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"Dividing the Wheat from the Chaff": How to Get at the True Picture of Entrepreneurship Behind Misleading Statistics – Lessons from Ukraine's Example

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In recent years, a growing emphasis has been put on results measurement and also on using hard data to evaluate and steer policy. Given the significant efforts in many countries to simplify business entry, this has led to an interest in using data from business registries to compare the number of businesses and the dynamics of entrepreneurship across countries.

Significant differences between the officially reported figures on entrepreneurship (which get reflected in international indices) and the real situation mean that the design of reform interventions and solutions can be seriously misguided. The government as well as the donor community, and not least IFC, need to take this into account when designing programs aimed at fostering private sector development. Paraphrasing the well-known slogan "what gets measured, gets done" – "wrong measurement will lead to wrong actions!"

Measuring is essential…but measuring what?

When asked last year about the survival rate of Ukrainian companies, the IFC Business Enabling Environment (BEE) project team was unable to respond immediately, as such data are not computed by the State Statistics Committee of Ukraine. The team volunteered to look into the data and try and calculate it.

The routine process (we thought) of examining both databases in order to calculate the survival rate suddenly yielded some startling and unexpected results. The most striking differences were that WBG ED reported more than twice the number of companies than the IFC BEE project had thought there were in Ukraine. In addition, the annual growth rate in the number of companies appeared to be much less according to WBG ED than according to the BEE project +4.3 percent,against +7.1 percent a year. In short, entrepreneurship in Ukraine appeared more developed (higher numbers) and simultaneously less dynamic (lower growth) according to WBG ED. Efforts got underway to try to understand this discrepancy. In this SmartLesson, we share what we learned in the process.

> The World Bank Group Entrepreneurship Database (WBG ED), a joint effort led by the IFC Small and Medium Enterprise (SME) Department and the World Bank Development Research Group, is known as the most comprehensive dataset on cross-country firm entry data available today. It includes cross-country, time-series data on the number of total and newly registered businesses and was collected directly from the registrars of companies via questionnaires. On the other hand, the IFC Ukraine Business Enabling Environment project has for several years been collecting data on the number of registered and active companies in order to structure the sample for business environment surveys and to provide basic data on the evolution of entrepreneurship in the country.

It is worth noting that the discrepancy is already considerable when one looks at companies. When attempting to count sole proprietors, the gap between registered and active worsens – in Ukraine, though no official data are available, it is estimated that only about one quarter (24 percent) of the 1.98 million registered sole proprietors are active.[1]

Lessons Learned

1) "Global-local": your key to better data

Officers working for a national statistics agen-

1 According to "Omnibus" survey conducted by IFC BEE project in Ukraine in 2007.

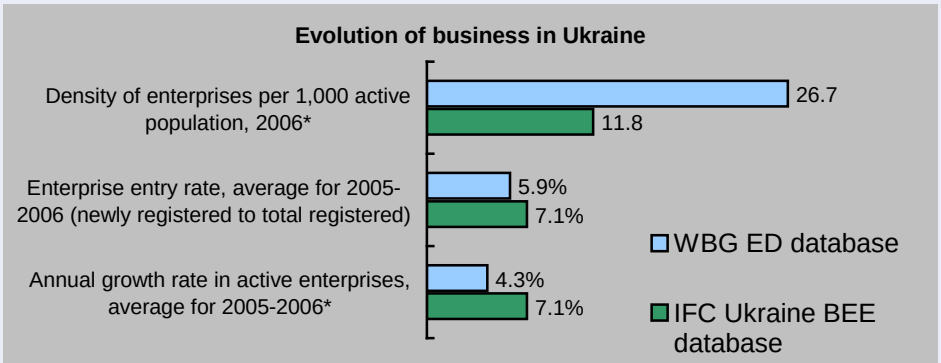


Chart 1. Enterprise demography in Ukraine – conflicting pictures…

cy may not have sufficient legal or economic expertise, or be familiar with international practice. Often they do not want to provide more information than required in their work plan. When one fills a request to compute aggregates from their datasets, at best they provide what one specifies in the request letter. No wonder that if any question is slightly vague, the request will be answered in a haphazard way. In addition, statistics in each country have their peculiarities in terms of definitions. To deal with these issues in Ukraine, we used our local experience of how business statistics are structured and our global knowledge of what should be considered as an enterprise. Our project found that, while not being a major part of official statistics on businesses, data on active companies in Ukraine are available. To separate entities that correspond to the internationally acceptable definition of enterprise, from others that are registered in the state registrar, but do not carry out commercial activity or do not fit the Eurostat definition, required joint work by the project's legal experts and economists to match the list of 'legal and organizational forms set by national legislation with the above definition.

Cooperation between local World Bank Group teams and the WBG ED team can help in understanding the specifics of each country's statistics and gathering more reliable statistics that reflect better the real situation of entrepreneurship and allow meaningful international comparisons.

