

Formalization of Business in Egypt



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Outline

1. Why most businesses are extralegal?.
Methodology
2. Why most businesses are extralegal?.
Findings
3. What are the proposals to reduce
extralegality?

**1. Why most businesses are
extralegal?
Methodology**

Main activities

- Identified areas of business concentration
- Reviewed existing rules and regulations
- Conducted in-depth analysis of case studies
- Corroborated findings with knowledgeable accountants and lawyers
- Conducted in-depth interviews with extralegal businessmen



*Practices documented
through fieldwork. In
depth interviews*

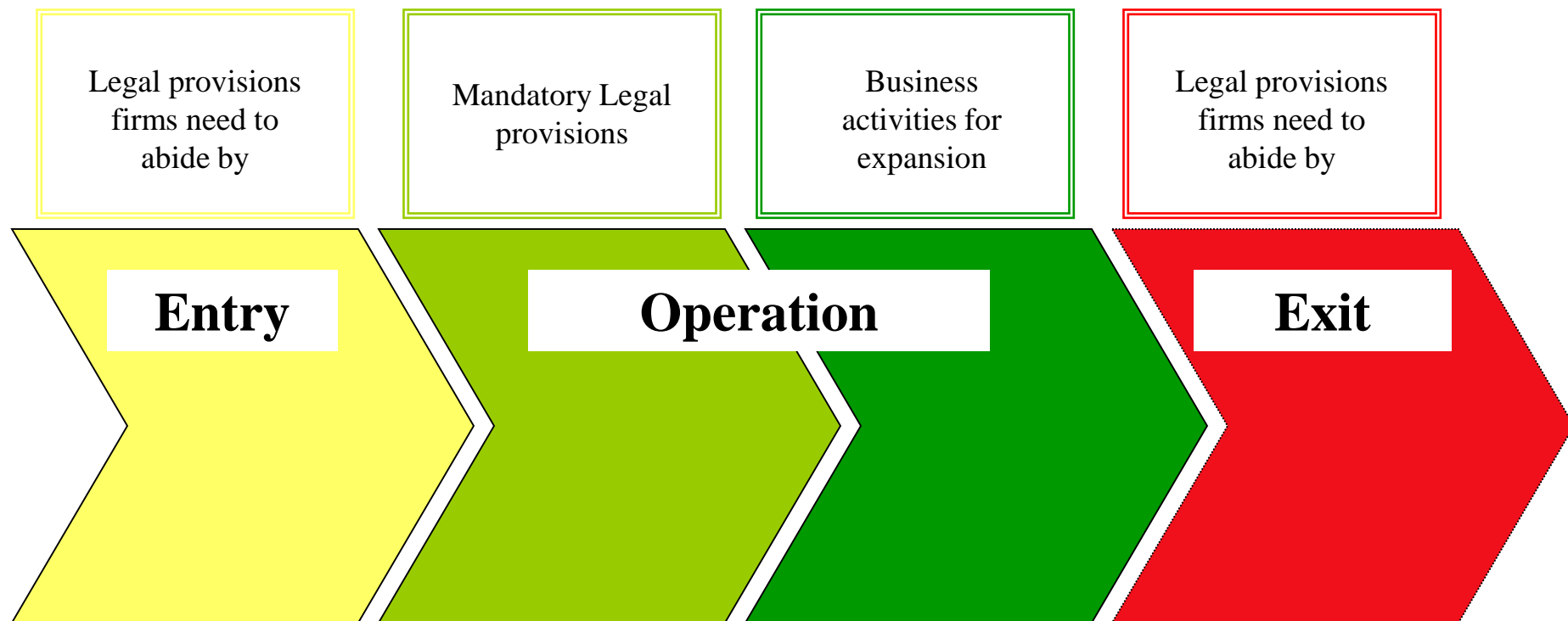
Implications

- Method helps to identify constraints in cases studied
- Appropriate approach for proposing reforms
- Findings do not necessarily apply for all cases
- Yet recommendations are made on solid grounds

How do we view the formalization decision?

