

Administrative framework for entry and growth

The administrative framework can significantly affect the success of innovative businesses when they seek to enter markets and also to grow. High barriers to entry can effectively discourage the creation and expansion of new companies. Substantial resources can be diverted to dealing with administrative issues instead of being invested in innovation. Moreover, such barriers can negatively affect markets by reducing competition and inhibiting innovative business activities. Evidence confirms the positive effects on firm entry and performance of lowering various administrative burdens. Over the past decade, many countries have invested substantially in reducing the administrative burdens their businesses face. Yet, substantial differences continue to exist across countries. Simplifying the administrative framework for entry and growth can also affect innovative firms indirectly by influencing the state of competition and access to foreign and domestic markets. Public policy can help innovative businesses by simplifying the administrative framework or offering more services utilizing information and communication technologies.

What is the administrative framework for entry and growth?

The administrative framework for entry and growth refers to the monetary requirements and the level of “red tape” (defined as the collection of rules and formalities) for starting a new company (including the cost and time required to start a business, the number of procedures, and capital requirements), and for firms at early growth and high growth stages (including the cost and time required for enforcing contracts).

How does the administrative framework for entry and growth affect innovative businesses?

- Administrative compliance costs associated with business activities (e.g. regulatory costs in the form of asking for permits, filling out forms and reporting and notification requirements) can also be an important **barrier to the development of innovative businesses**. They may hinder firms from shifting resources to new and productive uses, engaging in innovation and adopting new technologies (Scarpetta et al., 2002). They may create barriers to trade, investment and economic efficiency.
- Lengthy and costly company registration procedures **divert human and financial resources away from business activity**. These resources will not be invested in innovation-related activities.
- Particularly in environments where the legal context is weak, burdensome entry regulations may lead entrepreneurs to conduct their business activities in the **informal sector**. The consequence is that entrepreneurs are deprived of access to opportunities and protections that the law provides, which might be detrimental for their business expansion.
- If the administrative framework is a barrier to entry, it will **decrease competition**, giving existing firms less incentive to innovate and negatively affecting innovation performance in markets.

Evidence on the impact of administrative framework on the success of innovative firms

Impact on firm entry rate

The evidence uniformly shows that simpler entry regulations encourage the creation of new firms. In countries with excessive entry regulations, industries tend to respond to growth opportunities through the expansion of existing firms, while in countries with fewer entry regulations the response is primarily through the creation of new firms (Fisman and Sarria-Allenden, 2004). Studies show that reforms in the business registration process led to increases of 5% to 17% in the number of newly registered businesses in Mexico and Portugal (Branstetter et al., 2010; Bruhn, 2011). In contrast, a single extra procedure for business entry can reduce the entry rate by 0.32% (Djankov et al., 2008).

The impact of entry regulation on the creation of new firms depends on the specific industry. Klapper, Laeven and Rajan (2006) find that entry regulations particularly hamper entrepreneurship in industries that would naturally have high entry regulations.

Overall, the positive impact of simpler entry regulations on new firm registration is two-fold: 1) the opening of new business due to lower entry costs, and 2) simpler entry regulation encourages businesses that previously operated informally to formalize.

Impact on innovation and productivity

Evidence shows that cumbersome entry regulations may impact innovation. Aghion et al. (2006) show that such regulations encourage innovation in sectors close to the technological frontier, as successful innovation allows incumbents to prevent entry by new firms. In laggard sectors, however, increased entry threat discourages innovation, since it reduces incumbents' expected rents from innovating.

In addition, studies show that an increase in entry costs decreases total factor productivity (Banerjee and Duflo, 2005; Barseghyan, 2008). Based on a sample of 157 countries, Barseghyan (2008) finds that an increase in entry costs by 80% of per capita income decreases total factor productivity by 22%.

What is the evidence for the impact of administrative framework on the entry and growth of innovative businesses?**Measures**

The World Bank's indicators, published in the annual *Doing Business* report, measure the regulations that apply to domestic small and medium sized companies. There are two types of indicators: those related to the strength of legal institutions relevant to business regulation, and indicators related to the complexity and cost of regulatory processes. Based on time-and-motion case studies from the perspective of the business, the indicators measure the procedures, time and cost required to complete a transaction in accordance with relevant regulations. The referenced business is a limited liability company (or its legal equivalent), 100% domestically owned, located in the largest business city of the economy, has between 10 and 50 employees, and its start-up capital is 10 times the gross national per capita income.

The indicators encompass multiple areas in the SMEs' life cycle, such as starting the business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. The ease of doing business indicator summarizes the findings in these areas. Economies that rank highest in ease of doing business are not those with 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. Higher scores are given for simplified ways of applying regulation that keep compliance costs low (e.g. by allowing firms to comply with start-up formalities through a one-stop shop or a single online portal). The scores also reward risk-based

approaches to regulation that addresses social and environmental concerns, such as policies imposing a greater regulatory burden on activities that pose a high risk to the population.

In addition to the ease of doing business indicators, the World Bank computes the distance of each economy to the “frontier,” which represents the best performance since 2005 on each of the Doing Business indicators across all economies. 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. Figures 1 to 3 show a selection of those indicators.

Figure 1. Starting a business (ease of doing business index)

Figure 2. Number of procedures to start a business for a man

Figure 3. Time required to start a business for a man

Evolution

Administrative burdens tend to grow in number and complexity as governments target their regulations and instruments on more specific issues and populations, and need more information to implement their policies.

