Doing Business 2016

Starting a business

Third-party involvement in company formation

- Most of the cost of starting a business comes from the fees of third-party professionals such as lawyers and notaries.
- Entrepreneurs use third-party services in business start-up mostly because the process is too complex.
- Economies with greater third-party involvement in business incorporation tend to have more businesses operating in the informal sector. They also tend to have less accessible laws and regulations and less efficient systems of civil justice.
- Notary services are used in business start-up in 76 of the 189 economies covered by *Doing Business*.
- Latin America and the Caribbean has the largest share of economies where legal services are used in the start-up process.

Starting a business in Haiti takes 12 procedures and more than three months. Formal registration of a company is so complicated that the process cannot be completed without using the services of third parties—lawyers and notaries. Company statutes are often drafted by an attorney, then need to be certified by a notary before being submitted for incorporation. The result is an additional cost burden for entrepreneurs trying to navigate the complex process to enter the formal sector. In New Zealand, by contrast, an entrepreneur can complete the entire process of company formation in just a few hours through a single online procedure. There are many reasons why Haiti has far fewer registered limited liability companies relative to population size—only 6 per 100,000 working-age people in 2012, compared with 1,507 per 100,000 working-age people in New Zealand.[1] But its burdensome entry regulations are surely one of them.

Formalization has many benefits. Formally registered companies tend to have greater profits, investments and productivity,[2] while their employees benefit from social security and other legal protections.[3] As more businesses enter the formal sector, the government's tax base broadens, yielding additional revenue for social and economic policy priorities. Moreover, increases in the number of registered businesses have been linked to greater economic growth and job creation.[4] Yet in many economies around the world, entrepreneurs continue to face excessively burdensome entry regulations. Formalizing a business may involve multiple interactions with government agencies and with third-party private professionals whose services are either required by law or desirable because of regulatory complexity (figure 5.1).[5]

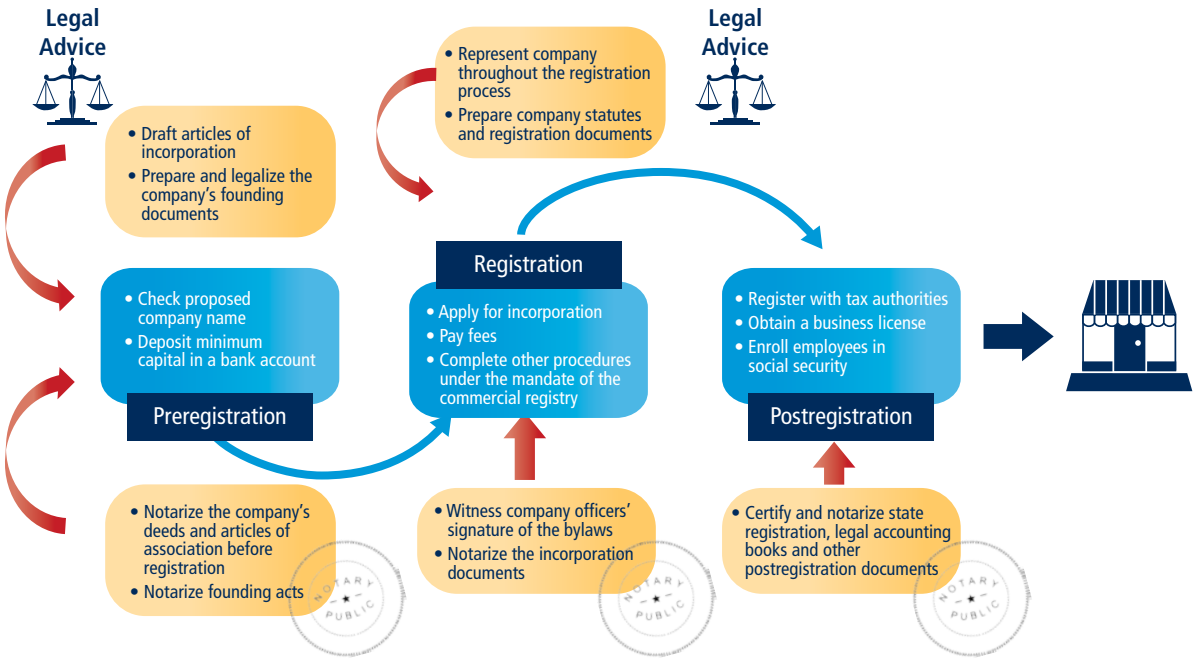
Even where the use of third parties is not explicitly required, unnecessary bureaucratic steps and long delays at government agencies can create ample opportunities for corruption and bribery—and provide an additional incentive for involving third parties early in the start-up process. While administrative delays at some government agencies may reflect meticulous due diligence, research has found that entry regulation can serve as a mechanism for rent extraction, with heavier regulation correlated with greater corruption and a larger informal sector.[6]

By capturing the steps in the process of forming a legal enterprise, the *Doing Business* indicators on starting a business shed light on the necessity for and cost of third-party involvement in this process. The indicators record all procedures officially required—or commonly done in practice—for a local entrepreneur to start a limited liability company, along with the time and cost to complete those procedures and the paid-in minimum capital requirement. Data show that the more cumbersome the process is, the more likely it is for third-party professionals to be involved.

