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# IFC SmartLessons

*real experiences, real development*

## ABOUT THE AUTHORS

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## Show Me the Money II: From Concept to Practice

*More than a year and a half has passed since IFC Advisory Services in Eastern Europe and Central Asia (AS ECA) introduced a standard methodology for assessing aggregate cost savings (ACS) for businesses resulting from IFC-supported Business Enabling Environment (BEE) reforms. Within the region, 13 regulatory reforms in six countries have been assessed with this methodology, showing an estimated \$301 million in cost savings for the private sector with an average impact of \$29 for every dollar spent on these advisory projects. These results look impressive, but they also raise questions on the concept and application of the methodology: How do we know this is adequate impact for the resources invested? What else needs to be done to refine the approach? Can these types of impact measures be applied as decision tools at the program level?*

*On a global level, a review of project supervision reports from the current active BEE portfolio reveals that 15 projects are reporting on the corporate-wide standard ACS indicator. Thus, another question emerges: What does it take to implement a consistent approach across regions?*

### Background

The ACS methodology was adapted from the extensive work done in the area of impact evaluation for regulatory reforms by various researchers in the European Union, the Organisation for Economic Cooperation and Development, and the United States, as well as analytical work conducted by Foreign Investment Advisory Service (FIAS). The methodology assesses aspects of the business environment before and after the IFC-supported reforms are enacted by the government in order to quantify the changed costs for SMEs undertaking the given procedure. Two types of costs are considered:

*Direct costs* include the economic costs (labor or administrative costs) to an enterprise related to the regulatory procedure before and after the reform.

*Indirect (opportunity) costs* include the impact on profitability due to the productive use of time that would otherwise have been dedicated to completing the regulatory procedure. For example, if registration time is reduced, then the SME can begin operation and collect revenues earlier.

A summary of the methodology is available in the annex, and a more detailed version can be found in the SmartLesson "[Show me the Money: Quantifying the Impact of Regulatory Simplification Projects](#)," published in June 2007.

The following lessons learned highlight the key issues that were considered while operationalizing the impact evaluation methodology.

### Lessons Learned

#### 1) Implementation: Simplicity and a conservative approach are key

Success factors:

- Provide a simple, easy-to-use Excel template for the project teams.
- Rely on conservative, data-supported approach focusing on direct impact.

After we completed the first "Show Me the Money" SmartLesson, we discovered that the conceptual framework was not sufficient to allow easy data collection of impact results on

the ground. Individual projects operate in widely different environments with varying priorities and resources. The project teams could do little with the formulas and the overall description of data points that were needed, as outlined in the methodology note. Explaining how every calculation has to be made to every team member was a daunting task. Therefore, the initial focus in 2007 was on turning the conceptual methodology into a practical, self-explanatory Excel-based tool<sup>1</sup>, which allows for the entry of very clear and predefined data points. This simplified Excel-based tool can be implemented at the project level in diverse environments with minimal support and training required. Once it was shown to work in the field, the regional monitoring and evaluation (M&E) team focused on ensuring that the methodology was applied uniformly across projects and products to ensure consistent results.

To gather input for the Excel-based template, public data are used whenever possible, supported by surveys and other credible sources.<sup>2</sup> To increase the simplicity and reliability of the methodology, the template focuses only on immediate impacts that can be attributed to the regulation, quantified and supported with data. By avoiding attempts to measure secondary impacts, such as social benefits, effects on rate of formalization, etc., the resulting tool is very simple for projects to use with impact results that are easily verifiable and that can be aggregated across different projects. The downside to this approach is that the methodology cannot be applied to every type of reform and will only collect a portion of the overall impact achieved. Although various approaches to measuring some secondary benefits of regulatory change have been considered, thus far no standard solution has been found that can be rolled out across multiple projects. This is our key challenge going forward: how to expand the scope of what gets quantified while still maintaining the simplicity of the tool, which has been a key success factor so far. For the time being the secondary benefits can still be captured through qualitative assessments.

Implementation also involves a number of judgments about what to include in the impact calculation. For example, a common issue is how much involvement a project must have in a given regulatory reform in order to count and attribute its impact. The ECA region has maintained a conservative guideline that requires projects to demonstrate significant contribution to a regulatory change in order to count the impact. Significant in this case means direct and verifiable involvement in the design of the specific reform as well as a close and sustained relationship with the government partner designing and implementing the reform. This has to be demonstrated via evidence of assistance provided in—

- *drafting the required policy papers to agree on the reform*
- *drafting the legislation enacting the reforms; and/or*

<sup>1</sup> Please see the related documents section on the SmartLessons Web site, below the abstract for this paper.

