

Measures to Improve the Environment for Business Start-Ups in Indonesia

SIGNIFICANCE

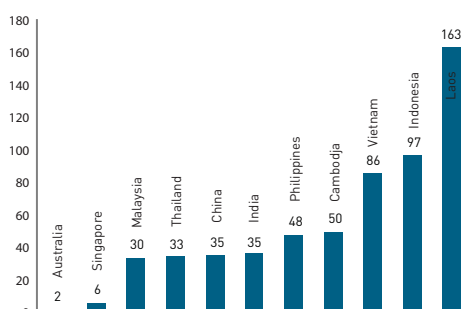
Indonesia has one of the most difficult environments for starting a business in Asia. Among regional economies only Laos requires more time to establish a company (see Figure 1). Out of 175 economies where the ease of starting a business has been measured, Indonesia ranks almost at the bottom in 161st place. Recognition of this problem has led the government to establish a target to cut business start-up time from 97 to 30 days, which would put Indonesia on par with Malaysia and Thailand¹. This can be achieved by eliminating the minimum capital requirement for limited companies, switching from sequential to parallel processing, and abolishing various nuisance requirements.

ANALYSIS

Lengthy and cumbersome business start-up procedures. Setting up a company in Indonesia involves far more than simply registering the company's name and basic information. Prior to registration, the investor establishes a limited liability company through a costly legal process that involves notaries, the Ministry of Law, banks, local officials, the tax department, the Ministry of Finance and the State Printing Office. The main steps to establish a limited liability company are shown in Box 1.

On average the entire process takes about three months, with additional weeks or months needed to obtain local permits and sectoral licenses²: This is one of the most complex start-up processes in East or Southeast Asia, as can be seen in Table 1. Only Laos and

Figure 1: Time to Start a Business
(Calendar days to establish and register a limited liability company)



Mongolia still require the use of notaries, which greatly adds to the cost.

Impact on private sector activity. Cumbersome and costly business start-up procedures increase reliance on the informal economy; limit investment, business expansion, and job creation; and impede private sector development. In addition, such procedures disproportionately affect activities of small and medium-sized enterprises (SMEs). With the cost to set up a limited company in excess of US\$3,000, most SMEs in Indonesia prefer to stay informal and to forgo the protection of limited liability³.

LESSONS FROM INTERNATIONAL BEST PRACTICE

Various approaches to reform. There is no single business registration model applicable to all countries, but some general features can be drawn from international experience. Best practice countries keep business start-up systems administrative, not judicial. These countries require investors to take the following three steps sequentially, but other steps are carried out in parallel with these steps (de Sa, 2005):

- check the uniqueness of a company name (this step can be taken before the process is started);
- file for incorporation;
- register for taxes.

³ This includes the notarial fee, official fees and the minimum capital requirement.

Box 1. Steps to establish a limited liability company in Indonesia.

- The investor locates a notary, who checks the uniqueness of the company's name through an online system operated by the Ministry of Law and draws up the deed of establishment;
- The investor, or notary, obtains a Certificate of Company Domicile from a neighborhood official and a tax identification number, which are needed to open a bank account for the required deposit of the company's initial paid-in capital;
- The notary arranges payment of a non-tax state revenue fee (PNBP) and state gazette printing fee, submits basic information about the company to the Ministry of Justice and Human Rights through the online system, and gets an online "statement of no objection";
- When all these steps are completed, the notary submits original paper documents to the Ministry of Justice and Human Rights, where they are checked against the previous electronic submission. If the new company is approved, a Ministerial Decree is issued legalizing the company;
- The investor then obtains a Business Trading License (SIUP) from a local government office, which is a prerequisite for registering the new company. The company is registered by obtaining a Business Registration Certificate from the local government (TDP);
- A copy of the deed of establishment, along with the TDP and the Ministerial Decree, is sent to the state printing office for publication in the supplement to the State Gazette.

¹ The 30-day target is incorporated into the government's medium term plan (PJM) and investment climate policy package (Inpres 3/2006) and has been stated in several Presidential speeches.

² Typical local licenses include a building permit, nuisance permit and location permit. Sectoral licenses, such as a hotel license or industry license, are also required for most businesses. Some sectoral licenses can be obtained locally while others, such as for a shipping company or power plant, must be obtained from line ministries.

Table 1: Regional Comparison of Starting a Business Index

Region or Economy	Procedures (number)	Duration (days)	Cost (% of income per capita)	Minimum capital (% of income per capita)	Ranking
Indonesia	12	97	86.7	83.4	161
Lao	8	163	17.3	0.0	73
Thailand	8	33	5.8	0.0	28
Malaysia	9	30	19.7	0.0	71
Vietnam	11	50	44.5	0.0	97
Philippines	11	48	18.7	1.8	108

Source: *Doing Business 2007*.