THE COSTS OF INVOLVING THIRD PARTIES

The start-up process can vary considerably in the number and complexity of procedures. Complying with the requirements often necessitates third-party

FIGURE 5.1 What business start-up procedures may involve third parties?



involvement, whether by law or in practice. Entrepreneurs use legal or notary services to start a business in 53% of the 189 economies covered by *Doing Business*. Hiring a lawyer is most common in Latin America and the Caribbean—while using a notary's services is most common in Sub-Saharan Africa, Latin America and the Caribbean and the Middle East and North Africa (figure 5.2).

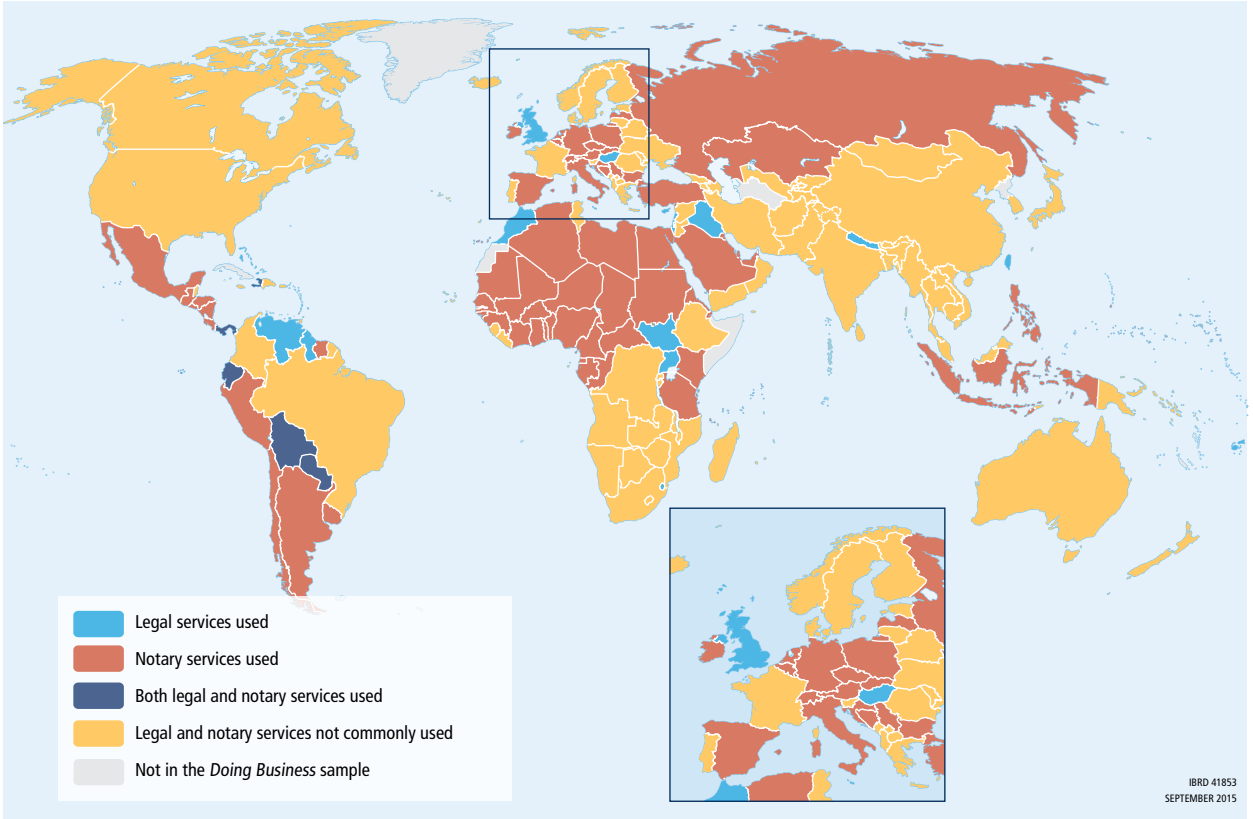
Where entrepreneurs employ third-party professionals to assist in start-up, they often do so for company incorporation and tax registration. *Doing Business* data reveal that these formalities are the major bottlenecks in the start-up process, requiring more procedures than other formalities such as business licensing and inspections. Company incorporation alone can involve multiple procedures. In Bhutan, for example, entrepreneurs wanting to set up a company must first submit a project proposal or business plan to the Ministry of Economic Affairs before proceeding to the Office of the Registrar for incorporation. In the Seychelles incorporation requires several separate procedures. First the company founders must deposit the memorandum and articles of association at the Companies Registry. Then the registrar certifies that the company is incorporated. And after that the founders must file information on the directors, company secretary and the registered business office.