2) Define what you count

Despite the fact that international definitions of enterprises or businesses do exist, there are still ample variations, and the rules that govern what statistical offices do largely reflect institutional and administrative arrangements that exist in their country. Therefore indicators of business demography may differ from country to country. For the purpose of our work in Ukraine, we adopted the definition used by Eurostat: **"The enterprise is the smallest combination of legal units that is an organizational unit producing goods or services, which benefits from a certain degree of autonomy in decision-making, especially for the allocation of its current resources. An enterprise carries out one or more activities at one or more locations. An enterprise may be a sole legal unit.[2]"** This definition is consistent with the one used in the 1993 System of National Accounts and International Standard of Industrial Classifications.

Table 1: Number of Enterprises and Corporations per Different Definitions

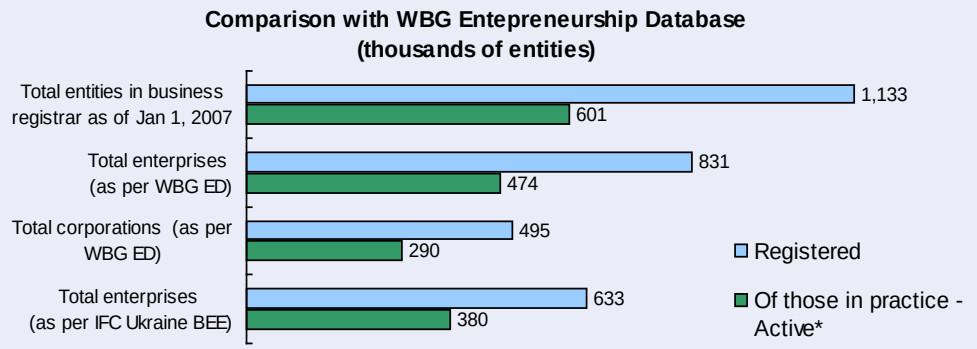
INDICATOR	*REGISTERED*
Total entities in business registrar as of January 1, 2007	1,330,200
of them:	
Total enterprises (per WBG ED)	830,719
Total enterprises (per IFC Ukraine BEE)	632,759
Total corporations (per WBG ED)	494,730
Total corporations (per IFC Ukraine BEE)	443,046

Aiming to have indicators that could be comparable across countries, we applied these criteria to include only certain types of legal entities registered in the Ukraine Business Registry. Namely:

- **LEGAL FORMS:** *We include market-oriented legal forms (e.g., limited liability companies, partnerships), but exclude business units in the central and local government sectors, associations, and unions. Due to the sub-optimal quality of the data, we also exclude sole proprietors[3] (which are also excluded from the WBG ED data for Ukraine);*

2 Council Regulation (EEC) No 696/93 of 15 March 1993 on the statistical units for the observation and analysis of the production system in the Community.
3 According to results of a population survey conducted by IFC in April-May 2007, the number of active sole proprietors is about a quarter of the official data on registered sole proprietors.

- **OWNERSHIP:** *We exclude business units owned by the central or local government; and*
- **ACTIVITIES:** *Production, construction, distributive trades, and services are covered, but agriculture, public administration, non-market, and extraterritorial activities are not. This is mainly to comply with the current coverage of statistical business registrars in most OECD and EU countries[4] - agriculture is typically excluded because of its specificities, which mean it is difficult to aggregate "farms" and "enterprises" in a meaningful way.*



* Since WBG ED does not provide data on active entities, the respective number was derived from IFC Ukraine BEE dataset.
Source: State Statistics Committee of Ukraine; WBG ED

Chart 2. A closer look: Which businesses are active?

About 60 percent out of over 1.1 million Ukrainian legal entities (not counting sole proprietors) satisfied this definition of enterprise in 2006. On the contrary, the dataset provided to WBG ED was not filtered to eliminate categories that are excluded from the Eurostat definition of an enterprise (see Table 1 for details). Business statistics regularly published by the Ukrainian State Statistical Committee does not make use of the above definition, either. The differences apply both to "enterprises" and to "corporations" as defined by the WBG ED questionnaire (see table on the next page).

3) Sort out the active from the inactive

The figure of 494,730 corporations reported by WBG ED corresponds to registered entities and corporations in Ukraine, irrespective of their being active or not (despite the fact that the questionnaire requires the data supplier to report only businesses considered to be active[5] - a requirement that was obviously overlooked by respondents). Given the heavy regulatory barriers to exit, however, and the absence of a systematic "clean-up" of the business registry's database, the total number of registered companies is far higher than the total number of active companies.

Data on active companies in Ukraine is not available directly from the business registrar, but nevertheless can be obtained from official statistics[6]. We define here active businesses as those, which pay taxes. This is a slight simplification, of course, but by and large acceptable[7]. The data on active businesses thus comes from the State Tax Administration and are matched by the State Statistics Agency on a quarterly basis with data from state registrar.

4) Wrapping it up: Wrong picture, wrong conclusions, wrong policies ...

The data reported to WBG ED significantly overstates enterprise density in Ukraine, making the country look "more developed" than it really is. Since in the country statistics on registered entities tend to be used by policymakers and the government, this false image of a country with an enterprise density "equivalent to the EU average" (once one includes sole proprietors, of which the vast majority are inactive!) is widespread. This means that, in-country and outside, the considerable problems that affect enterprise development and limit market entry, enterprise growth, and competition are underestimated. So too is the rate of annual growth in entrepreneurship, meaning that it is faster than usually believed, but from a much lower base.

