Background information

This paper was prepared as a background document to the OECD Ministerial Conference on Small and Medium-sized Enterprises, taking place on 22-23 February 2018 in Mexico. It sets a basis for reflection and discussion.

About the Ministerial Conference

The 2018 OECD Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth is part of the OECD Bologna Process on SME and Entrepreneurship Policies. The Conference will provide a platform for a high-level Ministerial dialogue on current key issues related to SMEs and entrepreneurship. It will seek to advance the global agenda on how governments can help strengthen SME contributions to productivity and inclusive growth; how SMEs can help address major trends and challenges in the economy and society; and how the OECD can support governments in designing and implementing effective SME policies.

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Improving the business environment for SMEs through effective regulation

Policy note
Summary

- Regulatory conditions are among the most important factors affecting SMEs and entrepreneurship. SMEs usually face bigger challenges than large firms in screening the regulatory environment and dealing with norms.

- In recent years, important progress has been made to reduce the administrative burdens on start-ups, lower legal barriers to entry, and reduce the costs for regulatory compliance in different areas. However, the complexity of regulatory procedures, covering a wide range of areas such as license and permit systems, insolvency and tax, among others, remains a major obstacle to entrepreneurial activity.

- To enhance regulatory conditions for SMEs, there is no one-size-fit-all model. Key elements for SMEs include: simplification of regulations and administrative procedures, regulatory impact assessment, reforms to tax administration and bankruptcy procedures, including to promote a second chance for honest entrepreneurs, improved availability and provision of information, and use of digital technologies to reduce administrative burdens and facilitate collaborative relationships with businesses and citizens.

Questions for discussion

1. Have government efforts to develop a business environment that offers a level playing field for SME and entrepreneurship development been effective? How can remaining obstacles be overcome?

2. When developing regulatory policies, how should governments take into account characteristics of SMEs such as size, age or sector?

3. How can governments achieve regulatory simplification for SMEs, while preserving the incentives for these businesses to grow? Have regulatory simplification efforts been effective in boosting investments by SMEs?

Why does it matter?

An effective and transparent regulatory environment is key for entrepreneurship and SME development at all stages of the business life cycle, including entry, investment and expansion, transfer and exit. Reducing the regulatory burden on SMEs can facilitate their participation in the formal economy, help improve their productivity and competitiveness, and enhance their participation in and benefits from a globally integrated economy.

What are current trends and challenges?

SMEs are typically less efficient than large firms in screening the regulatory environment and dealing with norms. The proportion of resources they divert to administrative functions is usually greater than for large firms (OECD, 2017). For
instance, about 12% of surveyed European SMEs cite regulation as their most pressing problem compared to 16% in 2016 (EU SAFE survey 2017). For SMEs that participate in global markets and value chains (GVCs), regulatory divergence across countries can impose an additional layer of difficulty. Asked about barriers to trade, 38% of SMEs with a digital presence cite different regulations in other countries as the main challenge to export in 2017 (Future of Business Survey, 2017).

Across most OECD countries, regulatory barriers to entrepreneurship have been declining over time (Figure 1). Over the last decade, reforms have focused on reducing the administrative burdens on start-ups, lowering legal barriers to entry, and decreasing the costs for regulatory compliance in different areas (e.g. environment, labour legislation, product standards and certification). For instance, in the OECD area over 2008-13, the number of days required to start a business fell from 14 to 6, and the cost from 5% to 2% of income per capita (median values). In Portugal, a reform was introduced in 2005 which reduced the time to incorporate a company from several months to as little as one hour; and the fees from EUR 2 000 to less than EUR 400. In Chile, since 2013, a virtual one-stop shop allows the creation of a firm in one day, with a single-step, minimal red-tape and at zero cost. In addition, a clear trend towards reducing the stringency of employment protection was observed over 2008-13, mostly focused on individual and collective dismissal of permanent workers.

