

## ERIA Discussion Paper Series

### Business Licensing: A Key to Investment Climate Reform\*

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**Abstract:** *Reforming business licensing is a key starting point for improving the investment climate. Complex licensing procedures may encourage firms to remain unregistered, giving rise to difficulties later in accessing finance from formal financial institutions and constraining productivity and expansion. Across sectors, this can suppress the establishment of new firms and therefore the creation of new jobs, dragging down overall economic growth. Improving and reforming business licensing can significantly increase the number of businesses and thus help nurture employment creation. Several quick-win interventions are possible. First, there is a need to improve the quality of the business licensing website and help desk. The website and help desk should act as a frontline in dealing with investment regulations and policies for investors. Improvements should cover both hard and soft infrastructure of the website and help desk, including the skills of officials. Second, business license simplification should be continued by limiting licenses to those that serve their objective and cutting unnecessary licenses, and or consolidating licenses. Third, full implementation of electronic application and payment systems for business licenses should be fostered, together with increasing the non-fiscal incentives for firms to become registered. The registration system should also function as a nationwide database which could then be a source of reliable information both on firms and for firms, linked to government programs and grants, and business regulation updates. Fourth, a transparent system to show the progress of each business application should be set up, together with a recorded evaluation system in which users can provide feedback to improve the system. Finally, efforts in the medium term should focus on improving coordination among government agencies and clarifying the roles of central and local regulations, both horizontally and vertically.*

**Keywords:** Investment, Indonesia, Business, Licensing, Economic Reform

**JEL Classification:** F2, K02, L6

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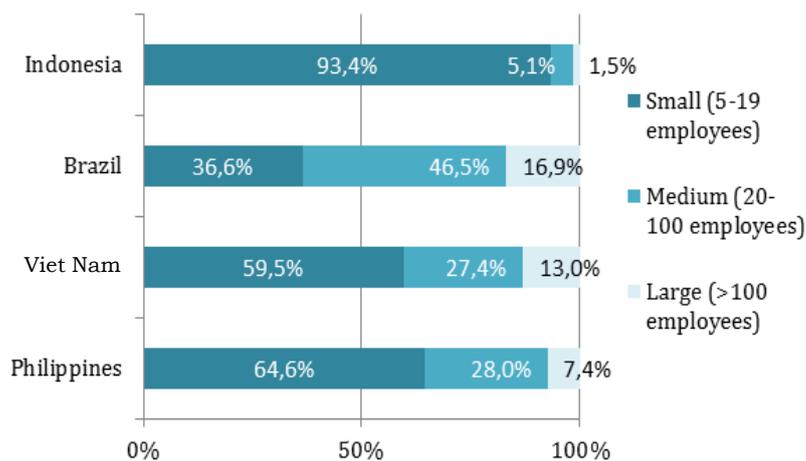
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## 1. Context

In Indonesia, 93 percent of firms are categorized as small, of which more than 30 percent are unregistered.<sup>1</sup> One finding of the World Bank's economic sector work (ESW) conducted on Indonesia's manufacturing sector is that, comparing plant size distribution between Indonesia and other emerging countries, there is a striking feature of missing medium-size firms in Indonesia, or a so-called *missing middle*.<sup>2</sup> The World Bank Enterprise Survey 2009 illustrates that the percentage of small firms, defined as firms with 5 to 19 employees, is larger in Indonesia, at 93 percent versus 37 percent in Brazil (Figure 1). Small firms in Vietnam and the Philippines constitute about 60 percent of total firms. Meanwhile, the medium-size firms or firms employing 20 to 100 workers constitute only 5 percent of all manufacturing firms in Indonesia, compared with 47, 27 and 28 percent in Brazil, Vietnam and the Philippines, respectively. In addition, in Indonesia more than 30 percent of the sample firms are unregistered.

**Figure 1. Distribution of Manufacturing Firms, by Size**



Source: World Bank Enterprise Survey, 2009.

<sup>1</sup> It is thought that the number of unregistered firms may even reach more than 60 percent.

<sup>2</sup> The World Bank ESW on Indonesia's Manufacturing Sector (World Bank, 2012).

There seem to be several reasons why some firms prefer to remain small and informal, one of which could be related to the desire to evade taxation and inspections, while another could be that the costs of being registered outweigh the benefits.<sup>3</sup> De Soto (1989) argues that excessive regulation and licensing is a factor in keeping firms small and informal. The idea is supported by a number of studies that argue that large informal sectors are a consequence of excessive taxation, overregulation and weak government institutions (Loayza, 1997; Auriol and Walter, 2004).<sup>4</sup> In the case of Indonesia, while licenses such as the company registration (TDP) and/or the trade license (SIUP) are often used to obtain financing from financial institutions, this fails to explain why many firms prefer to remain unregistered. Moreover, it is also suggested that complex business licensing in Indonesia is a factor underlying Indonesia's poor business climate and one of main constraints to business expansion. It has long been argued that simplifying business licensing has a positive effect on investment. However, very few studies provide evidence of how effective business licensing can positively impact investment.

This paper argues that simplifying business licensing would increase the number of registered firms, particularly small and medium enterprises.<sup>5</sup> This in turn would allow more firms to obtain financing and lead to improvements in productivity. The second section reviews the possible adverse consequences of business licensing and the current business licensing procedures in Indonesia. It argues that although business licensing does not appear to affect the value of investment, lower relative costs and fewer days needed to obtain business licenses indicate a positive relationship with the number of firms established, particularly small and medium enterprises. The third section reviews lessons learned from business licensing reforms in the most efficient business licensing countries, such as Singapore and

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<sup>3</sup> The costs are referred to in marginal terms.

<sup>4</sup> Excessive regulation encourages firms to engage in negotiations if the burden is sufficiently high or if the marginal effectiveness of bribes after taking into account uncertainty in regulations and procedures exceeds the marginal cost of bribes. The empirical results in Indonesia show that uncertainty in procedures such as business licensing, fire safety inspections, compliance with environmental regulations, building permits and employment contract inspections significantly affect the bribe level (Kuncoro, 2006).

<sup>5</sup> While there is also plenty of scope to discuss business expansion, this paper will focus on business start-ups and business licensing related to business start-ups as this is key to investment, while business expansion requires similar procedures and steps as business start-ups.

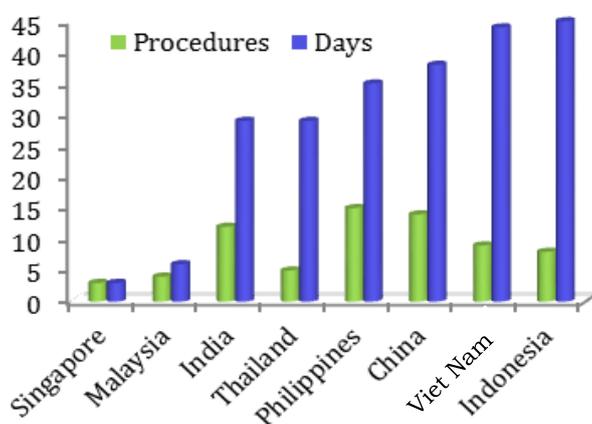
Canada, together with successful reformers in business licensing, such as Kenya, Malaysia and Mexico. The final section draws conclusions and proposes some recommendations.

## 2. Business Licensing

### 2.1. Complex business licensing and the adverse consequences for an economy

Complex licensing procedures have been identified as an important factor underlying Indonesia's poor business climate (Asia Foundation, 2007).<sup>6</sup> Starting a new business in Indonesia is relatively more difficult than doing so in peer countries in the region. It took about 45 days for 8 procedures to start up a new business in Indonesia, while it took only 38 days for 7 procedures in the Asia Pacific region in 2011 (Figure 2). Likewise, a business expansion takes about the same number of procedures and a similar length of time.

**Figure 2: Starting Up a New Business**



Source: Doing Business, 2012.

<sup>6</sup> The definition of business licensing in this note includes licenses and permits. The definition of a license is that it is used as a tool to assure that operators have the qualifications necessary to carry out an activity in a way that safeguards public welfare and/or to allocate scarce resources. Meanwhile, a permit is used to assure that structures and operations comply with standards that protect public health, safety and the environment. The differences between the two are that a license is used as an authorization for a core and continuous business activity issued by the central government and it requires periodic renewal, whereas a permit is used as an authorization to complete a single instance of an activity issued by the local/municipal authority (although national level permits may be appropriate for specific or sensitive activities) and it is only effective once per instance of activity (World Bank, 2006b).

Complex licensing procedures may keep firms unregistered, thus creating difficulties in their accessing finance from formal financial institutions and constraining their productivity. As in other countries, in Indonesia some licenses, such as TDP and/or SIUP are necessary in order to apply for and to obtain financial institution loans (KPPOD and Asia Foundation, 2011:34).<sup>7</sup> Difficulties in accessing finance have the potential to reduce firms' productivity. Lack of access to finance is one of the main factors limiting growth opportunities for SMEs. For smaller companies access to credit is an important source of productivity, growth and expansion. It is estimated that difficulties in accessing finance reduce productivity by 6 percent in Indonesia's manufacturing sector (World Bank, 2012). It is also argued that a poor investment climate often hits smaller and informal firms the hardest (World Bank, 2005).

