible to put forward several interrelated hypotheses within the framework of the set goal: the threshold interval of corruption; dynamic change of polarity in the influence of corruption on small business; socially effective level of corruption and institutional gap. These hypotheses mainly revolve around the specifics of the

country and can be used during the formation of policies regarding of what to do with the spread of corruption.

Key words: *economic development, small business, corruption, economic relations, institutional environment of small business, economic policy.*

Introduction. Small business and its importance for the development. Small business confidently occupies an important position among the factors of countries economic development. All over the world, small and medium-sized enterprises make an important contribution to job creation and global economic development: about 90% of enterprises, more than 50% of employment and up to 40% of national income (GDP) in developing countries [16]. In Ukraine, medium and small enterprises today provide about 75% of employment and 57% of added value [10]. It is no coincidence that the governments of countries, including Ukraine [25], and international organizations (for example, [3], [22]) pay so much attention to creating favorable conditions for the functioning and development of small enterprises.

Semantically, a small business is contrasted with a large one and compared with it during research [7]. At the same time, it is a peculiar phenomenon of socio-economic relations. Its operation is distinguished by a faster decision-making process, targeting narrow market niches, personalization of customer service, local priorities, etc. At the same time, it is accompanied by high dynamism and uncertainty of the external environment and related risks, limited access to information and financial resources, sensitivity to state regulation. An important factor affecting the activities of small businesses and, ultimately, economic development is corruption.

In economically underdeveloped countries where moreover there are institutional gaps the peculiarities of small business create a fertile ground on which corruption breeds.

1. Sensitivity to the condition of the economic environment: the low degree of development of the country's economy causes its excessive fluctuations, and with it, high uncertainty of the external environment and risks.

2. Limited resources (institutional, financial, material, intellectual, informational, personnel, etc.): this feature arises not only because of the small scale of the companies' activities, but also because of the restrictions imposed by the economic institutions of society.

3. The dynamism of decision-making: despite its small size, the relative cost of time spent in a small business, due to its close dependence on the condition of the external environment and the lack of proper access to resources, is much higher than the same for large enterprises, and this requires quick management solutions and gives small business considerable dynamism.

4. A high level of acceptance of institutional norms of behavior that operate in the immediate environment: big business is more public, and therefore large firms must adhere to formal norms of behavior: neglect of these norms can carry risks of significant losses. Small business in this sense should be more flexible to meet the institutional contradictions of society.

The ambiguity of the impact of corruption on business. Scientific publications present numerous studies of the factors that determine both the impact of corruption on development and vice versa—the level of corruption depends on the degree of economic development. The latter was proved for a sufficiently large sample of countries by comparing the development indicator (GDP per capita) with the Corruption Perception Index [6]: in general, a lower GDP per capita corresponds to a higher level of corruption.

In addition, the authors of other publications covering different countries and periods conclude that cultural and historical traditions, the level of the democracy development, the degree of state unitarity, etc. have a significant impact on the corruption condition [4, 5].

The negative impact of corruption on the main determinants of the country's development is a traditional view, which is largely demonstrated by empirical studies conducted over the past 30 years [15]. They show that corruption significantly reduces the quality of public investments, diminishes private investments both domestic and foreign; cuts down productivity; associates with low investment in education and research, decreases innovation potential and rises brain drain. Therefore, it is clear why it is recognized as the main source of inequality and poverty; as the

factor that negatively affects state revenues and expenditures, limiting the state's ability to perform its functions and generally undermines the main sources of socio-economic development.

At the same time, within the scientific environment, the assessment of the impact of corruption on development is not always unambiguous [14]. In the economies of developing countries, positive effects of corruption are observed, that is explained by the hypothesis of "grease the wheels", when the corrupt activities provide an effective way to mitigate distortions caused by inefficient bureaucratic procedures [8].

In general, despite the publications that discuss the positive consequences of corruption, the idea that corruption hinders rather than promotes development has gradually come to dominate the discourse both in development research and in practical politics [15]. Obviously, assessments of the "corruption-development" vector are mostly polar: either bad or good.

