SMEs and Smarter Business Regulations

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This 10th edition of the *Doing Business*[1] report marks a good time to take stock—to look at how far the world has come in business regulatory practices and what challenges remain. In the first report one of the main findings was that low-income economies had very cumbersome regulatory systems. Ten years later it is apparent that business regulatory practices in these economies have been gradually but noticeably converging toward the more efficient practices common in higher income economies. How much has the gap narrowed? Did some regions close the regulatory gap more rapidly than others? This year's report tells that story. It points to important trends in regulatory reform and identifies the regions and economies making the biggest improvements for local entrepreneurs. And it highlights both the areas of business regulation that have received the most attention and those where more progress remains to be made.

The report also reviews research on which regulatory reforms have worked and how. After 10 years of data tracking reforms and regulatory practices around the world, more evidence is available to address these questions. The report summarizes just some of the main findings. Among the highlights: Smarter business regulation supports economic growth. Simpler business registration promotes greater entrepreneurship and firm productivity, while lower-cost registration improves formal employment opportunities. An effective regulatory environment boosts trade performance. And sound financial market infrastructure—courts, creditor and insolvency laws, and credit and collateral registries—improves access to credit.

[1] www.doingbusiness.org

WHAT ARE SMART RULES FOR BUSINESSES?

Just as good rules are needed to allow traffic to flow in a city, they are also essential to allow business transactions to flow. Good business regulations enable the private sector to thrive and businesses to expand their transactions network. But regulations put in place to safeguard economic activity and facilitate business operations, if poorly designed, can become obstacles to doing business. They can be like traffic lights put up to prevent gridlock—ineffective if a red light lasts for an hour. Most people would run the red light, just as most businesses facing burdensome regulations will try to circumvent them to stay afloat. Striking the right balance in business regulation can be a challenge. It becomes an even greater challenge in a changing world, where regulations must continually adapt to new realities. Just as traffic systems have to adjust when a new road is being constructed, regulations need to adapt to new demands from the market and to changes in technology (such as the growing use of information and communication technology in business processes).

This challenge is one focus of this report. Through indicators benchmarking 185 economies, *Doing Business* measures and tracks changes in the regulations applying to domestic small and medium size companies in 11 areas in their life cycle. This year's aggregate ranking on the ease of doing business is based on indicator sets that measure and benchmark regulations affecting 10 of those areas: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. *Doing Business* also documents regulations on employing workers, which are not included in this year's aggregate ranking or in the count of reforms.

The economies that rank highest on the ease of doing business are not those where there is no regulation—but those where governments have managed to create rules that facilitate interactions in the marketplace without needlessly hindering the development of the private sector. In essence, *Doing Business* is about SMART business regulations—Streamlined, Meaningful, Adaptable, Relevant, Transparent—not necessarily fewer regulations. *Doing Business* encompasses 2 types of indicators: indicators relating to the *strength of legal institutions* relevant to business regulation and indicators relating to the *complexity and cost of regulatory processes*.

Those in the first group focus on the legal and regulatory framework for getting credit, protecting investors, enforcing contracts and resolving insolvency. Those in the second focus on the cost and efficiency of regulatory processes for starting a business, dealing with construction permits, getting electricity, registering property, paying taxes and trading across borders. Based on time-and-motion case studies from the perspective of the business, these indicators measure the procedures, time and cost required to complete a transaction in accordance with relevant regulations.

Economies that rank high on the ease of doing business tend to combine efficient regulatory processes with strong legal institutions that protect property and investor rights. OECD high-income economies have, by a large margin, the most business-friendly regulatory environment on both dimensions. Regions such as East Asia and the Pacific and the Middle East and North Africa have relatively efficient regulatory processes but still lag in the strength of legal institutions relevant to business regulation. Good practices around the world provide insights into how governments have improved the regulatory environment in the past in the areas measured by *Doing Business*

WHO NARROWED THE REGULATORY GAP IN 2011/12?

