Scientific Papers Series Management, Economic Engineering in Agriculture and Rural Development
Vol. 20, Issue 4, 2020
PRINT ISSN 2284-7995, E-ISSN 2285-3952

FINANCING OF UKRAINIAN DAIRY SERVICE COOPERATIVES

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Abstract

The article aimed to study current issues of financing of Ukrainian dairy service cooperatives. In particular, the authors' purpose was to gain a better understanding of capital components of agricultural dairy cooperatives in Ukraine, their funding options, and to propose the policy recommendations for supporting cooperatives as prospective means for agricultural development in Ukraine. The study found that currently, the main financing sources for Ukrainian dairy service cooperatives are members' payments, grants, and rented assets as credits are almost inaccessible for smallholder farmers. The survey showed that members, managers, and presidents of studies cooperatives think that the basic issues for the financing of Ukrainian dairy cooperatives are expensive credit capital, lack of the liquidity of cooperatives' funds, and limited access to better education about cooperative finances for both members and administration groups.

Key words*: *financing, service cooperatives, dairy cooperatives, Ukrainian cooperatives, smallholder farming

INTRODUCTION

Since Ukraine gained independence in 1991, Ukrainian rural communities start to renew their interest in agricultural cooperation. At the beginning of the 2010s, Ukrainian smallholder farmers have started to cooperate for different reasons such as getting finances from authorities or community development (Bezus & Bilotkach, 2018) [6]. Now, more and more farmers try to integrate into the wave of collective business. Institutionally, for the next 10-15 years, Ukrainian farming cooperatives are to find their unique balanced sustainable development models within Ukrainian and international legal frameworks. Farmers groups' collective action is an important strategy for dairy cooperatives to become and remain competitive in rapidly changing markets' conditions in Ukraine.

It is hard to become a successful agrarian businessperson for a small farmer in Ukraine, as farmers' rural communities constantly have to fight poverty, handle low standards of living and mediocre infrastructure (Bezus & Burtak, 2018) [5]. Therefore, it is important to investigate the ways of the development of farmers' communities and support the agricultural sector of Ukraine's economy. One of the ways of supporting is promoting cooperation to provide the markets with fresh, high quality, and not overpriced produce.

Running cooperatives with the number of profitable family farms can help to develop rural territories, reduce poverty, and spread financial literacy among small-scale agricultural food producers in Ukraine. Improved agricultural practices can lead to higher social standards and decreasing the unemployment rate, especially in remote villages.

Previously to establishing a cooperative, it is important to perform a feasibility study and design a model helping to reduce the cost of producers, market their products better, and increase their incomes. The important part of a business model of an agricultural cooperative is the financing of all cooperative activities. Investigating current ways of financing the cooperatives is important for both updating the internal policies about small-scale agricultural production, rural development, and support of necessary decentralization and social development reforms in Ukraine.

As of Ukrainian researchers, managers (both from the governmental and private sectors), and farmers, most of them support the definition of an agricultural cooperative provided by ICA (The Statement on the Cooperative Identity by International Cooperative Alliance). It states that a cooperative is "an autonomous association of person united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." (ICA, 2005) [8].

There are different types of cooperatives in the world depending on the needs and goals of its members. The Law of Ukraine "On agricultural cooperation" defines two types of agricultural cooperatives: the production ones and service ones. Agricultural service cooperatives are a type of service cooperatives having several particular qualities. For instance, such cooperative's founders and members are the producers of agricultural produce, and yet they still are independent. Additionally, farming cooperatives' members have concrete goals such as decreasing the costs and increasing the income of their family agribusiness instead of maximizing the profits as opposed to the ordinary firm, etc. (Parliament of Ukraine, 1997) [11].

The current Ukrainian agrarian scientific society is deeply into studying the features of agricultural cooperatives, as they become an important part of the agricultural sector of Ukraine. Many of them focus on the practices of developed economies in farming cooperation and try to design new policies for Ukrainian farmers based on the experience of Germany, the UK, the Netherlands, etc. For instance, A. Revutska and L. Smoliy (2019) [12] have studied the parallels of globalization's influence on farming cooperatives in Ukraine and the EU. They suggested that the vegetables and berries growing service cooperative is the most sustainable and affordable cooperative model for rural communities in Ukraine (Revutska & Smoliy, 2019) [12]. Yu. Amelina and R. Bezus have been studying organic farming in Ukraine for over 10 years including prospects of financing for organic dairy and vegetable farming cooperatives in Kyiv and Dnipro regions of Ukraine (Bezus & Bilotkach, 2018 [6]; Amelina, 2016) [2]. O. Sakovska has paid a lot of attention to the legal bases of the financing of agricultural cooperatives in Ukraine (Sakovska, 2020) [13].

