

# Framework Regulation Costs: Businesses' Perspective

P. Bordelo<sup>1</sup>, P. Braz<sup>2</sup>, S. Rodrigues<sup>3</sup>, A. Sousa<sup>4</sup>

*<sup>1, 2, 3, 4</sup> Statistics Portugal, Lisbon, Portugal*

*paula.bordelo@ine.pt; paulo.coutinho.braz@gmail.com; sofia.rodrigues@ine.pt; andre.sousa@ine.pt*

## **Abstract**

The global framework regulation cost indicator, which aggregates nine cost domains, scored an intermediate value (3.04 on a 1 to 5 scale), having been slightly higher in small and medium companies than in large and micro enterprises. By business sector, companies from accommodation and food services, construction and real estate, manufacturing and agriculture, forestry and fishing, perceived higher-than-average framework regulation costs. Among the nine cost domains analyzed, the main constraints to business activity were identified in the judicial system. Licensing and the tax system followed as the most problematic areas, and these three registered the highest values, regardless the size and business sector of companies. Furthermore, a micro data linking exercise is under development, based on the information of this survey and on business statistics data. The goal is to characterize, by different economic variables, the profile of the companies with high and low framework regulation costs.

**Keywords:** framework regulation costs; businesses; global indicator; constraints to business activity; administrative data.

## **1. Introduction**

The growing integration of businesses in the global economy, poses new challenges and the need of constant attention to factors affecting their competitiveness. Among them, the framework regulation costs stand out. Framework regulation costs are negative effects resulting from rules, procedures, actions or omissions, that hinder businesses and that are not attributable to the investor, its business or organization.

IaCC, a survey launched by Statistics Portugal in 2015, (INE, 2015) focused on nine main areas, identified as potential areas of obstacle to businesses' activities: starting a business,

licensing, network industries, financing, judicial system, tax system, administrative burden, internationalization and human resources. Companies were inquired on the levels of obstacle they perceived in the multiple areas and on their evolution between 2012 and 2014.

## **2. Business Framework Regulation Costs Survey**

Approximately five thousand non-financial companies were surveyed, constituting a stratified sample by size-class and business sector (INE, 2007). The survey went from June 05 to August 11, 2015.

Most questions of the survey have a qualitative nature, expressed by a discrete scale of response with five levels of intensity, with which the respondent may indicate the level of obstacle associated to each question. In order to synthesize the companies' evaluation of the obstacles, an indicator was calculated taking the average of the distribution of responses, weighted by the five levels considered which varies in a range of values between 1 and 5.

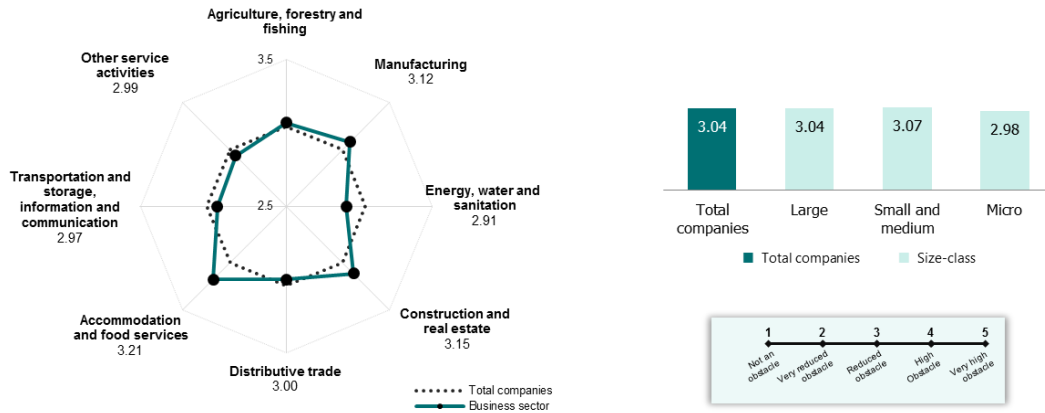
On the basis of the results of the survey, composite indicators were created, summarizing the information on the multiple areas of framework regulation costs, allowing thus their comparability. The global framework regulation cost indicator was finally calculated, considering the turnover weighted results, and taking into account the level of importance of the multiple areas of costs, attributed by companies.

Based on these results, the global framework regulation cost scored an intermediate value (3.04 on a 1 to 5 scale), as shown in figure 1. By size-class, the small and medium companies perceived slightly higher values (3.07). By business sector, we have the companies from accommodation and food services (3.21), construction and real estate (3.15), manufacturing (3.12) and agriculture, forestry and fishing (3.07), perceiving higher-than-average framework regulation costs.