Costs and benefits related to the full cycle of the business

Legal and institutional framework



Extralegal practices

**2. Why most businesses are
extralegal?
Findings**

The costs imposed by the legal system on businesses: Entry

COSTS	Explanation
<p><u>Legal Incorporation</u></p> <p>t= 55 days</p> <p>Steps (s)= 41</p>	<ul style="list-style-type: none"> •Lengthy and costly procedures •Abundant information requested
<p><u>License for operation</u></p> <p>t= 317 days</p> <p>Steps= 86</p>	<ul style="list-style-type: none"> •Significative number of requirements. •High discretionary power of officials.
<p><u>In total</u></p> <p>Estimated cost (C): around L.E. 8.700 /Offices involved= 50</p>	

Extralegal Practices: Entry

Practice	Main problems identified
Use of different documents and procedures as “proof” of property rights on real estate	Unsafe and vulnerable means to prove property rights. Acceptance is restricted to acquaintances
Utilization of licenses issued for other persons or activities different than actual activities	
Transferring possessory rights over real estate premises under rent control (Khelewerl and Bea bel ghadak)	

The costs imposed by the legal system on businesses: Operation

Concept	Main problems identified
<p>Costs</p>	<p style="text-align: center;"><u>Mandatory legal provisions</u></p> <p>t(year)= 1.000 hrs./ Steps= 24/ Cost = L.E. 7.750</p>
<p>Renewal of registries and licenses</p>	<ul style="list-style-type: none"> •Ample discretionary power exercised by local officials,. •There are not standarized procedures concerning entrepreneurs grievances before public administration.
<p>Tax and labor obligations</p>	<ul style="list-style-type: none"> •Most businesses (specially SMEs) do not keep regular accounting books. •Regulations are not harmonized or duly publicized. •Information required is abundant

The costs imposed by the legal system on businesses: Expansion

COSTS	Explanation
<p><u>Purchase/ Sale on credit(Contract exec.)</u> <u>Mortgage foreclosure</u> t= 411 days/ s = 61/ C= L.E. 7286</p> <p><u>Commercial Pledge</u> t= 810 days/ s = 47/ C= L.E. 8.599</p>	<p><u>Business activity: purchase equipment, services, inputs.</u></p> <ul style="list-style-type: none"> •Some procedures require special permits. •All court proceedings for the enforcement of contracts are long-drawn-out and costly.
<p><u>Importing goods</u> t= 116 days/ s= 46/ C= L.E. 6.799</p>	
<p><u>Purchase from state (customs)</u> t= 55 days/ s = 28/ C= L.E. 577</p>	
<p><u>Exporting goods</u> t= 48 days/ s= 28/ C= L.E. 2.331</p>	<p><u>Business activity: access to credit and sales of goods and services</u></p> <ul style="list-style-type: none"> •The market does not provide adequate information on the situation of debtors. •There are no efficient and predictable legal mechanism that ensure the recovery of a loan.
<p><u>Access to credit (application procedures)</u> t= 98 days/ s =115/ C= L.E. 8.504</p>	
<p><u>Sales to the state (Contract exec.)</u> t= 1018 days/ s= 94/ C=L.E. 52.053</p>	