<sup>2</sup> In most cases, publicly available data sources are sufficient to calculate the impact of reforms. These data sources include state statistics agencies, various government ministries and agencies, enterprise surveys, and Doing Business reports. Other sources of data that are used include focus groups, expert estimates, and targeted surveys conducted as part of the BEE project.

- *designing the related administrative reforms at the agency level.*

These dimensions are critical for solid attribution of the impact to the IFC project. Impacts of reforms where IFC's input can be questioned are not included. For example, the region has been tracking but not including in the impact calculations the reforms that have been implemented based on the general recommendations provided in policy papers or survey reports that the projects publish. Since 2005, these projects have contributed to amendments or revisions of a total of 53 regulations enacted by the governments, but we have quantified the impact of only 13 reforms that have met the criteria for significant contribution from IFC and lend themselves to this type of quantification (See Lesson Two).

Relying on easily accessed data sources, using a simple template, and maintaining a conservative approach of only measuring what can be supported by the data and is clearly attributable to IFC, have been key to creating the consistency that allows for aggregation and comparison of data across different projects and countries.

## **2) Consistency: Impact measurement starts with project design.**

Success factors:

- *Incorporate the M&E template into project design.*
- *Be aware of the limitations in quantifying impact for different regulatory reforms.*

At project design stage, setting impact targets becomes an easier and more meaningful task with this measurement tool because it requires structured thinking about the potential impact of regulatory changes. This helps to structure projects around regulatory issues that are likely to yield the greatest impact. For example, a project design team evaluating various options for reforming business licensing can use the tool to conduct scenario testing on various regulatory reforms and determine which will have the greatest impact and affect the largest population. In addition, previous results quantified through the methodology can guide future targets. This data-driven, impact-oriented approach has also been welcomed by the donors funding the BEE programs in the region such as the Swiss State Secretariat for Economic Affairs (SECO), the UK Department for International Development (DFID), the Canadian International Development Agency (CIDA), the Swedish International Development Corporation Agency (SIDA), and the Agency for International Business and Cooperation (EVD).

Finally, the ability to measure impact with this methodology is largely shaped by product and the ease of quantifying various reforms. ECA experience has been that the current methodology is very effective for business operations and business entry or exit and likely for tax simplification<sup>3</sup> but

<sup>3</sup> Tax product in ECA is in the early stages of development and is yet to show its full potential. Preliminary estimates based on tax reform projects elsewhere suggest that tax simplification reforms have the potential to yield significant benefits for the private sector and affect essentially all businesses. FIAS experience from the late 1990s in Latvia showed tax simplification to be the area with largest impact by far (156

perhaps may be somewhat less effective for other products, such as legal reforms aimed at investor protection or substantive provisions of the tax code. The reason for this is that the nature of changes enacted—procedural changes and changes to the requirements that the business has to satisfy to engage in a certain activity—lend themselves to quantification relatively easily. (All of these requirements take time and resources to comply. Once we know the time, we can express it in monetary values.) At the same time, improvements in legal provisions for minority shareholders or improvements in cost-deduction rules for tax purposes cannot be quantified this way. Quantifying these improvements would require a different set of data that is not as easily available in our countries of operation. The response on a product level should be to expand the methodology where feasible to capture the benefits of reforms and contribute to project design decisions but, at the same time, to ensure that the cost savings indicator is not prioritized to a degree that would result in the exclusion of reforms that can't be easily quantified.

### 3) Evaluation: Interpreting the results is as important as collecting them.

Success factors:

- *Normalize impact on an aggregate level.*
- *Standardization of impact calculation methodology IFC-wide is a key next step.*

Table 1. Results by country<sup>4</sup>

Country	Key Reforms	Reforms by Product	Impact (MUSD)	\$ Impact/\$ spent	\$ Impact/# registered businesses <sup>5</sup>
Azerbaijan	Registration	Entry/ Exit	\$8.3	24	47.5
Belarus	Registration	Entry/ Exit	\$21.5	9	86.3
Georgia	Mining Regulation	Operations	\$1.3	1	1.6
Tajikistan	Inspections, tax admin	Operations	\$11.2	6	79.8
Uzbekistan	Inspections, permits, registration, liquidation, tax admin	Operations, entry/ exit, taxation	\$47.1	35	95.1
Ukraine	Inspections, permits	Operations	\$212	63	70.1

Some of the impact data generated in ECA are shown in the following tables.