The main constraints to business activity were identified in the judicial system (see figure 2) with the highest obstacle indicator (3.70). Licensing (3.46) and the tax system (3.31) followed as the most problematic areas. These three registered the highest values, regardless of the size

and business sector of companies. Nonetheless, some differences were observed in the ordination and the degree of the perceived obstacles.

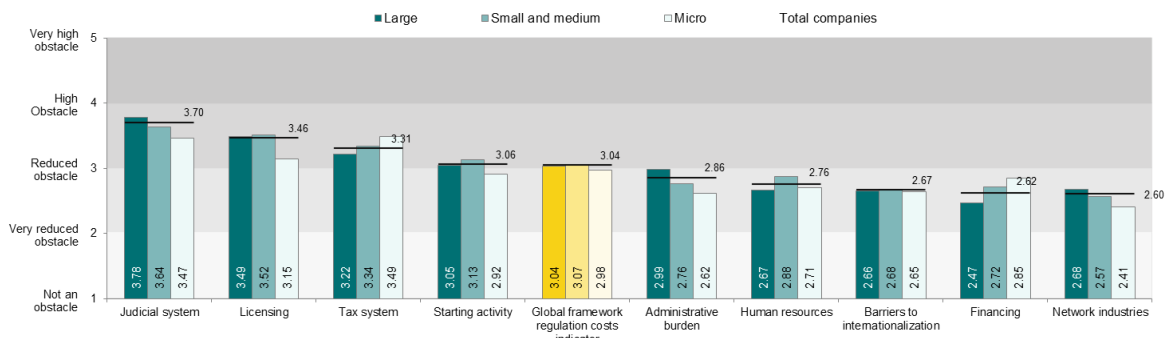
**Fig. 1 – Global framework regulation cost indicator by size-class and business sector (Turnover)**



**Source:** Statistics Portugal, Framework Regulation Costs Survey

Small, medium and large companies perceived more obstacles in the judicial system and in licensing, as we can see in figure 2, while the tax system was the main obstacle for micro companies. Network industries (2.60) and financing (2.62) did not constitute significant obstacles to the activity of most companies, with the lowest obstacle indicators.

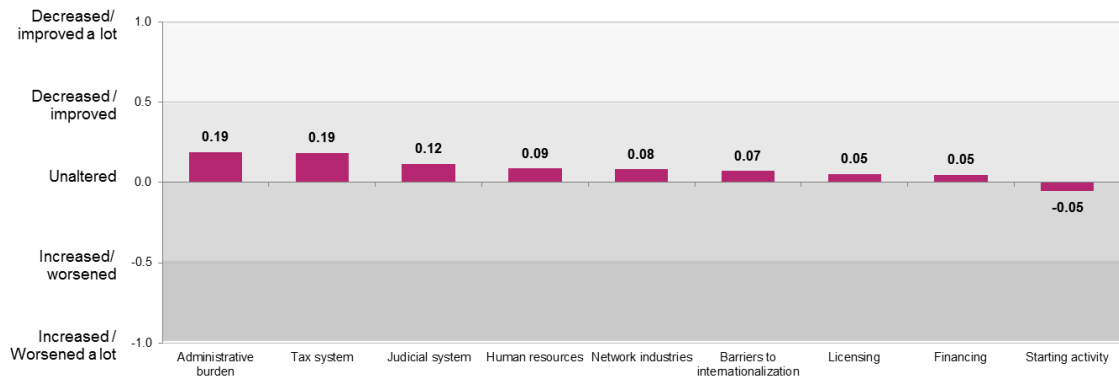
**Fig. 2 – Obstacle indicator by cost domains and enterprise size-class**



**Source:** Statistics Portugal, Framework Regulation Costs Survey

Companies did not perceive significant changes in the obstacles, in most cost domains, between 2012 and 2014 (see figure 3). Nonetheless, they indicated a slight increase in all obstacles, except in starting of activity. The tax system and the administrative burden were the ones that companies expressed the highest increase in obstacles to their activity.