Figure 1. Barriers to entrepreneurship, 2008 and 2013

Scores from 0 (least restrictive) to 6 (most restrictive)

However, the complexity of regulatory procedures remains a major obstacle to entrepreneurial activity. While important progress has been made in the communication and simplification of rules and procedures, challenges persist related to tangled license and permit systems. Countries are taking steps to address the complexity of license systems. For example, in Israel, a business license reform was enacted in 2012 to harmonise license requirements across the country and make it more difficult for municipalities to add extra local requirements on top of national ones (OECD, 2016). In December 2017, a new government resolution grouped businesses into different
environmental risk categories and made significant reductions in license specifications for low risk businesses.

To tackle remaining challenges, recent efforts have aimed primarily to cut red tape for businesses and to improve transparency and cost-efficiency of administrative regulations. In Denmark, for instance, the Business Forum for Simpler Rules was launched in 2012, based on a comply-or-explain principle, to identify business regulations that firms perceive as the most burdensome and propose simplification. In Denmark and Sweden, consultation with the private sector is encouraged through the Burden Hunt Programmes, which engage civil servants in developing smart regulation that can reduce red tape. In the UK, over 2011-13, the Red Tape Challenge website promoted open discussion on how the aims of existing regulation can be fulfilled in the least burdensome way possible. Comments were used by the British government to design a package of 3000 reforms to cut red tape.

In addition, dedicated institutions have been set up to help SMEs and entrepreneurs to better navigate the regulatory environment, including through the provision of e-government services, and to liaise with official bodies, such as through the creation of digital “one-stop shops,” i.e. single entry points for government services. In this context, the use of digital technologies holds the potential to further streamline procedures for SMEs in particular. In the Slovak Republic, for instance, the introduction of a “silence is consent” procedure and the creation in 2013 of a single contact point to handle notifications and licenses via the Internet have simplified the process of opening and operating a business. In 2017, Switzerland launched an e-Government platform dedicated exclusively to companies (EasyGov.swiss), which offers a customer-centric integrated approach to business to government interactions, overcoming silos between agencies and federal levels.

Regulatory impact analyses (RIA)\(^1\) have also become a common practice in most OECD members (Figure 2), including in most cases SME impact assessments, although in some countries only for major regulations or selected regulatory instances. In Mexico, for instance, the RIA process provides important public consultation opportunities, as well as safeguards to ensure that adequate account is taken of comments received from stakeholders, including extensive periods of consultation on the draft RIA (OECD, 2015a).

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\(^1\) Regulatory Impact Analysis (RIA) is a systemic approach to critically assessing the positive and negative effects of proposed and existing regulations and non-regulatory alternatives through a range of methods. In many OECD countries, it has increasingly become an important element of an evidence-based approach to policy making.
Inefficient insolvency regimes limit business dynamism, restructuring of viable firms and access to external finance by SMEs. In some countries, in the case of unincorporated micro and small firms, the treatment of individual defaulters is very severe, leaving full personal liability for many years beyond liquidation of the business. Lengthy and complicated processes can significantly affect the capital and reputation of small entrepreneurs, drastically decreasing the chance of starting a business again. The fear of social stigma, legal consequences and inability to pay off debts is stronger in some regions, such as Europe, partly because of much longer debt discharge periods (i.e. the time between liquidation and formal cancellation of debt).

Reforms have been particularly slow in this area, with efforts focusing mainly on prevention and streamlining (e.g. through pre-insolvency regimes), particularly in Europe, although early-warning systems and special insolvency procedures for SMEs are only available in about one-third of OECD countries (Adalet et al., 2017). Over 2010-16, barriers to firm restructuring remained stable or declined only marginally in most countries. In particular, the time to discharge – and thus the personal costs associated with entrepreneurial failure – remains high in many OECD countries (Figure 3).
Figure 3. Barriers to firm restructuring
Scores from 0 (low) to 1 (high)

Source: Adalet et al. (2017). Calculations based on the OECD questionnaire on insolvency regimes.