Both the sensitivity to the influence of corruption on activity and the use of corruption schemes as a tool to ensure the necessary profitability differ significantly in the environment of large and small and medium-sized enterprises. Corrupt actions of large enterprises are less obvious due to stable informal connections (for example, with government officials) and the availability of financial resources (*slacks*) sufficient to cover the unforeseen costs of carrying out corrupt operations. It is noted that within the framework of corruption, large enterprises mainly use lobbying for decisions favorable to them [13].

Small business, due to its specific features, does not have the opportunity to implement any considerable corruption projects, but is more often involved in corrupt activities. Its result, as research shows, is not always unambiguous, and the mechanisms of corruption's influence on the activities of firms are unclear [1]. Since both the extent of the spread of corruption and its impact on development depend on the state of the economy and the institutional environment, it can be assumed that the manifestations and results of corrupt activity in the small business environment can be specific for different countries and in different periods of time.

Considering the above, the main research question posed in this paper is to determine how and through which mechanisms corruption

Literature review. Until now, there is no universally recognized definition of corruption, and there is no universally accepted typology of it [21]. Corruption can cover many areas of society: political, economic, public, and reveals itself in numerous forms: bribery, collusion, extortion, favoritism, giving gifts, nepotism, patronage and so on. We will consider economic petty corruption in the sphere of small business activity. The forms of corruption do not matter. The main thing is that corruption changes the nature of economic relations and has a reciprocal effect on the institutional environment.

Schematically, the participants in the corruption act are, on the one hand, the limited-service provider (for example, certification, permission, position, etc.) and the one who, in one way or another, pays for the provision of such a service, on the other. Although, in the scientific literature, a distinction is made between corruption of supply and corruption of demand [17], in the framework of petty economic corruption, it is not particularly important who initiated the corrupt actions. The scheme of the corruption act is quite simple (adapted from [21] to the tasks of this analysis):

(1) The entrepreneur (the person offering to commit the corrupt act) wants to obtain (2) a limited service (order, permission, license, or position) to which (3) the supplier who is authorized to provide a service (the person to be bribed) can give access. The latter receives a particular incentive (money, payment in kind or services) for providing such access (4).

Such a scheme is a fragment of an institutional corruption network, where information channels play an important role, through which participants overcome the concealment of corruption connections. Agents of information transfer are the persons in the entrepreneur's environment: business partners, relatives, close acquaintances, etc. Sometimes information connections are interrupted, and the entrepreneur is unable to realize his corruption goals. The niche is usually filled by so-called "connectors" [20] – intermediaries who bridge the corresponding information gap. For big business, it can be, for example, former influential politicians and officials. In a small business environment, this function is performed (and often on a permanent basis) by micro-agents functionally "tied" to the source of a certain limited resource (production certifica-

tion, work permits, etc.). The cost of their services correlates with the amount of additional income expected by the entrepreneur, as well as his expenses to establish important connections and build the necessary relationships.

It is recognized that the extent of corruption largely depends on two main factors: the state of the economy and the quality of the institutional environment [1]. Indeed, two components are necessary for the conduct of a corruption act: economic as comparative benefits and costs, as well as institutional, within the framework of which the participants must correlate formal and informal norms of behavior.

In the context of economic relations, the idea is accepted that widespread corruption, in any of its forms, negatively affects the economic situation, because as a result, resources are distributed in contradiction to the market principles of the interaction of participants, that is, ineffectively.

The condition of the institutional environment, as a factor of corruption, is determined by the interaction of formal and informal institutions. The former covers the rules and regulations that have been officially adopted to create the economic and legal system of a given country. Others represent traditions, customs, social norms, "common mental models", unwritten codes of conduct, ideologies, and patterns [2]. Weak control over compliance with formal norms and low efficiency of economic institutions (for example, regulation of an entrepreneur's access to capital) and legal institutions (for example, contracts and property rights) contribute to the probability of an entrepreneur's involvement in corruption [18].

The institutional gap in the interaction of formal and informal institutions, i.e., the contradiction between accepted models of behavior and the quality of formal institutions (for example, contracts and property rights) is a factor that contributes to the involvement of entrepreneurs in corruption. In the presence of such a gap, firms direct their efforts to search for rent [12], competing not in the free market, introducing new technologies, developing new markets and products, etc., but for obtaining permissive privileges from the relative authorities.

