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ESTABLISHING AN ENABLING ENVIRONMENT FOR FINANCIAL SECTOR DEVELOPMENT

LESSONS FROM *DOING BUSINESS* FINANCIAL SECTOR REFORMERS

OCTOBER 2010

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CONTENTS

ACRONYMS

BCR	USAID Business Climate Reform Project
BEE	business enabling environment
CBE	Central Bank of Egypt
EFS	USAID Egypt Financial Services program
EGAT	USAID's Economic Growth and Trade Bureau
IFC	International Finance Corporation (World Bank)
MSME	micro, small, and medium enterprise
NRC	National Registration Center of Albania
NAPR	National Agency for Public Registry of Georgia
SME	small and medium enterprise
TCP	Albania Threshold Country Program

INTRODUCTION

The United States Agency for International Development (USAID) Bureau for Economic Growth Agriculture and Trade (EGAT) created the Financial Sector Knowledge Sharing Project (FS Share) to collaborate with USAID missions to develop effective and efficient financial-sector programs that increase access to financial services and develop well-functioning markets worldwide. USAID awarded Chemonics International, Inc. the FS Share delivery order under the Financial Sector Blanket Purchase Agreement. FS Share has a three-year period of performance, July 2008 through July 2011.

Through the FS Share Task Order, USAID EGAT and Chemonics proactively collaborate with missions to identify financial-sector priorities and develop strategies and programs for growing the financial sector. FS Share identifies financial-sector best practices and aggregates them through model scopes of work, primers, diagnostic tools, best-practice case studies, and other tools. These deliverables are disseminated to USAID missions for use in financial-sector programs. FS Share can assist with implementation and connect mission staff to external resources on best practices. In response to mission demand, FS Share delivers presentations and other knowledge-sharing endeavors.

Objective of This FS Share Paper

This paper examines how burdensome microeconomic policies can increase the cost and risk of lending, and identifies ways to remediate these barriers to facilitate financial sector development. We describe the experiences of USAID programs in Albania, Georgia, Egypt and Colombia as they apply to the design and implementation of initiatives to improve the policy and regulatory environment for micro, small, and medium enterprise (MSME) access to financial services and present lessons learned from these programs to inform future BEE programming to improve the enabling environment for finance. With this paper, we also provide a diagnostic checklist to be used as a tool for evaluating and assessing the readiness for and feasibility of reform.

This FS Share paper was developed by Olin McGill, Irakly Chkhenkely, and Anne Spahr, and reviewed by FS Share on behalf of Chemonics International.

FS Share Rapid Response Hotline

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EXECUTIVE SUMMARY

In this paper, we examine elements of business enabling environment (BEE) programming that more consciously pursues financial sector impacts to liberate finance and promote growth of businesses of all sizes. Using a financial sector lens, the paper looks at the way burdensome microeconomic policies can increase the cost and risk of lending, and identifies ways to remediate these barriers to facilitate financial sector development. We describe the experiences of USAID programs in Albania, Georgia, Egypt and Colombia as they apply to the design and implementation of initiatives to improve the policy and regulatory environment for micro, small, and medium enterprise (MSME) access to financial services. We also gather lessons learned across all of these programs to inform future BEE programming to improve the enabling environment for finance.

USAID's Economic Growth Strategy focuses on reducing poverty and growing more prosperous partners through rapid, sustained, and broad-based economic growth. USAID's strategy recognizes that business is the *engine* of growth; that rapid, sustained, and broad-based economic growth begins at the level of the productive enterprise. Economic growth is based on the ability of enterprises of all types and sizes to become more productive. Micro- and macroeconomic policies represent the *drivers* of economic growth as they shape the environment in which businesses operate. The financial sector is an *enabler* of growth, promoting expansion and enhancing competitiveness by channeling capital to new opportunities. Access to capital ensures that businesses have the resources to respond to new buyers, reach new markets, increase production, fill larger orders, and create additional jobs.

While banks in developing countries have excess liquidity, they rarely lend to MSMEs. Banks' hesitancy to lend is largely due to their fiduciary responsibility to their investors and depositors. Prudent lenders must carefully balance the costs and risks of lending against potential revenues to protect depositors and shareholders. In developing countries, many banks deem the costs and risks associated with lending as far too high to permit secure, affordable credit. These risks include:

- Informality of MSMEs (e.g., lack of formal registration, poor recordkeeping, and lack of financial statements)
- Difficulty enforcing loan contracts
- Inadequate collateral laws and registries
- Challenging bankruptcy regimes
- High loan reserve requirements
- Crowding out by government bonds
- Asymmetrical credit information
- Inadequate skills on the part of banks for assessing and managing risk of lending to MSMEs

Released in 2005, the first *Doing Business* survey provided a new tool for policymakers and donors to assess bottlenecks to business growth and address constraints in the BEE. As a result, USAID and other donor-supported initiatives have shifted from top-down overhauls of commercial framework laws to more precise, targeted reforms at the transactional level.

Incorporating a "*Doing Business* approach" in economic development programming can help generate political will to reform, invoking competition and the drive to attract investors. However, governments must be careful not to rely too heavily on the indicators. Though they can signal an area in need of reform, they do not tell *how* to improve the environment. Reformers must carry out a thorough analysis to uncover the underlying root of a poor score, and must undertake a series of reforms to affect the business environment. Improvements in the BEE should be measured not just by *Doing Business* indicators, but by additional qualitative and quantitative indicators that evaluate the impacts of reforms on stakeholders, consumers, and financial institutions. Though all of the *Doing Business* indicators can signal challenges in the financial sector, those most directly linked to MSMEs' ability to access finance include:

- Starting a Business
- Registering Property
- Enforcing Contracts
- Getting Credit

The four case studies presented in this paper are examples of USAID BEE programming in countries that have been recognized as "Top Reformers" and have shown marked improvements in Getting Credit on the World Bank's *Doing Business* rankings. The case studies help demonstrate how the *Doing Business* survey and its indicators can be tools for identifying and better understanding needed reforms, and they can be a catalyst for a friendlier environment for enterprise development, including greater access to financing for MSMEs.

Albania. With support from USAID's Threshold Country Project (TCP), Albania created a one-stop shop and streamlined and automated the processes for business registration. The new National Registration Center has significantly reduced the cost and time required to register a new business. It has also reduced opportunities for corruption. The new registration system enabled 18,000 new businesses to register, bringing them into the formal economy and increasing their ability to access financial services.

Georgia. With help from the USAID-funded Business Climate Reform (BCR) project, the government of Georgia created centralized, electronic, Web-based property and lien registries. The new registries, coupled with legislative changes, made the use of property as collateral much less risky and increased access to credit, particularly for small and medium enterprises (SMEs).

Egypt. Working closely with the Central Bank of Egypt, USAID's Egypt Financial Services (EFS) program helped create the country's first private credit bureau and link information across private and public entities. This central registry has decreased asymmetries in credit information for bank and non-bank entities, and has helped open more financial opportunities to MSME consumers.

Colombia. In addition to working to address specific regulatory constraints, including regulatory reforms that led to the doubling of bank locations between 2006 and 2009, USAID's More Investment for Sustainable Alternative Development (MIDAS) program also provided training and technical assistance to financial institutions to expand the availability of MSME finance. By going beyond regulatory reforms and directly addressing constraints at the institution and client level, USAID has helped dramatically expand access to financial services for MSMEs in Colombia.

We can draw a number of lessons learned for future BEE programming from these four experiences:

Identify linkages between business and financial sector development. It is critical to include initiatives to address bottlenecks in MSME lending in BEE programming.

Analyze and prioritize reform needs. Selecting a few key transactions to target, as opposed to broad, sweeping reforms, makes achieving the right results attainable.

