

Microenterprise

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Running the Gauntlet Registering a Business in Latin America

By Tor Jansson

Typically in Latin America, a microentrepreneur who wants to register his or her business legally must run a gauntlet of repetitive, convoluted, and tedious requirements at various government agencies. The myriad of formal requirements and the long processing times of the authorities virtually ensure a drawn out, onerous, and expensive registration process. In Costa Rica, for example, the entrepreneur generally must spend at least two to four months and pay at least \$100 to register with a minimum of six different government agencies. In Panama the process takes three to five months and costs the entrepreneur \$1,000 to \$2,800. In Argentina the entrepreneur typically spends one to four months and anywhere from \$350 to \$1,500.

The cases just mentioned are not the worst in Latin America; many other countries in the region present similar obstacles for the entrepreneur (see Table 1). And this is just to enter the formal economy. Once legally registered, the entrepreneur must also comply with numerous on-going requirements related to taxes, insurance,

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Microenterprises and Poverty A Profile of Latin America

By Glenn Westley

Although microentrepreneurs in Latin America are widely believed to be poor, many questions remain about the nature of their poverty. Are many, or

most, of the owners and employees of microenterprises in fact poor, and if so, how poor are they? Do female, young, and rural earners tend to be poorer? Is poverty concentrated in certain industries, such as manufacturing, commerce, or services? Are microentrepreneurs less educated than those working in larger firms? A recent study by the IDB Microenterprise Unit attempts to answer these and other revealing questions, providing a poverty profile of

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labor standards, social security, environmental protection, and operational permits.

A regulatory environment that is simple, convenient, and fair is in everyone's interest:

- Businesses receive protection under the law, which enables them to advertise and market themselves without fear of retaliation from the state, enter into stable and long-term relationships with suppliers and customers, and gain access to government support programs.
- The government receives higher tax contributions and, through more comprehensive information about the private sector, is better able to make good policy decisions.

- The employees of businesses that are registered are more likely to enjoy social security benefits, a safe work environment, and more stable employment conditions.

- The public benefits from legally registered businesses' increased adherence to minimum product, health and environmental standards.

Clearly, an expensive and lengthy registration process is in no one's interest since it prevents the formalization of enterprises without providing any benefits to the government, enterprises, or the general public. Streamlining registration is particularly important for microenterprises.

First and foremost, microenterprises employ about half the labor force

in Latin America and contribute anywhere from 20 to 30 percent of the region's economic output. Given the size of the microenterprise sector in Latin America, the potential benefits of higher rates of participation of this sector in the formal economy is enormous.

Moreover, business registration and regulatory compliance is particularly difficult and costly for microenterprises for two main reasons:

- Microenterprises are usually owner-operated businesses with limited administrative resources and management capabilities. They therefore tend to be more affected by new or additional regulations that increase the complexity and time spent on compliance.

- Typically, the revenue streams and cash flow of microenterprises vary and their access to financing is uncertain. Thus obligations (in terms of money or time) that do not vary with the ups and downs of revenues and cash flow (such as permit fees and social security contributions) can create serious problems.

Because of these characteristics, microenterprises are particularly sensitive to inappropriate, complex, or costly regulations. Consequently, it is especially important that regulatory requirements imposed on businesses in general, and microenterprises in particular, are justified by the benefits they bring to society *and* that regulatory compliance is as simple and convenient as possible. This is true for requirements associated with the initial start-up process as well as those associated with on-going compliance.

Streamlining the Business Registration Process

Business start-up registration is the first point of contact between the business owner and the government, and it will set the tone for their future interaction. Accordingly, governments

Regulation Out of Control?

In some cases the government's desire to control the behavior of businesses gets...well, out of control. As a result of legal and regulatory structures characterized by widespread government intervention, registering a business in Latin America is typically a long, expensive and arduous process. However, there is an increasing awareness among governments in the region that a simple and efficient business registration process is an important component of a dynamic environment for private enterprises.