The importance of the institutional context of corruption is also explored in a deeper sense, bearing in mind extensive cultural and historical sections. A comparison of countries from different global regions of

East Asia (Japan, Taiwan, India, China), North America, North Africa, the Middle East, and Korea made it possible to establish the ambiguous role of corruption in economic development [9]. It is noted, for example, that some types of corruption, such as bribery, kickbacks, nepotism, and favoritism, are not only widespread in some cultures, but also positively "functional" in the economies of countries.

In explaining the reasons for conflicting conclusions regarding the role of corruption in the economy, the distinguishes between two radically different business cultures are pointed [9]. It is emphasized that Western cultures are mainly *rule-based*, where business normally trusts the system and organizes its functioning around individual deals characterized by transparency and regulated by laws that apply to everyone. Whilst most of the world's cultures are *relation-based*, when the functioning of business is organized around human relations, which are bound by "personal honor, filial duties, friendship or long-term mutual obligations".

Thus, it can be considered that the modern understanding of corruption is generated to a greater extent by the Western model of business functioning. What is recognized as corrupt activity in Western countries seems to be an everyday and largely effective business practice in others.

Empirical analysis of the relationship between the small business and corruption in Ukraine. Within the framework of determining the characteristics of the interaction of small business and corruption in Ukraine, attention was paid to three main points: (1) the connection between development and the level of corruption; (2) the economic mechanism of organizing corrupt actions and (3) the condition of institutional environment. As the sources of information, we use statistical data of the State Statistics Service of Ukraine [10], Transparency International data on the Corruption Perceptions Index (CPI) [11] and World Bank data [23].

To determine the relationship between development and the level of corruption, GDP p.c. and CPI were compared for Ukraine and its seven neighboring countries: Russia, Moldova, Belarus, Romania, Hungary, Slovakia, and Poland. They are united not only territorially, but because in one way or another they share economic and cultural-historical experience of life with Ukraine (Fig. 1).
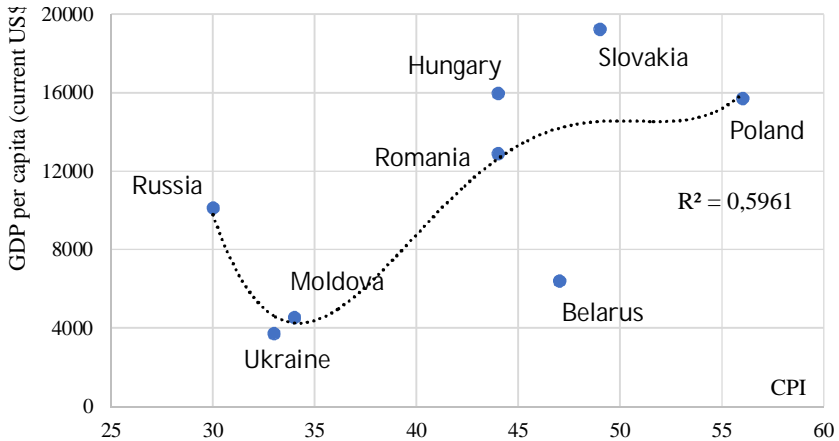
Dependence between GDP p.c. and the level of corruption for Ukraine and
its seven surrounding countries (2020)

The general conclusion is that a higher level of corruption means obstacles to economic development. It is obvious that the statistical relationship is not very tight: $R^2=0.5961$ for a polynomial equation of the 4th degree. If data on the Russian Federation and Belarus are removed from the sample, the relationship between the level of corruption and development will be much stronger − $R^2=0.9474$ for a polynomial equation of the second degree. Therefore, a comparison with this group of countries indicates a significant dependence of the opportunities for economic growth for the mentioned countries on the level of corruption.

Now let's consider the mechanism and conditions of decision-making regarding the participation of small businesses in corrupt activities.

As it was mentioned above, the decision made by an economic agent about whether to be engaged in corrupt activity has at least two contexts: economic and institutional.