The need to involve third-party professionals not only adds to the bureaucratic burden of the start-up process; it also imposes a cost that can be prohibitive to entrepreneurship. Indeed, *Doing Business* data show that professional services account for most of the cost to start a business (figure 5.3).

Entrepreneurs often hire lawyers or notaries simply because business registration formalities are so complex that complying with all the requirements is almost impossible without external help. Complex entry regulation can also encourage businesses to remain informal. Studies show that informal businesses are more common in economies where institutions foster complex rules and regulations.[7] As evidenced by *Doing Business* data, high costs for business incorporation, especially those incurred through third-party involvement, can drive entrepreneurs to choose to operate in the informal sector. Analysis shows a strong correlation between the cost of third-party involvement in business start-up and the level of informality (figure 5.4). For example, there is a strong positive association between the cost incurred in using third-party services in start-up and both the percentage of firms competing against the informal sector and the percentage identifying informality as a major constraint to their business operations. In other words, the higher the cost of third-party services because of complicated rules and regulations, the higher the level of informality.

Economies where the start-up process necessitates third-party involvement also tend to do worse on indicators measuring regulatory transparency and the performance of the civil justice system. The characteristics of good regulatory governance include clarity,

FIGURE 5.2 Where are legal or notary services used in starting a business?

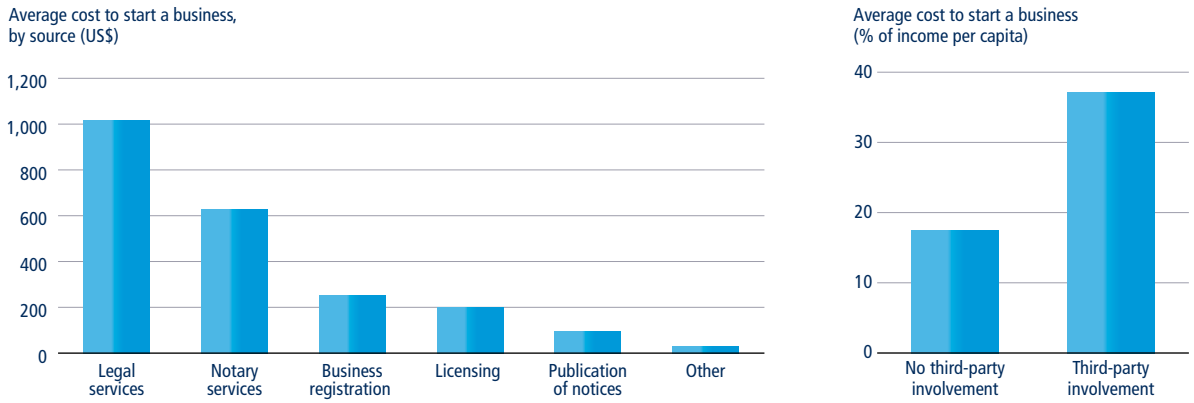


Source: Doing Business database.

predictability, autonomy, accountability, participation and open access to information. Each of these aids in making a regulatory system transparent in the eyes of stakeholders, helping to attract investment.[8] And introducing online solutions for regulatory compliance can help make the process less costly, encouraging entrepreneurship, economic development and growth.[9]