As reflected in the ranking on the ease of doing business, the 10 economies with the most business-friendly regulation are Singapore; Hong Kong SAR, China; New Zealand; the United States; Denmark; Norway; the United Kingdom; the Republic of Korea; Georgia; and Australia (table 1.1). Singapore tops the global ranking for the seventh consecutive year. A number 1 ranking on the ease of doing business does not mean that an economy ranks number 1 across all 10 regulatory areas included in this aggregate measure. Indeed, Singapore's rankings range from 1 in trading across borders to 36 in registering property. Its top 3 rankings (on trading across borders, dealing with construction permits and protecting investors) average 2, while its lowest 3 (on registering property, getting credit and enforcing contracts) average 20.

Similarly, Guatemala's top 3 (on getting credit, registering property and getting electricity) average 22, and its bottom 3 (on paying taxes, protecting investors and starting a business) average 151. So while the ease of doing business ranking is a useful aggregate measure, analysis based on this measure should also take into account the dispersion of regulatory efficiency across the areas measured by *Doing Business*. In the past year 58% of economies covered by *Doing Business* implemented at least 1 institutional or regulatory reform making it easier to do business in the areas measured, and 23 undertook reforms in 3 or more areas. Of these 23 economies, 10 stand out as having jumped ahead the most in the relative ranking. Others in this group advanced less in the global ranking because they already ranked high. Two are Korea and the Netherlands. Already among the top 35 in last year's global ranking, both implemented regulatory reforms making it easier to do business in 4 areas measured by *Doing Business*.

Four of the 10 economies improving the most in the ease of doing business are in Eastern Europe and Central Asia—the region that also had the largest number of regulatory reforms per economy in the past year. Four of the 10 are lower-middle income economies; of the rest, 1 is low income, 3 are upper middle income and are high income. And for the first time in 7 years, a South Asian economy—Sri Lanka—ranks among those improving the most in the ease of doing business.

Eight of the 10 economies made it easier to start a business. Kazakhstan, Mongolia and Ukraine reduced or eliminated the minimum capital requirement for company incorporation. Sri Lanka computerized and expedited the process for registering employees. Burundi eliminated 3 requirements: to have company documents notarized, to publish information on new companies in a journal and to register new companies with the Ministry of Trade and Industry. Five of the 10 made it easier to resolve insolvency, and 2 of these also strengthened their systems for enforcing contracts.

Serbia strengthened its insolvency process by introducing private bailiff s, prohibiting appeals of the court's decision on the proposal for enforcement, expediting service of process and adopting a public electronic registry for injunctions. The new private bailiff system also increased efficiency in enforcing contracts. Poland introduced a new civil procedure code that, along with an increase in the number of judges, reduced the time required to enforce a commercial contract.

Poland also made it easier to resolve insolvency, by updating the documentation requirements for bankruptcy filings. Four economies made it easier to register property. Poland increased efficiency in processing property registration applications through a series of initiatives in recent years. These included creating 2 new registration districts in Warsaw and, in the past year, introducing a new caseload management system for the land and mortgage registries and continuing to digitize their records.

Five economies improved in the area of getting credit. Costa Rica, Mongolia and Uzbekistan guaranteed borrowers' right to inspect their personal credit data. Sri Lanka established a searchable electronic collateral registry and issued regulations for its operation. Kazakhstan strengthened the rights of secured creditors in insolvency proceedings. Greece, driven in part by its economic crisis, implemented regulatory reforms in 3 areas measured by *Doing Business*—improving its regulatory environment at a greater pace in the past year than in any of the previous 6. It made construction permitting faster by transferring the planning approval process from the municipality to certified private professionals, strengthened investor protections by requiring greater disclosure and introduced a new pre-bankruptcy rehabilitation procedure aimed at enhancing the rescue of distressed companies. Costa Rica, the only economy in Latin America and the Caribbean in the group of 10, implemented regulatory changes in 4 areas measured by *Doing Business*. It introduced a risk-based approach for granting sanitary approvals for business start-ups and established online approval systems for the construction permitting process. Costa Rica also guaranteed borrowers' right to inspect their personal data and made paying taxes easier for local companies by implementing electronic payments for municipal taxes.

