DIRECT REGULATORY CONTROL POLICIES AND THEIR ROLE IN SMALL ENTERPRISE DEVELOPMENT IN THE PHILIPPINES: ANALYSIS AND RECOMMENDATIONS

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The study described in this article details some specifications about the consequence of direct regulatory control policies of the government affecting small enterprises that contravene promotive policies for the development of small enterprises. Too many regulatory laws are passed that non-compliance becomes the mode of response by the firms. Enterprises must then contend with the balancing of the costs of legal compliance with the costs of avoiding such penalties. The firm loses in many respects while total productivity of the small enterprise sector suffers.

Some proposals for alleviating the situation are indicated.

INTRODUCTION

There is no doubt that the small enterprise sector is vital to the attainment of a country's long-term economic growth. Small businesses contribute substantially to the generation of employment opportunities and promote the use of indigenous technology, thereby keeping traditional industries alive, while in the process preserving the national identity.

The importance of small enterprises has long been recognized by the Philippine government, as evidenced by its numerous technical, financing, information and marketing programs. However, there remains the need to create a more conducive policy environment, one that will seriously address the problems and requirements of the small business sector. Without such an environment, program interventions will not be effective. Critical macro-policies include those relating to trade, monetary, fiscal, labor and direct regulatory controls. This paper focuses on direct regulatory control policies.

Small businesses, like their larger counterparts, operate within an environment replete with rules and regulations of various government agencies. Entrepreneurs are continually confronted with transactions that involve legal considerations. The complexity and volume of these control devices make it impossible for an entrepreneur to know all of his rights, responsibilities and opportunities. Often, he only recognizes them when legal emergencies arise. This is true when the entrepreneur chooses to operate within the law. Unfortunately, because of the inherent difficulties involved in understanding and complying with certain rules and regulations, many small business persons opt to avoid such regulatory requirements.

OBJECTIVES OF THE STUDY

This paper seeks to examine Philippine direct regulatory control policies and assess their impact on small enterprises development. Specifically, the study: reviews existing laws and regulations affecting small and medium enterprises and evaluates their significance in the promotion and development of this sector, identifies and analyzes the problems of small enterprises associated with direct regulatory, control policies, and examines policy options and reforms, and makes recommendations for enhancing the growth of small enterprises.

SCOPE AND LIMITATIONS

The present study examines only one of several macro-policy areas. However, because of the regulatory nature of this policy area, mention of issues covered by other macro-policies cannot be avoided. For instance, except in the case

of labor laws, the review of existing legal rules include those pertaining to such matters as taxes, trade and pricing. Because the study was conducted over a two-and-a-half month period, it draws heavily from secondary sources.

METHODOLOGY

The role of the small enterprise sector in the Philippines in relation to direct regulatory control policies was ascertained through a review of related literature, consultations with government representatives and representatives from the small enterprise sector, as well as limited observation of certain Philippine government procedures.

THE PROBLEM OF DEFINING SMALL ENTERPRISES

In understanding the impact of regulatory policies, it is crucial to define "small" enterprise, particularly where laws and regulations attempt to distinguish between large and small businesses. Unfortunately, there appears to be little consensus as to what constitutes a small-scale operation. Liedholm and Mead (1987) view the small enterprise as "a relative concept, and what is considered small in one country may be considered large in another."

Harper (1984) notes the result of a survey conducted by Auciello *et al*, in 1975, involving 75 countries. Over fifty different definitions of small enterprise were obtained, based on asset size, employment size, sales turnover, or some combination of these.

Table 1 indicates that employment size is the dominant criterion for scale definition among industrialized countries, while the combination employment size-asset size is more popular among the less developed nations, where the definition used varied depending on the purpose for which they were to apply.

There are problems associated with the use of employment size in defining the scale of a firm's operation. Liedholm and Mead (1987) note that the "limitations of using employment as a measure are the seasonality of labor, and its relative inappropriateness as a measure when employment promotion is a policy or program objective."

Even a dual mode of classification has its limitations. Business establishments that are capital intensive may have employment levels that fall within the definition of small-scale although they may actually be large-scale under the assets valuation classification method.

The main problem lies in the difference in the nature of processes and basic operations among the various industries. The Fundamental Law on Small and Medium Enterprises of Japan attempts to solve this issue by adopting multiple definitions. For the mining, manufacturing, transportation and construction sectors, a small firm is defined as one with ¥100 million[1] or less capital or 20 or fewer employees. For firms engaged in wholesale trade, small means ¥30 million or less capital, or 5 or fewer employees. For retail and service industries ¥10 million or less capital, or 5 or fewer employees is the relevant cut-off (MTI, 1983).