Initially, we looked only at the total impact per country. From these results, it became apparent that we needed to normalize the impact numbers so that there could be meaningful comparison across countries. Larger economies produce larger absolute impacts simply due to the greater number of businesses affected by the changes. As a result it is difficult to compare \$200 million in cost savings in Ukraine with \$11 million in Tajikistan. To address the issue, additional

MUSD of 171.5 MUSD of total cost savings). FIAS Occasional Paper #18 by Sanda Liepina, Jacqueline Coolidge, and Lars Grava (November 2007). [http://www.ifc.org/ifcext/fias.nsf/Content/FIAS\\_OccasionalPapers](http://www.ifc.org/ifcext/fias.nsf/Content/FIAS_OccasionalPapers)

<sup>4</sup> For 13 ECA BEE supported specific regulatory reforms for which impact was quantified with this methodology.

<sup>5</sup> Including legal entities (companies), sole proprietors, agricultural enterprises (farms).

metrics normalized for country size have been introduced. These include the cost savings as a percentage of the private-sector share of GDP and the cost savings per registered business entity in the country.

Table 2. Results by country type

Country Type	\$ Impact/\$ spent	Impact as a % of private sector shared of GDP			Impact per registered entity		
		Ops	Entry/Exit	Tax	Ops	Entry/Exit	Tax
MIC	122	0.2%	0.02%	NA	67	7	NA
IDA	35	0.1%	0.06%	0.01%	44	24	5

We also looked at the impact by the income group. The table 2 shows that while middle-income countries (MIC) do very well in absolute dollar terms, when the same results are put into perspective, based on GDP and the number of registered entities, the trends and possible impact lessons that could be derived from the data look quite different.

Even with normalized data for countries within the region, we still do not know if the level of impact generated in this region is adequate, compared to what IFC could achieve with the same resources and products elsewhere. In order to do this, we need a standard impact measurement methodology across all regions. The current practice where each region assesses impact by its own methodology weakens the aggregate results and makes it more difficult to tell a compelling and credible story about the work being done by the business line and what impact we have on private-sector development globally. Discussions with different regions indicate that there is interest in pursuing this, assuming endorsement from the BEE business line and the IFC Results Measurement Unit.

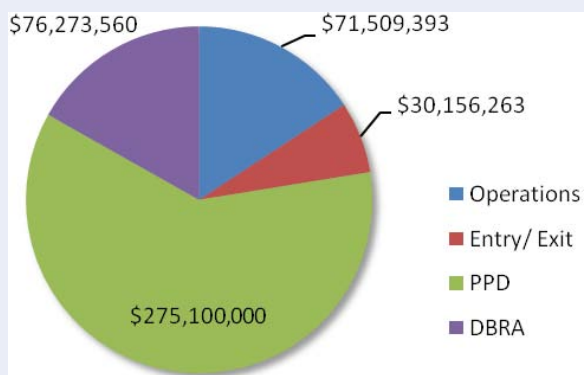
To introduce a uniform approach across all regions to allow for meaningful aggregation and comparison of impact data, we need to address several issues:

- *Attribution: There is no standard for attribution among products such as the public-private dialog (PPD), the Doing Business reform advisory, and business operations. PPD projects in the Mekong region have addressed this issue in their impact assessment,<sup>6</sup> and some business operations projects have regional standards; but these are not unified across different regions.*
- *Timeline: Some impact results are calculated over a multiyear timeline while others are not, which leads to inconsistent reporting of impact. In ECA, the impact is calculated on a one-year horizon to maintain a consistently conservative approach; some regions include a three- or five-year outlook.*

<sup>6</sup> Impact Assessment of the Public-Private Dialogue Initiatives in Cambodia, Lao PDR, Vietnam. Accessed through IDESK for Capacity Building for Public Private Dialogue project (539685).