STRAIGHTFORWARD REFORMS COULD GREATLY SIMPLIFY BUSINESS START-UP AND SIGNIFICANTLY IMPROVE INDONESIA'S RANKING

Step 1: Eliminate the paid-in (or minimum) capital requirement for limited liability companies. Eliminating the minimum capital requirement is a recent global trend. Over the past few years this requirement has been eliminated in Vietnam, India, and Japan. Malaysia and Thailand do not have a paid-in capital requirement for limited companies. Indonesia inherited this requirement from Dutch colonial law yet the Netherlands has already decided to eliminate the paid-in capital requirement. Eliminating this single procedure would significantly simplify business start-up⁴. According to simulations by the World Bank Jakarta office, this would improve Indonesia's ranking as follows (see Figure 2):⁵

- Starting a Business ranking: 40 places from 161st to 121st place;
- Overall Doing Business ranking⁶: eight places from 135th to 127th.

This reform would boost Indonesia's starting a business ranking above China, but Indonesia would remain below major regional economies in rankings.

Step 2: Eliminate nuisance requirements, switch to parallel processing and set time limits. The following reforms would further reduce the time to start a company:

⁴ Many banks demand a copy of the company's legalization decree to open an account, but a bank receipt is a prerequisite for obtaining the decree, creating a "Catch-22" for potential investors.

⁵ These simulations assume that other countries are not simultaneously making similar reforms.

⁶ The "Doing Business" index measures the overall business regulatory environment in a country

1. Eliminate "nuisance" requirements such as the Certificate of Company Domicile, PNPB and the publication requirement⁷. This would save about 13 days.
2. Switch from sequential to parallel processing. At present most steps must be completed sequentially. For example, investors cannot apply for the SIUP or TDP before obtaining the decree legalizing the company from the Ministry of Law. Allowing parallel processing would save about 29 days.
3. Establish statutory time limits for remaining steps. For example, a 2006 decree issued by the Ministry of Trade established a 5-day ceiling for issuing the SIUP. The tax department could set a similar limit for issuing tax identification numbers, and time limits could be set by the Ministry of Law for processing applications to legalize a limited liability company⁸.

If the three reforms under step 2 were implemented along with step 1 (and other countries did not simultaneously reform) Indonesia's ranking would improve as follows (see Figure 2):

- Starting a Business ranking: 102 places from 161st to the 59th; and
- Overall Doing Business ranking: 16 places from 135th to the 119th.
- Time to start a business would be cut by 65 days from 97 to 32 days.

These reforms would boost Indonesia's starting a business ranking above Malaysia, the Philippines, and Vietnam.

⁷ Creation of an on-line public access corporate registry would make the publication requirement redundant.

⁸ The tax department recently instituted an online system for tax ID numbers that should make it possible to set a very short statutory time limit. The limit already exists for the SIUP but not for the TDP.

CHALLENGES AHEAD

Most of the reforms mentioned above can be implemented by internal changes within the bureaucracy, such as through issuance of a ministerial decree or regulation. However other reforms, such as elimination of the minimum capital requirement, might require changes to existing laws or draft laws⁹. Broad social support is therefore needed, including support from Parliament for legislative changes. Fortunately the government has already expressed its strong commitment to the goal of simplifying business licensing and cutting business start-up time to 30 days. The challenge is therefore for the bureaucracy to design and implement the procedural changes, and for the government to coordinate the changes among ministries and with Parliament.

Sources:

De Sa, Liliana. 2005. "Business Registration Start-up: A Concept Note." World Bank. 2006. "Doing Business 2007: How to Reform."

Figure 2: Changes in Ranking through Two Reform Options

Impact on Starting a Business Ranking

Ranking	Economy
1	Canada
11	Singapore
28	Thailand
59	Indonesia
71	Malaysia
97	Vietnam
108	Philippines
121	Indonesia
128	China
159	Cambodia
160	Timor-Leste
161	Indonesia
175	Guinea-Bissau

Sources: *Doing Business database*

⁹ The minimum capital requirement is specified in the draft Company Law currently being discussed in Parliament. Parliament has the authority to amend this draft law.

For further information, contact:

L. Peter Rosner
Enrique Aldaz-Carroll

Financial & Private Sector Development
World Bank Office Jakarta
Email: fpd_id@worldbank.org
Ph. 62 21 5299 3000
Fax. 62 21 5299 3111

Please visit our website:
<http://www.worldbank.org/id>
<http://www.doingbusiness.org/>

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