In the economic context, the key person of an SME − its manager or sole decision-maker − will be guided by the principle of rationality, maximizing profit. He should compare the possible benefits and losses from deciding to commit corrupt acts. For individuals who decide not to participate in this practice, the cost of refusing the "services"

of institutional corruption networks can be quite high [1]. Under the conditions of significant risks of market activity in a small business environment, corruption ties can reduce the degree of uncertainty for an entrepreneur significantly. Therefore, he will try to expand and strengthen them, supporting the institutional network and counting on receiving benefits in the form of rent. There is no doubt that the economic agent makes an opportunistic decision against the existing formal norms. At the same time, such a decision is accompanied by additional costs, the source of which are hidden financial resources (*financial slacks*), which are also formed in the shadow sector of the economy (19.7% of GDP or UAH 702 billion in 2018 [24]). The costs, meanwhile, are offset by the expected benefits of reducing restrictions and expanding access to resources.

The degree to which the institutional environment in Ukraine is favorable for the activity of small businesses was assessed by comparing the dynamics of the number of micro-enterprises, as the most sensitive and dynamic business segment, and the level of corruption (Fig. 2).

Figure 2
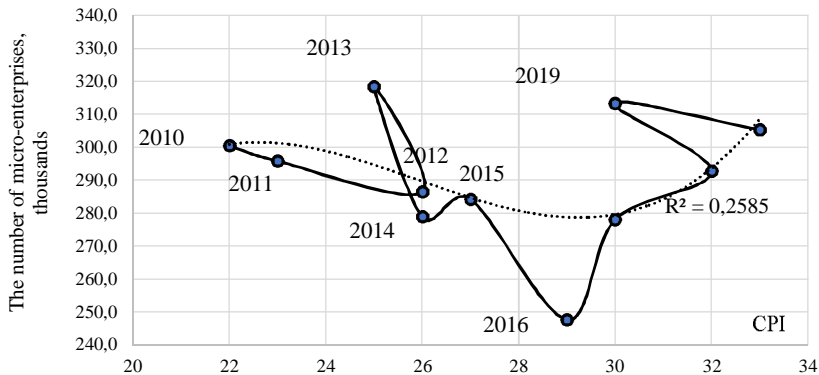
Dynamics of the number of micro-enterprises and the level of corruption in 2010-2021

The coefficient of determination () indicates a weak dependence of the variation in the number of enterprises on the variation of the CPI. At the same time, one can see some time intervals where the nature of the relationship is radically different. If in the period 2016-2020, the number

of enterprises increases along with the reduction of corruption, which generally corresponds to traditional view, then from 2010 to 2016, on the contrary, the reduction of corruption was accompanied by a decrease in the number of enterprises. The changes in the number of enterprises dynamics depending on the level of corruption are supposed to be, as can be imagined, the result of the 2014 crisis and the 2019 pandemic.

Under so statistically weak dependence certain judgments can be made by comparing the directions of both factors changes (Fig. 3).
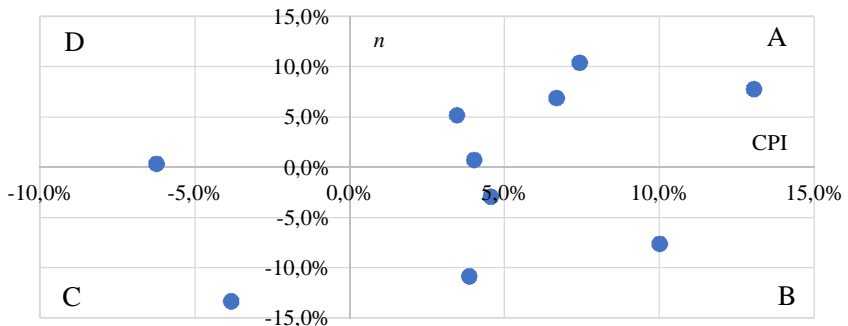
Figure 3

Figure 3 - Rate of growth in the SB enterprise number (n) and the CPI level (2012-2021 with the CPI 1-year lag)

The traditional point of view is as follows: a decrease in corruption leads to an increase in the number of enterprises and vice versa. Therefore, the values in zones A and C correspond to it. Exceptions are points in zones B and D with coordinates (4.5 %; -2.9 %) − 2012, (3.8 %; -10.8 %) − 2016, (-6.3 %; 0 .4 %) − 2020 and (-7.6 %; 10 %) − 2021. If the first appeared because of the economic crisis, the rest are the consequences of the COVID-19 pandemic.