Table 3. Aggregate Cost Savings by Region and Product globally<sup>7</sup>

REGION	# OF PROJECTS USING ACS INDICATOR	TOTAL VALUE (USD) OF REPORTED ACS
SSA	2	114,001,932
EAP	5	279,679,769
ECA	4	33,955,917
LAC	3	768,372
CSA	1	8,000
<b>Total</b>	<b>15</b>	<b>428,413,990</b>



- *Documentation: Very few projects provide supporting information in the Project Supervision reports on the impact being counted, the nature of the reforms, or the methodology used in the calculation of the value.*

As a result, while technically we do have aggregate data for the business line (Table 3), we cannot rely on it for meaningful analysis.

## Conclusion

The strengths of this methodology are ease of use at the project level and the ability to meaningfully aggregate the results across projects. The tradeoff for this simplicity is that the methodology provides a conservative estimate without evaluating most of the secondary impacts. There are several opportunities to continue to develop the methodology to address some of the current limitations, but the immediate need is for a standard system to be implemented across all BEE projects globally. Deciding on a common approach will increase the data available for analysis and the resources available to help develop the methodology.

<sup>7</sup> Active portfolio, December 31, 2008. Data collected from PSRs. Data from global projects reflected in regional portfolios to avoid double counting. The total sum of aggregate cost savings reported through PSRs as of FY09Q2 is \$836.5 million, however when corrected for double counting with "world projects" and visible data entry mistakes, the aggregate results, shown below, fall to \$428.4 million

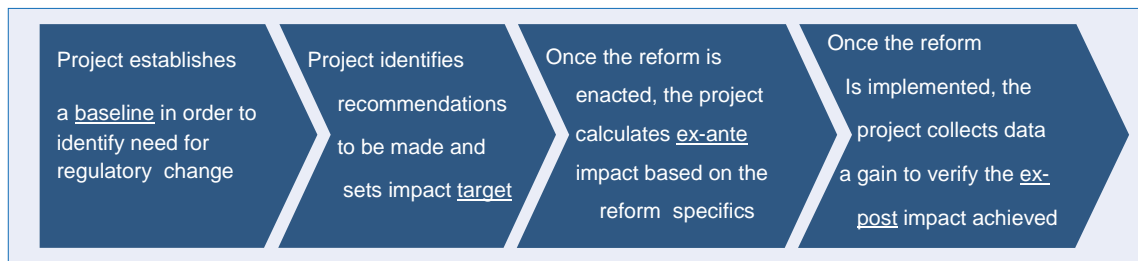


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## ANNEX 1: Quantifying the Impact of Regulatory Simplification Projects

By comparing specific aspects of the business environment *before and after*<sup>1</sup> IFC-supported reforms are enacted by the government, it is possible to quantify the benefits accruing to the target population, i.e., the aggregate private-sector cost savings. The methodology described below can be used to assess the economic cost for businesses at four distinct stages along the reform cycle:



### Detailed methodology:

It distinguishes between two types of costs on businesses:

- **Direct costs:** *direct impact on economic cost (labor or administrative costs) of an enterprise resulting from the reform of regulatory procedure*
- **Indirect (opportunity) costs:** *impact on revenues or costs, due the different use of time formerly dedicated to administrative procedures.*

To the extent possible, all of the data below should be specific to the affected sample of firms. For example, if the reform affects small farmers differently than it does individual entrepreneurs, the calculations below should be made for each subsector of the economy and then summed at the end for a total impact. If the data are not available at the subsector level, then countrywide data can be used as a substitute.

### Direct Costs

Direct costs can be estimated at firm level, at a specific economic sector level, or for the SME sector as a whole, depending on the set of data available for each. The calculation of direct costs makes use of basic indicators and, in particular, leverages IFC experience with surveys in the region. Direct costs can be differentiated between **administrative costs (AC)** and **labor costs (LC)**.

**Administrative costs (AC)** can be calculated for each procedure by multiplying the cost of the procedure<sup>2</sup> by the number of times the procedure is undertaken by a representative firm per year:

**Labor costs (LC)** can be calculated for each procedure by multiplying the cost of employees directly dedicated<sup>3</sup> to the given procedure by the number of times the procedure is undertaken by a representative firm per year:

Total direct cost is calculated as the impact on net profits of administrative and labor costs (AC + LC). A variation in administrative and labor costs increases gross profits but, in turn, will imply higher profit tax, i.e. reducing the total impact. For this reason, in order to calculate direct costs effects, an estimated average profit tax rate<sup>5</sup> will be needed. The average tax rate can be estimated for the overall economy or be differentiated according to the typology of businesses (i.e. individual entrepreneurs versus legal entities) or economic sectors.