Complex business regulations may also be a constraint to expansion of businesses in Indonesia.<sup>8</sup> An expansion permit is needed if a company wishes to produce a new product that is different from the current product, or to produce 30 percent or more over and above its current permitted production capacity (Nuridzki, 2010). The length of time and the costs of business expansion in Indonesia may be roughly similar to those for starting a new business. Similar to the application for an industrial license, additional documents are needed for expansion, e.g. an environmental impact permit and documents stipulating technical information related to the expansion plan, for instance the use of raw materials, human resources, etc. Based on data from the Monitoring Investment Climate Survey 2009, which covers 471 manufacturing firms across six main business districts in Indonesia, it is

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<sup>7</sup> A recent study undertaken in Sri Lanka claims that there is no significant effect on formalizing the relationships with the financial sector – applying for business or personal loans or having a business bank account; or on relationships with the government – having an electricity connection in a business's name, applying for a government contract, making sales to the government, or participating in a government SME program (de Mel, *et al.*, 2011). Nonetheless, in Indonesia and most developing countries, some business licenses are required to obtain loans from formal financial institutions.

<sup>8</sup> In certain sub-national areas, business expansion requires that businesses to update their trade license (SIUP) for general trading businesses that wish to produce new products or to be engaged in new activities within the confines of the general trading sector) or their technical permits (TDI/IUI) for industrial business that wish to broaden their activities within the confines of the industrial sector. An expansion permit is also a requirement that applies for business operating within the framework of investment, including all foreign investments.

estimated that if the days to expand a business could be cut by 4.5 days, this would raise the willingness to invest by 10 percent.<sup>9</sup> Among business registrations, decisions to invest are highly sensitive to company expansion registry procedures (World Bank, 2012).

Complex business licensing may also suppress the creation of firms and jobs, thus having significant implications for overall economic growth. It is argued that excessive regulation and licensing may keep firms small and informal. In addition, the complex procedures could be particularly detrimental to domestic, micro, small and medium scale enterprises, which represent more than 90 percent of Indonesian enterprises and absorb about 70 percent of the workforce (Asia Foundation, 2007). More than 30 percent of firms in these categories are unregistered or without legal status.<sup>10</sup> In the period after decentralization in Indonesia, from 2000 to mid-2005, the vast majority of the new revenue instruments appear to be license-user charges (LPEM, 2005). The burdens relating to poor licensing policy have become a major issue for businesses across Indonesia, either forcing them to remain informal or to deal with the costs of compliance (Asia Foundation, 2007). It is also argued that regulatory uncertainty plays a significant role in affecting the level of bribery, which increases the costs of obtaining business licenses in Indonesia (Kuncoro, 2006).

## **2.2. Business Licensing in Indonesia**

Foreign companies, as well as those domestic companies desiring certain tax facilities, must apply for their licenses through BKPM. The process begins with the formation of the company and the investment approval; the latter is necessary for the tax facilities. This is followed by the application for various permits, the technical licenses authorizing the business, and the business registration process. Several of the steps needed to obtain licenses and permits must be done sequentially (Figure 3 and Table 1). Cross-industry permits and licenses include the Land Usage Permit

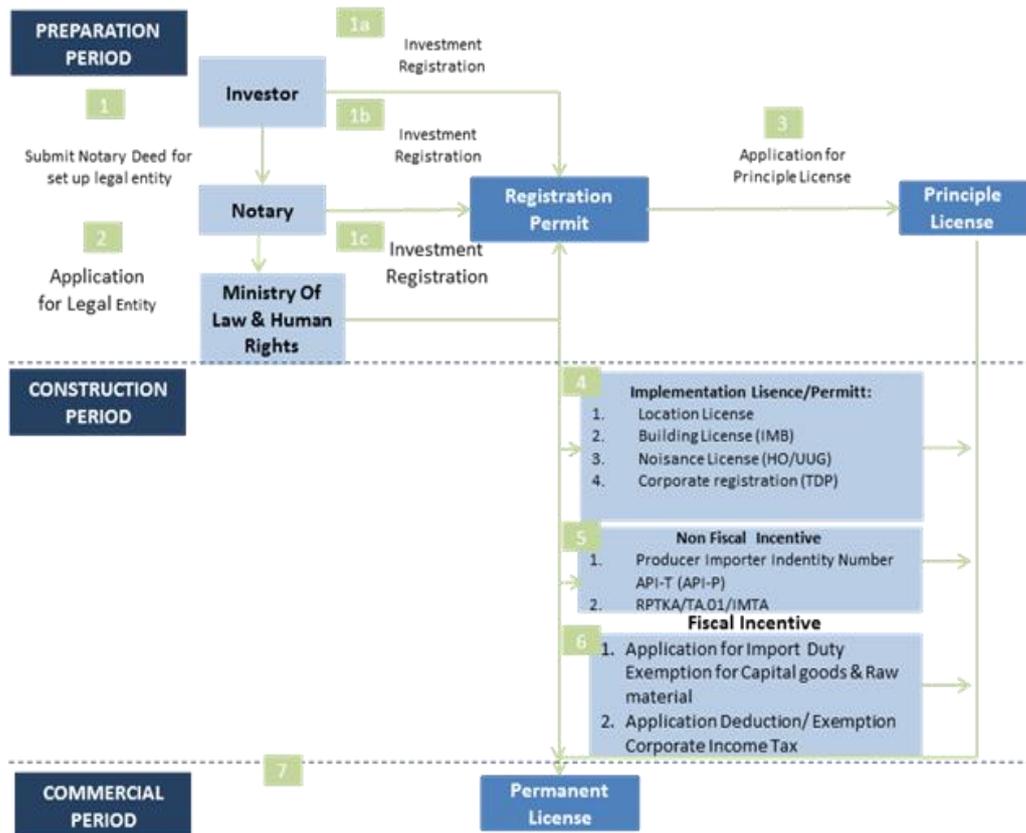
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<sup>9</sup> The survey covers 471 firms: 36 in North Sumatra, 204 in DKI Jakarta and its surrounding, 66 in Banten, 36 in West Java, 38 in Central Java, 83 in East Java and 8 in South Sulawesi. The analysis is conducted by using Ordered Probit estimation.

<sup>10</sup> The World Bank Enterprise Survey records that 36 percent of 1,176 manufacturing firms are unregistered (Enterprise Survey, 2009).

(SIPPT),<sup>11</sup> the Nuisance Permit (UUG), Manpower Permits for foreign workers, overtime and a management system for worker safety and health, and Environmental Permits (AMDAL/UKL/UPL/SPPL).

**Figure 3. Obtaining Key Licenses and Permits for a Business Start-up in the Manufacturing Sector**



Source: BKPM, 2012a.

<sup>11</sup> SIPPT is only required for the usage of land encompassing an area of 5,000 square meters or more; if less, then it is not required.

**Table 1: Key Licenses and Permits for a Business Start-up in Indonesia's Manufacturing Sector<sup>12</sup>**

<b>Name of license/permit</b>	<b>Name of institution in charge</b>
<b>Company formation and legalization</b>	
1. Company Formation	
Deed of Establishment	Notary
Domicile Letter (Surat Domisili)	Kelurahan (Sub District Office)
Tax ID (NPWP)	Tax Office of Ministry of Finance (Central Government)
Approval of Deed of Establishment (SK Pendirian PT)	Ministry of Justice and Human Rights (Central Government)
2. Initial Approvals	
Approval Letter (SP)	Badan Koordinasi Penanaman Modal (Investment Coordinating Board) Central Government
Principal Permit	Dinas Perindustrian (Local Office for Industry)
<b>Physical permits</b>	
3. Land and Building License	
Land Usage Permit (SIPPT)	Dinas Tata Kota (City Planning Office)
Environmental (AMDAL/UKL/UPL/SPPL)	Badan Pengelola Lingkungan Hidup Daerah (Local Environmental Body)
Building Construction Permit (IMB)	Dinas Penataan dan Pengawasan Bangunan (Local Office for Building Permits and Control)
Location for Business Permit and Building Usage Permit (SITU and IPB)	Dinas Penataan dan Pengawasan Bangunan (Local Office for Building Permits and Control)
Nuisance Permit (UUG)	Dinas Keamanan dan Ketertiban (Local Office for Civil Security) and Head of Local District
<b>Sectoral licenses</b>	
4. Final Operating Licenses	
Permanent Operating License	Bakan Koordinasi Penanaman Modal (Investment

<sup>12</sup> Licenses and permits in specific industry activities, trade, transport and other sector, and local government permits and retributions can be classified as follows: (i) industry activities permits including permits for elevators, boilers, forklifts, cranes, conveyor belts, high-pressure water pipes, scales, radio-active materials and radio communications; (ii) trade permits including import and export permits, Trade License (SIUP) and warehouse registration; (iii) transport permits including designated route permit, testing and certification of motorized vehicle, vessel specification document, load line certification, use of foreign vessels, certificate of owner's representatives (COR), clearance approval for Indonesian territory (CAIT), dredging permit for port development and expansion or maintenance; (iv) other sector permits including radio frequency permits, wood, food processing, and other sector specific permits; and (v) local government permits and retributions including parking, motor vehicle, warehousing, surface and underground water, advertisement, street lighting, and etc.

(IUT) Industrial Permit (TDI or IUI)*	Coordinating Board) Central Government Dinas/Sudin Perindustrian dan Perdagangan (Local Office for Industry and Trade)
Trade License (SIUP)**	Dinas/Sudin Perindustrian dan Perdagangan (Local Office for Industry and Trade)

### **Business registration**

5. Business Registration (TDP)	Suku Dinas Perindustrian dan Perdagangan (Local Office for Industry and Trade)
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*Note:*

\*An Industrial Permit (IUI) can be issued without requiring a principal permit, providing that the industrial company is domiciled in either an Industrial Estate or Bonded Zone.