Reform and automate: "simplicity is power." Streamlining, simplifying, and automating processes eliminates opportunities for corruption and introduces systems of accountability that make rent-seeking easier to identify.

Promote ruthless transactional efficiencies. Aggressive incrementalism — a swift succession of small reforms to the same business process — can lead to faster, more far-reaching, and better-implemented reforms, rather than sweeping overhauls of legal regimes.

Generate political will by empowering the private sector and engaging stakeholders. Each of these projects implemented strategic public relations campaigns to increase public awareness about the benefits of these reforms and to garner buy-in from the private sector; without these stakeholders, reform would have fallen flat.

Leverage other donor initiatives. The World Bank and other donors saw the need for reform in these countries; in many cases, they were already well positioned to identify or alleviate constraints to doing business. The goal of any USAID program is to build on, not duplicate, the efforts of other donors.

Measure and monetize for results. Reducing the cost of inefficiency and the benefits of reform to a dollar amount is an extremely effective communications tool for stakeholders, and may prove to be a powerful tool in generating the political will to reform. In the case of improvements to the enabling environment for finance, this may translate to reductions in the average interest rate, the number of days to register a lien, or the time required to process a credit check.

Be prepared for reform to take time and roll with the punches. The process of generating political will and encouraging stakeholder buy-in for reform is usually a protracted and taxing one. More than likely, it will take months, if not years, and require several starts and restarts. Be prepared to "roll with the punches" as internal and external forces affect the process, government administrations change, and counterparts move in and out of positions.

PAPER

In this paper, we examine elements of BEE programming that more consciously pursue financial sector impacts to liberate finance and promote growth of businesses of all sizes. Using a financial sector lens, the paper looks at the way burdensome microeconomic policies can increase the cost and risk of lending, and identifies ways to remediate these barriers to financial sector development. We present the World Bank's *Doing Business* surveys as a tool for identifying and addressing needed reforms. We also draw on experiences and lessons learned from USAID programs in Albania, Georgia, Egypt, and Colombia, as they apply to the design and implementation of initiatives to improve the policy and regulatory environment for MSME access to financial services. Our goal is to provide a series of steps and tips for improved BEE programming to achieve USAID's overarching goal of helping partner countries achieve rapid, sustained, and broad-based growth through enterprise development and, more specifically, to improve the enabling environment for finance (USAID, 2008).

A. Introduction

A1. USAID's Economic Growth Strategy

USAID's Economic Growth Strategy focuses on reducing poverty and growing more prosperous partners through rapid, sustained, and broad-based economic growth. This translates to helping USAID's developing country partners achieve gross domestic product (GDP) growth of at least 2 percent per year. In turn, this leads to continuing increases in per capita income and output for all major income groups, ethnic groups, and women. As a result, poverty is significantly reduced (USAID, 2008).

Business is the engine of growth. USAID's strategy recognizes that rapid, sustained, and broad-based economic growth begins at the level of the productive enterprise (USAID, 2008). National economic growth is the sum of myriad firms, from the smallest microenterprises and family farms to the largest multinational corporations, each striving to maximize profits by increasing revenue and reducing costs. A country's wealth increases as its producers find ways to increase sales and reduce production costs by using better-skilled workers, finding lower-cost ways to organize production and distribution, and improving the quality of goods and services to serve or create new markets (USAID, 2008).

Policy is the driver of growth. Recognizing that economic growth is based on the ability of enterprises of all types and sizes to become more productive, USAID efforts target advancements in enterprise development through three program approaches:

1) Develop well-functioning markets
2) Enhance access to productive activities
3) Strengthen the international framework of policies, institutions and public goods

The first approach, developing well-functioning markets, aims to identify and address barriers to enterprise growth, and promote legal and regulatory reforms that will ensure a climate for sustained expansion. USAID initiatives focus on microeconomic reforms, or reforms that affect enterprises at all levels, from small producers to large corporations, as well as macroeconomic reforms, or reforms that affect a country's national economy (USAID, 2008).

Microeconomic and macroeconomic policies represent the "drivers" of economic growth because they shape the environment in which businesses operate. A government's macroeconomic policies (e.g., tax, budget, deficit control, inflation, monetary policy, exchange rates) create the national-level framework in which businesses make operating decisions. Microeconomic policies govern two sets of relationships at the transactional level: the regulatory relationship between businesses and government, and the efficiency of market relations among businesses (USAID, 2008).

A2. The Financial Sector as an Enabler of Business Growth

The "enablers" of economic growth — the financial sector, infrastructure, and human resources — provide inputs that entrepreneurs need to increase productivity and outputs. The first of these enablers, the financial sector, promotes growth and enhances competitiveness by channeling capital to opportunities. Access to capital ensures that businesses have the resources to respond to new buyers, reach new markets, increase production, fill larger orders, and create additional jobs. A strong financial system also promotes entry of new firms, innovation, and larger equilibrium size, which in turn can lead to improved aggregate economic performance for the country.

Debt financing fuels enterprise growth in developed countries. Access to domestic credit enables entrepreneurs to obtain financing to start a business and for established businesses to purchase new equipment and technologies to expand their operations. The relatively easy access to financing for borrowers in developed countries has allowed their small businesses to be the drivers of job creation and economic growth. For example, in the U.S., small businesses generated 64 percent of net new jobs from 1993 to 2008 and created more than half of the non-farm private gross domestic product (U.S. SBA).

In contrast, in developing countries, only large, well-established companies can obtain easy access to financing. In the absence of commercial credit, entrepreneurs struggle to cobble together resources from family and friends or take exorbitantly expensive loans from loan sharks and payday lenders to start or grow their businesses. When financing is available from commercial sources, it usually comes with unattractive or unattainable terms. Most bank loans are very short-term and come with collateral requirements of 150 percent of the value of the loan or more, effectively excluding the large majority of MSMEs, which lack fixed assets.

A3. Why Banks Do Not Lend

Access to capital for enterprises is critical to economic growth, yet developing country banks limit lending to many businesses, and especially to MSMEs. In the U.S., domestic credit to the private sector in 2002 represented 159 percent of GDP (World Bank, 2004). In contrast, domestic credit provided to the private sector in 15 of the largest developing countries was only 37 percent of GDP (Hanson, 2000). Banks in developing countries tend to collect deposits and borrow from Western financial centers, but keep a sizeable percentage of their portfolios in liquid assets, such as cash, deposits with other banks, central bank debt, and short-term government securities. In their article, *Banks That Don't Lend? Unlocking Credit to Spur Growth in Developing Countries*, authors Paul Freedman and Reid Click demonstrate that banks in developing countries generally do have more than sufficient funds to lend. Examining the ratio of liquid assets to deposits in 35 developing countries, and using the U.S. ratio of 6.5 as a benchmark, Freedman and Click found more than $531 billion in additional liquidity in the countries sampled, ranging from $67 million in Armenia to $107 billion in Brazil. Additional liquidity as a percentage of GDP ranged from 1.4 percent in El Salvador to 54.9 percent in Jordan, and had a mean of 14.5 percent (Freedman and Click, 2006).

Collateral Constraints to Credit

When GVR, a small agricultural processor in El Salvador, approached commercial banks for financing to expand production to meet orders from the U.S., all the banks required collateral (in the form of real estate) of 125 to 150 percent. Owner Kelly Ramirez said, "We were lucky that we had recently paid off our mortgage and were able to put our house up as collateral. Lots of small businesses do not own a home and are cut off from credit."

Given that banks in developing countries have excess liquidity, why do they choose not to lend? Banks' hesitancy to lend is largely due to their fiduciary responsibility to their investors and depositors. Prudent lenders must carefully balance the costs and risks of lending against potential revenues to protect depositors and shareholders. In developing countries, many banks deem the costs and risks associated with lending as far too high to permit secure, affordable credit. Therefore, banks in developing countries tend to place their assets in safe investments, such as government guaranteed t-bills or money markets in developed countries instead of in higher-risk local private sector credit markets.