**Fig. 3 – Obstacle evolution indicator by area of framework regulation cost and enterprise size-class**

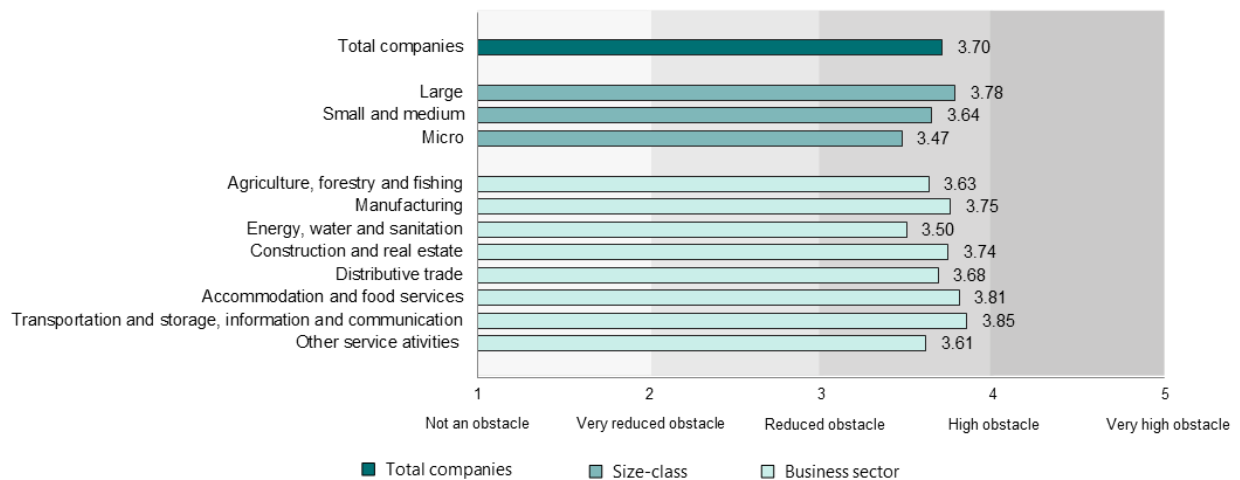


**Source:** Statistics Portugal, Framework Regulation Costs Survey

By cost domains, the following should be highlighted:

The judicial system was the area where companies perceived the highest obstacles to their activity. Tax disputes posed more obstacles to companies than those commercial or labour related. In relation to the judicial proceedings, the main barrier was the related judicial length. The perceived evolution was an increase in obstacles felt by companies, particularly those related to the costs of juridical support and court related expenses. The obstacles in the judicial system were particularly high for large companies and also for companies in the transportation, storage, information and communication sector (see figure 4).

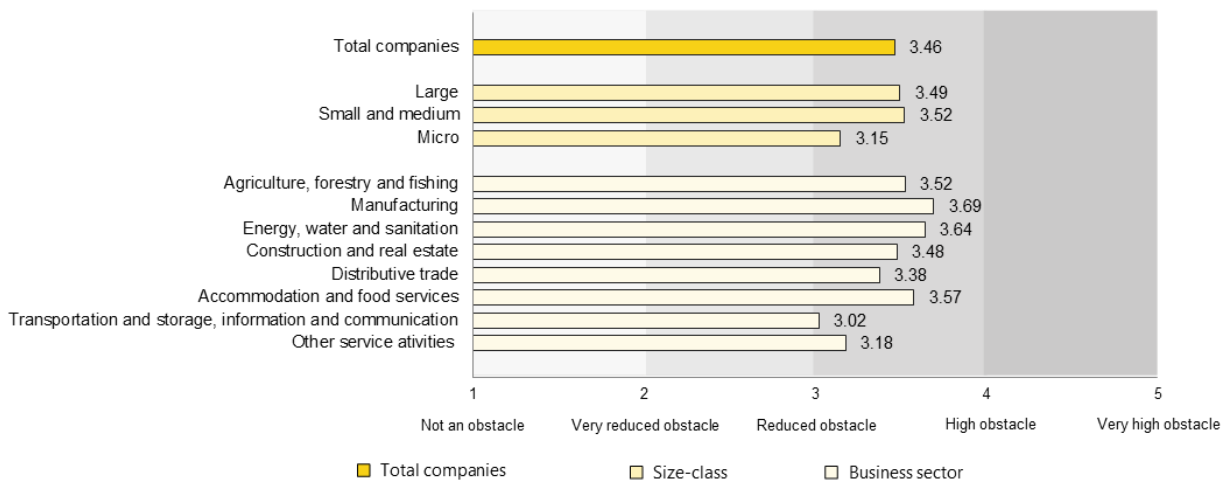
**Fig. 4 – Obstacle indicator in the judicial system by enterprise size-class and business activity**



**Source:** Statistics Portugal, Framework Regulation Costs Survey

The complexity of some licensing and certification processes posed important framework regulation costs to companies. Among business sectors, the highest obstacle indicators were in manufacturing and in energy and water (see figure 5). In both, the main barriers were caused by the complexity of environmental licenses. In accommodation and food services, and in distributive trade, the main obstacles came from municipal licenses. These obstacles were, also, felt more by small, medium and large companies than by micro companies.