However, efforts by governments to reduce the administrative burden have led to substantial improvements over the past decade. As measured by Doing Business (World Bank, 2013), business regulatory practices have been slowly converging, as poorly performing economies narrowed the gap with better performers. Among the categories of business regulatory practices measured by Doing Business, there has been more convergence in those that relate to the complexity and cost of regulatory processes (business start-up, property registration, construction permitting, electricity connections, tax payment and trade procedures) than in those that relate to the strength of legal institutions (contract enforcement, insolvency regimes, credit information, legal rights of borrowers and lenders, and the protection of minority shareholders).

Overall, Eastern Europe and Central Asia improved the most while high-income OECD economies continue to have the most business-friendly environments. The ten countries 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 (World Bank, 2013). Overall, the number of procedures needed to create a limited liability company is low in almost all OECD countries, typically between four and six, although in Greece and Spain ten different procedures are requested. There are more differences across OECD countries in terms of the number of days needed for creating a business: only one and two days are necessary in New Zealand and Australia, respectively but almost 30 in Austria and Spain (OECD, 2012). The average time to register a firm in high-income OECD countries fell from 22 days in 2006 to 12 days in 2012. The average cost of registration also fell considerably, from 8.2% to 4.7% of per capita income (World Bank, 2012). These improvements are largely the result of the application of information and communications technology solutions, such as electronic company registers, one-stop-shops for company registration and online registration facilities.

What other topics relate to the administrative framework for entry and growth and innovative businesses?

State of competition (see [State of competition](#) [1]). Administrative burdens can deter the entry of new firms into a market, thereby reducing the competitive pressures on established firms.

Access to foreign and domestic markets (see [Access to foreign and domestic markets](#) [2]). Effective administrative framework may encourage foreign firms to operate in a country. Evidence shows that economies closer to the frontier in regulatory practice attract larger inflows of foreign direct investment (World Bank, 2013). Lower administrative burdens may significantly enhance the competitiveness of domestic companies and facilitate exports to foreign markets.

Costs of hiring and firing (see [Costs of hiring and firing](#) [3]). The costs of hiring and firing are a specific and often very important type of administrative framework, with impacts on the entry and growth of innovative firms.

Bankruptcy regulation (see [Bankruptcy regulation](#) [4]). Strict bankruptcy regulations that severely penalise “failed” entrepreneurs may constitute a barrier to entry and can therefore be a challenge to entry and growth. Moreover, strict bankruptcy regimes may limit entrepreneurs’ ability to start new future businesses.

Trajectories of new innovative ventures (see [Trajectories of new innovative ventures](#) [5]). The trajectories of innovative new ventures (including birth, growth and exit) can be significantly affected by the administrative framework for entry and growth, as burdensome regulation can be a significant barrier to the entry and development of innovative new ventures.

What policies relate to the administrative framework for entry and growth and innovative businesses?

Public policy can influence administrative framework by:

Quantifying administrative burdens for SMEs and setting quantitative targets for their reduction. Qualitative methods, especially those assessing the burdens of regulation, should complement quantitative methods, to better target these efforts.

Proceeding to administrative simplification by re-engineering and streamlining processes. Re-engineering and streamlining administrative processes should be based on reviewing and optimizing information transactions required by government formalities, including reducing their numbers and burdens through redesign, elimination of steps and application of technology, as appropriate. For instance, one-stop shops that supply a high variety of services, from information about the business environment to licensing requirements, could be created.

Using information and communication technologies to further reduce administrative burdens. Information technology mechanisms, such as web-portals, on-line one-stop shops, and web-based experts on regulation, can deliver substantial savings in time and costs by facilitating access to legislation and providing seamless, integrated and easily accessible points of contact.

Involving innovative entrepreneurs before and after administrative simplification. Innovative entrepreneurs, as stakeholders, could be actively involved in the process of administrative simplification, in the ex ante assessment of prepared regulations and in ex post simplification. Additionally, advances in administrative simplification should be effectively communicated to entrepreneurs, since their perception of such measures plays a critical role in their success.

Involving sub-national governments. As multi-level regulatory governance is becoming important in many OECD countries, high-quality regulation and administrative simplification at a certain level of government can be compromised by poor regulatory policies and practices at other levels, negatively impacting the performance of business activities. Therefore, the involvement of and co-operation with sub-national authorities should be strengthened.

Integrating and coordinating administrative simplification with other activities in the area of regulatory reform. Significant tension can arise from contradictory trends. On the one hand, there is a demand for the reduction of unnecessary administrative burdens. On the other hand, new regulations need to be adopted for various and sometimes contradictory reasons (e.g. requirements from inter- and supranational institutions). Part of the answer to this challenge lies in ensuring that the ex ante impact assessment of new regulation is further strengthened with a focus on ex ante assessment of administrative burden.

Introducing special procedural measures to assess the impact of regulation on early stage firms and small businesses. This includes, for example, requiring agencies to prepare special impact statements for proposed regulations that affect small businesses. These small business impact statements can contain a description of any significant alternatives that accomplish the stated objectives, while minimizing any significant economic impacts on small businesses by the proposed rule.

Considering implementation approaches that limit the burden for smaller businesses. This includes: exemptions to some regulations for the smallest businesses, combining regulations to minimize the number of inspections and forms, instituting a system of “presumed consent” (i.e. that a business is assumed to have registered/complied with a regulation if the relevant authority does not object in a certain time, and that lack of response can be interpreted as assent), and seeking to have consistent approaches and times for processing particular procedures (since uncertainty can be more damaging than the actual length of a procedure).

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Related Link: Trajectories of new innovative ventures

Access to foreign and domestic markets

State of competition

Bankruptcy regulation

Costs of hiring and firing

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