One of the largest barriers to banks lending to MSMEs is the informality of the businesses themselves. MSMEs in developing countries may be forced to stay in the "shadow economy" when business registration demands high capital requirements, multiple steps or visits to different agencies, and takes several months or even years. Exorbitant tax rates or corrupt practices may further disincentivize MSMEs from seeking formal status. However, lack of formal status further hinders business growth and expansion because it limits the ability to access finance from commercial lenders. Streamlining and automating business registration and tax payment systems can have a huge impact on the number of firms accessing bank credit in a developing economy. (See Section B, on p. 6.) The following sections present additional conditions in the legal and regulatory environment in developing countries that limit bank lending to MSMEs.

A3a. Challenging Legal and Regulatory Regimes

Freedman and Click group the reasons banks believe the costs and risks of lending in developing countries are high into five main areas. They note that most detrimental to lending are significant deficiencies in a country's business environment that increase the risks and costs of enforcing contracts and liquidating collateral (Freedman and Click, 2006). Lenders are significantly deterred from lending to the private sector for the following

Examples of Risks Associated with Lending in Developing Countries

- Lack of predictable court support for contract enforcement
- Limited markets for repossessed collateral used to secure loans
- Lack of or limited credit information on borrowers
- Inadequate credit discipline within the market
- Macroeconomic instability
- Tight or unpredictable market liquidity
- Limited real private sector economic activity.

reasons:

Difficulty in enforcing contracts. Enforcing loan contracts is an extremely time-consuming and costly process in many developing countries. Even if a borrower defaults and is in clear breach of a loan contract, it can take several years before the lender obtains a final court judgment against the defaulting borrower (Freedman and Click, 2006). The World Bank's *Doing Business* report provides substantial data on the difficulties with contract enforcement in developing countries. This report illustrates that the costs of pursuing litigation can ultimately outweigh the amount recovered from the borrower because developing countries often maintain dozens of procedural hurdles to the enforcement of a contract. This results in significant delays and legal fees. For example, in Guatemala, enforcing a simple contract dispute takes roughly 1,460 days. Forty percent of the amount of the claim goes to an attorney and court fees (World Bank, 2004).

Inadequate collateral laws. Pledges of collateral from borrowers, such as real estate, vehicles, or equipment, can help lenders offset losses in the event that the borrower defaults. The prospect of losing collateral is also a powerful incentive for borrowers to repay. However, collateral is only of value to the bank if it can quickly recover and sell that collateral in the event of default. While the process of repossessing and selling collateral is relatively easy in developed countries, most legal systems in developing countries require judicial proceedings, leading to long delays from the time of default to the time the collateral can be sold to pay off the loan (Freedman and Click, 2006). According to a 2004 *Doing Business* survey, it takes just a week for a creditor in the U.S. or Germany to seize and sell business equipment that was pledged as collateral, but the same process takes five years in Brazil and Chile (World Bank, 2004). The long process associated with repossessing and selling collateral means that not only are banks more hesitant to lend, but also require extreme amounts of collateral to ensure they can recover the full cost of the loan in the face of depreciation and drawn-out court battles. Most banks in developing countries require upwards of 150 percent collateral to secure a business loan.

In addition, lenders often accept only those forms of collateral that are most easy to secure and sell, such as real estate. Collateral laws in developing countries may even prohibit inventory, receivables, or other assets that change over time to be pledged as collateral. This, coupled with the fact that few individuals in developing countries have legal title to their home and land, makes it extremely difficult for small business owners to meet banks' collateral requirements (De Soto, 2000).

Similarly, the challenge that many developing countries face is their lack of central registries for liens on property. If a lender already has a lien on a home or vehicle, it has first rights to the property in the case of default or bankruptcy. If another lender cannot determine if the collateral has already been pledged to someone else, it is much less likely to make a loan. In the U.S. and other developed countries, a bank simply must request an electronic report to determine what collateral, if any, a borrower has pledged to other creditors. Many developing countries, however, do not have central registries or electronic databases of liens granted to creditors. This lack of critical information makes it extremely difficult for the lender to determine which assets may have existing liens, and extremely difficult to be able to approve a loan based on a pledge of collateral (Freedman and Click, 2006).

Bankruptcy regimes. Banks need to know that they can recover at least a portion of the loan should the borrower enter into insolvency proceedings. However, in many developing countries, the claims of workers and tax authorities take priority over the claims of private-sector creditors. If lenders cannot guarantee that their claims will be met first in bankruptcy, they will be less likely to make loans to MSMEs. If they do lend, they will charge higher interest rates to offset the high risk. Similar to collateral laws, securing assets from a borrower in bankruptcy requires lengthy and costly court proceedings that in some countries take more than a decade. In some cases, the costs to secure a pledged asset may outweigh the cost of the asset itself.

All of these factors make basic business operations in countries with burdensome regulatory environments more costly, with greater risks, and less cash flow. This makes financial intermediation (i.e., access to credit) more expensive and less available, creating a negative feedback loop that makes business growth and job creation even more difficult.

A3b. Other Impediments to Lending

High reserve requirements. Banks are legally required to maintain a certain percentage of deposits in cash reserves to ensure depositors are able to gain access to their funds when they need them. These required cash reserves cannot be lent.[1] The higher macroeconomic risk and volatility seen in developing countries, however, mean that bank regulators often impose higher reserve requirements than regulators in developed countries, leaving fewer funds available to lend. Requiring banks to keep a greater share of deposits in liquid assets makes sense given some countries' higher susceptibility to economic or financial crises, which can trigger massive borrower defaults or runs on banks. Loan or deposit insurance is rarely available in developing countries to stem the fallout that can result from these types of events (Click and Freedman, 2006). However, many argue that regulators in developing countries often set reserve requirements too high given the amount of risk confronting the financial system. Reserve requirements average more than 20 percent in developing countries but only 7 percent in industrialized countries (Fry, 1995). In addition, regulators in some countries set higher reserve requirements for micro or SME loans that are perceived as riskier, including those to MSMEs. This creates a double disincentive to lend to businesses.

Crowding out by government bonds. As developing countries run large deficits, they curtail economic growth in two ways (Easterly and Rebelo, 1993). First, large debt issuances by national governments increase the demand for financing and drive up domestic interest rates. Second, the availability of government debt that offers moderate or high returns is a disincentive for banks to search for profitable lending opportunities with private-sector borrowers. Lending to the private rather than public sector is generally riskier and requires more people and time to manage and conduct proper due diligence. The prevalence of government debt offerings in many developing countries discourages banks from developing these skills because they can make a sufficient and satisfactory profit without them (Hanson, 2003).

Asymmetrical information. Unlike in developed countries, lenders in developing countries lack access to information about prospective borrowers' finances and credit history. Many developing

[1] Basel II requirements have resulted in increased costs of capital, particularly in developing economies, contributing to impeded lending practices in these countries.

countries do not have reliable credit bureaus to collect information from lenders — or courts, tax authorities, credit rating agencies, or public registries — about individuals and businesses. Lenders therefore cannot utilize a single credit report to easily and reliably determine a potential borrower's payment history, examine his or her debt load, and determine the likelihood of default (Click and Freedman, 2006). The degree of credit provided by banks to the private sector is much higher when there is substantial sharing and dissemination of credit information, beacuse borrowers have a powerful incentive to repay a loan if their repayment or failure to repay is captured by a credit bureau (Jappelli and Pagano, 1999). In addition, banks face the challenge of evaluating the credit risk of MSMEs, which rarely have audited financial statements based on reliable accounting standards. Limited financial literacy, lack of financial management skills, and even maintenance of multiple sets of books make obtaining accurate financial statements from prospective MSMEs in developing countries extremely challenging.