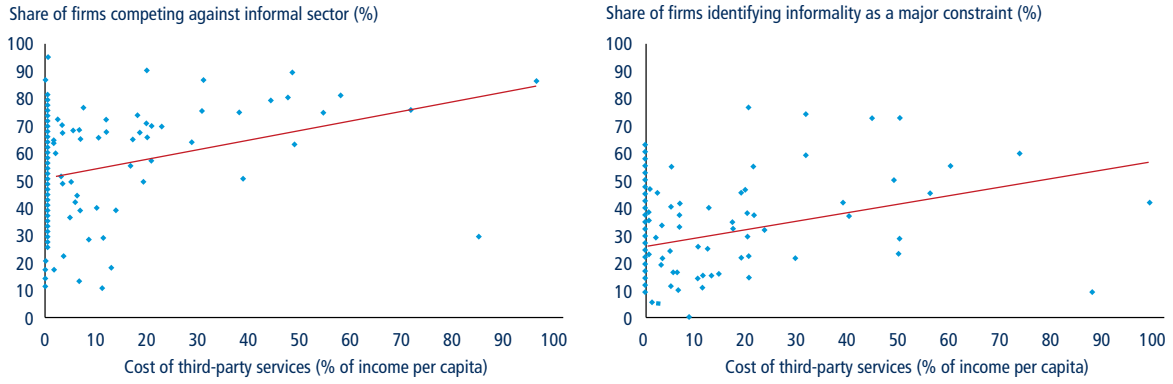
Analysis shows a strong negative association between third-party involvement in business start-up and both the accessibility of laws and regulations and the efficiency of the civil justice system (figure 5.5). These relationships remain significant even after controlling for income differences across economies. It is no surprise that where laws are opaque and the justice system is inefficient, entrepreneurs need to engage

FIGURE 5.3 Most of the cost of business start-up comes from professional services



Source: Doing Business database.

FIGURE 5.4 Economies with greater costs for third-party involvement in business start-up tend to have a higher level of informality



Sources: Doing Business database; Enterprise Surveys database (http://www.enterprisesurveys.org), World Bank.

Note: The cost of third-party services is based on the fees that an entrepreneur in each economy typically pays to lawyers or notaries to start a business. The correlation between the cost of third-party services and the share of firms competing against the informal sector is 0.31. The correlation between the cost of third-party services and the share of firms identifying informality as a major constraint is 0.34. The relationships are significant at the 1% level after controlling for income per capita.

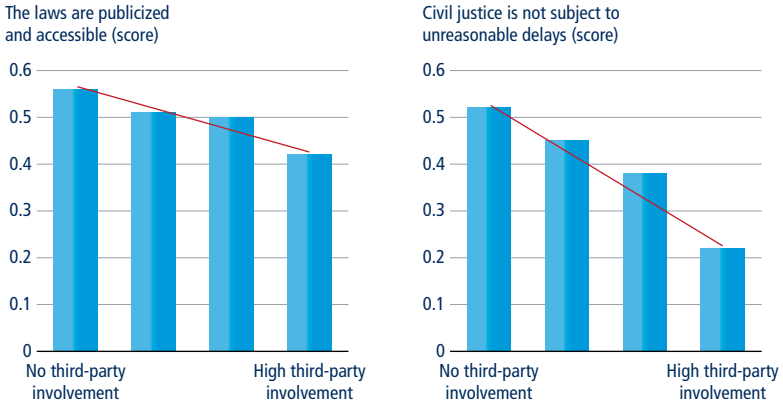
the services of lawyers and notaries to get things done—an outcome that in itself runs counter to the principles of good governance and regulatory transparency.

NOTARIES AT BUSINESS START-UP

As public officers, notaries are appointed by governments and public agencies to certify documents and make them official. Among their most fundamental roles is to maintain impartiality. But while there is much commonality in what notaries do in economies around the world, there is also much variation in the powers they have and in the use of notary services. Laws in some economies empower notaries to perform critical tasks and exercise higher levels of authority and jurisprudence. The law defining the role of notaries in Italy, for example, grants them the sole authority to authenticate property transactions as well as the authority to draft and execute public deeds of incorporation, including company bylaws.[10]

Entrepreneurs use notary services in business start-up in 76 of the 189 economies covered by *Doing Business*—in more than 40 of them, at least in part because of legal requirements to do so. This practice of using notary services appears to vary little with differences in income level (figure 5.6). It differs much more by region. The practice is most prevalent in Sub-Saharan Africa and Latin America and the Caribbean, where notaries play a notably crucial role in legal transactions, including the creation of legal entities, the transfer of land and the verification

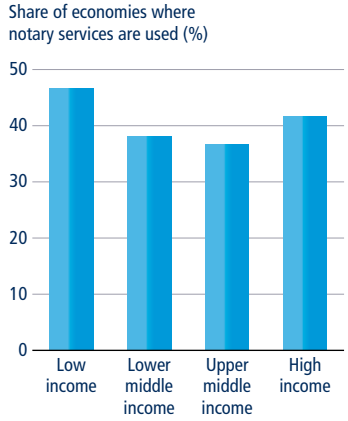
FIGURE 5.5 Greater third-party involvement in start-up is associated with less regulatory transparency and less efficiency in the civil justice system



Sources: Doing Business database; World Justice Project 2014 database (http://worldjusticeproject.org).