Extralegal Practices: Operation

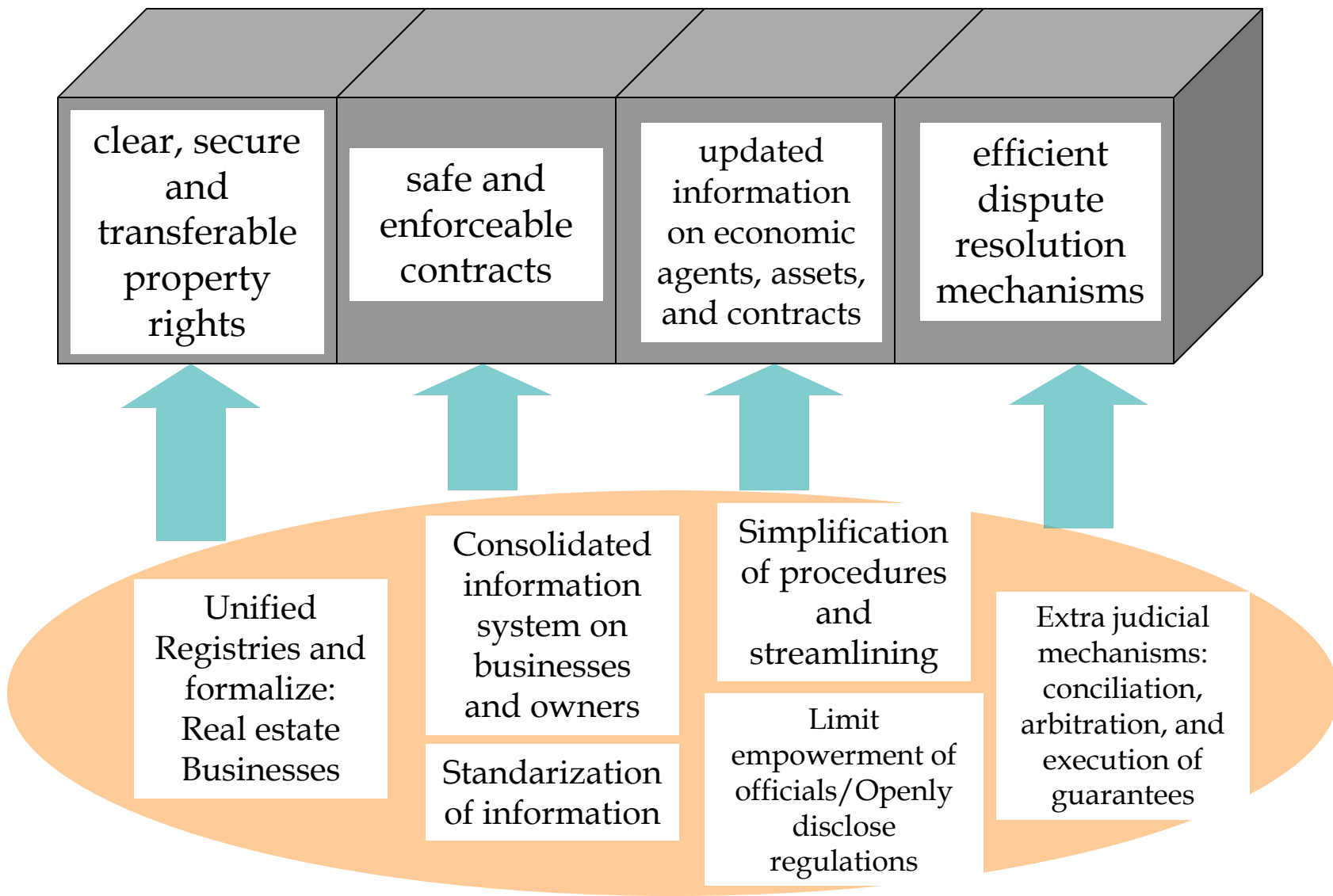
Practice	Main problems identified
<p>De facto companies operating as single-person-businesses</p>	<p>Unsafe mechanisms to operate and unsecure alternative to associate</p>
<p>Low profile and other practices to hide economic reality. Use of partial indicators to appraise business activity</p>	<p>Uncertain situation regarding final payments on administrative obligations.</p>
<p>Use of checks and <i>esal-al-amanas</i> as credit guarantees. Use of some enforced collection methods such as Thaliz Há</p>	<p>Effective but yet inefficient mechanisms to grant financing</p>
<p>Extralegal payments</p>	<p>Uncertain situation regarding final payments on administrative obligations</p>

The costs imposed by the legal system on businesses: Exit

COSTS	Explanation
<p data-bbox="150 479 571 579"><u>Voluntary Company Liquidation</u></p> <p data-bbox="113 625 340 665">t= 244 days</p> <p data-bbox="113 711 305 751">Steps= 25</p> <p data-bbox="113 796 513 893">Estimated Cost: L.E. 9.963</p>	<ul data-bbox="683 419 1881 1036" style="list-style-type: none"> • Unvoluntary exit procedures are very long and costly • There are confusing rules regarding the order and opportunity of closing and cancelling of registries and permits. • Whenever a dispute related to due obligations arise, results become more uncertain
<p data-bbox="247 991 494 1031"><u>Bankruptcy</u></p> <p data-bbox="113 1076 340 1116">t= 653 days</p> <p data-bbox="113 1162 305 1202">Steps= 53</p> <p data-bbox="113 1248 513 1345">Estimated Cost: L.E. 18.804</p>	

3. What are the proposals to reduce extralegality?

FRAMEWORK FOR THE PROPOSALS



Broad features of proposed reforms

1. Consistent set of solutions to remove obstacles regarding entry, operation, expansion and exit.
2. A new entity to manage and maintain the formalization process
3. Legal reforms covering all aspects of formalization into one law

Proposals related to **entry and exit**

- Creation of an integrated and simplified system for the legal entry of companies and single-person businesses (New Business Public Registry)
- Facilitation to Limited Liability Status especially of single-person businesses
- Establishment of efficient and timely mechanisms to enable companies to exit the market legally

Business Registry

Basic Information (from procedures)

Initial registration

- Company's contract/ articles of incorporation (Business name, type of activity, capital, etc.)
- Address/ Geographical location
- IDs: Partners /Owners/ Legal representatives
- Tax Card
- Accounting books/ Financial information

Up date

- Changes in legal information/ Property transactions
- Financial information

Criteria: streamlined procedures, ex – post controls, de-concentrated decision making (decentralized), successive registration, etc