**Total Direct Cost = (AC + LC) \* (1 - t) \* F**

t = Average profit tax rate  
F = Number of firms affected by the given procedure

$$AC = (P_o + P_u) * N$$

$P_o$  = Cost of official payments related to the completing the given procedure (data available from official sources)

$P_u$  = Cost of unofficial payments related to the completing the given procedure (data available from surveys or estimated as a % on top of the official costs)

N = Number of times the given procedure is undertaken by a representative firm per year

$$LC = D_e * W * N$$

$D_e$  = Number of full-time employee working days dedicated to the given procedure

W = Average daily employee wage

N = Number of times the given procedure is undertaken by a representative firm per year

<sup>1</sup> IFC ECA understands that, under ideal circumstances, impact assessments would involve the use of experimental analysis to compare the counterfactual of an IFC intervention rather than a before-after comparison. However, given that in our region the relevant legislation exists at the national level, it is not possible (or advisable) to construct municipal-level comparisons for the sake of impact assessment. We believe that this methodology provides a sound alternative in cases where project intervention occurs at the national level, i.e., cases where it is virtually impossible to assess impacts using experimental methodology.

<sup>2</sup> IFC BEE surveys collect data on total costs of the procedures, which are represented by the sum of official and unofficial payments.

<sup>3</sup> These estimates assume that the employee time can be disposed of or dedicated to other administrative activities (versus revenue-enhancing ones)

<sup>4</sup> Including all social benefits costs.

<sup>5</sup> Estimated taking into account, among other factors, the share of revenues officially reported.

## Indirect Costs

Indirect costs require a more detailed approach to calculations and greater use of assumptions. Overall, we distinguish between two main categories of opportunity costs: those related to **delay of entry (DE)** and those resulting from **temporary closure (TC)** of a firm's activities:

**Delay of entry (DE)** costs are those resulting from a new firm's entrance to the market, i.e., costs from the deferral of launching profit-generating activities. Examples of these types of procedures are business registration, the first time a firm applies for a specific permit or license, or any other entry controls. The cost of this delay can then be measured as the proportion of profits "lost" due to delayed entry into the market, i.e. by multiplying the annual net profit for start-up companies by the proportion of working days spent on the given procedure:<sup>6</sup>

**Temporary closure (TC)** costs result from suspension of a firm's activity, i.e., the loss of productive activities for existing companies. Typical examples of procedures stopping economic activity are inspections, repeated licenses, repeated permits, and the suspension of activity due to the absence of licenses or permits. These costs are typically faced by existing companies and should only be calculated in cases where the closure or suspension was unjustified, or only for that subpopulation of firms that appealed and overturned the closure or suspension.<sup>7</sup> The cost of this delay can be calculated by multiplying the average annual loss of a company whose activities are stopped by the proportion of working days that a company is stopped by the number of times the procedures is undertaken by a representative firm per year:

$$TC = L * (D_c \div D_s) * (1 - t) * N$$

L = Average annual losses for an active firm whose activity is stopped but which remains active, i.e. which retains all its production factors  
DC = Average number of working days a firm is closed due to the given procedure  
DS = Average number of working days per year in the economy/sector  
t = Average profit tax rate  
N = Number of times the given procedure is undertaken by a representative firm per year

$$\text{Total Indirect Cost} = (DE * F) + (TC * F)$$

F = Number of firms affected by the given procedure

## Total Costs

If we sum to total direct and indirect costs from the baseline and compare them to the summed costs for our target ex-ante- or ex-post calculations, we are able to calculate the one-off savings resulting from the passed legislation. As seen in the attached template, in order to ensure conservative numbers, wherever applicable, data from the baseline year (e.g. number of firms affected, wage levels, etc.) are used in calculating impact.

$$DE = P * (D_f \div D_s)$$

P = Average annual net profit for start-up firms, for each industry or average for the specific sector affected by the given procedure

D<sub>f</sub> = Average number of working days spent by firms in order to complete the given procedure

D<sub>s</sub> = Average number of working days per year in the economy/sector<sup>14</sup>

<sup>6</sup> Note that in the case of barrier to entry there is no need to multiply by the number of times the given procedure is undertaken in a given year; it is assumed that it is undertaken at most once a year.

<sup>7</sup> Please review Excel templates with calculations to see how this has been done, it can be achieved based on results of overturned cases of firm closure.