As of international studies on financing dairy cooperatives, the most recent reviews include articles on capital structure and financial performance of dairy co-operative societies in Kenya and dairy cooperatives' development in India (Buluma, Kung'u, Gicohi, 2017 [7]; Anbu, 2020) [3]. It is important to note the major survey of cooperative capital based on information of 300 biggest cooperatives performed and published within the Blueprint of the Co-operative Decade. It presented recommendations for policymakers to find solutions for better access to capital for cooperatives all over the world (Andrews, 2015) [4].

MATERIALS AND METHODS

This study has been conducted to gain a better understanding of capital components of agricultural dairy cooperatives in Ukraine, their funding options, and to propose the policy recommendations for supporting cooperatives as prospective means for agricultural development in Ukraine.

The study of financing the dairy cooperatives in Ukraine involves the analysis of statistic data from open access sources and dairy cooperatives' accounting reports, as well as the surveys conducted by the CoopAcademy, an educational department of the «Agricultural Extension Service» in the Dnipropetrovs'k region of Ukraine. 6 dairy cooperatives from Dnipro, Zaporizhzhia, Kherson, and L'viv regions producing up to 19% of cooperatives' milk in Ukraine (as of 2019) have been studied.

This study has been structured into three parts. Firstly, we found out the components of the cooperatives' capital at the stage of their establishing. Secondly, we studied the capital structure of the cooperatives as of the beginning of 2020. Finally, we determine the current issues of cooperatives' financing by a phone survey of 50 respondents including presidents, managers, and members of the studied cooperatives.

RESULTS AND DISCUSSIONS

At the beginning of 2020, there were 2,275 agrarian cooperatives in Ukraine; 1,005 of them have a production purpose and the rest 1,269 are service cooperatives. The largest number of operating cooperatives is in Kyiv, Cherkasy, and Zaporizhzhia regions. However, not all of the registered agrarian cooperatives are operating currently. Thus, as of 2019, in total there were 735 operating agricultural service cooperatives, 186 of them were dairy cooperatives and 162 were tilling and harvesting cooperatives. Meat producing farmers have been united into 35 cooperatives; 113 cooperatives have had berries, fruit, and vegetables growing specialization; 4 cooperatives have been united for grain crops growing support, and 198 were registered for providing other services to farmers (State Statistics Service of Ukraine, 2020) [14].

Issues of financing of dairy cooperatives in Ukraine. Historically, small-scale agricultural production has been a key element in Ukrainian agriculture. Due to the wide range of production and marketing practices of Ukrainian dairy cooperatives and the limited number of long-term studies about farmers' cooperation in Ukraine, it is important to design financial plans for each cooperative individually.

The amount of Ukrainian dairy cooperative's capital depends on its type, a number of its members, the daily amount of milk to be sold, milking and storing equipment, type, and amount of services to be provided. Dairy cooperatives need financing to support their day-to-day operations and for such inputs as buildings, track for milk collection and delivery, milking machines for members, mini laboratories, and equipment.

In general, cooperative's capital consists of long-term, short-term types of capital and special organizational funds. Long-term capital means buildings and machines in cooperative, short-term capital is for financing such expenditures as salaries, inventories, and different types of supplies. Organizational funds are to provide expenses associated with an organization, registration, and running a cooperative. Also, it is for covering the fees such as permits for some types of cooperative activities if needed (Mishenin et al., 2017) [10].

At the beginning of the current wave of the cooperative movement in Ukraine (started approximately at 2000), their vast majority has registered themselves as non-profit organizations, yet about five years later, the management of the successful ones decide to run their cooperatives using taxation regimes for small-scale entrepreneurs due to many changes in policies towards agricultural cooperatives.

There are two types of sources for all-Ukrainian dairy cooperative capital. They are internal capital and external capital.

Usually, a cooperative get equity capital from members in the form of direct investment, a retained portion of income, or from the sale of products as per–unit capital. Direct investment of equity from cooperative members forms its portion of general capital in tree basic ways – membership fees, shares, and additional shares.

In case if the equity capital of cooperative paid by members is not enough to cover all the expenses needed to run it, then its managers must look for external sources of financing. Cooperatives may borrow the capital from state and commercial banks, credit unions for farmers, rural entrepreneurs, and external individuals. However, non-profit agricultural cooperatives usually get refuse from Ukrainian commercial banks because of limited repayment guarantees so about 50% of them changed its registration to a profit-generating organization violating the actual legislation.