**Fig. 5 – Obstacle indicator in licensing by enterprise size-class and business activity**



**Source:** Statistics Portugal, Framework Regulation Costs Survey

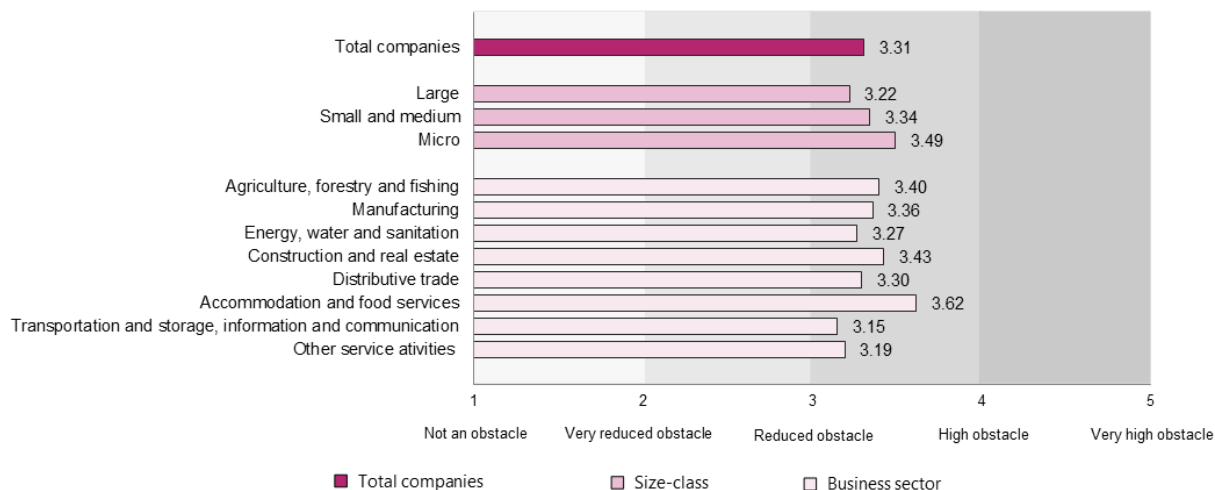
The tax system also posed a relatively high obstacle. VAT was the tax that posed the highest barriers to activity, particularly in the accommodation and food services sector (see figure 6). Micro companies indicated higher obstacles in the tax system, especially in the contributions to social security.

For the majority of the companies, the starting of activity did not constitute a big obstacle, and the situation remained relatively stable, with a slight improvement between 2012 and 2014. The costs associated with starting a business (including the fees to set up and the necessary capital) constituted the main barriers to this process, whereas the necessary time had the lowest obstacle indicator.

In general, access to financing did not constitute a high barrier to a great number of companies. The situation remained essentially unchanged to the majority of the companies. By

business sector, some points of obstacle should be highlighted, particularly the access to middle and long term credit by construction and real estate, and accommodation and food services sector companies. By size-class, in spite of the globally low indicators, a higher obstacle indicator and obstacle evolution indicator was observed in micro companies.

**Fig. 6 – Obstacle indicator in the tax system by enterprise size-class and business activity**



**Source:** Statistics Portugal, Framework Regulation Costs Survey

Operations related to human resources of companies did not constitute a high obstacle to their activity. A relatively higher obstacle indicator was identified in layoffs, such as in the accommodation and food services sector.

Internationalization of businesses was still not an area applicable to most companies. The most common means for internationalization was through imports and exports, where no particular constraints to activity were identified. Opening of foreign affiliates or branches, although affecting a reduced share of companies, posed a relatively higher obstacle to them, namely in the construction and real estate, distributive trade and manufacturing sectors.

The administrative burden did not, in general, pose a significant obstacle to business activity. However the results varied according to the entity analyzed. Information requests from and to the Tax authorities (AT), caused the main obstacles for businesses. Large companies were more affected by the administrative burden, while no major differences were found among business sectors.

Network industries did not constitute a major obstacle to the activity of companies, showing the lowest indicator among all the cost domains. Between 2012 and 2014, the situation did not change significantly, with a slight tendency for an increase of obstacles, aggravated in the case of electricity and liquid fuels activities. For companies that identified high and very high obstacles, in network industries, their cost tended to be the main problem. The only exception was telecommunications, where the availability of the service was the main problem, with the quality gathering a significant part of the responses as well.