Inadequate skills for assessing and managing risk. In addition to legal and regulatory impediments, banks and regulators in many developing countries do not have the capacity or tools to assess and manage the risks associated with lending to MSMEs. Collateral, rather than cash flow analysis, is usually the driving force behind decision-making on loan applications. Additionally, most banks do not have appropriate financial products for MSMEs; they need guidance in developing MSME lending platforms with appropriate cash flow lending methodologies for evaluating and mitigating risk, a variety of complementary products tailored to meet MSME needs, and properly trained and incentivized staff who understand the importance of MSMEs to future growth.

B. *Doing Business* as a Tool for Reforms to Enable the Financial Sector

The introduction in 2005 of the World Bank's annual *Doing Business* survey provided a new tool for policymakers and donors to assess bottlenecks to business growth and address constraints in the BEE. Our efforts have shifted focus from top-down overhauls of commercial framework laws to more precise targeting at the transactional level — the actual interactions between business and government. A fundamental premise of *Doing Business* is that economic activity requires "good" rules. These include rules that establish and clarify property rights and reduce the costs of resolving disputes; rules that increase the predictability of economic interactions; and rules that provide contractual partners with core protections against abuse. The objective is that regulations are designed to be efficient, accessible to all who need to use them, and simple to implement (*www.doingbusiness.org*).

The indicators presented and analyzed in *Doing Business* provide quantitative measures of business regulation and the protection of property rights, as well as their effect on businesses, especially small and medium-sized domestic firms. They measure factors that directly and indirectly help or hinder firms' access to financing, as described in section A3, including:

- The degree of regulation, such as the number of procedures to start a business or register and transfer commercial property
- Regulatory outcomes, such as the time and cost to enforce a contract, go through bankruptcy, or trade across borders

- The extent of legal protections of property, such as the protections of investors against looting by company directors or the range of assets that can be used as collateral according to secured transactions laws
- The flexibility of employment regulation (*www.doingbusiness.org*)

B1. Benefits and Limitations of *Doing Business*

Utilizing the World Bank's *Doing Business* as a tool for reform can facilitate the development of the financial sector and improve banks' ability to lend to MSMEs by targeting specific regulatory constraints. In his paper *Uses and Abuses of* Doing Business *Indicators*, Wade Channell explains that "*Doing Business* indicators allow reforms to pinpoint areas in which costs, risks or both are out of line. This allows governments to make reforms that reduce the dangers and facilitate growth of business and commerce for economic development." But Channell also notes that changing the indicators does not fix the problem; the underlying problem must be addressed and the indicators will follow (Channell, 2006). The indicator can signal an area in need of reform, but this is just a starting point, because the indicators do not tell *how* to improve the environment. Reformers must conduct a thorough analysis to uncover the underlying root of a poor score and, in most cases, must undertake not just one, but a series of reforms to affect the business environment.

Incorporating a "*Doing Business* approach" in economic development programming can help generate political will to reform, invoking competition and a drive to attract rather than lose investors. While the publicity surrounding this annual report helps produce immediate rewards for success, governments must be careful not to rely too heavily on the indicators. They should not mistake low scores for a lack of problems. Nor should they assume that because they have seen improvements in the indicators that the underlying problem has been solved and the business environment has improved. Improvements in the BEE should be measured not just by *Doing Business* indicators, but by additional qualitative and quantitative indicators that evaluate the impacts of reforms on stakeholders, consumers, and financial institutions.

B2. *Doing Business* Indicators that Affect the Enabling Environment for Finance

Starting a business. This indicator measures the number of procedures, time (in days), costs, and minimum capital requirements. A process that is too lengthy or too expensive creates disincentives for entrepreneurs to formally register their businesses. In turn, they will likely be unable to secure finance from commercial lenders.

Registering property. As discussed in Section A, banks generally require a pledge of collateral from the borrower to secure a loan. This indicator measures the number of procedures, the time (in days), and the cost (as a percentage of the property value) to register property. If the process is too lengthy, costly, or involves battling corrupt practices, the entrepreneur may forego registering property that could potentially used as collateral. Additional challenges in the legal and regulatory environment could include problems with land titling systems, lack of property registries, or lack of pledged collateral registries.

Enforcing contracts. The ease or difficulty of enforcing commercial contracts is measured by following the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment a plaintiff files the lawsuit until actual payment. If this process is too lengthy or costly, the bank may deem the risks of lending to MSMEs as outweighing the economic benefits.

Getting credit. This indicator measures credit information-sharing and the legal rights of borrowers and lenders. The Legal Rights Index ranges from 0-10; higher scores indicate laws are better designed to expand access to credit. The Credit Information Index measures the scope, access, and quality of credit information available through public registries or private bureaus. It ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau. Countries where credit registries are limited or lacking, or where lenders rights are low or poorly enforced, will generally see lower rates of lending to businesses (*www.doingbusiness.org*).[2]

C. Case Studies of Top *Doing Business* Reformers: Albania, Georgia, Egypt, and Colombia

The following case studies are examples of USAID BEE programming in countries that have been recognized as "Top Reformers" and have shown marked improvements in Getting Credit on the World Bank's *Doing Business* rankings. The case studies help demonstrate how the *Doing Business* survey and the indicators listed above can be a tool for identifying and better understanding needed reforms, as well as how they can help to serve as a catalyst for a friendlier environment for enterprise development, including greater access to financing from commercial lenders. All four countries underwent a series of interlinked reforms, but for ease of reading we will highlight just one or two BEE reforms that had a marked impact on MSME access to financial services.

C1. Creating Incentives for Businesses to Join the Formal Economy in Albania

After more than four decades under communist rule, Albania emerged in the early 1990s and moved swiftly toward a market economy and integration with NATO and the European Union. Its development was impeded, however, by a deeply entrenched culture of corruption at all government levels that made doing business frustrating and expensive. In 2006, the World Bank ranked Albania 135th out of 178 states in Ease of Doing Business, largely due to corrupt practices in processes ranging from registering a business to applying for public procurements to paying taxes. After Albania scored below the median on the "control of corruption" indicator and thus failed to qualify for the large bilateral assistance package that accompanies Millennium Challenge Corporation compact status, MCC agreed in 2006 to sponsor a Threshold Country Program (TCP) aimed at combating corruption and helping Albania qualify for compact status.

The two-year, $13.7-million program, administered by USAID, focused on reforming public procurement, tax administration, and business registration using an "e-governance" approach to streamline and improve the transparency and efficiency of these services. In just two years,

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[2] For more information on challenges and solutions to credit issuance and contract enforcement, see the following at www.fsshare.org: *FS Series #4: Enabling Small- and Medium-Sized Enterprise Access to Finance*; *Asset-Based Finance: White Paper*; *FS Series #7: Enhancing the Leasing Enabling Environment; FS Series #8: Rural and Agricultural Finance for Food Security*; and *FS Series #10: Establishing Modern Secured Financing Systems in Developing Economies*.

reforms and systems implemented under the program helped Albania move from 135 to 86 in overall Ease of Doing Business and to become recognized as a "top reformer" in the *Doing Business* survey. Institutional reform coupled with e-governance solutions have helped cumbersome and opaque government operations become measurably more transparent and efficient, and less corrupt. More businesses have become formally registered, easing their access to finance from commercial lenders.

C1a. Albania's Reform Success

Easing registration for thousands of businesses. Under the TCP program, USAID helped the government of Albania design and implement a one-stop shop for business registration. This National Registration Center aimed to reduce the cost and time required to register a new business or make changes in an existing business registration, and to reduce opportunities for corruption. Previously, the commercial registration system was administered by 29 courts throughout Albania using a variety of non-standardized, paper-based application forms and recordkeeping systems; registering a business was a lengthy and expensive process that involved multiple court petitions and trips to government offices. To register, an entrepreneur had to first receive a court decision approving his or her registration. Then s/he had to register with different agencies, including the tax authority, the social and health insurance authorities, and the local municipality. The challenges to becoming formally registered prevented many business from doing so. This limited access to commercial financing and, in turn, limited opportunities for expansion and creation of new jobs (Chemonics, 2008).