Table 1. Business Registration in Latin America

Country	Steps	Monetary Cost	Time (days)	Year of Data
Argentina	10-30	\$350-\$1,500	30-139	2000
Bolivia	5	\$12-\$17	15-30	1991
Brazil	22	\$45-\$100	31-60	1991
Chile	23	\$110-\$220	12-65	1991
Colombia	N/a	N/a	40-70	1999
Costa Rica	10-25	\$200-\$290	50-150	1998
Ecuador	60	\$32-\$240	60-240	1991
Guatemala	31	\$215-\$895	179-525	1991
Mexico	N/a	N/a	7-21	1999
Panama	10-15	\$1,037-\$2,813	86-130	2000
Uruguay	16	\$337-\$405	75-90	1991
Venezuela	28	\$80-\$145	170-310	1991

Sources: Tokman, Victor E (ed.). *Beyond Regulation. The Informal Economy in Latin America*. Lynne Rienner Publishers. 1992; FUNDES/Panamá—Programa Entorno (preliminary results), 2000; SRI International, *International Practices and Experience in Business Start-up Procedures*, 1999 (research document financed by the IDB and FUNDES).

Note: The exact time and cost of registration depends on the nature of the business (whether it is a sole proprietorship or a partnership) and the type of sector it is in (industrial activities tend to require more paperwork than commerce and services).

Business start-up registration is often the first point of contact between the business owner and the government, and it will set the tone for their future interaction.

in the region recognize the need to streamline business start-up registration as an important step toward a more favorable environment for private enterprises, particularly for small and microenterprises. However, this has proven to be a complex and elusive task as the issues cut across local and national jurisdictions, involve several agencies, and at times challenge special interests.

In spite of the difficulties involved, several countries—including Australia, Canada, Mexico, Peru, and Spain—have had success in streamlining business registration. These experiences provide some common principles that should be seriously considered in a program to streamline business registration procedures. If applied, these principles will enhance the likelihood of achieving a faster, less complicated, and more responsive system of business registration.

1. *Undertake a comprehensive review of business start-up formalities.* Often the government lacks comprehensive and detailed knowledge of its own business registration system—knowledge that is absolutely necessary for the design of an effective reform program. As part of the simplification effort in Mexico, a special deregulation unit was set up under the Ministry of Industry and Commerce to review all existing business formalities, including start-up requirements. Although the review and revision of the regulatory process was

time-consuming, the comprehensiveness of the approach led to much more fundamental reform than if the government had sought fast results.

2. *Eliminate redundant forms, regulations, steps, and processes.* Government agencies often appropriate or add certain functions that they are not really authorized or required to carry out. In many cases, archaic regulations are out of touch with the times and create unnecessary obstacles for businesses. Invariably, this results in more complex procedures and longer processing times.

3. *Establish a unified window of contact for businesses.* The internet networking revolution is opening up extraordinary opportunities for creating unified points of contact that are not limited by office hours, geographical location, or manpower. However, it is important that the technology used in the registration process correspond to the skills and abilities of agency staff and prospective clients. A highly sophisticated

system such as Ontario's may not (yet) be feasible in countries where the use of technology has not come as far. For locales with fewer financial resources and less technological sophistication, the state of Ceará in Brazil provides a good example of what can be done. In 1985, the state adopted a low-tech assembly-line system in which several of the agencies involved in the registration process stationed personnel at the offices of the Junta Comercial. These officials are authorized to process registration requests and, as a result, the time to register at the participating agencies has been cut from weeks to a few hours.

4. *Establish a single business identification number to expedite and track the processing of official requests.* A single identification number will create a unified reference for the government and enhance its ability to provide fast and reliable service to businesses. Oregon and Ireland are two locales that have begun to unify various identification numbers. Oregon has integrated its

Table 2. Selected Good Practices in Business Registration

Country	Company Type	Prerequisites for Registration	One-Stop-Shop?	Number of Formalities Post Registration	Total Delay in Days
Belgium	SP	1	Yes	2	1-7
	Corp.	3	Yes	0	25-40
Ireland	SP	2	No	0	1-3
	Corp.	6	No	0	14-28
Luxembourg	SP	0	No	0	1-3
	Corp.	2	No	1	7-14
Sweden	SP	0	Yes	2	1-14
	Corp.	3	Yes	3	14-28
United Kingdom	SP	0	Private Agents	3	1-3
	Corp.	1	Private Agents	3	1-7
United States	SP	0	Private Agents	2-5	1-14
	Corp.	0	Private Agents	2-5	1-14
Japan	SP	2	No	5	7-21
	Corp.	8	No	5	14-28

Source: "Commission Recommendations for Improving and Simplifying the Business for Business Start-Ups." European Commission, 1997.