Note: The third-party involvement measure is computed based on the number of interactions an entrepreneur in each economy needs to have with lawyers or notaries to start a business. World Justice Project scores range from 0 to 1, with 1 being the best possible score. The relationships are significant at the 1% level after controlling for income per capita.

FIGURE 5.6 The practice of using notary services in the start-up process appears to follow similar patterns across income levels



Source: Doing Business database.

of legal documents (figure 5.7). Indeed, in most economies in these two regions, legal transactions can rarely be completed without the involvement of a notary.

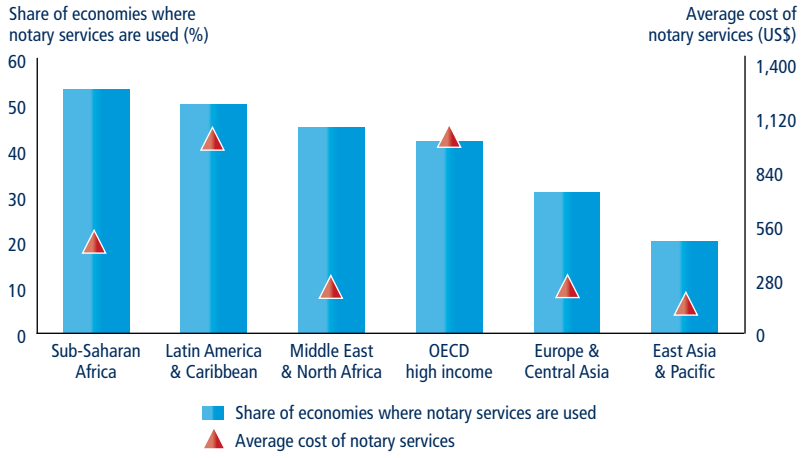
Practices vary among economies in Latin America. In Argentina, for example, a company is not obligated to have its bylaws notarized, but it must have the specimen signatures of its founding partners certified by a notary. In Guatemala company founders must present a letter from a notary to open a bank account, and the notary also draws up the deed of constitution. In Sub-Saharan Africa there was a noteworthy change in 2014, when the Council of Ministers of the Organization for the Harmonization of Business Law in Africa (known by its French acronym OHADA) adopted a revised Uniform Act on Commercial Companies and Economic Interest Groups. The new act made the use of notary services in business start-up optional in the 17 OHADA member states. Yet the practice remains prevalent in OHADA countries. For example, in Burkina Faso, where proof of capital deposit is required for incorporation, a notary certifies the declaration of start-up capital subscriptions. In Côte d'Ivoire a notary usually drafts the company statutes and certifies the paid-in capital.

Among OECD high-income economies, notarization is widely used in business start-up in Italy and Poland as well as in the Netherlands, where a company's public deed of incorporation and bylaws are often executed before a notary. The notary profession in some high-income economies has seen significant advances thanks to reforms introducing electronic systems. In Belgium the e-notariat system enables notaries to file a company's deed of incorporation electronically with different institutions and obtain its enterprise number within minutes. In Croatia notaries can use an electronic system to submit documents to courts.

Across Europe and Central Asia, 31% of economies include notary services in business formalization. In Bosnia and Herzegovina the 2002 Law on Notary requires that all documents needed for registering a company be prepared and certified by a notary. In Turkey a company's legal accounting books must be certified by a notary; in Kazakhstan the certificate of state registration must be authenticated.

Notarization not only represents an additional start-up formality often required by regulators; it can also be a costly transaction. Globally on average, entrepreneurs incur notary fees amounting to 5.6% of income per capita when starting a business. Average rates are highest in OECD high-income economies, followed by Latin America and the Caribbean (see figure 5.7). In some economies, such as Chad and Costa Rica, notary fees for business registration are fixed by regulation.[11] In others, they represent a percentage of the company's start-up capital or are negotiated on the basis of the services provided.

FIGURE 5.7 Notary services are most widely used at start-up in Sub-Saharan Africa and Latin America and the Caribbean—while the fees are highest in OECD high-income economies



Source: Doing Business database.

Note: Notary services are not used in business start-up in South Asia. The measure of cost also reflects the frequency of interaction with notaries because it captures all costs associated with using notary services within each economy as well as across the economies in each region.

ATTORNEYS AT BUSINESS START-UP

The use of legal services in the company registration process also adds to the financial burden of starting a business—and even more so than the use of notary services. Around 17 economies covered by *Doing Business* have laws mandating the use of legal services in company registration. One of these is The Bahamas, where a lawyer must prepare a company's registration documents, such as the memorandum of association.