As one can see, the directions of changes coincide in 60 % of cases (Fig. 3). In six of them, the change in the level of corruption was accompanied by corresponding changes in the number of enterprises (2013-2015, 2017-2019). As a hypothesis, it can be assumed that the peculiarities of the country's development determine a certain level of corruption, according to which it acts as a positive factor of the institutional environment: CPI in the interval 29–33 corresponds to the growth of the number

of micro-enterprises. On the contrary, in the range of 22–29 points, the number of enterprises decreases significantly.

The institutional context of corrupt activity is very important in the functioning of small businesses. It is assumed that individuals' perception of how widespread corruption is in their environment can force them to engage in such practices and justify their actions [1, 18].

The quality of the institutional environment, namely the perception of the extent to which agents trust and follow the rules of society, and in particular the quality of contract enforcement, property rights, the police, and courts, as well as the likelihood of crime and violence, characterizes in a certain way by the Rule of Law index. Its value (percentile rank) indicates a country's rank among all countries covered by the aggregated indicator, with 0 corresponding to the lowest rank and 100 to the highest [23].

In 2020, the highest level of the Rule of Law index took place in the countries of the European Union with a high level of GDP per capita − 87.36. For low-income countries − 20.25. For Ukraine, the value of the indicator is 27.4 (Fig. 4). This is higher than its level in 2010 − 22.12. The relative change was +24 %.

Figure 4

Percentile rank of the Rule of Law in 2020 (**-**) and its relative change compared to 2010 (-)
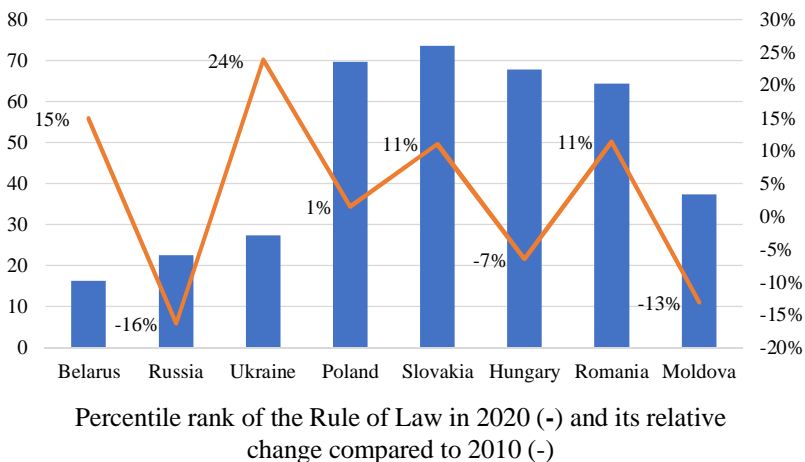
Among neighboring countries, Ukraine ranks 6th − a rather low level, as well as the level of the institutional environment quality, which, as can be assumed, does not contribute to the reduction of corruption, particularly related to the functioning of small businesses.

Results and Discussion. Previous empirical analysis, due to the limited amount of data, showed often contradictory results and weak statistical dependence. Taking this into account, in the part of presenting the results of the analysis, we tried to hypothetically generalize the main qualitative features inherent in the activities of small businesses in Ukraine. As a result, it became possible to formulate four hypotheses, which, among other things, are confirmed by the logic of the identified relationships between the functioning of small businesses and corruption.

1. *Hypothesis regarding the threshold interval of corruption.*

There is a certain threshold interval of the amount of corruption determined by the specifics of the country's development, after reaching which corruption begins to act as a favorable factor in the institutional environment.

Since Ukraine has a high level of corruption: 122nd place out of 180 in the world ranking [19], it can be assumed that the positive impact of corruption is a manifestation of the fact that stable institutional networks have formed in it, which "lubricate friction" in business and avoid uncertainty. which increases the efficiency of activity. In general, an institution (formal or informal) as a social structure that ensures the regulation of certain behavior, relationships and connections between the persons who create it. The weakness of the business institutional environment has a compensatory effect by creating various corrupt institutional networks, participation in which can open entrepreneurs access to critical resources and remove obstacles that small businesses usually face.