Notes: SP = Sole Proprietorship; Corp. = Public Limited Company; Prerequisites for registration include notarization of the company's statutes.

employment obligations by creating a single business identification number for all employment-related matters. This number is then used when reporting, paying, or making inquiries about employment-related obligations, such as withholding, unemployment, and transit taxes and workers' compensation assessments. In a similar vein, Ireland has brought tax registration details for income, social security, and value-added taxes together under a single registration number.

5. *Set target deadlines for as many procedures as possible.* A useful principle is *affirma ficta*, whereby official requests accepted by the authorities are automatically approved if the responsible agency does not respond within the time period specified in the law. Mexico has successfully introduced such a system, which now allows businesses to start operations within 7 working days in the case of low-risk activities and 21 working days for businesses whose activities require health, safety, or environmental controls. This compares to average approval times of 46 days and 200 days, respectively, before the reform.

4 Peru provides another example of how to curtail the bureaucracy's ability to prolong the application process. Once an administrative process has been initiated, it may not be halted on grounds of insufficiency or inadequacy of the documentation provided—only on the grounds of inaccuracy. If the applicant has not heard from the agency within 60 days, he or she has the right to assume that the application has been approved. Peru has gone even further in instilling accountability among public agencies by forbidding them to demand machine-typed forms, more than one copy of any document, or uncommon forms of identification from clients.

6. *Maintain close coordination between national and local authorities.* The case of Spain illustrates how close

coordination between municipal, regional, and national governments has created a framework that can be easily expanded upon, in terms both of geographic coverage and functional scope. New municipalities that want to sign on to the voluntary program need only sign standard, ready-made agreements with the national and regional authorities that commit them to manage incoming paperwork in a standardized way. An on-line system will soon connect all layers of government over the internet, allowing officials from each level to track the status of applications and files.

Regulatory reform will provide a more hospitable and dynamic environment for small and micro enterprises.

7. *Provide adequate training and resources to licensing authorities.* One of the success factors in Australia was the award of federal funds to help states cover the costs of reform. Additionally, the federal government provided training to licensing authorities on the use of new technologies for business registration.

8. *Make all information regarding registration requirements and procedures widely available to the public.* In Australia, entrepreneurs have easy access to regulatory information through the internet and other media. The popular Business License Information Service (BLIS) provides a comprehensive database of registration and permit needs through the internet. As an alternative, businesses can also use Bizlink, which offers access to information databases through diskette or a downloadable software program. Finally, businesses can talk directly to experts by phone on a 24-hour hotline. These innovations have helped achieve simplification and

transparency of business procedures and regulations.

9. *Provide help to entrepreneurs in filling out forms, reporting on status, and trouble-shooting.* Applicants cannot be expected to know all the procedural requirements imposed by the state in registering a business. Consequently, it is important to disseminate information and provide assistance in completing the requirements. These types of services have the greatest positive effect on small businesses and microenterprises, which generally do not have the resources to spend on legal assistance. The success of business registration efforts in Ceará, Brazil, is partly built on the technical assistance given to applicants, many of whom are illiterate or semi-literate.

10. *Maintain a feedback loop whereby clients can express their (dis)satisfaction with the process.* Ontario has successfully incorporated the principles of customer input, review, and program innovation as core features of its streamlining efforts. The strength in Ontario's reform process comes from consistent review and innovation. Many of the new regulations have "sunset" clauses built in to ensure that these regulations will be reviewed within a certain time limit. This process helps to guarantee that the red tape burden will be prevented in the future, as well.