But even in economies where the use of legal services is not required by law, some entrepreneurs seek legal guidance to ensure that the registration process goes smoothly—because the process can be far too complex to navigate without professional assistance. Local entrepreneurs in St. Kitts and Nevis, for example, hire lawyers to prepare company documents even though this is not required by law. Similarly, in Swaziland entrepreneurs can use the standard forms available for the memorandum and articles of association, but most choose to hire a lawyer anyway, to facilitate the start-up process. Worldwide, the most common reasons for hiring a lawyer at

start-up are to prepare and draft articles and memorandums of association, sign company documents, prepare company statutes, conduct name searches and draft company deeds.

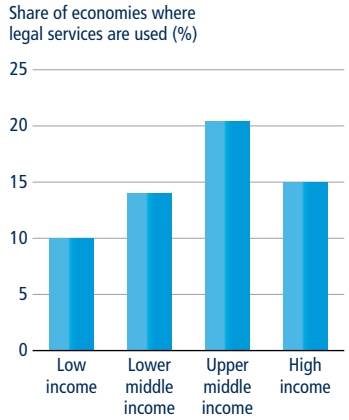
Overall, entrepreneurs use legal services in the start-up process in 15% of the economies covered by *Doing Business*, with the practice being most common among upper-middle-income and high-income economies (figure 5.8). Examples from several economies illustrate the kinds of services that lawyers provide. In República Bolivariana de Venezuela lawyers are required to provide a legal assessment as part of the process of preparing a company's incorporation documents—a procedure that takes five days and costs more than 87% of income per capita. In St. Lucia entrepreneurs hire a lawyer to conduct a company name search and get an approval for the proposed name, which is rarely granted on the first attempt. Once the Commercial Registry guarantees the approval of the company name, an attorney prepares incorporation documents, which takes about two days and costs 18% of income per capita. In Iraq lawyers must draft a company's articles of association and are often responsible for completing the entire registration process. While drafting the articles of association takes only one day, the overall cost of using legal services for start-up averages about 19% of income per capita.

Among regions, Latin America and the Caribbean has the largest share of economies where entrepreneurs hire lawyers for company registration (figure 5.9). It also has the highest average cost of doing so, with fees ranging from roughly $70 in Guyana to more than $10,000 in República Bolivariana de Venezuela. The legal services vary. In Antigua and Barbuda the owners of a new company must have a lawyer provide a declaration attesting that they are not bankrupt, are mentally sound and are over 18 years old. In practice, they also have an attorney prepare all the incorporation documents, including the notice of address and the articles of incorporation. In Ecuador those starting a new company hire a lawyer to prepare the minutes of incorporation, and in Bolivia they engage an attorney to prepare the articles of incorporation, bylaws and constitution acts. The fee schedule established by the Bolivian lawyers association (Colegio de Abogados) sets out a minimum fee for company incorporation amounting to around 42% of income per capita plus 2% of the company's capital.

In Sub-Saharan Africa, by contrast, legal services are rarely used in the company incorporation process. The practice is most prevalent in South Sudan, Swaziland and Uganda. Several other countries in the region implemented reforms in recent years eliminating the need to use legal services when forming a company. For example, in 2009 Liberia introduced standard forms for articles of incorporation, making them available at several government offices in Monrovia. These enable entrepreneurs to register their business without an attorney. In the same year, the South African government eliminated the need to submit documents through a legal professional.[12]

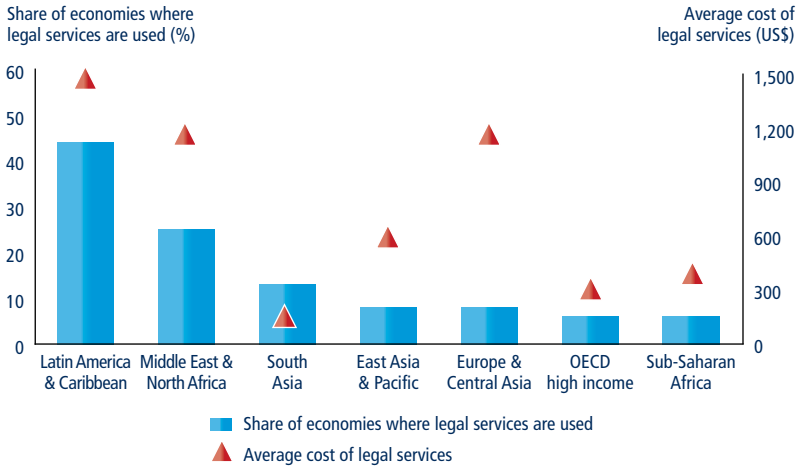
While the legal services used in the start-up process are most costly on average in Latin America and the Caribbean, they are also quite costly in the Middle East and North Africa. In Lebanon each newly formed company must retain an attorney. The annual retainer fee, increased in 2012 by the Beirut Bar Association, can be as

FIGURE 5.8 Entrepreneurs are most likely to use legal services for business incorporation in upper-middle-income economies



Source: Doing Business database.