While these 10 economies improved the most in the ease of doing business, they were far from alone in introducing improvements in the areas measured by *Doing Business* in 2011/12. A total of 108 economies did so, through 201 institutional and regulatory reforms. And in the years since the first report was published in 2003, 180 of the 185 economies covered by *Doing Business* made improvements in at least one of these areas—through nearly 2,000 such reforms in total.

In 2011/12 starting a business was again the area with the most regulatory reforms. In the past 8 years the start-up process received more attention from policy makers than any other area of business regulation tracked by *Doing Business*—through 368 reforms in 149 economies. These worldwide efforts reduced the average time to start a business from 50 days to 30 and the average cost from 89% of income per capita to 31%.

In the past year Eastern Europe and Central Asia once again had the largest share of economies registering improvements, with 88% of economies implementing at least 1 institutional or regulatory reform making it easier to do business and 67% implementing at least 2. This region has been consistently active through all the years covered by *Doing Business*, implementing 397 institutional and regulatory reforms since 2005. At least some of this regulatory reform push reflects efforts by economies joining the European Union in 2004 to continue to narrow the gap in regulatory efficiency with established EU members—as well as similar efforts among economies now engaged in EU accession negotiations.

WHO HAS NARROWED THE GAP OVER THE LONG RUN?

To complement the ease of doing business ranking, a relative measure, last year's *Doing Business* report introduced the distance to frontier, an absolute measure of business regulatory efficiency. This measure aids in assessing how much the regulatory environment for local entrepreneurs improves in absolute terms over time by showing the distance of each economy to the "frontier," which represents the best performance observed on each of the *Doing Business* indicators across all economies and years included since 2005. The measure is normalized to range between 0 and 100, with 100 representing the frontier. A higher score therefore indicates a more efficient business regulatory system.

Analysis based on the distance to frontier measure shows that the burden of regulation has declined since 2005 in the areas measured by *Doing Business*. On average the 174 economies covered by *Doing Business* since that year are today closer to the frontier in regulatory practice. In 2005 these economies were 46 percentage points from the frontier on average, with the closest economy 10 percentage points away and the furthest one 74 percentage points away. Now these 174 economies are 40 percentage points from the frontier on average, with the closest economy 8 percentage points away and the furthest economy 69 percentage points away.

OECD high-income economies are closest to the frontier on average. But other regions are narrowing the gap. Eastern Europe and Central Asia has done so the most, thanks to about 17 institutional and regulatory reforms per economy since 2005. Economies in the Middle East and North Africa and Sub-Saharan Africa have implemented more than 9 institutional and regulatory reforms on average—and those in East Asia and the Pacific, Latin America and the Caribbean and South Asia about 8. With its faster pace of improvement, Eastern Europe and Central Asia overtook East Asia and the Pacific as the second most business-friendly region according to *Doing Business* indicators.

But the variation within regions is large. In Latin America and the Caribbean, for example, Colombia implemented 25 institutional and regulatory reforms in the past 8 years, while Suriname had none. In East Asia and the Pacific, Vietnam implemented 18 reforms, and Kiribati none. In a few economies (such as República Bolivariana de Venezuela and Zimbabwe) the business environment deteriorated as measures added to the complexity and cost of regulatory processes or undermined property rights and investor protections. Within the European Union, 4 Southern European economies have recently accelerated regulatory reform efforts.

Improvements happened across all regulatory areas measured by *Doing Business* between 2005 and 2012. But governments were more likely to focus their reform efforts on reducing the complexity and cost of regulatory processes—the focus of 1,227 reforms recorded by *Doing Business* since 2005—than on strengthening legal institutions—the focus of close to 600.