In addition to these principles, political commitment, budgetary power, and constituent support are crucial aspects of any reform program. For example, the success of the streamlining efforts in Ontario and Mexico were principally due to the political commitment of the premier and the president. Whenever impasses were reached, they would step in to create momentum and force the bureaucracy to resolve any problems.

Budgetary power is also crucial. The implementation of the Mexican reforms, although successful in the

end, was considerably delayed because of the limited leverage that the implementing agency had over other government departments. Experience has revealed that agencies with power over other agencies' budgets tend to receive more cooperation.

Finally, constituent support is important for the legitimacy and long-term survival of the program. Spain built constituent support among municipalities by using a voluntary approach and gradually proving the benefits of reform. Ontario and Australia consulted extensively with the private sector before and during the reforms.

In spite of all the challenges of streamlining the business registration process, this and other regulatory reforms must remain high on governments' agenda. Such reforms will provide a more hospitable and dynamic environment for private enterprise—particularly for small and micro enterprises. These businesses have enormous potential for job creation and economic growth. Unleashing this force should be a priority of Latin American governments. ■

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Microenterprises and Poverty

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microenterprises in Latin America.¹ This article presents highlights from that study.²

A Poverty Profile of the Microenterprise Sector

The microenterprise sector is important

The conclusion is clear: efforts to reduce poverty must focus on microenterprise employees and the self-employed. These two groups together contain half of all earners, but a disproportionate 70 percent of all poor earners.

economically, providing more than half of employment in most Latin American countries and generating 84 out of 100 new jobs in the region between 1990 and 1995. The sector contributes about one-fifth of the region's GDP, according to the best estimates.

More than half those working in the microenterprise sector—some 56 percent are self-employed; that is, they have no employees. The remaining workers in the sector consist of microenterprise employees (37 percent) and owners of microenterprises that have employees (7 percent).

A clear portrait of poverty in the microenterprise sector emerges in Table 1, which displays the poverty rates of employees and firm owners for the nation as a whole as well as in rural areas. The table is based on household survey data from 1994 to 1996 for 13 Latin American countries: Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Mexico, Panama, Paraguay, Uruguay, and Venezuela.

To determine whether an earner is poor, two measures are utilized: whether his or her individual earnings

fall below the poverty line; and whether the total income per capita of the household to which the earner belongs falls below a per capita income poverty line. While poverty studies typically examine only the second measure, Table 1 illustrates both measures for different subgroups of the population (for example, employees of microenterprises and of larger firms, and owners of microenterprises and of larger firms). Some interesting facts emerge:

- Poverty rates among *employees* of microenterprises are substantial—much higher than among employees of larger firms (25 percent versus 12 percent for the household poverty measure, and 46 percent versus 15 percent for the individual poverty measure).
- There is significant poverty among the self-employed (that is, owners of firms without any employees). Their average poverty rate is far above that of wage earners as a whole (24 percent versus 15 percent for the household poverty measure, and 38 percent versus 24 percent for the individual poverty measure).
- Poverty rates for *owners of firms with one or more employees* are much lower (9 percent for the household poverty measure and 8 percent for the individual poverty measure). The distinction between microenterprise and larger firm owners matters little; the poverty rates for both types of owners are low (compare rows 1.b.i and 1.b.ii of Table 1).
- Poverty rates are substantially higher for *those located in the rural areas*. This is true across the board: for microenterprise and other employees, for owners of both single-person and larger firms, and with either definition of poverty.

¹ Maria Beatriz Orlando and Molly Pollock. "Microenterprises and Poverty: Evidence from Latin America." Microenterprise Unit, Inter-American Development Bank, Washington, DC, February 2000.

² Unless otherwise stated, microenterprises are defined as any enterprise with five or fewer employees. This reflects the definition used in the household surveys from which the data presented here are taken.