\*\* SIUP only applies for business engaging in general trade.

*Source:* LPEM, 2008 and BKPM, 2012a.

### **Box 1. Negative Investment List of (DNI) for Foreign Investment**

The negative investment list (DNI) is based on Law No. 25/2007 and Presidential Decree No. 39/2014. The list is regularly reviewed and updated going forward. It provides a list of all restrictions on investment that impact both foreign and domestic companies, including limits on foreign equity if any. There is also a special column with restrictions on investors from ASEAN countries. Under the ASEAN Economic Community, ASEAN investors are treated more favorably than other foreign investors.

One drawback in the effectiveness of the DNI is that the breakdown of sectors is sometimes unclear. For example, currently business is growing in electronic trading or e-trading, which includes retail and trading transactions. However, these have not been specified in the DNI. If these activities fall under the category of the retail industry, then foreign equity is limited to the hyper-market category. However, as these businesses can claim that they also operate as consultancies for buying and selling, they could also be categorized as management consultancies, in which case they can be 100 percent foreign-owned. Such problems are likely to persist and may become even greater over time if the government attempts to micromanage the list. Technological advances may make it even more difficult to define sectors while restrictions on investors can greatly impact their efficiency.

Therefore, BKPM in collaboration with line ministries needs to improve the clarity of the definition of sectors included in the DNI in order to avoid different interpretations and thus improve the quality of the investment selection process. Moreover, the implementation of the DNI is not yet nationwide (i.e. local governments have not been fully informed of its existence and how they should use it). In order to make better use of the DNI, BKPM should collaborate with local governments and help them to use the DNI to provide recommendations for investment.

Among licenses and permits, businesses claim that construction permits (IMB) and nuisance permits (UUG) are the most onerous. Although some licenses are processed at the national level, most are processed at the local level, especially those relating to physical permits, sectoral licenses and business registrations. In order to acquire IMB and UUG, a series of other permits, such as the Land Usage Permit (SIPPT) and Environmental Permit (AMDAL/UKL, UPL and SPPL) must be obtained first. The prerequisite requirements do not only include blue prints of buildings, but also attestations by village and sub-district heads, plans for building use and neighbors' approval (Asia Foundation, 2007). There are two main reasons for complexity in business licensing in Indonesia. First, there are so many regulations referring to buildings, nuisance and the environment that this creates overlapping rules and confusion in implementing them. Second, there are limited technical standards for building construction and site safety, and this often leads to negotiations with officers over standards (Elliot, 2008 and 2009; SENADA, 2009).

## **2.3. Business licensing reforms in Indonesia**

### *2.3.1. The reforms*

Indonesia's licensing system is considered by many to be unwieldy with a complex division of authority, and has led to a poor ranking on Doing Business. As a result, the Government is attempting to streamline the process and has embarked on a number of reform initiatives to improve the country's business and investment climate. The reform efforts include the following.

The introduction of a new investment law (Law No. 25/2007) marked a new phase in Indonesia's investment regime. The Government also introduced several implementing regulations, one of which is a presidential regulation on the investment negative list (DNI). At the same time, Indonesia's Investment Coordinating Board (BKPM) also introduced measures to simplify investment procedures. The 2007 Investment Law and implementing regulation (No. 27/2009) set out a framework for *One Stop Integrated Services* (PTSP) for all licenses and permits. As part of PTSP, all technical ministries are to delegate licensing authority to BKPM (note: although BKPM claims that 15 Ministers have delegated authority, there are very few

instances, perhaps only one, where this is indeed the case). The technical ministries have found ways to “delegate” without actually eroding their authority over “operational licenses”.<sup>13</sup> The PTSP is to be implemented both by the central government (through BKPM) and by local governments.

The introduction of one-stop shops (OSS) in Indonesia has reduced the time needed to arrange basic permits. OSS were first introduced into Indonesia in 1999 and then expanded in 2006. They have been lauded for significantly reducing the time and costs of obtaining business licenses. Over one year, the time needed and the costs to obtain basic permits (i.e., the building permit (IMB), the business location license (SITU/HO), the trading business license (SIUP), and the company registration certificate (TDP)) have been reduced by 47 percent and 44 percent, respectively (Asia Foundation, 2007). Indonesia has implemented One-Roof Stop-Shop (*Pelayanan Terpadu Satu Atap*, or PTSA) even though it is named as One-Door Stop-Shop (*Pelayanan Terpadu Satu Pintu*, or PTSP). The main differences between these two types of OSS are that in the former system there is no authority delegated to one particular agency to issue licenses. Conversely, in the latter system authority is delegated to a particular agency to issue licenses. Both of them allow parallel processing and thus reduce the time and costs needed to obtain business licenses. The main advantage of the implementation of ODSS (PTSP) is that they reduce overlapping licenses as one agency takes control of issuing.

### *2.3.2. The impact of business licensing on the number of firms being established and employment creation*

Studies suggest that there could be a positive relationship between quicker and less costly procedures to obtain business licenses and the number of firms being established. However, there has long been a debate over whether business licensing reforms and simplification have an impact on investment, and there is no consensus on the issue in Indonesia. The significant investment reforms since 2005 and the development of an OSS system have had an inconclusive impact on the total value of investment at the sub-national level in Indonesia (Appendix A.1). The business

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<sup>13</sup> This conclusion is based on a review of each letter of authorization for BKPM to issue licenses.

climate ranks fourth as a determinant in affecting decisions on the location of investment (FDI Intelligence, 2012).<sup>14</sup> However, while the value of investment may not be affected by business licensing (Figure 4), relatively less costly and faster procedures to obtain business licenses indicate a positive relationship with the number of firms being established and on employment creation, as illustrated in Figures 5 and 6.<sup>15</sup> Relatively rich natural-resource regions, such as Riau and East Kalimantan, still have relatively higher investment values despite the fact that starting a business in these regions takes relatively longer and costs more compared with other regions. On the other hand, regions such as Yogyakarta, Aceh, South Sumatra, Bali and South Sulawesi, where it is relatively easier to start a business, tend to see a higher number of firms being established, as well as a higher level of employment creation compared with East Kalimantan, North Sulawesi and Riau. The high number of firms being established is largely driven by the growing number of SMEs.

This is consistent with the finding that there is a correlation between the number of SMEs per 1,000 inhabitants and the cost of starting a business.<sup>16</sup> However, this does not necessarily mean that a decrease in cost will automatically lead to more SMEs and job creation. The reasons could be that large and foreign firm investors, particularly in natural-resource-based products, may not be sensitive to the costs of obtaining business licenses, and therefore the value of investment may not be significantly affected by business licensing procedures and costs, particularly in natural-resource-abundant regions. Moreover, simplified business licensing is only one element in the overall business environment for starting up a business. In some cases, simplified business licensing may not necessarily spur further private sector

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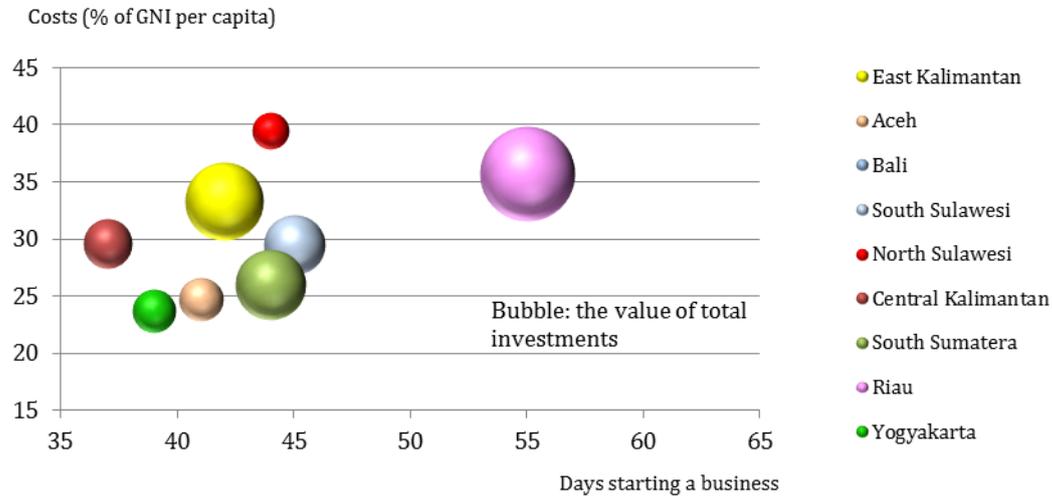
<sup>14</sup> FDI investors rank domestic market growth potential in terms of proximity to consumers, availability of skilled workers, business climate, infrastructure and logistics as the first to fifth main determinants in FDI location selection, respectively, from 2003-10 (FDI intelligence, 2010).

<sup>15</sup> Due to limited data on starting a business at the sub-national level, there are no formal correlation estimations for observing the relationship between starting a business and the number of firms being established and employment creation. One may argue that the relatively higher number of firms being established could largely be correlated to infrastructure, availability of skilled labor, land acquisition, tax administration, property registration, and/or other variables. If there were data on starting a business at the sub-national level for at least three years, the correlation between starting a business and one of measures on investment (e.g. the value of total investment or the number of firms being established) could be tested by estimating changes in starting a business and the investment variables, controlling for other independent variables.