The first step in helping the government establish a one-stop shop for business involved helping lawmakers draft legislation for the new National Registration Center (NRC) framework. The TCP program helped prepare the new NRC law, the goal being to establish an integrated, standardized system of electronic processing and recordkeeping that would provide a one-stop application process and one-day approval. A testament to the government's political will to improve the operating environment for business, parliament, with the support of the TCP, developed and enacted the draft law in just seven months. TCP worked in parallel with this process to develop the harmonizing amendments and secondary legislation required to put the law into operation.

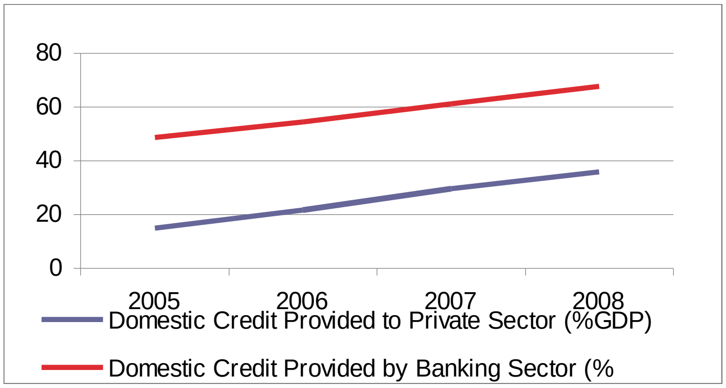
Once the NRC was approved, the program set out on an ambitious trajectory to create the infrastructure and supporting systems to allow for fast and accurate processing of registration information, then trained staff to use these systems. In less than three months, TCP helped design and construct the NRC headquarters, and procure furniture and hardware for the main facility and its network of regional service windows. TCP also prepared standardized forms for business registration and assisted in the development of software to support 20 registration functions (e.g., registration of a new business, cancellation of registration, increase of capital, change of ownership or address). Once the software was developed, the program team tested it extensively and made modifications to improve its reliability and user interfaces.

Achieving full functionality of the system meant that the new NRC registration system had to be linked with electronic record systems in the tax authority and other registration agencies so information in these agencies could be updated daily. To ensure registered businesses did not have to re-register, the program also had to help transfer, automate, and integrate existing registration records into the new system. These records dated back to 1991 and comprised more than one million pieces of paper, many in very poor condition. Additionally, the TCP program helped establish regional service windows in 11 municipal locations.

C1b. Impacts of Reforms

By September 2008, the new system had been operating successfully for a full year, helping to stimulate investment and economic growth by providing one-stop, one-day business registration. Today, registration requires only one application, processed within 24 hours at a cost of about U.S. $1.00. From its main office in Tirana, the NRC and networked service windows in 11 municipalities throughout Albania processed nearly 85,000 applications and registered more than 18,000 businesses. Entrepreneurs that had hesitated to register or update their information due to the lengthy process now have greater incentive to formalize their businesses. Not surprisingly, Albania moved from 135 of 178 under the Starting a Business indicator on the *Doing Business* survey to 86 of 181 (Chemonics, 2008).

Additionally, as new enterprises registered, they gained greater access to financial services, including credit, from commercial banks. The graph below shows a steady increase in domestic credit to the private sector and credit provided by banks over the period of the TCP program. Albania rose in the Getting Credit indicator due in part to the establishment of the NCR, but also as the result of complementary reforms during the same period, including the establishment of a public credit registry, strengthening of investor protections, and reductions in the corporate income tax rate.



C2. Improving Property and Lien Registries in Georgia

Georgia was once ranked No. 112 out of 181 on the World Bank's *Doing Business* survey, but bold reforms to the country's business climate in the last five years have catapulted it to 11th place, as of 2010. A commitment to aggressive reform by the government of Georgia and support from USAID underpin what the World Bank calls an "unprecedented" climb in the history of the survey, moving Georgia past countries such as France and Germany. Since 2005, the Georgian government has focused on implementing 23 *Doing Business* reforms, which has dramatically improved the operating environment for businesses (Chemonics, 2009a).

The USAID BCR project directly supported 18 of the 23 reforms implemented in eight of the 10 *Doing Business* key areas. This $13-million, 4-year project had a staff of 28 professionals organized into three component teams focused on commercial law, fiscal reform, and regulatory streamlining (Chemonics, 2009a).

BCR's expected results included:

- Increased capacity and professionalism of administrative bodies connected with the government's management of business regulation
- Developing streamlined business and property registration procedures, and collateral systems
- Improvements in key framework commercial laws
- Simplified, sensible, and transparent regulations, standards, and procedures for licenses, permits, and inspections
- One-stop shop functioning for registrations, licensing, and permits
- Rationalized, orderly, even-handed, and user-friendly tax and customs procedures

The program was backed by exceptional involvement and support from the government. The chief of party utilized the guidance of a high-level project "steering committee" chaired by Georgia's state minister on reforms coordination. The steering committee met weekly to review activities and provided input into annual program work plans and budgets. BCR also created individual work plans with five Georgian government counterparts to generate buy-in and drive institutional reform (Chemonics, 2009a).

C2a. Georgia's Reform Success

The inadequate legal framework present at the start of BCR had stunted the growth of enterprise financing. High risk produced high interest rates, over-collateralization, and short loan terms. With the exception of vehicle loans, lending secured by movable[3] and intangible property was almost nonexistent. SMEs in particular suffered from the lack of access to credit caused by the inadequate legislative framework.

BCR's focus on improving Georgia's ranking in several *Doing Business* transactions, particularly in Starting a Business, Registering Property, and Enforcing Contracts, helped address many of the bottlenecks to finance presented in section A3 and helped move Georgia from 96 in 2006 to 30 in the *Doing Business* Getting Credit ranking in 2010. Similar to TCP in Albania, BCR helped the Georgian government unify and streamline business and tax registration processes, and eliminate the exorbitant capital requirements for starting a business.

[3] Immovable property, by definition, includes real estate (i.e., parcels of land and the buildings or permanent facilities attached to the land, and also pieces of buildings, such as apartments and stores, which have ownership separate from that of other parts of the building). The definition of movable property is broad, including the all property other than land and buildings attached to it. For example, movable property included cars, bank accounts, wages, securities, a small business, furniture, insurance policies, and jewelry. Movable property is frequently referred to as personal property or chattel; immovable property is often called real estate or real property (USAID MicroLinks Rural Agricultural Finance Specialty Topic Series).

From January 2005 to May 2009, the number of registered businesses increased by 67 percent, and Georgia currently ranks 5th globally on the World Bank 2010 *Doing Business* survey's Starting a Business category. Hand-in-hand with this reform, the Georgian government, with BCR support, set out to improve the environment for Getting Credit by focusing on building functional collateral and lien registries.

Table 1. Georgia's Unprecedented Rise on *Doing Business*

Categories	2006 Rank	2010 Rank
Overall Rank	112	11
Starting a Business	59	5
Registering Property	18	2
Getting Credit	96	30
Protecting Investors	133	41
Enforcing Contracts	56	41

Building one of the world's best property registry systems. Five years ago, Georgia's property registration system, administered by the National Agency for Public Registry (NAPR), was paper-based and decentralized, distributed among 67 regional offices. Registering property required six steps and took nearly two months; the process included searching through poorly organized, Tbilisi-based archives of Soviet-era documents. The legal framework governing NAPR and property registration allowed for multiple interpretations and applications, which decreased transparency.