Table 1. Poverty Rates for Earners in 13 Latin American Countries, by Household Earnings per Capita and by Individual Earnings (percent)

Earner Category	Household Earnings Per Capita		Individual Earnings	
	National	Rural Areas	National	Rural Areas
All firm owners and employees	18	34	27	44
1. All firm owners	22	36	34	46
1.a. Self-employed microentrepreneurs (no employees)	24	38	38	50
1.b. Owners of firms with employees	9	20	8	16
1.b.i. Owners of microenterprises (1-5 employees)	11	23	10	18
1.b.ii. Owners of larger firms (5 employees)	5	19	4	11
2. All employees	15	32	24	41
2.a. Microenterprise employees (1-5 employees)	25	42	46	56
2.b. Employees of larger firms (5 employees)	12	26	15	30

Note: Each value shown in the table is an unweighted average of poverty rates in 13 countries. A poverty line of US \$60 per month per person in 1985 dollars is used. The poverty line is converted to each country's local currency value in 1985 using 1985 purchasing power parity exchange rates; it is further converted to the year of the survey using local consumer price indices. Each country's resulting poverty line, thus expressed in local currency in the year of the survey, is then compared to the total income per capita of each household in that country and year to determine whether all earners in that household will be classified as poor.

To obtain the poverty line for individual earners, the poverty line of US\$60 per month per person (converted to local currency in the year of the survey) is multiplied by the dependency ratio (population/earners), which is calculated for each individual country from its household survey. These ratios typically range from 2 to 3, and account for the fact that each earner supports a certain number of dependents. Finally, these poverty lines are compared to the income of each earner to determine whether that earner is classified as poor.

Microenterprise employees and the self-employed are large groups, containing an average of 19 and 30 percent of total earners, respectively, across the sample of 13 countries. Given their high concentrations of poor, these two groups contain about 70 percent of Latin America's poor earners. Of that 70 percent total, approximately 30 percent are microenterprise employees and 40 percent are self-employed. These last three percentages hold with either definition of poverty, and for the rural areas as well as the national sample. The conclusion is clear: efforts to reduce poverty must focus on microenterprise employees and the self-employed. These two groups together contain nearly half (49 percent) of all earners, but a disproportionate 70 percent of all poor earners.

Poverty reduction efforts also must target rural microenterprises. Poverty rates are clearly higher in rural than in urban areas in the microenterprise (and non-microenterprise) sector

There is an important role for programs that extend and improve education for the poor.

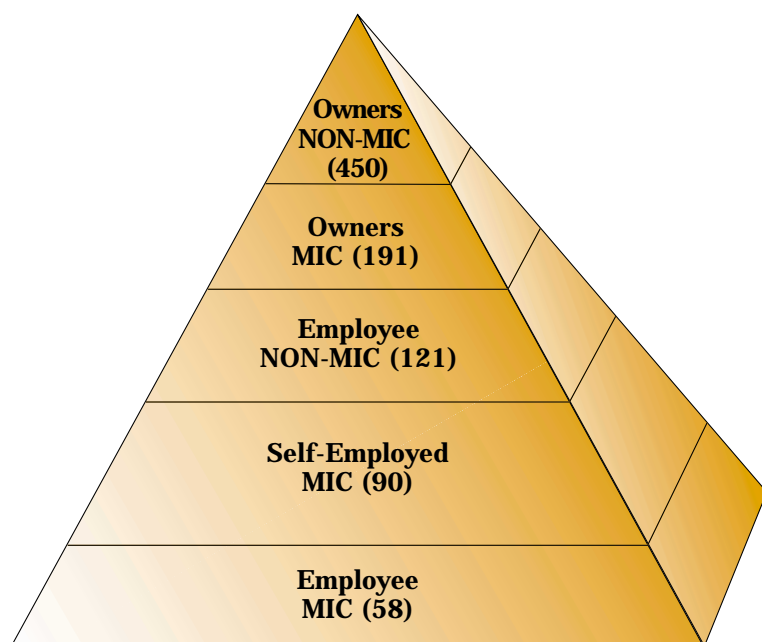
and among each sector's subgroups—typically by 10 to 15 percentage points. Contrary to the conventional wisdom, the same is not true of other groups often thought to be at a dis-

advantage in terms in income: youth, women, and single female heads of households. Judging poverty according to household income per capita, these earners have very nearly the same poverty rates as earners overall (within a few percentage points up or down). This holds across the board, for the totals and for all subcategories shown in Table 1 as well.

