Business Entry Regulations and Reforms

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Abstract:

This paper outlines short and long-term regulatory reforms that governments could implement to make starting a business easier in their respective countries. The short-term reforms represent "quick-wins" because they are primarily administrative in nature and can be accomplished quickly. Although rapid, they would have a large impact on the business environment in countries by eliminating red tape that hinders businesses. These "quick-wins" also create an environment in which longer-term, more in-depth reforms are more likely to succeed. The longer-term reforms may require more time for implementation, a conducive and enabling environment, as well as changes to prevailing laws.

Overview:

A vibrant private sector - with firms making investments, creating jobs, and improving productivity - promotes growth and expands opportunities for poor people. To create one, countries have implemented a wide range of reforms -- including macro-stabilization programs, price liberalization, privatization, and trade-barrier reductions. However, youth employment remains limited, poverty rate is still high, and anti-poor economic growth holds higher than pro-poor economic growth. Meanwhile, other countries have spurned orthodox macro reforms and done well. How and why so? What can they do to help entrepreneurs create jobs?

There is a growing consensus that the quality of business regulation and the institutions that enforce it are a major determinant of employment creation, private sector development, and economic prosperity. Haidar 2012 investigated the link between business regulatory reforms and economic growth in 172 countries. It established that, on average, each positive business regulatory reform is associated with a 0.15 percent increase in income growth rate.

Relatively little research has provided guidance to policymakers about assessing how good legal and regulatory systems are and determining what to reform in. In countries with relatively weak business environments, business entry reforms allow firms to grow faster and create more jobs (Klapper and Love 2010). An increasing number of new jobs will be in the formal economy because the benefits of being formal (such as easier access to credit and better utility services) often outweigh the costs (such as taxes). And more formal jobs mean more workers are protected by pensions, safety regulations and health benefits[1].

Earlier studies confirm this pattern following business regulatory reforms. For example, quarterly job creation in Portugal, one of the most heavily regulated labor markets, is 59% of that in the United States on a per capita basis. A Portuguese business is 40% less likely than a U.S.

[1] See Amin and Haidar (2012a,b), Haidar (2007, 2008, 2009)

one to create jobs during an economic upturn (Blanchard and Portugal 1998). Such jobless recoveries are common to heavily regulated markets -- and mean that some people remain without work for long periods. But where regulations are costly and burdensome, businesses often operate in the informal economy -- and remain small, creating few jobs. Indeed, opportunities exist for creating jobs in countries.

This paper outlines both short and long-term reforms that governments could implement to make starting a business easier in their countries. The short-term reforms represent "quick-wins" (see section A) because they are primarily administrative in nature and can be accomplished quickly through ministerial action. Although rapid, they would have a large impact on the business environment by eliminating red tape that hinders businesses. These short-term reforms also create an environment in which longer-term, more in-depth reforms are more likely to succeed. The longer-term reforms (see section B) may require more time for implementation, a conducive and enabling environment, as well as changes to prevailing laws.

A. Quick Win Reforms for facilitating business entry

This section focuses on areas where action is feasible in the short run. The objective of these reforms is to improve part of the business regulatory environment for entrepreneurs and thus encourage economic growth and job creation.

To reduce the steps, cost, and time, as well as the minimum capital, the following short-term reforms could be feasible in the short run:

- Abolish the minimum capital requirement (thus also eliminating opening bank account procedure)
- Make optional the requirement to designate a lawyer for standard small-medium businesses

*Abolish minimum capital requirement***:** Many countries defend the capital requirement as necessary to protect creditors. But the effect is counterproductive. Without all their funding immediately at their disposal, entrepreneurs have a harder time establishing an office, hiring employees, marketing new products and otherwise getting their business underway. Furthermore, minimum capital requirements can be a barrier to small business development, which is often important for economic growth and job creation. Lenders also base their decisions on commercial risk, not whether the firm is able to make its minimum capital payment. In most, and all high-income, countries around the world, this requirement is now considered obsolete[2]. Several countries - including Egypt, Georgia, Macedonia, and Saudi Arabia - have recently eliminated or reduced to a nominal amount the paid-in minimum capital requirement[3]. Starting a business in Saudi Arabia used to be limited to those who could afford one of the highest minimum capital requirements in the world -- $125,000 for limited liability companies. In July 2007 Saudi Arabia slashed the minimum capital requirement. Subsequently, new business

[2] Djankov et al. (2002)
[3] Belayachi and Haidar (2008)

registrations jumped 81 percent. Also, Bruhn (2011) found that simplifying business entry regulation Mexico increased the number of registered businesses by 5%.