Today, registering property is a very different experience. The procurement of registry software and a modern data server allowed NAPR to replace its ineffective, decentralized structure with a centralized, electronic, and Web-based property registry system. All NAPR offices are now linked to a unified electronic property registration database over the Georgian Government Network. This interactive system allows applicants, NAPR personnel, and other government agencies to receive up-to-date information on the status of applications. NAPR has also outsourced many interactions with citizens to a network of more than 350 "authorized users," including bank branches, notaries, law firms, and real estate companies, which process NAPR registration applications with registrars online. The network of NAPR regional offices and authorized users provide one-step, one-stop service that includes short message service (i.e., text) and e-mail notifications when registration is complete (Chemonics, 2009a).

Changes to the commercial law framework governing NAPR clearly defined its role and streamlined property registration procedures. At present, it requires just one day and one visit to a NAPR office or authorized user, and two procedural steps. Notarization and fees based on transaction values have been eliminated. The 2010 *Doing Business* survey ranked Georgia 2nd globally in the Registering Property category.

Creating a centralized Web-based electronic pledge registry. Lenders in Georgia relied almost exclusively on immovable property — land and buildings — and vehicles as collateral for loans to businesses and consumers. Only about 5,000 pledges (i.e., security interests in other movable or intangible property) have been registered by NAPR. SMEs, which are less likely to have sufficient immovable property, are adversely affected, with less access to credit, because they are unable to secure loans with the types of movable and intangible property they possess (e.g., machinery and equipment, inventory, and accounts receivable).

> **Impacts Beyond *Doing Business* Indicators**
>
> As part of BCR reforms, the Georgian government procured a nationwide information communications technology network that expanded the Internet from five cities to the entire country. When the ministry responsible for social services plugged in, it reduced the time to process requests for safety net services from two months to two weeks. Similarly, the network enabled authorities to identify, register, and begin providing services to refugees from the August 2008 conflict with Russia in record time.

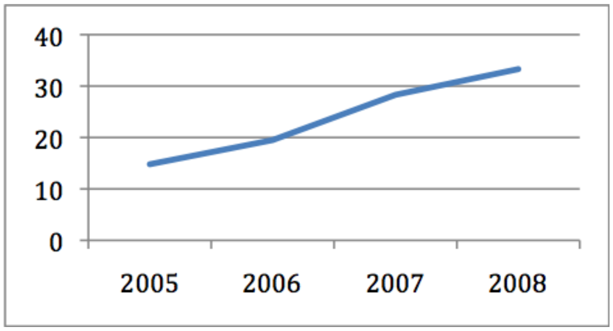
Lenders are reluctant to secure loans with movable property because of the high risk involved. Lenders could never be sure that another lender had not already taken a lien on the same collateral. Often, the status of borrower assets that could be used as collateral was just as murky. Under Georgia's paper-based systems, for example, tax and judgment liens used to arise at the moment a tax official or judge signed a piece of paper, with no way for third parties to know they existed. This meant that banks and buyers of real estate could not know from examining the land registry whether or not any liens existed on a pledged piece of property. Anecdotal evidence even suggests that bailiffs were bribed by judgment debtors to delay delivery of court liens to the registry, giving time for the judgment debtor to sell the encumbered property to an unsuspecting buyer.

With USAID support, Georgia's law was changed so security interests, including tax and judgment liens, took effect only after the claims had been registered. Furthermore, in 2009, the Georgian government rolled out a modern, Web-based pledge registry that now allows free public searches, and allows lenders and lessees to register their claims online from their offices. The new registry, coupled with legislative changes — both of which are supported by BCR — made the use of movable property as collateral much less risky, and will increase access to credit, including leasing, particularly for SMEs (Chemonics, 2009).

C2b. Impacts of Reforms

Georgia's sweeping reforms have reduced the time, steps, and costs for businesses to operate in in the country and have increased their ability to access financing from commercial sources. BCR estimated the total annual monetized benefits of business climate reforms supported by USAID to the public and private sectors to be approximately $743.7 million. This is an annual return of $57 for every dollar of USAID's investment in the $12.9 million project expenditures. This represents only a portion of Georgian government and BCR efforts. Limitations in statistical data, the complex nature of reforms, the variety of stakeholders affected, and multiplier effect of some reforms meant that not every benefit to stakeholders could be monetized (Chemonics, 2009).

In addition to moving from 96 to 30 in the area of Getting Credit in just four years, domestic lending to the private sector as a percent of GDP more than doubled from 2005 to 2008 (see graph on next page) (*www.data.worldbank.org/indicator*).



C3. Improving Information Asymmetries in Egypt

The World Bank's 2006 *Doing Business* report ranked Egypt 165 out of 175 surveyed economies on the Ease of Doing Business. Egypt scored only slightly better in Getting Credit, at 160. In every measurement of credit — scope, accessibility, and quality of information — Egypt scored lower than its regional peers (*www.doingbusiness.org/rankings*).

Credit history is the primary means of determining whether or not to grant a line of credit, but Egypt lacked a central credit information agency to capture and report information about borrowers' levels of indebtedness and past payment history. The Central Bank of Egypt's (CBE) registry only gathered data for loans of more than 40,000 Egyptian pounds (U.S. $6,000), and only from banks that reported problems such as missed payments from borrowers. Searches showed aggregated information only on total indebtedness and number of banks owed. Under Egyptian law, banks were prohibited from approving credit if an applicant had delinquent credit with any bank. Banks could not see what type of loans were outstanding or the balance on each loan, and consumers could not verify or contest information in the reports. One of several problems with the current registry was that combined exposures above the threshold amount were not reported: Borrowers might have multiple loans at different institutions, yet went unreported in CBE's systems. In addition, the U.S. $6,000 threshold meant that it was of limited use for applications such as consumer or small business loans. Furthermore, non-bank institutions had no access to the registry.

C3a. Egypt's Reform Success

Recognizing that a well-designed private credit bureau could help facilitate greater access to credit information in Egypt, particularly for MSMEs and consumers, USAID began working with the CBE in 2005. USAID's EFS program helped draft amendments to the Banking Law to permit the establishment of private-sector credit bureaus, the sharing of credit information with a private-sector credit bureau, and the designation of the CBE as the licensor and regulator of private-sector credit bureaus. EFS also helped CBE develop a comprehensive regulatory model, determine minimum information requirements, and ensure clarity in agreements that govern the relations between the credit bureau and information users or providers. EFS developed and provided CBE with an oversight manual for monitoring banks' relations with credit bureaus. Processes were based on best practices that addressed how information related to credit transactions is disclosed, how financial privacy is maintained, and how information is corrected.

At the same time, the EFS team engaged a group of four commercial banks interested in investing in the establishment of the credit bureau and becoming guiding shareholders. Following approval of the law authorizing the CBE to license a private credit bureau, the CBE granted this group of shareholders a preliminary license in 2005 to establish iScore, Egypt's first credit bureau. Within a year of iScore's establishment, EFS helped the CBE develop rules and regulations for governing private credit bureaus according to international best practice. This included a system for consumer protection rights, including the right to obtain a credit report and lodge a complaint.

The EFS program also engaged bank shareholders and presented possible ownership and management structures, stressing the importance of an "open" credit bureau (i.e., one that is owned and used by a variety of bank and non-bank financial organizations) and shedding light on the implications of a credit bureau owned by banks. EFS also provided the credit bureau with action plans for banks and non-banks to support the credit bureau's recruitment and partnering with such entities.

Once established, iScore set out to make credit history reports available to lenders and institutionalize a credit score that rates positive and negative transactions. To ensure quality control, iScore, with support from EFS, worked with the CBE to collect and reconcile personal data information against the national identification system to avoid duplicate or misinformation of clients. This large undertaking was successful; it was able to match 70 percent of CBE's records to national identification numbers. iScore also set a standardized method of recording new personal data among iScore members to minimize incorrect or duplicate information.