Business Registry

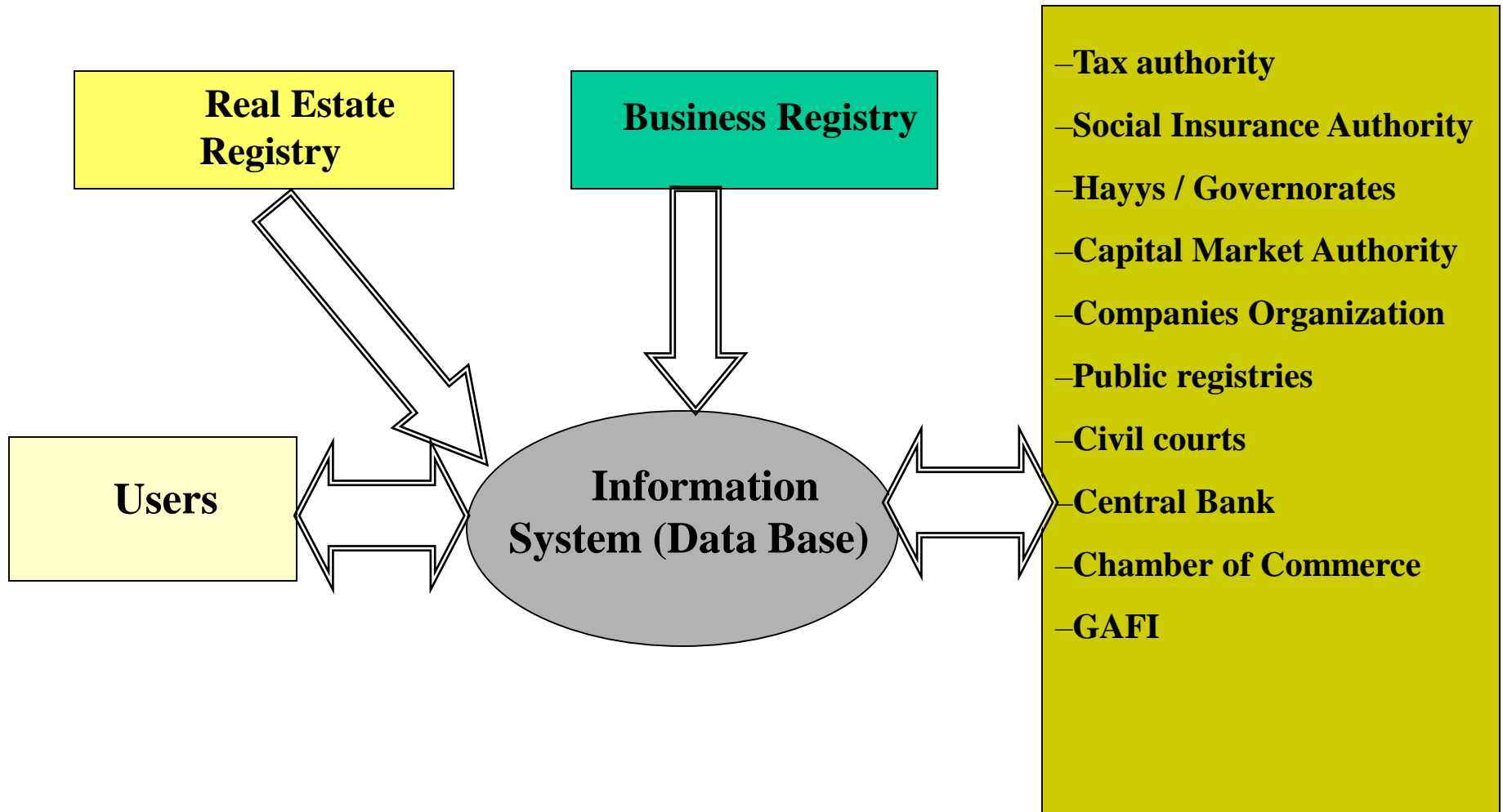
Proposals to facilitate business operations

- Establish a Program for regulatory improvement and **administrative simplification** of legal business procedures
- Simplify labor and social security procedures
- Establish the legal framework to implement a Program for **Regulatory Improvement** and Administrative Simplification (single legal text of general application).
- Establish an effective **system of accounting principles** and rules.
- Establish a **simplified Tax payment regime**

Proposals to promote **expansion** of businesses

- Creation of a **Business Information System** (businesses registered in the NBPR)
- Simplification of Import and export procedures

INFORMATION SYSTEM : Real Estate and Business



Proposals to promote expansion of businesses (Facilitating **contract enforcement**)

- To create a simplified and inexpensive system of **Pledges (with and without transfer of possession)**.
- To establish an optional system for **certifying signatures** that eliminates the mistrust that impedes the courts from ordering the enforcement of obligations.
- To establish speedy mechanisms for the **execution of guarantees registered in the Registry of Pledges**.
- Simplify the procedure to **contest an administrative decision before the State Council**.