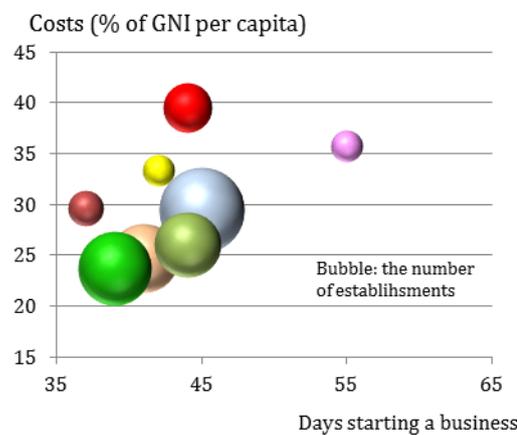
<sup>16</sup> <http://rru.worldbank.org/Themes/SmallMediumEnterprises/> quoted in de Sa, 2005.

development or the formalization of existing enterprises, as taxes may remain too high and complicated, or land acquisition and property registration may be a more onerous process.

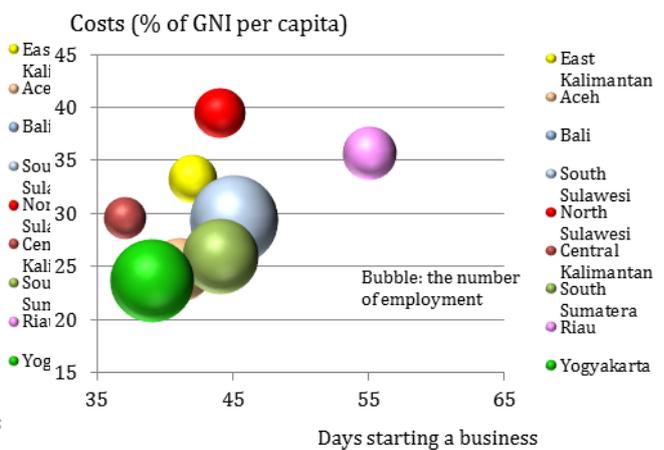
**Figure 4: Starting a Business and the Value of Investment, 2010**



**Figure 5: Starting a Business and the Number of Firms Being Established, 2010**



**Figure 6: Starting a Business and Employment Creation, 2010**



*Note:* The choice of the area is based on availability of data on ease of doing business sub nationals 2010 and data on census industry on the value of investment and the number of total establishments. Jakarta, West Java, Central Java and East Java are excluded in these figures as they are outliers in terms on the value of investment, the number of firms being established and employment creation. Bali is at the back of South Sulawesi. The complete figures that include them are in Appendix A.2.1, A.2.2 and A.2.3. The trends in the number of firms being established and employment creation are in Appendix A.2.4.

*Source:* Authors' calculations based on Doing Business sub nationals, 2010; CEIC Database, 2011; and Statistics Indonesia, 2010.

### *2.3.3 The reforms ahead*

While rolling out of One-Door Stop Shops (PTSPs) is well underway, they are still far from being fully effective. Based on Regulation on Decentralisation, Ministry of Home Affairs Regulation No. 24/2006 manages arrangements for the implementation of PTSPs at the local level and also authorizes PTSPs to act as institutions with the responsibility to issue a number of business licenses. Other than this, Presidential Decree No. 27/2009 authorizes the Investment Coordinating Board (BKPM) to implement PTSPs. Based on a Ministry of Home Affairs survey conducted by KPOD in 2011 more districts have implemented PTSPs, indicated by the increasing number of PTSPs, from 105 in 2009 to 196 in 2011 across 252 districts in Indonesia. However, more than half of the PTSPs claim that they have authority to issue fewer than 20 business licenses out of over 100 licenses in total (Asia Foundation, 2012). As a result, PTSPs are still often perceived by the private sector as being inefficient due to the still lengthy process of obtaining licenses and because the costs continue to exceed those stated in the regulations (KPPOD and Asia Foundation, 2011:33, 102).

National Single Window for Investment (NSWi) has been developed, but its implementation is still not nationwide. To facilitate the OSS system even further, based on Presidential Decree No. 27/2009 and BKPM Regulation No. 14/2009, the National Single Window for Investment (NSWi) and Electronic Investment Licensing and Information Service System (Sistem Pelayanan Informasi dan Perizinan Investasi Secara Elektronik, or SPIPISE) were developed.<sup>17</sup> The implementation of SPIPISE was prioritized for investments that exceeded IDR 500 million in value. The system was first launched in January 2010 in the Free Trade Zone of Batam. To date, SPIPISE has been adapted in 99 districts across 32 provinces out of a total of 497 districts in 33 provinces in Indonesia. Despite this

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<sup>17</sup> NSWi is an electronic platform for investments that enables investors to apply for licenses and non-license services online. The ability to fully automate the investment license process would significantly enhance the efficiency of licensing services.

roll-out the system has still not be fully implemented and has yet to become fully effective.<sup>18</sup>

**Box 2. A Review of the Implementation of One-Door One-Stop (PTSPs) Services and Electronic Investment Licensing and the Information Service System (SPIPSE)<sup>a</sup>**

***Bandung, West Java***

Bandung is the capital of the province of West Java, one of leading cities in the implementation of PTSPs and SPIPSE in Indonesia. This was evidenced by the fact that Bandung received an investment award in 2009. Bandung has developed its PTSPs relatively well in terms the delegation of issuing business licensing (30 licenses and permits out of around 100 licenses and permits), as well as its electronic system for business licensing. Bandung had the highest level of implementation of SPIPSE, with 19 out of 26 offices using the system by 2011. Yet at the same time, Bandung has its own electronic business licensing system. Our discussions with local officials indicated that one of the problems holding the system back is that it has a unit that is a division of the national planning agency (Bappeda Investment Unit). This unit still deals with investment, but it is not integrated into the overall business licensing system. The unit acts as a local BKPM and produces a letter of recommendation for business applicants. Our discussions revealed that many local officials felt that this unit should become part of the integrated PTSP system.

One of the main highlights of the system in Bandung is its well-designed electronic business licensing system that has been operational since 2009. An applicant can track the current status of his application, including the division and the individuals in charge of issuing licenses or permits. Another highlight of the system is that it allows users to provide feedback and evaluation on the system. In addition,

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<sup>18</sup> The only province that had still not implemented SPIPSE in 2012 is North Maluku due to lack of infrastructure in connection of internet.

definitions on how to calculate costs of licenses or permits are posted at the front office and clearly defined and transparent.

Among business licenses in Bandung, building construction permits (IMB) and nuisance permits (HO) are perceived as being the most onerous for businesses. Other than these licenses, different regulations implemented in different areas have caused varying business licensing costs and confusion. To further improve business licensing in West Java, it would appear to be important to synchronize regulations across local jurisdictions, as well as develop an electronic payment system.

### ***Batam, Riau***

Batam is a Special Economic Zone in Riau. It was the first location to implement SPIPISE in Indonesia, in January 2009. However, the level of implementation and the degree use of SPIPISE are still relatively low, as indicated by our interviews with local notaries and businesses. They claim that this is partly due to the fact that Batam is a small island and they therefore prefer to submit applications manually.

Despite this low level of use of SPIPISE, all business licenses in Batam have been managed by the One-Stop Service (Unit Pelayanan Investasi Terpadu, or UPIT), which later merged into a PTSP in July 2006. To further improve services at the PTSP, our interviews suggested empowering the PTSP with clear delegated authorities. Our interviews indicated that efforts to simplify business licensing significantly increase the willingness of SMEs to become registered, as they also receive certain advantages by being registered.

The highlight of the current business licensing reform is that Trade Licenses (SIUP) and Business Registrations (TDP) can be obtained at zero cost since January 2012, and obtaining each of them takes a maximum two days. Our interviews indicated that among business licenses in Batam, building construction permits (IMB) and nuisance permits (HO) were the most onerous for businesses. In addition, to start up a business in a number of sectors also required an endorsement from the business association, which was claimed to be one of the hurdles in starting up a new

business. Our interviews suggested that while joining a business association may provide a number of benefits, it should not be a requirement for starting up a new business.

<sup>a</sup>The review of the implementation of PTSP and SPIPSE is the result of focus group discussions with BKPM, Bappepam, PSTPs, businesses, and notaries from May to July 2012.

There are two main limitations hindering efforts to reform business licensing in Indonesia. First, efforts focus only on simplifying the process but not necessarily simplifying the licenses (e.g., dropping unnecessary licenses). While simplifying the process is helpful, it would provide a much greater impact if it were conducted after the licenses themselves were simplified. Second, reforms have to provide greater benefits for businesses to become registered and comply with business licenses.

### **3. Lessons Learned from Business Licensing Reforms**

One of the main reasons for the mushrooming of licenses is that ministries and regulatory bodies, including those at the local level, often have a direct financial interest in creating new licenses and business fees, because these revenues support staff salaries and provide increased opportunities for corruption (World Bank Group, 2010b). The situation may become even more complex where provincial and district governments have the authority — whether *de jure* or *de facto* — to introduce new regulations.

In general, there are two approaches to business licensing reforms. The first approach is a “guillotine” approach, which involves documenting and reviewing all business licenses and permits whereby those that cannot be justified for retention within a certain timescale are automatically rescinded. This approach was initially developed by Sweden in 1984, then developed in middle-income countries such as Hungary, Mexico, and South Korea in the 1990s, and more recently adapted by transitional and developing countries such as Moldova, Ukraine and Kenya (Jacobs, et al., 2006; World Bank Group, 2010b; IFC-FIAS, 2012). The second approach is the Standard Cost Model (SCM), which is a method for measuring the administrative burdens imposed on businesses complying with various regulations and

requirements. The SCM is used to determine the administrative burden and compliance costs related to obtaining licenses and permits. The Government then sets targets for the reduction of administrative costs (World Bank Group, 2010a). The SCM was first introduced in the Netherlands in the 1990s, and has since been developed there and in other OECD countries. This method has also been implemented in developing countries such as Rwanda and Madagascar. Meanwhile, some countries may have a combination of both approaches.