What this discrepancy in data shows, on the other hand, is the effect of bad regulation. Since market exit in Ukraine is very difficult (according to Doing Business 2008, Ukraine ranks 140 out of 178 countries on barriers to closing a business), most companies that stop operating nevertheless remain registered. As such, the difference in data can also be treated as an indicator by itself as a backlog of inactive businesses.

Different picture, depending on the dataset you use

Good policymaking would require data that adequately indicate not only the number of enterprises and how this compares with international averages, but also the survival rate of new businesses, which is a key indicator. The State Statistics Committee of Ukraine does not publish data on survival rates, nor is it possible to compute this indicator

4 Specifically, companies accounted for here are filtered by their main type of activity Industry, Construction, Trade, Public Catering and Hotels, and Transportation Services are included; Agriculture/Forestry, Public Administration, and extraterritorial activity are excluded. See also Eurostat-OECD Manual on Business Demography Statistics, OECD, p. 13 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-07-010/EN/KS-RA-07-010-EN.PDF.
5 See footnote 4 to questionnaire.
6 Data on active enterprises originate from matching the list of taxpayers provided by the State Tax Administration of Ukraine with the list of legal entities provided by Unified State Register of Enterprises and Organizations of Ukraine. The matching is done on a quarterly basis by the State Statistics Committee of Ukraine, and IFC Ukraine BEE data were obtained directly from it.
7 While mostly not applicable in Ukraine, there might be several reservations tor this approach in other countries: a) enterprises which do not file returns in a regular way due to the tax holidays provisions would not be in that list; b) if there are thresholds below which enterprises should not file tax returns, these enterprises are out of the list; c) if enterprises did not perform any business activity in a specific year and did not file tax returns, but would go back into business using the same legal entity next year, such enterprises would not be in the "tax returns" list for a given year. Overall, using enterprises paying taxes as a proxy for active enterprises is still the best solution available, and it is the one that the Ukraine State Statistics Committee has chosen.

from WBG ED (since it provides data only on registered entities, and a survival rate indicator is applicable only to active entities). Our estimates[8] show that the 1-year survival rate for Ukraine was 91 pecent and the 2-year survival rate was 81 percent. This is a rather high rate, and only further research would determine how much is due to the business cycle (Ukraine has enjoyed growth rate of around 7 percent for several years), and how much to a lack of competition, which actually can shield existing firms from those that do not make it over significant regulatory hurdles.

Overall, the lack of statistics reflecting the true picture, and the difficulty in making meaningful international comparisons on such a basis, means that policy decisions risk being inadequate – in this case, decisive action would be needed to facilitate business entry, business survival…and business exit! Still, if one looks at the growth rate, it appears that previous business entry reforms (adopted partly thanks to IFC and WBG support) have started to yield results…

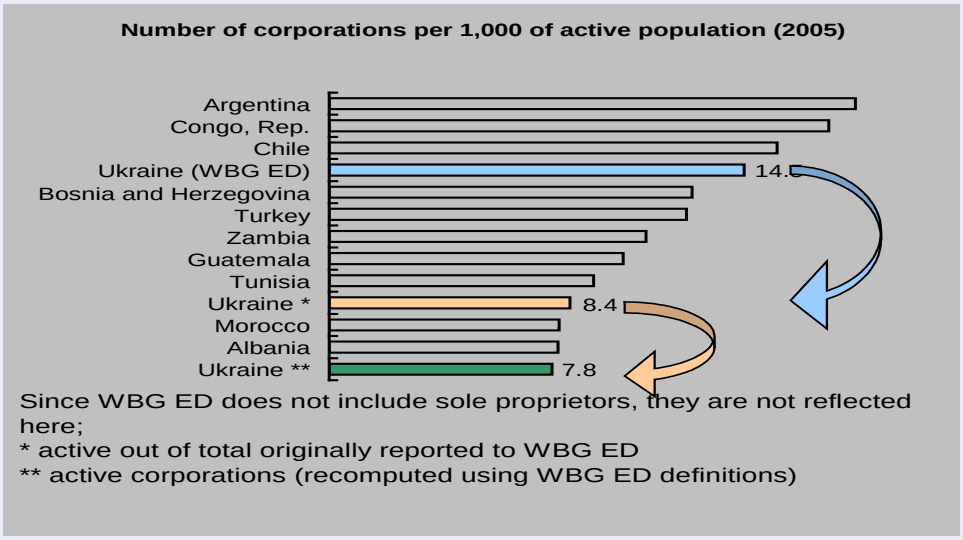


Chart 3. How you count influences where you stand…

8 The estimates are based on the data obtained from State Statistics Committee of Ukraine by our special request and are computed according to the methodology used by Euro stat (Eurostat-OECD Manual, Op. cit., p.97). 'The survival rate of newly born enterprises in a given reference period is the number of enterprises that were born in year xx-n and survived to year xx as a percentage of all enterprises born in year xx-n'.