Besides, to raise some part of funds dairy cooperatives may apply for grants from governmental agencies and international foundations. Borrowed capital may be categorized as a long-term or short-term loan. Short-term credit is to repay in one year and can be used to support everyday cash flow, to buy supplies or services needed for ongoing operations in a cooperative. Another important function of short-term credit is covering a cash deficiency in case of payment delay from a milk factory or processing plant. Adherence of the cooperative to timing in payments for high-quality milk is an important issue for interaction with member farmers, especially in distant rural areas as it influences to their loyalty to cooperation idea.

Long-term credit helps cooperative to fund the purchase of fixed assets. A credit for funding storing buildings or equipment can have a repayment period of up to 8-10 years. Sometimes, long-term credits may be used for increasing the capital for operating purposes. However, this type of credit is not as accessible as a short-term one for dairy cooperatives because commonly the lender requires specific conditions for obtaining such a loan. For example, a bank can set the limits for the specific type of fixed assets or standards for economic performance indicators.

Once an agricultural cooperative starts to operate, its member farmers plan to generate the income to cover all the expenses and accumulate an adequate volume of equity for further development of the cooperative. Basic sources of equity generated are holding a part of cooperative income, and gathering per-unit retains from members. Retained money may become equity in the allocated or unallocated form. Allocated equity remains linked to the accounts of particular members. On the contrary, unallocated equity does not have a connection to the specific members' accounts and remain collected to support the cooperative in general. If the cooperative needs extra capital for expansion or modernization of fixed assets, then members may be asked to invest more money.

Managing income is a major issue for cooperative members and managers at the end of every fiscal year. After calculating all of the income and expenses, the accountant receives the fiscal result of the year. The general gathering may distribute any income left among the members or turn it into unallocated equity of cooperative. In the case of transforming income into cooperative members' payment, it becomes another form of retained payment or cash pay-outs. Otherwise, accumulated funds will finance the cooperative's business operations and growth for the next year. Retaining patronage is a reliable instrument of investment for ongoing farming cooperative, but only in the case of a successful year. If not, a lack of capital requires a new portion of investments from members and non-members. So sometimes, the cooperative's board sets a specific fund to retain 5%-10% of income after deducting expenses to cover financing challenges of poor business periods.

Deciding on the ways of the income distribution can be challenging for agricultural cooperatives. When obtaining refunds in a newly established cooperative, most of the member farmers vote for full pay-outs of income without retaining any portion of it at the end of the financial year. However, a few years later, farmers becoming more literate in cooperative running often decide against patronage refunds of financial results. Nevertheless, since income is the basic source of financing the cooperative, farmers may decline in investing having a successful year. This may lead to distancing from regular investments and other types of maintaining the cooperative. Therefore, the board and president have to balance carefully managing the surplus earnings to back the patronizing of the cooperative by farmers. As an alternative to raising funds from retained portions of surplus income, a dairy cooperative can try the model of per unit capital retaining. This method depends on the number of operations made by farmers with the help of cooperative.

Taxation of the cooperatives in Ukraine. The taxation regimen chosen during its official registration in the state registries impacts partly the funding model of cooperative.

Dairy service cooperatives in Ukraine commonly use one of the three most common taxation models:

- general taxation model,
- single tax model (special regimen),
- non-profit model.

Using the general taxation model means that agricultural cooperative has to pay all of the taxes and linked fees as for-profit enterprise depending on the business model of a cooperative. The list of such taxes and fees may consist of enterprise profit tax (18%), VAT (20%), land tax, property taxes, and social contributions (Tax Code of Ukraine, 2020) [15]. Managing accounting, reporting, and paying all of the listed is hard to perform properly for rural businesses and lead to extra expenditures.

Until the beginning of 2017, there was a special regimen of VAT for agribusiness that allow to accumulate VAT payments at the farm's account and use them for further business development. Nevertheless, in 2017 such an option has been replaced with agricultural subsidies programs.

If the yearly income of cooperative amounts under UAH 7 mill., then it can use a single tax regimen. It is more preferable for a moderate dairy cooperative in rural Ukraine. Usually, the dairy cooperative business model fits into group 3 or 4 of single tax regimen users. According to the Tax Code of Ukraine, group 3 gets a tax rate of 5% of total income and no VAT payment obligation or 3% including such obligation. Besides, group 4 taxpayers' tax rate depends on agricultural land value rather than the amount of income or profit. Along with simplified tax calculations, a single tax regimen includes simplified rules for its accounting and reporting. Once choosing this regimen, farmers' cooperative is not obligated to pay enterprise profit tax and the number of other taxes including land tax (Tax Code of Ukraine, 2020) [15].