This note focuses on business licensing reform in two of the world's top-ranked economies — Singapore and Canada — to provide good examples of continuous reforms, as well as the top reformers in business licensing, such as Kenya, Malaysia and Mexico, which also provide good examples in comprehensive business regulatory reforms. The key highlight of the reforms in these countries is that a combination of streamlining procedures and the use of technology works best. With an online system investors are responsible for information and data entry, and thus this reduces the time of registration. However, the bottom line is that simplifying business procedures should be placed first on the reform agenda.

### *Singapore and Canada*

Singapore has been the world's top-ranked economy on the ease of doing business for the past five consecutive years, while Hong Kong, New Zealand and Canada are among the top ease-of-doing-business countries. Starting a new business in these countries requires an average of nominal or zero minimum capital, standardized forms, online registration, no court involvement, fixed registration fee, simple publication requirements (or none), an average of 3 procedures, 5 days, fees of 1.5 percent of GNI per capita (on average). Singapore and Canada are highlighted below: Singapore because it has been the top-ranked country and conducted reforms in a short period; and Canada because it has one of the simplest and fastest business entry procedures in the world.

### *Singapore*

Singapore started its business regulatory reform in 2003. Singapore's Accounting and Corporate Regulatory Authority (ACRA) is the first stop in starting

a business using Bizfile, an Internet-based online registration, filing, and information retrieval system. With Bizfile up and running, information is now updated within half an hour of a successful filing — down to 14 from 21 days before reform. The time to register a new business has fallen from 24 hours to 15 minutes, and the time to incorporate a company from 5 days to just 15 minutes. Likewise, costs are down too. Businesses will benefit through faster business licenses and lower registration fees. ACRA has also developed an online business start-up system, *enterpriseone.gov.sg* which is a comprehensive network for business start-up. The good thing about the system is that it is not only an online application system, it also provides a range of business services starting from providing business guidelines to a whole range of comprehensive information on government assistance programs, regulations and e-services for businesses.

### *Canada*

Canada has one of the simplest and fastest business entry procedures (Doing Business, 2006).<sup>19</sup> The reforms to simplify business start-up procedures were part of a comprehensive reform package to support SMEs, guided by ‘Growing Small Businesses’ released by the Ministries of Industry and Finance in 1994. There was a huge improvement in the use of technology for the delivery of business support services, which has led to the development of a network called the Canada Business Service Centers (CBSC). The CBSC network is designed to improve services to small businesses and entrepreneurs in the start-up phase, providing a single window for information on federal and provincial/territorial government services, programs and regulatory requirements either online, in person, or by phone. The Government Online initiative was the driving force that facilitated CBSC’s involvement in the development of the *BusinessGateway.ca*, Canada’s business portal. One online tool developed by the CBSC network is the Business Start-up Assistant that provides links on how to register a new company.

Finally, the Corporation’s Canada Online Filing Center (CCOFC) was introduced in 1999, which belongs to the Industry Canada Department headed by the

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<sup>19</sup> The benchmarking takes into account the number of procedures and days to start a business, the cost to start a business as percentage of income per capita, as well as the minimum capital as percentage of income per capita.

Minister of Industry. Information required from the applicants was fairly simple and is in the public domain. In 2001, the fees were reduced by 50 percent, down to CAD (Canada Dollar) 250. CCOFC has been able to process 50 percent more registrations annually (de Sa, 2005). To date, CCOFC accounts for more than 80 percent of all incorporations. One good point about the system is that it allows the information about registered businesses to be open to public access, providing value-added for business promotion, as well as business backward and forward linkages. On-line business surveys show that companies are highly satisfied with the possibility to incorporate their businesses on-line.

### ***Kenya***

In 2005, Kenya launched a reform program to reduce the growing number of business licenses and fees. First, it established a central reform committee under the Ministry of Finance. The central reform committee compiled a list of licenses, recording 1,325 licenses in total. It also formed a neutral council to review licenses against clear criteria. The burden of proof is on regulators to demonstrate that the license is in the public interest. Licenses that could not be justified for policy needs were eliminated and justifiable licenses that were not business friendly were streamlined. As a result, 315 licenses were eliminated, 379 simplified, 25 reclassified not as licenses. The other licenses will be evaluated later. Second, the Government established a Permanent Business Regulatory Reform Unit for evaluating future licenses and drafted a Business Regulation Bill that requires a positive list of electronically registered licenses. Non-registered licenses would not be enforceable (World Bank, 2006b). Along the way, Kenya also established an electronic registry for all business licenses (Jacobs et al., 2007).

### ***Malaysia***

The Government of Malaysia set up a regulatory reform committee, which is a Special Task Force to Facilitate Business (Pemudah), in February 2007. Pemudah consists of highly respected members from the Government and the private sector. This is a kind of public-private partnership helping to inform and monitor the implementation of the national business climate reform agenda. This task force

reports directly to the prime minister. Every year, Pemudah has targets for improving business licensing. Many believe that Pemudah has played a significant role in improving Malaysia's ranking on the ease of doing business: it has risen from 23rd in 2010 to 18th in 2011, largely driven by the significant improvement in starting a business, which jumped in ranking from 111<sup>st</sup> to 50<sup>th</sup> over the same period (Doing Business, 2012). Pemudah has cut the number of procedures, the length of time and costs of starting a business from 10 procedures, 37 days and 25 percent of income per capita in 2006, to 4 procedures, 6 days and 16 percent in 2011, respectively (Doing Business, 2007-2012). Between 2007 and 2010, Pemudah initiated a series of improvements in business licensing, which include among others:

- *Time reduction for business registration.* The Companies Commission of Malaysia has actively engaged in reducing the time taken for approval of activities (e.g. registering a new business from 3 days to an hour, renewal of registration from 1 day to 15 minutes, approval of a company's name and incorporation from 5 days to 1 day, registration of Charge from 5 days to 2 days and register of Deeds of Trust and Prospectus from 14 days to 5 days).
- *Establishment of One-Stop Center (OSC) for business licensing.* With the establishment of One-Stop Center (OSC) for business licensing, all applications can be submitted concurrently. The OSC will then circulate them simultaneously to all relevant technical agencies to get feedback within a stipulated time. In 2007, 103 OSCs were established at sub national levels.
- *Validation of Certificate of Completion and Compliance (CCC) issued by industry professionals* within 6 months compared with the issuance of Certificate of Fitness for Occupation (CFO) by local authorities within 2 years. This is a regulatory reform implemented with the aim of changing from government-regulated to self-regulation. The initiative has reduced the number of procedures and the time taken in registering a property.
- *Establishment of commercial courts* to ensure speedy and efficient disposal of commercial cases. Beginning 1 September 2009, the New Commercial Courts handle cases filed and lodged for all codes except those involving Intellectual Property and Muamalat.

- *Development of Business Licensing Electronic Support System (BLESS).* The purpose of BLESS is to increase processing speed, enhance transparency, and maintain consistency in the application and approval of licenses. The system shows the time taken by the various departments to process applications, thus ensuring that government departments and agencies adhere to their respective client charter. It also enables on-line tracking and monitoring of applications and on-line payment of fees. BLESS will be implemented nationwide by the end of 2012.

### ***Mexico***

In 1989, the Government of Mexico created an Economic Deregulation Unit (UDE) within the Ministry of Trade and Industry. It was mandated to reduce red tape, particularly for business start-ups. In 1995, the President issued a decree titled the Agreement to Deregulate Business Activities. This required 12 ministries to submit lists of all business start-up formalities, including the legal basis for each. UDE determined efficiency and recommended streamlining or elimination. Along with this policy, the Government also initiated an inter-ministerial deregulation council with representatives from business, labor and the universities. The council reviews agency submissions and prepares reform proposals for each agency. Agencies negotiate a final reform package with the UDE and the Council. In 2000, the UDE became the Commission for Regulatory Improvement, an autonomous unit within the Ministry of Economy, formerly the Ministry of Trade and Industry. As a result, some licenses have been condensed. For example, before 1997, most businesses required a Sanitary License prior to beginning operations and underwent ex-ante inspections. All activities are now exempt, except for chemical, pharmaceutical and medical activities. Random inspections are held ex-post. There is a Federal Registry containing all federal business formalities, including licenses. In most cases, a government agency cannot require a formality unless it is on the list (World Bank, 2006b).

Moreover, the Government has also implemented the OSS system. The implementation of OSS (Expedite Business Start-up, or SARE program) in Mexico

has increased new firms registered by 5 percent and increased job creation by 2.8 percent (Bruhn, 2008).<sup>20</sup>

#### **4. Conclusions and Quick-Win Interventions**

In conclusion, Indonesia still lags far behind its peer countries, such as Malaysia and Thailand, in terms of starting a business. Indonesia ranked 155<sup>th</sup> out of 183 countries in starting a business, while Malaysia and Thailand ranked 50<sup>th</sup> and 78<sup>th</sup>, respectively, in 2011. In Malaysia, starting a business only took about 4 procedures in 6 days and cost 16 percent of income per capita and in Thailand, it took 5 procedures in 29 days and cost 6.2 percent of income per capita. Meanwhile, in Indonesia, it took 8 procedures in 45 days and cost 18 percent of income per capita (Doing Business, 2012). Therefore, there is considerable scope for improvement in Indonesia and the following are some possible quick-win interventions.