Proposals to promote expansion of businesses (Facilitating contract enforcement) (2)

- To establish a **special judicial system** outside the established courts for the resolution of disputes exclusively related to resolutions expedited by administrator of NBPR and its members entities.
- To improve the existing alternative resolution mechanisms by giving enforcement to conciliation agreements; simplifying the execution of arbitration rulings; and, establishing a **Center of Conciliation and Arbitration** for them.
- To establish **out-of-court mechanisms to foreclosure on movables and non-movables guarantees** (pledges, mortgages).

Proposals to promote expansion of businesses (using **Real Estate Assets**)

- *Create a Unified, Simplified and Low-Cost system for the Capitalization of Extralegal Real Estate Assets*
- *Simplify the Registration Procedures for Drawing Up Mortgages*

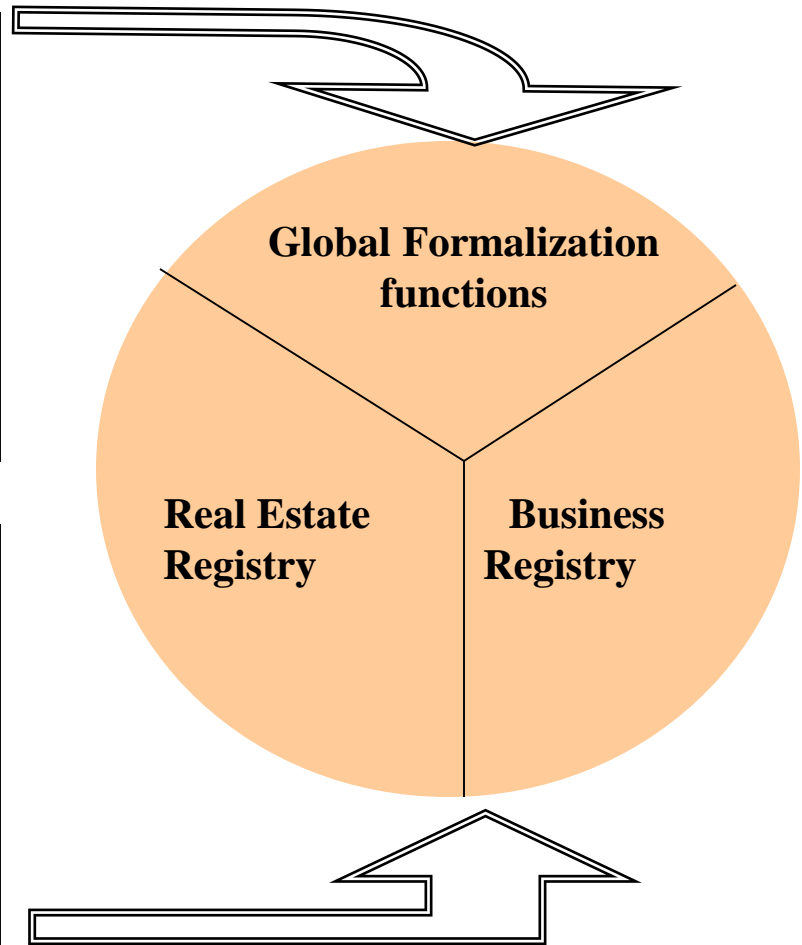
Create a Specialized Body responsible for the formalization process

- Unify the implementation of proposed reforms under the administration of an independent public authority (**Public Authority for Capitalization of the Poor**) empowered exclusively to carry out a national program for formalization of businesses.
- **Main Functions:**
 - PAP will formalize businesses through NBPR
 - PAP will spearhead the gradual unification of all public registries for moveable and business assets.
 - PAP will control the information system for business assets.
 - PAP will organize and administer the service for certification of signatures
 - PAP will propose complementary reforms to increase benefits of operating legally.

Capitalization Organization

Government agencies in charge of Real Estate Property rights (33 entities): Ministries of Housing, Justice, Economy; Governorates, Districts (Hays), etc.

Government agencies in charge of Authorizing Business (29 entities): Ministries of Economy, Finance, Supply and Domestic Trade, Social Affairs; Governorates, Hays, etc.



Concluding remarks

- Extralegality is widespread in Egypt as in most developing countries.
- Egypt can benefit greatly from formalization.
- The proposed solutions are comprehensive and will provide the necessary institutional mechanisms to promote formalization.
- The process has worked in Peru and other developing countries.