According to the authors' observations, efficient dairy cooperatives prefer to use a single tax regimen as using a general tax system is too costly, and non-profit status is hard to prove to the local tax authority.

The non-profit organization model may be chosen for rural dairy cooperative because of its mission and main goals, which are getting better marketing for local farmers, achieving access to cheaper credit, and providing services, yet not profit generation. However, until September of 2019, tax authorities have rarely agreed to register agricultural cooperatives as non-profit claiming that its charter does not have a direct restriction for surplus income distribution among its members. At the beginning of 2020, the situation has started to change. Among the observed cooperatives, all of them have been using a single tax regimen.

The capital structure of dairy service cooperatives in Ukraine. All of the cooperatives under study have been established in 2010-2011 and had a very similar capital structure when start running. Members' capital is the most reliable fund source for a new dairy cooperative in Ukraine, it usually accounts for 100% of newly established cooperative's capital. Membership fee (6%) and members' shares (10%) present about 16% of the capital and the other portion of 84% is the capital raised from selling additional shares to associated members (see Fig. 1).

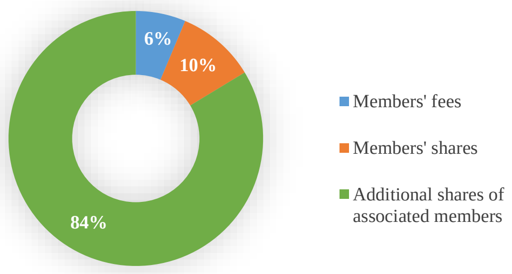

Fig. 1. Capital structure of newly established dairy cooperative in Ukraine
Source: studied cooperatives' reports 2020.

A balanced and detailed marketing strategy is essential for potential farmers' cooperative in rural Ukraine as it helps attract regular and associated members able to invest.

Unfortunately, credit capital is almost inaccessible for new dairy cooperatives in Ukraine. These funds are very expensive for smallholder farmers as they are hard to get without sufficient mortgage and the interest rate starts up from 14% for credits in UAH. Accessibility of cheap credit for agrarian entrepreneurs is a common problem in Ukraine and dairy cooperatives are no exception.

In 2020, the studied group of dairy cooperatives have already gained experience in its running and have passed several crises caused by both internal and external reasons. As soon the cooperatives had started to

Scientific Papers Series Management, Economic Engineering in Agriculture and Rural Development
Vol. 20, Issue 4, 2020
PRINT ISSN 2284-7995, E-ISSN 2285-3952

succeed, members become trustier and more loyal to it. For instance, once a cooperative has managed to buy effective mini-laboratories for milk testing, members ready to invest more to buy something else like a big cooling tank, etc. With years passing, members can see that cooperative is helpful to their farm and local communities, therefore, the portions of such capital components as retained earnings and reserves appear and increase (Fig. 2).

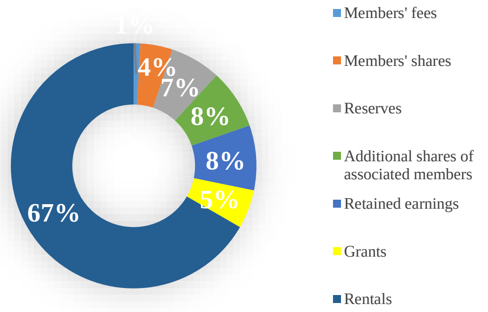

Fig. 2. Capital structure of dairy cooperative in Ukraine with 10 years of experience
Source: studied cooperatives' reports 2020.

As of the beginning of 2020, for the studied dairy cooperatives, retained earnings account for 8% and reserves especially for a goal as cooling of storing capacities accounts for 7% of capital. Members' fees and shares account for up to 5% of the capital of dairy cooperatives. After 10 years, additional shares to associated members account for up to 8% of such cooperatives' capital.

In some time after the cooperative began to succeed, local businesses and authorities consider the partnership with its members and management more acceptable. With gaining a good reputation, cooperatives may rent a range of means. Rented assets provided to it are very important for dairy cooperatives. In terms of rural Ukrainian communities, such assets may be both buildings of an old abandoned collective farm provided by local authorities and modern cooling tanks or milk-gathering trucks and stations. If the local authority's leader supports the farmers' cooperation activities than they may provide cars or laboratory equipment for free use. Currently, dairy cooperatives have up to 67% of capital in a rental form.

Furthermore, rural dairy farmers may apply for local or international grants. National grants may be covered by a local budget if it has something to offer, by regional subsidies or by national support programs of the Ministry of Agrarian Policy and Food of Ukraine (Ministry of Agrarian Policy and Food of Ukraine, 2019) [9]. As of 2020, grants account for 8% of the capital of the studied dairy service cooperatives.