- 1. Improving the quality of the website and help desk.** Based on the Global Investment Promotion Best Practices 2012, Indonesia recorded only 11 percent on inquiry handling (GIBP, 2012). In 2011, 96 percent of inquiry handling was related to business licensing procedures (BKPM, 2012b). Therefore, a priority should be to improve the service quality of the website and help desk at investment offices. The website and help desk should act as a front line in dealing with investment regulations and policies for investors. Improvements should cover both hard and soft infrastructure of the website and help desk, including the skills and capacity of officials. It could start first by providing detailed information on business start-up requirements online, or publicly available, along with the costs of obtaining licenses, departments that are responsible for issuing licenses, as well as the individuals in charge and their contact details. Second, the help desk and/or investment relations unit should be empowered with enough

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<sup>20</sup> Most reforms in business licensing include either a number of the following reforms or all: registration simplification, online registration, cut registration fees or implement flat fees, creation/improvement of one-stop shop services, abolishment/reduction of minimum capital requirement, introduction or shortening of statutory time limits and computerization of the registry.

knowledge to respond to basic questions relating to investment in Indonesia, investment policy and regulations, PTSPs and SPISPIE and how to start up a business.

2. **Continuing business license simplification.** Simplifying licensing is about limiting licenses to those that are justifiable. The first step is to compile a list of all licenses and then to cut unnecessary licenses. This could be started by setting technical standards to ensure that licenses should fulfill legitimate regulatory purposes, such as safeguarding public health and safety, environmental protection, national security, or managing limited natural resources (World Bank, 2006a). Box 3 presents principles on licensing. Moreover, Indonesia should also foster the full implementation of One-Stop Shops (*Pelayanan Terpadu Satu Pintu*, or PTSP), where authority is delegated to a particular agency to issue licenses, allowing reductions in overlapping licenses as one agency can take control. One of the simple quick-win would be to issue an official announcement that joining a business association is optional and not a requirement for starting up a new business in Indonesia.
  
3. **Fostering the implementation of an online system, not only an electronic business licensing system but also an electronic payment system.** The Government should foster full implementation of an electronic application and payment system of business licenses nationwide. Also, the government should increase (non-fiscal) incentives for firms to become registered. The system should provide more incentives for firms to be registered. For example, the system should also automatically act as a nationwide database linked to a database of international firms, which could act as a reliable information database of firms. The system could be automatically linked with government programs and grants, and could also provide basis assistance for firms such as: knowledge on marketing, book-keeping, administration and continuous business regulation updates. The system should also increase the involvement of the private sector in completion and compliance, shifting from government-regulation to self-regulation.

4. **Improving monitoring and evaluation.** The monitoring and evaluation system should be improved such that it can monitor and evaluate the implementation of One-Stop Shops (PTSP) and the SPIPISE system nationwide, and how efficient the process of business application is. This system should also allow the private sector to provide feedback to enable improvements to be made.
5. Efforts in the medium term should focus on improving coordination among government agencies, clarifying the roles of central and local governments in the licensing process, and ensuring that local governments comply with national laws and regulations on licenses, permits and fees.

On top of the quick win interventions mentioned above, in Indonesia, there is a need for a fundamental reform beyond licensing process such as PTSP and SPIPISE. As these systems may even aggravate problems unless there is more fundamental reform. An example is when a “one-stop shop” becomes “one-more shop”. In countries that have successfully reformed their business licensing system, the focus is more on the objectives of licensing and on guiding principles for the licensing process. Licenses should fulfill legitimate regulatory purposes, such as to safeguard the public health and safety, environmental protection, national security, or to manage limited natural resources. Business activities that do not fall within the list of legitimate licensing categories are either eliminated or a converted to a single business operating license. Even when a business falls within the list, countries may adopt different methods for meeting licensing objectives, for example by giving different emphasis to ex-post monitoring versus ex-ante approval for ensuring compliance of safety requirements. Single business operating licenses and ex-post monitoring allow a country to simplify licensing procedures while meeting public policy goals regarding safety, resource allocation, environmental protection, and others.

The first step in most licensing reform projects is to compile an inventory of the licenses required, where the inventory covers all core business sectors requiring a license, where a license is defined as a document that authorizes an individual or

company to conduct a business activity – such as the manufacture of shoes. If the manufacturing of the shoes is the main line of business for the company, then the license is the core business license.<sup>21</sup> In Indonesia, such licenses are regulated at the national level by the technical ministries as indicated below:

Agriculture	Law
Communications	Fishing/Maritime
Education	Tourism
Finance	Trade
Forestry	Transportation
Health	Public Works
Industry	Mining and Energy

Second, for each ministry, the different business activities that require a core authorization license would be identified. The Project will determine how business sectors are defined, the way they are incorporated into the licenses, and the degree to which licensed companies can move into related lines of business without applying for new licenses. In some cases, the classification of business activities can themselves be an issue. For example, this occurs when the SITC codes used in the DNI do not match the business sector definition used by line ministries (see previous example on electronic commerce).

Third, for each sector, the Project would also provide details on the type of license, its contents and the licensing process. Licenses have different characteristics. For example, a “class” license can be offered to any company meeting the conditions defining the class, where these conditions are contained in the license or in separate regulations. Class licenses are much easier to approve. Operator-specific licenses, on the other hand, are unique to the operator. In Indonesia, such licenses may require negotiations between the company and a government ministry, and may require ministerial approval.

Finally, the Project would identify the objectives of each license and evaluate the license vis-a-vis various public interest criteria, thereby leading to recommendations for licensing reforms. See Box 3 below for examples of the principles behind good

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<sup>21</sup> In contrast, a permit authorizes actions related to the business activity, such as construction, use of public resources, etc. In some cases, the license to operate and the permits are contained in a single document (e.g. authorization to offer cellular service with permission to use a given band of spectrum).

licensing. The project could for example develop a positive list of businesses requiring a core business license. Those business activities which safeguard the public interest or manage limited public resources would be on the list and would remain under the authority of the technical ministries, which have the expertise needed to manage these licenses. Licenses not on list would be converted to class licenses, i.e. a single business operating license that could be under the authority of BKPM.

**Box 3. Principles in Licensing (CESE ACE)**

1. Clear. When issuing a license, make legislation and rules as clear as possible; use a committee, not an individual; keep decisions at operational/administrative levels, not at the political level (do not use licenses to generate revenue); and establish a credible complaints mechanism that is independent from the start.
2. Equal. Apply the same rules to all businesses in similar categories (activity, size, location).
3. Symmetric information. Provide symmetric information (to both government and businesses) about which licenses exist, what are their legal bases, which businesses need them, what are the criteria and the costs.
4. Efficient. Improve efficiency by simplifying rules, reducing documentary requirements, simplifying the internal flow of documents, issuing justified and timely decisions.
5. Appropriate. Select the most appropriate method for issuing a license. At one end of the spectrum is authorization/approval – government screens the suitability of the application against specific conditions or legislation, and then issues a license. At the other end is registration/notification – the applicant provides the authorities with information before engaging in a business activity, and takes responsibility for accuracy and compliance. There is no discretion by the authorities (for those activities that do not affect public health and/or safety and/or managing natural resources, there is no reason to restrict economic activity).
6. Compliant. Keep a database of registered companies as a basis for inspections; offer regular and targeted training to businesses that have the license.
7. Effective. Abolish licenses that are no longer needed and streamline or combine those that are currently overlapping in function, purpose or requirements.

*Note:* Some suggestions from the source have been modified and reworded to clarify and simplify the messages.

*Source:* IFC-FIAS, 2006 (mimeo).