Judging poverty according to each person's *individual* earnings, however, yields the usual story: youth, women, and single female head of household earners have higher poverty rates overall and for all subcategories shown in Table 1 (with poverty rates typically about 5 to 15 percentage points higher). This suggests that significant numbers of these "disadvantaged" groups escape poverty through the income

Figure 1: Earnings Pyramid for Latin American Earners

(Index values: 100 = average earnings of all employees)



earned by other household members. While this allows them to escape poverty, it does leave them vulnerable to poverty in case of household breakup.

The earnings pyramid in Figure 1 illustrates the concentrations of poverty among workers in microenterprises (MIC) compared to workers in larger firms (NON-MIC). The earnings pyramid shows the average earnings of each group relative to an index value that has been set to 100 for the

group of all employees for the same 13 countries. Microenterprise employees are at the bottom of the pyramid, with earnings levels scarcely more than half that of the average employee. The self-employed are the next lowest group; their earnings are 90 percent of the average wage of all employees.

These findings parallel the results in Table 1, which also shows that these two groups have the highest poverty rates. Employees in microenterprises earn only half of the wage levels pre-

vailing in larger firms (58 versus 121). Owners have the highest earnings. Significantly, owners of larger firms earn more than twice that of microenterprise owners (450 versus 191), and microenterprise owners earn more than twice as much as self-employed microentrepreneurs (191 versus 90).

Somewhat surprisingly, the highest poverty rates in microenterprises and larger firms are found in industry, rather than in commerce or services. The percentage of individuals in microenterprises whose earnings are less than the poverty line is 37 percent in industry versus 31 percent in each of commerce and services. The corresponding percentages for larger firms are 30, 24, and 26 percent.³

Differentials in human capital have often been mentioned as one of the key factors in explaining differences in earnings and, therefore, in determining poverty rates. Table 2 supports this thesis. In all six countries, workers in larger firms average substantially more years of schooling than workers in microenterprises. This finding correlates well with the lower earnings and higher poverty rates found in the microenterprise sector. The difference in education in the six countries averages nearly two years (9.5 versus 7.7 years of schooling). In addition, the poor earners in microenterprises have an average of 2.5 years less schooling than the non-poor (6.1 versus 8.6 years).

Table 2: Average Years of Schooling for Latin American Earners

Country	NON-MIC	MIC Total	MIC Poor	MIC Non-Poor
Bolivia	10.8	8.0	6.8	8.7
Chile	11.2	9.6	7.8	9.9
Costa Rica	9.0	8.0	5.8	8.4
Honduras	7.8	5.5	4.9	8.0
Paraguay	8.9	7.3	5.6	8.3
Uruguay	9.0	8.0	5.8	8.2
AVERAGE	9.5	7.7	6.1	8.6

These results suggest an important role for programs that extend and improve education for the poor. But other measures are also necessary to assist the poor, including those that provide financial and non-financial services to the large share of the poor that labor in microenterprises. ■

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³ These figures are unweighted averages across six countries (Bolivia, Chile, Costa Rica, Honduras, Paraguay, and Uruguay), using household survey data from the mid-1990s, a definition of microenterprises as having 10 or fewer employees, and the poverty line used by the Economic Commission for Latin America and the Caribbean (FCLAC).

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Book Announcement

The book, *Safe Money: Building Effective Credit Unions in Latin America*, edited by Glenn Westley of the Inter-American Development Bank and Brian Branch of the World Council of Credit Unions, is now available in English and Spanish.

**To order the book, contact the IDB bookstore in Washington, D.C.
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See the January 2000 issue of the *Microenterprise Development Review* for an article based on this book.



Microenterprise Development Review

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The Microenterprise Unit manages the IDB's microenterprise projects with the private sector and provides training, disseminates best practices, and develops policies and strategies to guide Bank country operations and promote the growth of the microenterprise sector in Latin America and the Caribbean.

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