### **3. Methodological Aspects of the Survey**

#### *3.1. Answers structure by costs domains*

In all the nine costs domains, for the total companies and for each aggregate of activity sector and dimension, it was determined the answers structure. This aggregation corresponds to the simple average applied to the answers of each component, in each domain. Some components of licensing and administrative burden were not considered, namely the options “others n.s.” and “regional administration”, respectively.

#### *3.2. Obstacle indicator*

This indicator is the average of the distribution of responses, weighted by the five levels considered, and it varies in the range of values between 1 and 5, described as follows:

- 1 – Not an obstacle
- 2 – Very reduced obstacle
- 3 – Reduced obstacle
- 4 – High obstacle
- 5 – Very high obstacle

For the calculus of this indicator, we do not consider the answers “do not know / do not answer” and “not applicable”. The corresponding percentages of these options were redistributed proportionally by the others.

The obstacle indicator (OI) is calculated as follows:

$$OI = \frac{\sum_{a,i=1}^5 x_a \cdot \varphi_i}{\sum_{a=1}^5 x_a} \quad (1)$$

Where  $x$  represents the percentage of answers in the option  $a$  and  $\varphi$  represents the obstacle answers scale 1 to 5.

### 3.3. Obstacle evolution indicator

The values represent the balance of extreme respondents (BER) as follows:

$$BER = [\%(++) * 1] + [\%(+) * 0.5] + [\%(neutral) * 0] + [\%(-) * 0.5] + [\%(--)] * 1 \quad (2)$$

Where:

- (++) Increased / worsened a lot
- (+) Increased / worsened
- (neutral) Unaltered
- (-) Decreased / improved
- (--) Decreased / improved a lot

### 3.4. Global framework regulation cost indicator

Represents the aggregation of the obstacle indicators, obtained in each costs domains, weighted by the number of answers in one specific question of the survey: “Indicate the importance that each of the following dimensions have nowadays in the activity of your company”.

The weightings were based in the following steps:

- i. Measure of importance: it is obtained for each domain of cost, based on the answers for the total of companies, assigning the following values to scale:
  - 1 – Important
  - 2 – Very important
  - 0 – Other options



For the calculus of this indicator, we do not consider the answers “do not know / do not answer” and “not applicable”. The corresponding percentages of these options were redistributed proportionally by the others.

- ii. Calculus of the weightings ( $Pd$ ): we obtained the weightings by the following formula:

$$Pd = \frac{\text{Importance } d}{\sum_d \text{Importance}} \quad (3)$$

Where  $d$  represents the framework regulation cost domain and  $Pd$  the weight of the domain  $d$ .

The calculus of the global framework regulation cost ( $GFRC$ ) indicator is given by:

$$GFRC \text{ indicador} = \sum \text{Obstacle indicator} * Pd \quad (4)$$

#### **4. Further Developments – microdata linking exercise**

At this stage, we are exploring the information of the survey by characterizing the profile of the companies with high and low framework regulation costs. In this micro data linking exercise, we use the survey’s results and business information (based on administrative source, such as IES, Simplified Business Information). Both datasets have a common key - the fiscal number of each company (NPC). The main goal of this exercise is to obtain economic data for each company that answered the IaCC, which serves as the basis for calculating various economic and financial ratios and profiles.

Up to now, an individual framework regulation cost indicator per company was calculated, in order to assess their perception of these costs. Then, using the intensity scale defined on the survey and with this individual indicator, we created four groups of intensity, comprehending the following intervals: [1, 2[, [2, 3[, [3, 4[ and finally [4, 5].

We are using a bivariate analysis, crossing these new four groups of intensity with several dimensions. Apart from the size-class and business sector previously explored in the survey, we are studying other dimensions such as: the exporting profile of the companies, the high growth enterprises, the belonging to a corporate group and groups of age. We are studying the

following variables: turnover, apparent labour productivity, capital intensity, gross value added (GVA) growth rate, solvency ratio and investment rate.

## **5. Conclusions**

Nowadays, companies face new challenges and the need of constant attention to factors affecting their competitiveness. IaCC bring us the evaluation of nine main areas that affect company performance and let us know the best to worst areas of framework regulation costs, giving information to policy makers and public in general. The key challenge, and new opportunity, is to use this dataset and explore the information of business statistics in parallel, using micro data linking to characterize the profile of these companies.

## **6. References**

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