FIGURE 5.9 Legal services for business incorporation are most commonly used—and most expensive—in Latin America and the Caribbean



Source: Doing Business database.

Note: The measure of cost also reflects the frequency of interaction with lawyers because it captures all costs associated with using legal services within each economy as well as across the economies in each region.

high as 20% of income per capita. In West Bank and Gaza a lawyer is hired to draft the articles of association and the company bylaws. Once these documents are complete, they must be stamped by the Lawyers Bar Association before being filed at the company controller. This procedure alone costs more than $1,000.

Europe and Central Asia has the second highest average cost of lawyers' services in company registration. In Cyprus there is a statutory requirement to have a lawyer prepare the memorandum and articles of association, which costs a small or medium-size company about $1,300. When starting a business in Hungary, the first procedure is to hire a lawyer to represent the company, create the company deed and prepare all the other founding documents. The use of a lawyer is required throughout the registration process, and while the cost varies depending on the complexity of the case, it can end up close to $1,000—around 7% of income per capita.

Globally on average, it costs an entrepreneur around 18% of income per capita to hire a lawyer to assist in starting a business, more than the average cost incurred for notary services. In OECD high-income economies, by contrast, the average notary fees for business start-up are almost four times the average legal fees.

While the cost of using incorporation lawyers is high, the upside is that once a lawyer is hired, incorporating a business usually does not take long. Globally on average, procedures that involve the use of a lawyer's services take only two days to complete, while those involving a notary's services take more than twice as long. But in some cases the time requirements can be more burdensome. In Haiti preparation of the company statutes, which must be done by a lawyer, takes 10 days. In Nepal verifying and drafting memorandums and articles of association—a procedure for which entrepreneurs continue to use legal services even though they are no longer required to—takes about 5 days.

Where the start-up process entails complex procedures and many bureaucratic hurdles, entrepreneurs are better off using professional services. Hiring a lawyer may be expensive, but it can save time and help ensure that the process goes smoothly. Better yet would be a business registration process designed so that the use of legal services is unnecessary. Entrepreneurs, especially those starting a small business, should be able to complete the process without having to pay exorbitant lawyers' fees.

REFORMS AND GOOD PRACTICES

Using the services of third parties in business start-up is a common and established practice. But governments have the power to ease the burden that this represents, saving entrepreneurs both time and money (box 5.1). One way to do so is by making the use of such services optional.

A number of countries have taken steps to do just that. Burundi enacted a law in 2011 that eliminated the need to have articles of association notarized.[13] This alone reduced the cost to register a business by 21% and the time by four days. Similarly, Albania adopted a law in 2007 that made the notarization of incorporation documents optional.[14] This led to cost savings of 8% at business start-up.

In Samoa a new Companies Act enacted in 2008 created a standard model of incorporation forms and thus made the use of lawyers optional. By eliminating the requirement to visit a lawyer, this reduced the cost to start a business by 4% and the time by seven days. Hungary not only made the use of notaries optional but also limited the role of attorneys by introducing standard articles of association and online incorporation. In most cases company documents are still prepared by a lawyer, but the time and cost have been reduced.[15]

Establishing and promoting the use of online registration platforms is a good practice that can reduce opportunities for bribery as well as cut costs associated with third-party services. Online incorporation systems generally do not require the involvement of lawyers or notaries as intermediaries to authenticate company documents and complete the registration process. Such platforms may also enable digital forms of identification, such as electronic signatures, thereby replacing some of the functions of notaries. The Republic of Korea eliminated the requirement to have a company's

BOX 5.1 Indonesia eases the burden of third-party involvement in incorporation

The use of notary services throughout the business start-up process remains inevitable in Indonesia. But the country has introduced changes reducing the burden of third-party involvement. In 2007 Indonesia launched online services related to business start-up that enabled notaries to complete company name searches and reservations more quickly.[a] The following year it introduced standard business incorporation forms. And in 2009 Indonesia reduced notary fees—including the fees for notarizing company deeds—by amending the official fee schedule. These changes have led to time and cost savings for entrepreneurs. If Indonesia keeps up the pace in adopting international good practices in the business start-up process, entrepreneurs starting a simple business like the one in the *Doing Business* case study soon will no longer need to involve third parties.