**High costs and complexity of tax compliance fall disproportionately on small and young firms.** Given the substantial fixed cost of compliance with tax regulatory requirements (e.g. record keeping, filing and payment processes), small businesses are at a disadvantage with respect to large enterprises. For young firms, which also tend to be small, high compliance costs and complexity of tax regimes can exacerbate the resource and cash-flow constraints often experienced in the early stages of business development, and may act as a deterrent to formalisation. In some cases, tax compliance costs for small firms may even exceed their tax cash payments. In recent years, policy approaches have focused on reducing compliance complexity for SMEs, reflecting a more systemic perspective on the SME business environment and activities. Greater emphasis is being placed on ensuring compliance from the outset, making tax compliance a by-product of the steps a business follows to transact. For instance, in Chile, an Electronic Invoicing System allows business taxpayers to issue and receive invoices that are immediately available to the revenue body, and provides, free of charge a simplified and complete accounting system. However, despite widespread reforms in recent years, tax compliance remains a challenge for SMEs. While electronic filing and changes in the payment system have generally reduced the number of payments required by businesses, time to comply has remained stable in most countries (OECD, 2015b, 2017).

**While lack of transparency and corruption in the public sector are detrimental to all businesses, they pose particular problems to SMEs.** which often lack the capacity to cope with an opaque public sector, design and implement anti-corruption strategies and lobby for their needs in the absence of an established framework for participation in public decision making. Most OECD countries have accelerated the implementation of Open Government Data (OGD), to increase transparency, ease access to information and create opportunities for citizens, businesses and civil society organisations to reuse the data in new ways. For instance, in the United States, a dedicated portal provides public users with access to federal regulatory content and a tool for commenting and influencing the regulatory process. In addition, several OECD countries have adopted principles of transparency for lobbying activities (OECD, 2017).
What are key areas for policy to consider?

Cross-country evidence suggests that different types of regulatory burdens may have greater importance for SMEs than for large firms, with their impact depending on the general macroeconomic framework, institutional legacy and structure, as well as the sectoral make-up of the economy. At the same time, size-contingent policies that seek to ease the regulatory burden on SMEs with employees below a certain threshold can also produce adverse effects by discouraging these firms to grow (OECD, 2015).

As the complexity of economies increases and new societal needs emerge, regulations need to evolve while limiting burdens and pursuing cost efficiency. However, there is no "one size fits all" model for regulatory reform, and policy responses need to be context-specific, while following established good practice principles for regulatory reform, as outlined in the 2012 Recommendation of the OECD Council on Regulatory Policy and Governance. Key areas for policy consideration include:

- **Improving the efficiency of bankruptcy procedures and fostering a second chance for honest entrepreneurs**: This can include reduction in the time for discharge, which decreases the administrative burden imposed on entrepreneurs in the course of bankruptcy procedures. In several countries discharge is automatic and does not require an additional court decision.

- **Facilitating tax compliance**: Process simplifications, particularly through targeted use of technology, can be a powerful tool to enhance compliance and to reduce its costs. Certain tax preferences may help support SME creation and growth. However, such measures should be carefully targeted to ensure that they meet their policy objectives in a cost-effective way and do not create further distortions or complexities.

- **Cutting red tape for businesses**: Consultation with the private sector and continuous dialogue with citizens can support civil servants in developing smart regulation that reduces red tape. An increasingly popular instrument for controlling the administrative burden on business is the One-for-One rule (or one-in-one-out rule), which stipulates that regulators must remove a regulation each time they introduce a new one that imposes an administrative burden on business. At the same time, policy needs to consider potential trade-offs and strike a balance between regulatory exemptions or simplifications and compliance to norms across different areas, such as, for example, labour protection.

- **Strengthening public sector integrity and transparency, and conducting regulatory impact analysis (RIA) to enhance the effectiveness of regulation and assess its implications for SMEs**: Regulatory frameworks can support regulators in analysing the specific impact of legislation on SMEs, and in considering flexible regulatory options that reduce costs for small businesses. At the EU level, the SME Test helps implement the “Think Small Principle”, by analysing possible effects of EU legislative proposals on SMEs, including through: i) consultation of SME stakeholders; ii) identification of affected businesses; iii) measurement of the impact on SMEs (cost-benefit analysis); and iv) assessment of alternative mechanisms and mitigating measures. For major regulation, focus groups and panels can be used to produce full tests of regulatory impacts on SMEs. A regulatory policy body, close to the centre of government and responsible for regulatory oversight, can ensure that regulation serves whole-of-government policy, although the specific institutional solution should be adapted to each system of governance.
Further Reading