Additionally, we have observed that the cooperatives with a general taxation regimen tend to have lower portions of retained earnings and reserves than those with a single tax regime and non-profit status due to high tax rates.

The phone interviews with members, presidents, and managers of 6 studied dairy cooperatives demonstrate that the basic issues for the financing of Ukrainian dairy cooperatives are expensive credit capital (42% of respondents), lack of the liquidity of cooperatives' funds (34% of respondents) and limited access to better education about cooperative finances for both members and administration groups (24% of respondents).

Regarding the access to credit capital for farmers, it has been always a sufficient problem for rural agribusiness development in Ukraine. Moreover, Ukrainian authorities have always tried to solve it, but due to the rapidly changing market and policy environment within Ukraine, their efforts were not successful enough. The new governmental program of affordable credits "5-7-9%" may be the brake in this problem yet the results of its implementation to analyse will appear only a few years later (Affordable credits program "5-7-9%", 2020) [1].

Improving liquidity of cooperatives' funds is an important part of a cooperative business strategy for creating development opportunities. To improve liquidity cooperative management, it needs to make cash flow plans. Even so, the current changing market environment may lead to situations when dairy cooperatives need cash to pay the producers or banks but milking plants or processing factory delays with their payments for a week or two. Delays of payments to members may cause the withdrawing the membership of fewer producers and increasing their engagement with local milk intermediaries. In remote rural areas of Ukraine, it might lead to cooperative closure due to decreasing the amount the milk to be sold to the plant. Delays of payments to banks (or other creditors) cause the fines generation according to the credit agreement. The core articles of current legislation on agricultural cooperation has been updating since 2013 due to the lobbying of activists' groups. Among other problems, new laws were aimed to protect the economic and social rights of cooperatives' members yet the articles on protecting the farmers' rights are hard to use for protection in real life. Unprotected status discourages farmers and prevents them from cooperating that may bring them back to poverty. At this point, dairy farmers' cooperatives need to have effective, transparent, and understandable procedures to protect their interests in the best way even in very remote areas of Ukraine.

Another issue for farmers' cooperation and its financing is a lack of professionals in this sphere. Massive practical and scientific publications about this topic have started to spread since the middle of the last decade so now there are very few reliable knowledge bases for cooperative members. This situation has been changing since international NGOs entered Ukraine to spread their practices yet still it is not enough because of the high demand for such educational services. To get further development, dairy cooperation needs more knowledge investments like extension services. Most active agencies of such services have been working in Kyiv, Dnipro, and L'viv regions of Ukraine.

CONCLUSIONS

Ukrainian dairy cooperatives finance their activities like any other enterprise, by raising the capital. However, such cooperatives financing methods and capital components differ from those used by non-cooperative as cooperative members provide capital to the cooperative.

In cases, if these types of funding are not enough, borrowing from non-members is a good strategy, yet the returns from such borrowing should cover the cost of borrowing and provide the surplus for cooperative and members. As of 2020, most of the Ukrainian smallholder dairy farmers still have a hard time getting cheap credits for their small businesses so group action regarding borrowing for cooperatives' operating capital may be a good resolution.

As of the beginning of 2020, for top dairy service cooperatives in Ukraine, members' fees and shares account for up to 5% of its capital, retained earnings account for 8%, and reserves for such special goals as cooling or storing capacities account for 7% of capital. After 10 years, additional shares to associated members account for 8% and rented assets account for 67% of such cooperatives' capital. Local grants account for 8% of the studied dairy service cooperatives.

According to survey results, the basic issues for Ukrainian dairy cooperatives are expensive credit capital (42% of respondents), lack of the liquidity of cooperatives' funds (34% of respondents), and limited access to better education about cooperative finances for both members and administration groups (24% of respondents).

For over twenty years, the policymakers in Ukraine try to solve the problem of credit accessibility for smallholder farmers; however, the policies towards this issue still needs improvement of its funding and implementation mechanisms.

Delays of payments to members often cause the withdrawing of their membership, discourage farmers, and prevent them from further cooperation. Sometimes, it means the end for the local cooperative leading to fully unprotected status for farmers and decreasing their social standards. Farmers need to learn how to protect their economic and social rights through the updated legislation on agricultural cooperation and its effective procedures to be developed.

For increasing the number of successful dairies in Ukraine, both public and private institutions have to pay more attention to the development of such matters as extension services or similar agencies because rural dairy farmers need modern education in this sphere.

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