a. The online system (Sisminbakum) was introduced on January 31, 2001, by a decree of the minister of justice and human rights (decree M-01.HT.01.01 of October 4, 2000).

articles of association and meeting minutes notarized through an amendment to its Commercial and Notary Public Acts in April 2008, then moved toward online incorporation a couple of years later. Portugal launched an online registration portal in 2007 and Germany did so in 2008, both after adopting the necessary regulations to allow electronic incorporation.[16] Germany made electronic registration compulsory in all its states and allowed online publication of incorporation notices, reducing start-up time by six days.

In 2013 the Chilean government made starting a business simpler by allowing entrepreneurs to register certain types of legal entities online free of charge.[17] This change reduced the time it takes to have company statutes registered by notaries from two days to one. In the past year the former Yugoslav Republic of Macedonia made electronic submission mandatory for registration applications for new limited liability companies. The use of electronic signatures on company documents eliminates the need to get them notarized.

Governments can also limit the burden of third-party services in the start-up process by increasing the number of notaries available to provide services or by regulating the fees that notaries can charge. In the Democratic Republic of Congo in 2011/12, new public notaries were appointed in the city of Kinshasa, where previously only one had been available. This cut the time required to get incorporation documents notarized in half. In Côte d'Ivoire the government issued a decree in May 2013 that lowered the notary fees in forming a limited liability company by introducing a scale based on the start-up capital.[18] The notary fees for incorporation were also reduced in Guinea, through a 2012 agreement between the one-stop shop and the Chamber of Notaries.

CONCLUSION

Local entrepreneurs seeking to formally register a new business may confront several bottlenecks along the way. Where the business registration process does not follow good practices, the opportunity costs can be high, especially for small and medium-size businesses—because company founders may end up spending far too much of their scarce resources on third-party services. Moreover, frequent use of third-party services in business incorporation is associated with a higher level of informality, less regulatory transparency and a less efficient civil justice system. Many economies have much room for improvement in the regulatory environment for business entry, particularly in making compliance with regulatory requirements less complicated and in limiting the need to use third-party services. One way to do so is by making the use of third-party services an option rather than a requirement.

NOTES

This case study was written by Julia Brouillard-Soler, Baria Nabil Daye, Morgann Courtney Reeves, Julie Ryan, Valentina Saltane and Evgenia Ustinova.

1. Entrepreneurship Database (http://www.doingbusiness.org/data/exploretopics/entrepreneurship), World Bank Group.
2. Sharma 2014.
3. Rand and Torm 2012.
4. Acs and others 2012.
5. Businesses that are complex or that operate in medium- to high-risk sectors may choose to seek the assistance of third-party professionals. But the discussion here refers to a simple, "low-risk" business that conducts general commercial or industrial activities, as outlined in the *Doing Business* case study.
6. Djankov and others 2002.
7. Elgin and Oyvat 2013; Bruhn and McKenzie 2014; Williams 2014.
8. Bertolini 2006.
9. Vallbé and Casellas 2014.
10. Law 89 of February 16, 1913.
11. In Chad notary fees were fixed by Decree 004/PR/PM/MJ/2010 of January 5, 2010. In Costa Rica the fee structure established by Executive Order 36562-JP of January 31, 2011 (section 95 a), fixes the fee for notarizing articles of association at 150,000 colones ($288) for any corporation, though notaries may negotiate other fees.
12. Corporate Law Amendment 63(3) of the Companies Act.
13. Law on Public and Private Companies, article 33.
14. Law 9723/2007, on the National Registration Center, of May 2007.
15. Amendments to the Companies Act made the use of notaries optional by authorizing an attorney who drafts a company's corporate documents to also authenticate specimen signatures and other relevant documents.
16. In Portugal a special system of online incorporation for civil and commercial companies was created by Decree-Law 125/2006 of June 29, 2006, and Administrative-Rule 657-C/2006. In Germany electronic registration and publication were enabled by the Act on the Maintenance of Electronic Commercial Registers, Cooperative Registers and the Companies Register, effective January 1, 2007.
17. This change was introduced through Law 20.659.
18. Decree 2013/279, issued May 22, 2013, sets the notary fees for the formation of limited liability companies. These fees are 120,000 CFA francs ($228) for companies with start-up capital of up to 1 million CFA francs ($1,900) and 3% of the share capital for companies with start-up capital between 3 million CFA francs ($5,700) and 9 million CFA francs ($17,100).