In January 2008, iScore received its final license from the CBE. It commenced operations in September 2008 with a "soft launch," serving its members free of charge and allowing banks, mortgage finance companies, and financial leasing companies to test the system and become accustomed to it. EFS subsequently supported iScore in training all its members on how to search for and read a credit report, how to conduct a self-inquiry, and how to facilitate the dispute resolution process. All iScore members are now able to independently interface with iScore. EFS also encouraged iScore to open membership to non-banks, paying particular attention to the needs of the insurance segment and microfinance lenders (Chemonics, 2009b).

C3b. Impacts of Reform

> "The Egyptian Credit Bureau is an integral part of a sound credit cycle ... . Credit has now become an integral part of our economic cycle."
>
> *–Mohamed Kafafi, Chairman, iScore*
> *Credit on the Rise, Emerging Egypt 2008*

USAID and the CBE's extensive efforts to create a centralized database for credit history and link information across private and public entities has decreased asymmetries in credit information for bank and non-bank entities, and has helped opened more finance opportunities to consumers and MSMEs. In 2008, iScore incorporated more than 30,000 SMEs in its system. With all Egyptian banks, mortgage finance companies, and financial leasing companies now members of the iScore system, the number of Egyptian consumers registered in the previous system has tripled in just two years. iScore gives lenders better access to these borrowers' credit information and reduces the risks, time, and costs associated with lending to enterprises. Egypt is no longer behind its peers in Ease of Doing Business, and ranks third in the region in terms of Getting Credit. Egypt advanced 13 spots from 2009 to 2010 in ease of Getting Credit, and was named one of the survey's top reformers for the third year in a row (*www.doingbusiness.org/reformers*).

C4. Going Beyond *Doing Business* in Colombia

While taking a "*Doing Business* approach" can help pinpoint and address specific transactions that limit entrepreneurs' ability to access credit, it does not address limitations of the business owners themselves, and does not address the "inadequate skills of lenders to assess and manage the risks associated with lending to MSMEs," as identified by Freedman and Click. Additional initiatives designed to provide tools for bankers and supervisors to better understand and mitigate MSME risk, coupled with appropriate reforms to the regulatory environment, are often most effective at further increasing enterprise lending in developing economies.

USAID has been helping top *Doing Business* reformer Colombia address specific regulatory constraints while also providing tools to financial institutions and MSMEs to improve access to finance. Prominent among these reforms was Law 1231, which established the legal framework for factoring and alternative sources of finance for SMEs.

USAID's MIDAS program aimed to provide assistance to businesses to create permanent economic and social alternatives to illicit crops and activities in Colombia. To this end, MIDAS' Policy Component supported ambitious regulatory reforms that led to the doubling of bank locations between 2006 and 2009 (USAID, 2010). The new regulations helped bring financial services to virtually every municipality in the country. Coupled with USAID-supported reforms to reduce the time to start a business, increase consumers' access to information about their credit histories, and improve investor protections, Colombia moved from 79th in 2007 to 37th in 2010 in overall Ease of Doing Business, and is now considered the top-performing country in Latin America (*www.doingbusiness.org/reformers*).

In addition to addressing challenges within the regulatory framework to MSME lending, the MIDAS program provided training and technical assistance to financial institutions to expand the availability of microfinance. MIDAS also supported pilots of branchless banking through bank correspondents, as well as mobile banking pilots to expand financial institution presence to more rural clients. It also focused on providing technical assistance to entrepreneurs to mitigate the risks to lenders and facilitate increased access to credit.

Between 2005 and 2008, the number of active clients in USAID-supported financial institutions grew to 427,881, with clients benefitting from $465 million in loans since the program start. Financial institutions assisted by MIDAS have opened 641 new non-bank correspondents, and there is now financial presence in virtually all municipalities in Colombia. By going beyond regulatory reforms and directly addressing constraints at the institution and client levels, USAID has helped to dramatically expand access to financial services for MSMEs in Colombia (ARD, 2009).

D. Conclusions and Lessons Learned

We can draw a number of lessons learned for future BEE programming from these four case studies. Though the focus of two of the programs was not to directly improve the enabling environment for finance, implementing reforms using the "*Doing Business* approach" translated easily to reforms to increase access to finance. Next, we highlight a few of the lessons from each program that can be applied to the design of future BEE programs.

Identify linkages between business and financial-sector development. USAID's BCR initiative in Georgia helped improve the enabling environment for finance by targeting key sources of risk to businesses and lenders. Financial-sector results were merely ancillary consequences of reform efforts, not the focus of reform efforts. As a result, program staff and USAID were largely unaware of the effects of reforms on lending to MSMEs. Business and financial-sector development are inextricably linked, and it is critical to include initiatives to address bottlenecks in MSME lending in BEE programming. It is also critical to focus on improvements to pledge registries and secured financing regimes, including leasing, to enable lenders to make loans secured by movable property and the kinds of assets that MSMEs are most likely to have.

Analyze and prioritize reform needs. TCP's, BCR's, and EFS's mandates to streamline business and property registration procedures, develop collateral systems, and reduce asymmetries in credit information ensured a singular focus on processes most directly tied to MSMEs' ability to access financing from commercial sources. It is important in the initial stages of program design to conduct a thorough analysis using seasoned experts to identify the critical bottlenecks to business growth. Then, selecting a few key transactions to target — as opposed to broad, sweeping reforms — makes achieving the right results attainable. To create an enabling environment for finance, reforms should focus on centralizing and automating property and collateral registries; streamlining the process for formally registering a business; simplifying processes for enforcing loan contracts, and repossessing and selling pledged collateral; and improving access to borrowers' credit information.

Reform and automate: "simplicity is power." Streamlining, simplifying, and automating processes eliminates opportunities for corruption and introduces systems of accountability that make rent-seeking easier to identify. With USAID support in mastering transactional efficiency, the capacity and professionalism of government of Georgia agencies in streamlining, automating, and developing and implementing transaction-based reforms increased dramatically. In particular, mid-level managers were able to apply reform principles in new settings. Senior management increasingly trusted these managers, and delegated greater authority to them to streamline and rationalize business processes. This accelerated the pace of overall reform.

Promote ruthless transactional efficiencies. As seen in Albania, ruthless transactional efficiency produces dramatic increases in transactional volumes, leading to greater productivity. Aggressive incrementalism — a swift succession of small reforms to the same business process — can sometimes lead to faster, more far-reaching, and better-implemented reforms rather than sweeping overhauls of legal regimes. Hundreds of changes have been made to laws, regulations, and business processes. The fact that most of the changes were to reduce complexity, expenses, and delays also helped achieve significant changes.

Generate political will by empowering the private sector and engaging stakeholders. Success in all cases was due in large part to the commitment of the government to improving the BEE, as demonstrated by the *Doing Business* rankings, and their involvement in and support of the program itself. *Doing Business* is a useful tool for generating political will because the survey and the country's ranking receive a lot of press each year; improvements in *Doing Business* rankings often result in praise from media outlets. Each project also implemented strategic public relations campaigns to increase public awareness about the benefits of these reforms and to garner buy-in from the private sector. Without these stakeholders, reform would have fallen flat. For example, USAID assistance to iScore included development of a communications campaign and training to credit bureau management on addressing the media.

Leverage other donor initiatives. In most cases, the World Bank and other donors also saw the need for reform and, in many cases, were positioned to identify or alleviate constraints to doing business. In Egypt, the EFS program collaborated with the World Bank, which was working with the CBE to enlarge its public registry, and with the International Finance Corporation, which had offered to assist the private sector credit bureau. The goal of any USAID program is to build on the efforts of other donors, not duplicate them.