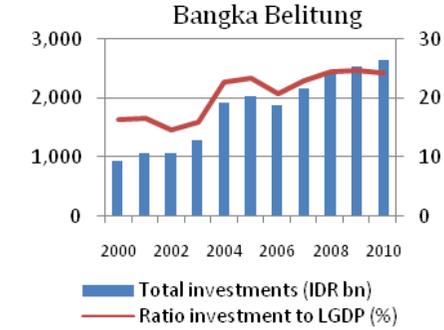
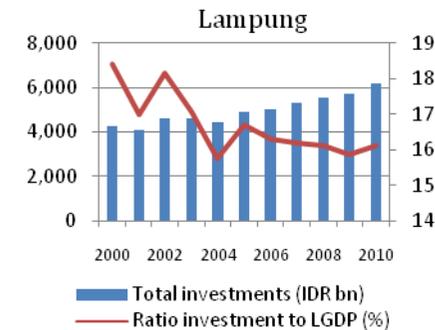
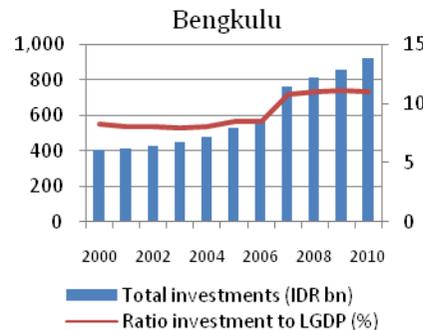
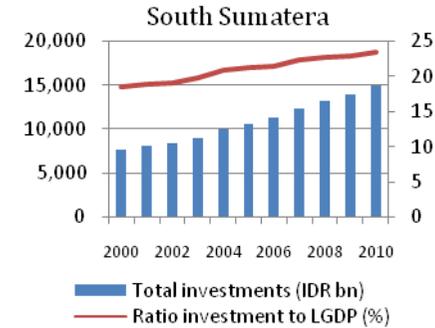
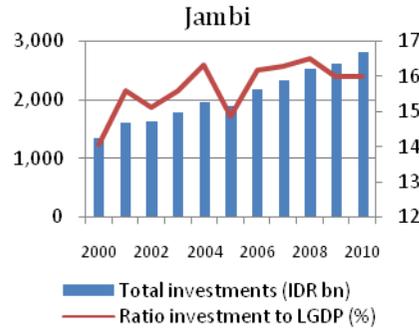
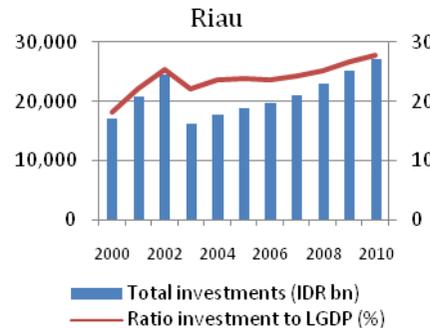
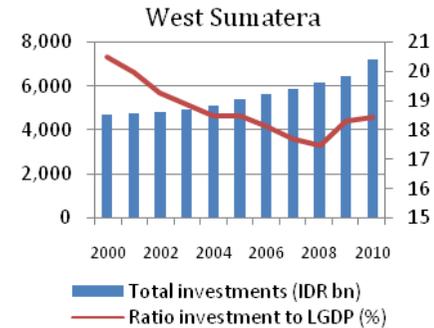
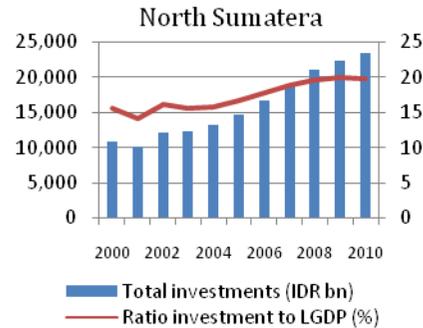
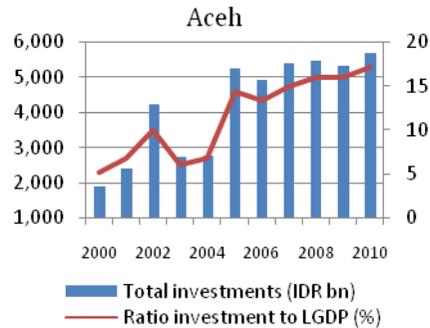
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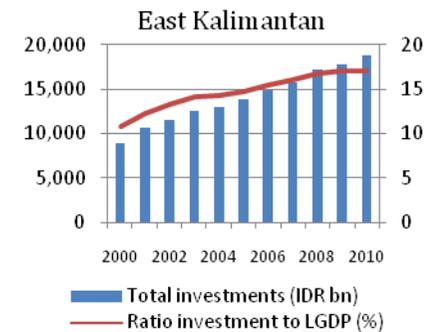
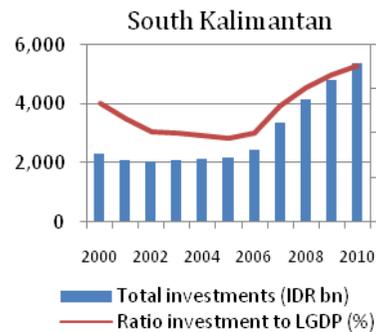
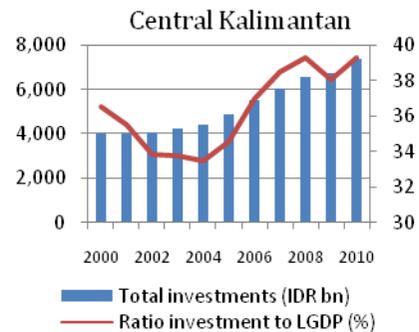
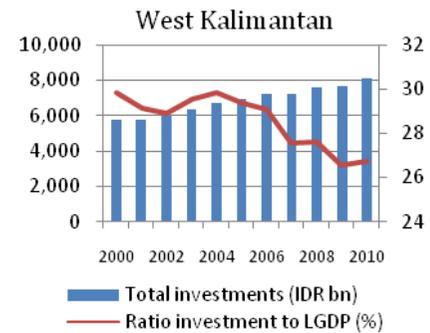
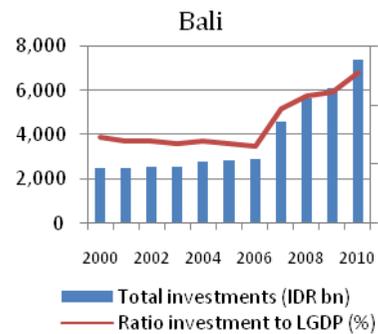
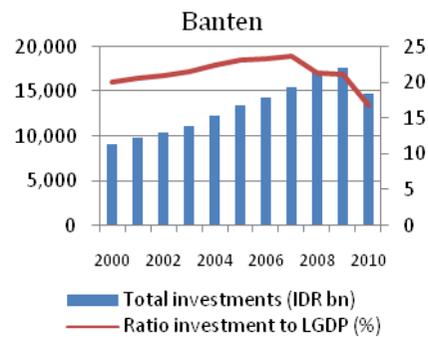
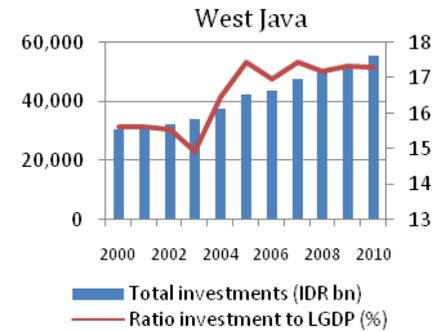
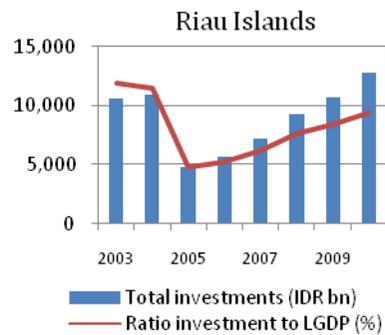
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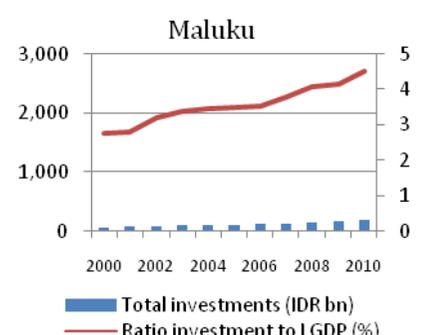
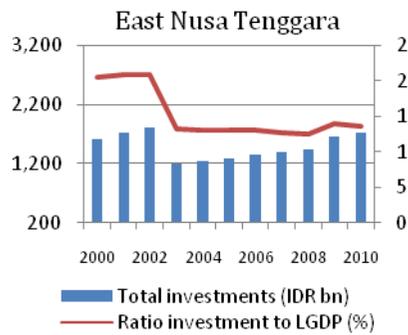
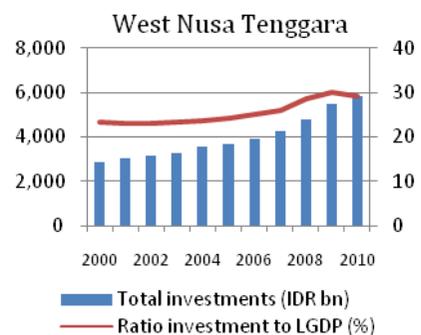
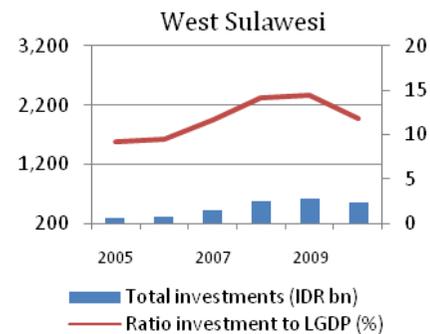
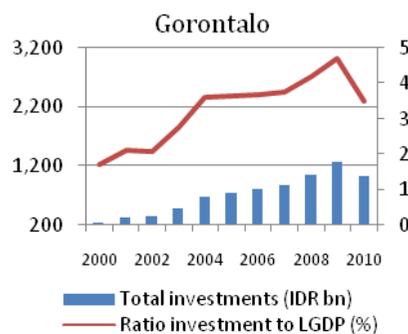
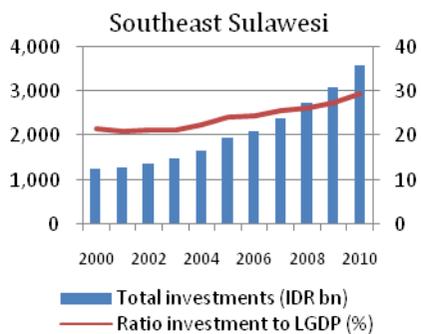
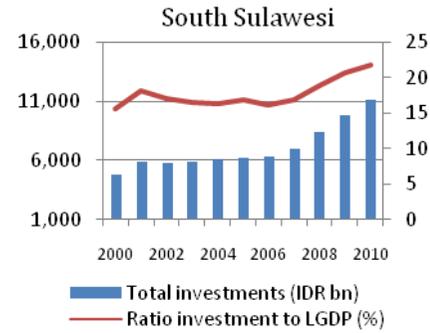
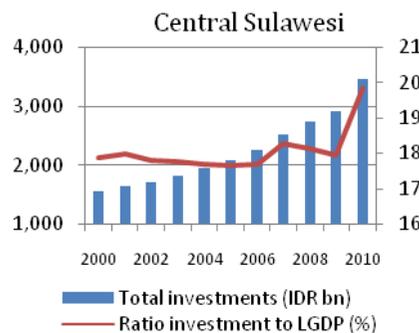
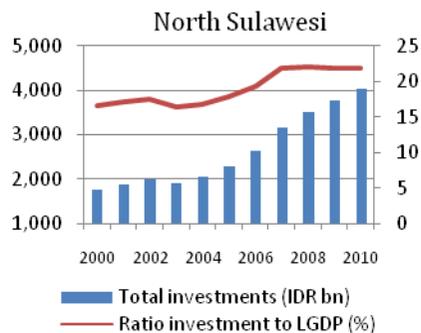
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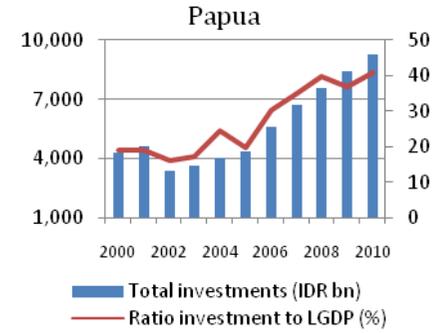
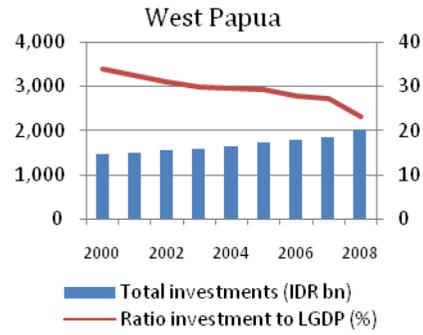
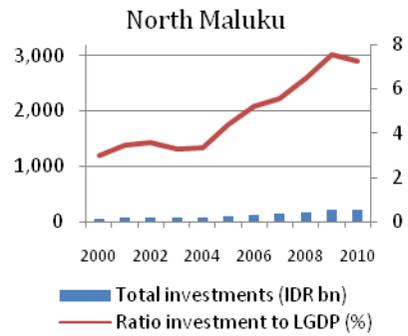
# APPENDIX