Make optional the requirement to designate a lawyer for standard small-medium businesses: In some countries, each newly formed company - from bookstores to factories - must contract an attorney and pay him an annual retainer. To further streamline the process, the lawyer designation requirement could be optional for small and medium businesses. This reform could save entrepreneurs' steps, time, and the attorney fees, while encouraging investment and job creation. Top performing countries, like Australia and Canada, do not require the retention of a lawyer for standard commercial activities.

B. Long-term reforms to facilitate business entry

While the above "quick win" reforms may simply require administrative changes or ministerial action (with the possible exception of the elimination of the minimum capital requirement for starting a business), deeper reforms could demand legislative action and a time-consuming process to build consensus among affected parties. To improve the ease of starting businesses within their borders, countries could benefit from additional administrative and legal reforms by, for example, *creating a one-stop shop at the Commercial Registry*. The entrepreneur would simply fill in all requisite forms at the beginning of the process, making only one contact with the Commercial Registry, then return at an agreed-upon date to pick up the certificate of incorporation and confirmation of registration with the other agencies. To complete the process, the Commercial Registry can issue a unique company registration number, which would be used to register for tax and any other agencies. Other countries including Belgium and Mauritius have created such single access points and experienced a significant reduction in time to start-up, as well as an increase in the number of formally registered businesses (Djankov 2008 and Haidar 2013).

Concluding remarks:

Various developing countries are using their business environment reform progress to show results of their reform efforts which can play a role in their access to loans related to development projects supported by development institutions such as from the Millennium Challenge Corporation, USAID, and the World Bank Group. The experience of business entry reformers shows that what gets measured gets done. A results-based incentive system with credit for reformers in the government can deliver results.

One element of successful reform is communicating that the reform has happened and monitoring the results. Reforms are only effective if entrepreneurs know of the reforms and how to make use of them. Any reforms that a country makes should be communicated to the relevant beneficiaries and stakeholders and monitored. Publicity surrounding reforms supports that changes are accepted and implemented. It also signals that the country is serious about improving its business environment to encourage investment and job creation. Monitoring results and feedback will highlight what was a success and where further effort is needed.

Last but not least, it is important to highlight that (i) business regulatory reform is not costly and (ii) social protection does not necessarily require strict and complex business regulation. The costs are modest for many of the reforms just outlined. Setting up a private credit bureau cost less than $2 million in Bosnia and Herzegovina. Setting up an administrative agency for business registration cost less than $2 million in Serbia. Integrating the business start-up process into a single access point cost $10 million in Turkey. Easing start-up was recently listed by a panel packed with Nobel laureates as one of the most cost-effective ways to spur development -- ahead of investing in infrastructure, developing the financial sector and scaling up health services.

And, one can look at Nordic countries to know that social protection does not necessarily require strict and complex business regulation. All four Nordic economies in Doing Business rankings are on the list of countries with the simplest business regulation: Norway (#5), Sweden (#9), Denmark (#12) and Finland (#14). Few would argue that they scrimp on social benefits relative to other countries, or regulate too little. Instead, they have simple regulations that allow businesses to be productive. And they focus regulation on where it counts—protecting property rights and providing social services. Estonia, Latvia and Lithuania, having learned much from their richer neighbors, are also among the countries with the best business environment. Heavier business regulation is not associated with better social outcomes.

Business regulatory reforms are now necessary and timely but not sufficient. The above recommendations are not comprehensive but can serve to highlight the first steps for what needs to be changed and where when reforms are designed in specific areas. Reformers can also benefit from reviewing the experience of countries that perform well according to the indicators. Business regulatory reforms are expanding significantly across countries and being used as benchmark measures for the success of policy makers. Thus, implementing the above reforms can signal tangible achievements for the current ministers of finance, economy and trade, as well as internal and municipality affairs – especially in the current challenging times. And, most importantly, they can pave the road for longer-term, more in-depth reforms that can target the broader business environment.

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