Improving business regulation is a challenging task, and doing it consistently over time even more so. Yet some economies have achieved considerable success since 2005 in doing just that. A few of these economies stand out within their region: Georgia, Rwanda, Colombia, China and Poland. Georgia is the top improver since 2005 both in Eastern Europe and Central Asia and globally. With 35 institutional and regulatory reforms since 2005, Georgia has improved in all areas measured by *Doing Business*. In the past year alone it improved in 6 areas. As just one example, Georgia made trading across borders easier by introducing customs clearance zones in such cities as Tbilisi and Poti. These one-stop shops for trade clearance processes are open all day every day, allowing traders to submit customs documents and complete other formalities in a single place. Georgia also strengthened its secured transactions system. A new amendment to its civil code allows a security interest to extend to the products, proceeds and replacements of an asset used as collateral.

Georgia has also distinguished itself by following a relatively balanced regulatory reform path. Many economies aiming to improve their regulatory environment start by reducing the complexity and cost of regulatory processes (in such areas as starting a business). Later they may move on to reforms strengthening legal institutions relevant to business regulation (in such areas as getting credit). These tend to be a bigger challenge, sometimes requiring amendments to key pieces of legislation rather than simply changes in administrative procedures. Georgia has followed this pattern, focusing initially on reducing the complexity and cost of regulatory processes and later on strengthening legal institutions. But among a group of 5 top regional improvers, Georgia has improved the most along both dimensions.

Rwanda, the number 2 improver globally and top improver in Sub-Saharan Africa since 2005, has reduced the gap with the frontier by almost half. To highlight key lessons emerging from Rwanda’s sustained efforts, this year’s report features a case study of its reform process. But Rwanda is far from alone in the region: of the 50 economies advancing the most toward the frontier since 2005, 17 are in Sub-Saharan Africa.

Worldwide, economies at all income levels are narrowing the gap with the frontier on average—but low-income economies more so than high-income ones. This is an important achievement. Indeed, while business regulatory practices in all lower income groups are converging toward those in high-income economies on average, low-income economies have reduced the gap the most, by 4 percentage points since 2005. Lower-middle-income economies have closed the gap with high-income economies by 3 percentage points, and upper-middle-income economies by 2 percentage points. This convergence is far from complete, however.

While the Arab Republic of Egypt is the top improver in the Middle East and North Africa since 2005, its improvement was concentrated in the years before 2009. In the past 4 years there was no visible improvement in the areas measured by *Doing Business*. Regionally, there was less focus on reforming business regulation in the past year than in any previous year covered by *Doing Business*, with only 11% of economies implementing at least 2 regulatory reforms.

Colombia, the economy narrowing the gap with the frontier the most in Latin America and the Caribbean, is also featured in a case study this year. Between 2006 and 2009 Colombia focused mostly on improving the efficiency of regulatory processes, with an emphasis on business registration and tax administration. But in 2010 it began reforming legal institutions, such as by strengthening the protection of minority shareholders and by improving the insolvency regime.

Two of the “BRICs” rank among the top 50 improvers—China and India, each also the top improver in its region since 2005. Both implemented regulatory reforms particularly in the early years covered by *Doing Business*. China established a new company law in 2005, a new credit registry in 2006, its first bankruptcy law in 2007, a new property law in 2007, a new civil procedure law in 2008 and a new corporate income tax law in 2008. After establishing its first credit bureau in 2004, India focused mostly on simplifying and reducing the cost of regulatory processes in such areas as starting a business, paying taxes and trading across borders.

Five OECD high-income economies make the list of top 50 improvers: Poland, the Czech Republic, Slovenia, Portugal and France. Poland in the past year alone implemented 4 institutional and regulatory reforms, among the 20 recorded for it by *Doing Business* since 2005. It improved the process for transferring property, made paying taxes more convenient by promoting the use of electronic facilities, reduced the time to enforce contracts and strengthened the process of resolving insolvency.