## Appendix A.1. Investment in Indonesia, by Region, 2000-2010



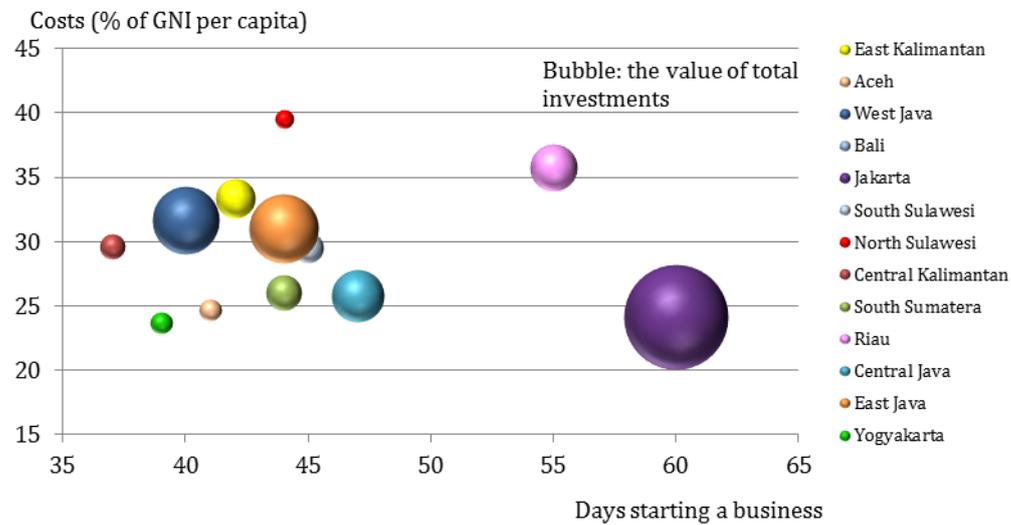




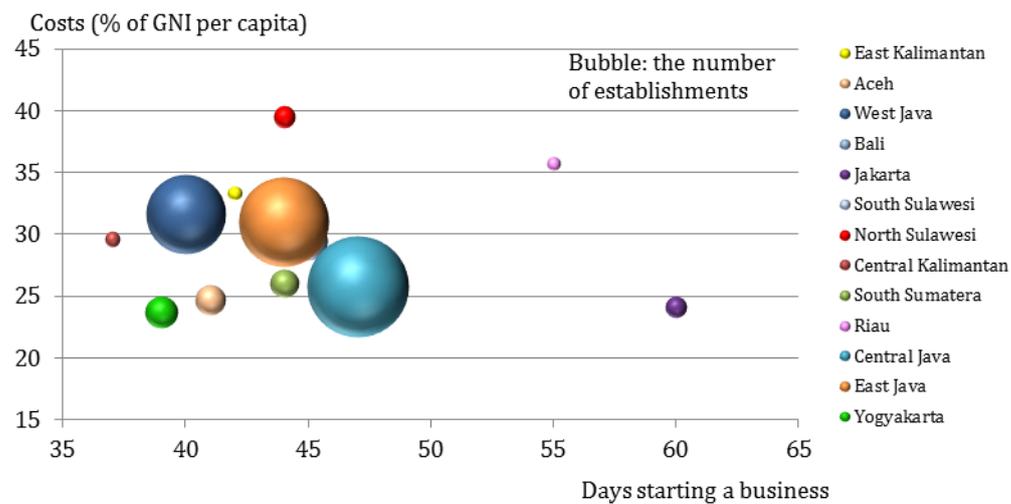


## A.2. Starting a Business in Indonesia

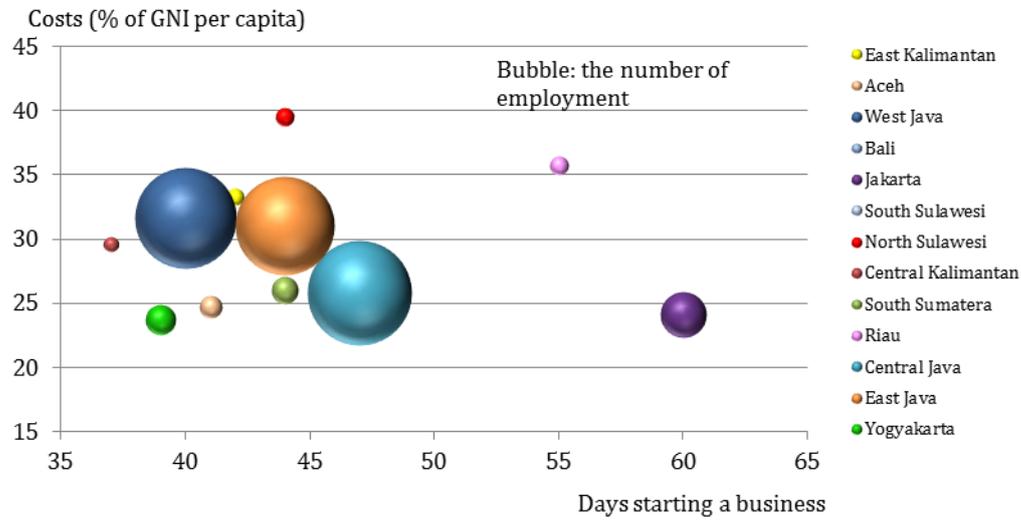
**Figure A.2.1. Starting a Business and the Value of Investment, 2010**



**Figure A.2.2. Starting a Business and the Number of Establishments, 2010**

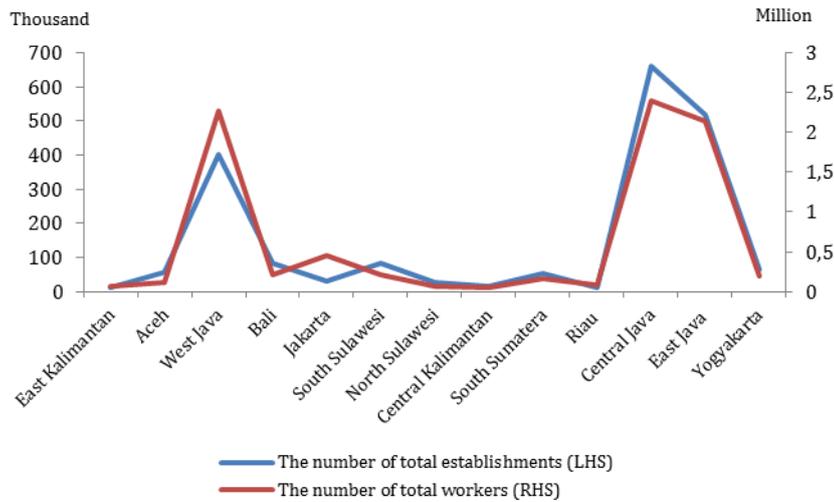


**Figure A.2.3. Starting a Business and the Number of Employment, 2010**



Source: Authors' calculation based on Doing Business Sub nationals, 2010; CEIC Database, 2011; and Statistics Indonesia, 2010.

**Figure A.2.4. The Trends of the Number of Establishments and the Number of Employment**



Source: Authors' calculation based on Statistics Indonesia, 2010.

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