Institutional networks can be considered as various connections, contacts or relationships that entrepreneurs develop in the business environment in order to obtain privileged services. Entrepreneurs, to protect investments and keep their firms competitive, are likely to engage in corruption. Most likely, this will be the case where corruption is widespread and the cost of doing business is high. Generally, ill-defined laws, unclear regulations, and heavy regulation increase the cost of doing

business, which is a factor that can encourage entrepreneurs to seek connections in institutional networks to bypass obstacles and support the competitiveness of their firms.

2. Hypothesis regarding the dynamic change in the polarity of the influence of corruption on small business

There is a flexible wave-like relationship between the level of corruption and the development of small businesses, which suggests a consistent transition of corruption from a favorable factor to a deterrent and vice versa - it is related to the first hypothesis but covers extended time horizons.

The level of corruption and small business dynamically interact with each other. The latter can be considered as a breeding ground for corruption. On the other hand, corruption can offer businesses various ways to facilitate their activities. Therefore, there are situations when corruption through its institutional networks encourages the development of small business: provided that the level of corruption is slightly reduced, the MB develops at a sufficiently high pace. By the way, "reduction" may be the result of adaptation or better organization of corrupt institutional networks.

Over time, the development needs of the MB naturally outstrip the capabilities of the institutional environment. Then there is a reverse or restraining effect of institutional networks: the level of corruption continues to slowly decrease, but, at the same time, the sphere of small business is also decreasing at a faster rate.

3. Hypothesis regarding the socially effective level of corruption

For a certain condition of the country's economy and institutional environment, there is a socially effective level of corruption, which equates the marginal private benefit from corrupt actions with the marginal social costs (Fig. 5).

Figure 5
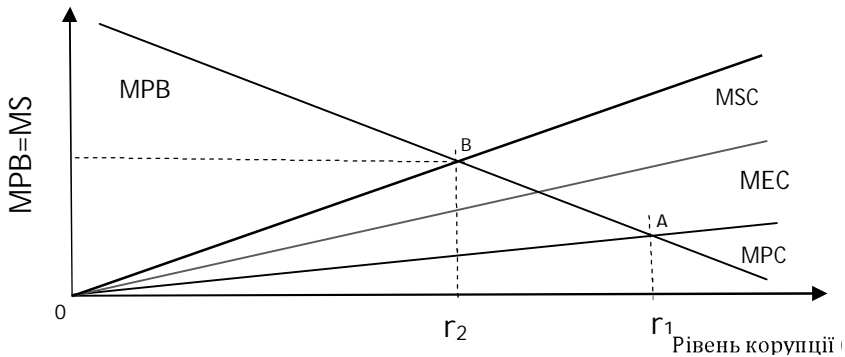
Socially effective level of corruption where:

MEC − marginal external costs (losses of society) associated with inefficient distribution of resources in the economy due to corruption.

MPC − private costs of the corruption activities participants.

MPB − marginal private benefit of the participants from carrying out corrupt activities.

MSC − the marginal social cost of resources associated with corruption.

MPC, together with the increase in the level of corruption, grows more slowly than due to the increase in the number of participants in corrupt relations, which determines the relative reduction of costs and the expansion of access to corruption networks. MPB with the spread of corruption decreases because barriers to access to scarce resources that are the subject of corruption bargaining are weakened.

The socially effective level of corruption is located at point r₂, where the marginal social cost of resources associated with corruption is equal to the marginal private benefit of partcipants in corrupt actions.

4. Hypothesis of the institutional gap

Corruption in the specific environment of small business is a consequence of the gap between the norms of social institutions and the objective economic conditions of the functioning of small enterprises. In the presence of such a gap, firms, due to limited access to resources, compete not in the free market, for example, by introducing new

technologies, developing new markets and products, but for receiving rents (for example, permission privileges from officials).