IN WHAT AREAS IS THE GAP NARROWING THE MOST?

Since 2005 there has been a convergence in business regulatory practices in two-thirds of the areas measured by *Doing Business*: starting a business, paying taxes, dealing with construction permits, registering property, getting credit and enforcing contracts. This means that laws, regulations and procedures in these areas are more similar across economies today than they were 8 years ago. Overall, more convergence has occurred in the areas measured by *Doing Business* that relate to the complexity and cost of regulatory processes than in those that relate to the strength of legal institutions.

The greatest convergence in regulatory practice has occurred in business startup. Among the 174 economies covered by *Doing Business* since 2005, the time to start a business in that year averaged 112 days in the worst quartile of the economies as ranked by performance on this indicator, while it averaged 29 days for the rest. Since then, thanks to 368 reforms in 149 economies, the average time for the worst quartile has fallen to 63 days, getting closer to the average of 18 for the rest. Similar but less strong patterns are observed for indicators of time, procedures and cost for paying taxes, dealing with construction permits and registering property.

But in 3 areas the trend runs weakly in the other direction. In protecting investors, trading across borders and resolving insolvency the realities in different economies have slowly drifted apart rather than converged. This does not mean that in these 3 areas the average regulatory environment is worse today than in 2005; it is actually better. But it does mean that economies that were in the best 3 quartiles of the distribution in these 3 areas in 2005 have strengthened practices and institutions somewhat faster than those in the worst quartile.

WHAT IS THE IMPACT ON ECONOMIC OUTCOMES?

Beyond what *Doing Business* measures, have the business regulation reforms undertaken by governments since 2005 had an impact? In presenting analysis of this question, earlier editions of *Doing Business* focused on cross-country analyses linking business regulation to economic variables such as corruption or rates of informality in the economy.

With more years of data now available, previous research on the impact of reforms in the areas measured by *Doing Business* can be extended over time and linked to more economic outcomes. Using several years of data for the same economy makes it possible to take into account country characteristics that remain constant over time when doing analysis across economies—something not possible in the earlier cross-country analyses. Based on a 5-year panel of economies, one such study finds that in low-income economies that implemented reforms making it easier to do business, the growth rate increased by 0.4 percentage point in the following year.2 Emerging evidence from analysis based on 8 years of *Doing Business* data and building on the earlier studies shows that improvements in business entry and other aspects of business regulation matter for aggregate growth as well. Credibly pinning down the magnitude of this effect is more difficult, however.

Research on the effect of regulatory reforms is advancing especially rapidly around the question of business start-up. A growing body of research has shown that simpler entry regulations encourage the creation of more new firms and new jobs in the formal sector. Economies at varying income levels and in different regions saw noticeable increases in the number of new firm registrations after implementing such reforms.

Within-country studies have confirmed the positive association between improvements in business registration and registration of new firms in such countries as Colombia, India, Mexico and Portugal. These studies have found increases of 5–17% in the number of newly registered businesses after reforms of the business registration process (for more discussion, see the chapter “About *Doing Business*”). Better business regulation as measured by *Doing Business* is also associated with greater new business registration. Ongoing research by *Doing Business* using 8 years of data shows that reducing the distance to frontier by 10 percentage points is associated with an increase of 1 newly registered business for every 1,000 working-age people, a meaningful result given the world average of 3.2 newly registered businesses for every 1,000 working-age people per year.

Yet another finding relates to the relationship between foreign direct investment and business regulation. A case study in this year's report shows that although the *Doing Business* indicators measure regulations applying to domestic firms, economies that do well in this area also provide an attractive regulatory environment for foreign firms. Again using multiple years of data, the case study shows that economies that are closer to the frontier in regulatory practice attract larger inflows of foreign direct investment.

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