Measure and manage for results. As demonstrated by BCR, the staggering costs of regulatory inefficiency can be quantified, and the specific benefits to beneficiaries of USAID-supported reforms can be monetized at the output level. Reducing the cost of inefficiency and the benefits of reform to a dollar amount is an extremely effective communications tool for stakeholders, and may prove to be a powerful tool in generating the political will to reform. For improvements to the enabling environment for finance, this may translate to reductions in the average interest rate, the number of days to register a lien, or the time required to process a credit check. In Georgia and Albania, we cannot know the opportunity costs of not including financial-sector impacts among the criteria for identifying future reform priorities.

Be prepared for reform to take time and roll with the punches. Albania is a rare case: Drastic reforms to legislation and systems are not often achieved in a matter of months. The process of generating political will and encouraging stakeholder buy-in is usually a protracted and taxing one. More than likely, this process will take months, if not years, and will require several starts and restarts. Be prepared to "roll with the punches" as internal and external forces affect the process, as government administrations change, and as counterparts move in and out of positions. For example, in Egypt the first set of banks licensed to start iScore had to be replaced when they lost the momentum to move forward with the credit bureau. The TCP program in Albania found that working with the government to set a firm, well-publicized deadline helped ensure that all government agencies and policymakers were working toward the same goal. This can be a good tactic, but USAID and its implementing partners should always remain flexible and able to find "work-arounds" when politics and macroeconomic forces threaten advances in the BEE.

ANNEX A. CHECKLIST FOR EVALUATION OF BUSINESS ENABLING ENVIRONMENT PROGRAMS

This checklist serves as a reference for USG program officers when considering Business Enabling Environment (BEE) programming options. It contains a non-exhaustive series of questions relevant to BEE projects with a view on the financial sector. It is designed to help programmers identify and compare opportunities for BEE programming.

Key Questions	Yes	No	Comments/ Responses
Business Climate and World Bank *Doing Business* (WBDB) Ranking			
1. Is there a political will to reform in the country?			Calculate savings to business and government from reforms aimed at optimizing business processes and communicate those monetized benefits effectively to generate political will. In addition, utilize WBDB rankings to generate interest in reforms.
2. Is there a formal institutionalized mechanism for public-private dialogue in place?			Create a mechanism for public and private sectors to talk to each other coherently. An issue focused *ad hoc* public-private task force can serve as a basis for institutionalizing a formal mechanism for public-private dialogue.
3. Are citizens of the country aware of the reforms that have been implemented or are in the process of being implemented? Are the benefits communicated to the public (and not just the business and government)?			Initiate public awareness campaigns. Communicating with the electorate can also help generate political will to reform.
4. Is the government communicating reforms to the outside world to attract FDI?			Devise investment promotion technical assistance to attract potential investors.
5. Have the barriers that stymie business growth and impose extra costs on business and government been identified?			Using the WBDB, map the existing processes (e.g. trading across borders, dealing with construction permits, etc.) from beginning to end and identify barriers to be eliminated. Focus on specific transactions to streamline, simplify and automate business transactions.
6. Can the costs to government and business from identified barriers be quantified at project start and/or ongoing basis?			Costs arise from *both* government regulation and inefficient bureaucratic implementation. Eliminating extra costs can be a functional equivalent of increasing investment in the economy.
7. Is there a mechanism in place to identify optimal business processes?			Using WBDB, map an optimal process. Achieving an optimal process may

			require numerous incremental reforms ("aggressive incrementalism" - a swift succession of small reforms to the same business process) over time instead of a single top-down legislative overhaul. Modify procedures, document new process maps, and automate. Initiate pilot projects to test optimal business processes.
8. Are there provisions of procedures, decrees, regulations, laws that have to be changed to implement optimal processes?			"A poor transitional country needs poor transitional laws." Draft and enact legislation to streamline bureaucratic procedures.
9. Do the government institutions/agencies and business possess the capacity to engage fully in the reform initiatives (i.e. mapping business processes, eliminating barriers, understanding the value and utility of WBDB survey, etc.)?			Increase the capacity of government officials and business representatives by developing and delivering training targeted at specific business processes and/or pilot projects
Financial Sector Lens			
1. Are banks well-capitalized, prudentially sound, and adequately supervised?			
2. What are the major business enabling obstacles to lending? Does the country have effective collateral laws and registries, an efficient bankruptcy regime, and credit-recovery procedures that protect lenders, supported by reliable commercial courts?			Creditor rights under defaulted loans or leases may be a barrier to expanding access to finance.
3. Is reliable credit information available from public credit registries and/or private credit bureaus?			If not, engage other donor agencies to determine current activities related to public or private credit registries. Review legal framework regarding secrecy and Central Bank laws that allow for the creation of a registry. Refer to FS Share's FS Series #3: *Supprting the Establishment of Credit Bureaus" at www.fsshare.org*
4. Do banks have plans to increase lending to local firms/start-ups through expansion of branch networks, development of new finance products, and/or other initiatives?			
5. Is there additional liquidity in the banking system [(Liquidity Ratio - 6.5)*Total Deposits]?			Using Freedman and Click's methodology (2006) calculate the liquidity ratio and additional liquidity.

ANNEX B. GLOSSARY

Borrower: Any person (physical or juridical) who obtains value from another person or institution under a certain set of contractual conditions (e.g., a debtor obtaining loan from a lender, a lessee, and a conditional buyer).

Capital: The measure of the accumulated financial strength of an individual, firm, or nation, created by sacrificing present consumption in favor of investment to generate future returns above investment costs.

Commercial bank: A federally or state-chartered financial institution that makes loans, accepts deposits, and offers financial services that are likely to include issuing letters of credit, renting safe deposit boxes, and buying and selling foreign currency.

Doing Business: The annual World Bank-International Finance Corporation benchmarking exercise launched in 2004 that aims to measure the costs to firms of business regulations in 178 countries and ranks the countries along 10 dimensions: starting a business; getting credit; registering property; paying taxes; trading across borders; enforcing contracts; dealing with construction permits; closing a business; protecting investors; and employing workers.

Enforcement: A legal mechanism for implementing the rights of lenders and borrowers. In the case of movable property, this entails the possibility for lenders to repossess and dispose of property from borrowers, or the rights of borrowers to object, monitor, or redeem property subject to enforcement.

Lender: A person or institution (physical or juridical) that grants value to another under a certain set of contractual conditions (e.g., a lender providing loan to a borrower, a lessor, and a conditional seller).

Private credit bureau: Similar to a central bank registry except that it contains broader information, including information from non-bank financial institutions and other financial institutions not supervised by a central bank. It also contains information from public court records, collateral registries, land title registries, corporate registries, bankruptcies, and other sources of credit-related information. A credit bureau offers products and services not available from a public registry. It is normally a for-profit business, and data contribution is voluntary from data providers, unless otherwise prescribed by law. It also can be classified as a credit information agency.

Regulatory compliance: An ongoing goal that corporations or public agencies aspire to in their efforts to ensure that personnel are aware of and take steps to comply or conform with relevant laws and regulations. Due to the growing number of regulations and the need for operational transparency, organizations are increasingly adopting the use of consolidated and harmonized sets of compliance controls. This approach is used to ensure that all necessary governance requirements can be met without the unnecessary duplication of effort and activity from resources.

Regulatory environment: The laws, rules, and regulations put into place by federal, state, or other government entities and civilian organizations to control the behavior and actions of business activities.

Small and medium enterprise (SME): There is no universally accepted definition of an SME that is based on specific criteria (e.g., number of employees). SMEs are generally considered to have a maximum of 250 employees. (This number is smaller in Africa.) According to Gibson (2008, pp. 18-29), definitions of SMEs should be adjusted to the size of their home country's national economy and, furthermore, should be based upon functional attributes rather than size.

ANNEX C. REFERENCES

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