Western entrepreneurs organize their business around separate contracts provided by the legal system (rule-based activities). In other mostly Asian countries, entrepreneurs organize business more around interpersonal commitments (relationship-based). In the rules of the Western paradigm, such mental models of business relations are considered as corrupt (nepotism, family, loyalty to friends, etc.).

The hypothesis is based on the following considerations. Ukraine is officially trying to adopt the institutional norms of the Western model of business activity, which is reflected in the content of organizational and social institutions (legal acts, laws, decrees, regulations, instructions). However, informal norms of business behavior were organized during the last decades based on the actualization of successful practices, which in turn quite transparently testified to the effectiveness of corruption ties.

Conclusions. Small business, in contrast to large enterprises, is characterized by certain specific features on which corruption grows in societies where there are institutional gaps: sensitivity to the state of the economic environment, limited access to resources, dynamic decision-making and a high level of acceptance of institutional norms of behavior in environment.

1. The negative influence of corruption on the main determinants of the countries' development is a traditional view, which is largely demonstrated by published studies. At the same time, the assessment of the impact of corruption on development is not always unambiguous. Since both the extent of the spread of corruption and its impact on development depend on the state of the economy and the institutional environment, it can be assumed that the manifestations and results of corrupt activity in the environment of small business can be specific for different countries and in different periods of time.

2. Decisions making by an economic agent on whether to commit corrupt activity or not has at least two contexts: economic and institutional. In an economic context, the key person of a small business or the owner, who decides alone, will be guided by the principle of rationality, maximizing profit, and compare the possible benefits and losses of deciding to commit corrupt acts. The institutional context of corrupt activ-

ity is manifested in how individuals assess the prevalence of corruption in their environment, which may lead them to engage in such practices. Among neighboring countries, Ukraine ranks 6th out of 8th in terms of the quality of the institutional environment, which, as can be assumed, does not contribute to the reduction of corruption, particularly related to the functioning of small businesses.

3. The analysis of the main qualitative features inherent in the activity of small businesses in Ukraine made it possible to formulate four hypotheses, which, among other things, are confirmed by the logic of the revealed relationships between the functioning of small businesses and corruption: the threshold level of corruption; changes in the polarity of the influence of corruption on small business, the socially effective level of corruption and the institutional gap.

These hypotheses can be useful in developing policy decisions about what to do about the spread of corruption in the country.

МАЛИЙ БІЗНЕС І КОРУПЦІЯ: ОСОБЛИВОСТІ ВЗАЄМОДІЇ

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Мале підприємництво є важливим фактором соціально-економічного розвитку. Вона створює нові робочі місця, постачає на ринок необхідні товари та послуги, забезпечує значну частку доданої вартості та ВВП країни в цілому. Водночас малий бізнес має суттєві риси, які формують специфічне середовище функціонування: висока чутливість до державного регулювання, обмежений доступ до ресурсів, динамічність прийняття рішень, необхідність прийняття інституційних норм поведінки тощо. за поширення корупції в суспільстві. Сучасні наукові видання здебільшого називають корупцію фактором, що стримує розвиток, але не все так однозначно. Залежно від стану економіки та

інституційного середовища корупція може виступати фактором, що сприяє розвитку країни. Нашою метою було розкрити особливості взаємозв'язку корупції та функціонування малого бізнесу в Україні. Порівняння України та семи сусідніх країн показало, що рівень корупції негативно впливає на показники розвитку. Відносно високий рівень розповсюдження корупції в країні зумовлений стимулами, створеними для малого бізнесу поточною економічною політикою держави. Ситуація підтримується сприятливими неформальними інститутами, які сформувалися протягом останніх десятиліть. Хоча емпіричний аналіз не показав високого рівня залежності між змінними, якісна оцінка дозволила висунути декілька взаємопов'язаних гіпотез у рамках поставленої мети: пороговий інтервал корупції; динамічна зміна полярності впливу корупції на малий бізнес; соціально ефективний рівень корупції та інституційний розрив. Ці гіпотези здебільшого спираються на специфіку країни та можуть бути використані під час формування політики щодо того, що робити з поширенням корупції.

Ключові слова: *економічний розвиток, малий бізнес, корупція, економічні відносини, інституційне середовище малого підприємництва.*

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