There are more technical problems arising from the use of assets size in defining the level of operation of an enterprise. Fajardo (1979) opined that, "The use of assets value as a criterion poses problems on true valuation since asset values are taken as the book value (depreciated) for each year. The fixed assets value will, therefore, exhibit a change for each year although the enterprise may still fall within the same size classification."

A more rational mode of classification has yet to be developed, not only for purposes of regulation, but even more importantly, for purposes of program intervention. In spite of the problems associated with the use of either employment size or assets valuation, these two variables are the most commonly used because they are relatively simple to measure and are easily obtainable. However, to avoid the possible problems brought about by inconsistencies in using both methods of scale definition, a classification scheme that allows cross references between these two measures would be more appropriate. In addition, the classification method must take into account the varying characteristics of the different industries. Thus, it is suggested that a classification matrix be developed for each industry or group of industries.

Table 2 illustrates how such matrix might look for the manufacturing sector. Some of the cells in the enterprise classification matrix shown in Table 2 have not been identified because they require closer examination. For example, while the possibility is remote that a firm employing at least 200 workers would have assets below ₱50,000, the question still remains whether such an enterprise would be considered micro, cottage, small, or medium. This can only be resolved after more careful study.

[1] Exchange rate in 1983 is: ₱1.00 - ¥4.73

OVERALL ASSESSMENT OF DIRECT REGULATORY CONTROLS

There are at least 175 non-labor laws and regulations affecting small and medium enterprises. A most prominent observation is that, in general, these regulations apply to all establishment sizes, and do not distinguish between large firms and small ones. Although there is no explicit disincentive to smaller firms, the policy environment created by such legal provisions is detrimental to the growth of small enterprises.

The cost of legal regulation and complying with all relevant regulations is apparently high, and relatively higher in the case of a smaller firm. An entrepreneur is expected to satisfy a host of regulations to meet the requirements of various government offices. Setting up a small business operation and having it registered involves a long list of steps and requirements that may take a number of months to complete. For instance, Figure 1 illustrates how a person would go about registering his business with the Securities and Exchange Commission, the Bureau of Domestic Trade and the Bureau of Internal Revenue. Because of the complexity involved, many entrepreneurs decide to avoid the law. Unfortunately, by so doing, they may end up devoting tremendous effort and resources trying to avoid detection. In either case, the small enterprise owner stands to lose.

While the legal costs of compliance, including time and money, are obviously high, by operating illegally, the entrepreneur must contend with the cost of avoiding the corresponding penalties and spend a substantial amount corrupting public officials (de Soto, 1989). On the other hand, the legal route entails spending a considerable part of the entrepreneur's time complying with government regulations, which inevitably affects his flexibility and causes his limited resources to be used inefficiently.

Policies create the structure within which businesses and government programs operate. Unfortunately, those policies associated with direct regulatory controls are often in conflict with government programs. This is particularly true in the case of programs designed to promote and develop small enterprises. Incentive schemes, training, financing and marketing programs are numerous but their reach has apparently been limited, due to the failure to communicate such programs and the inability of small entrepreneurs to handle the paperwork and other requirements of concerned government agencies.

A case in point is the BOI. Despite the good intentions of its programs, they continue to be perceived as exclusively designed for larger firms. The following observation was made by the Harvard Institute for International Development study team in 1984:

> BOI incentives continue to operate in a way that discourages domestic competition and encourages exclusively large investments by registered firms.
>
> Small and medium progressive firms, who neither have the contacts nor the resources to acquire registered status, are de facto excluded from a whole series of activities. BOI registered firms are handed the opportunity to monopolize the spoils which always accompany the introduction of new products." (Biggs, 1984)

Whether true or not, the above comment could just as well have been made by a small business entrepreneur. Consultations with the small/medium enterprises sector indicate that BOI has not been very successful in changing such negative impressions. Procedure for registration and availment of incentives are too complex causing small entrepreneurs to seek substantial external advice which adds on to the already high cost of compliance.

In 1988, the BOI embarked on a simplification of its own bureaucratic requirements which significantly reduced the processing time for applications for incentives. However, the requirements have not changed; only the internal procedures have been altered. In other words, small entrepreneurs may still be dissatisfied with the procedures that they must follow unless there is a further simplification and reduction of requirements. Evidence that the small enterprise sector has not really gained much from BOI incentives appears in the size-distribution of BOI registered firms.

Table 3 shows that there has been an increase in the number of small/medium enterprises which have taken advantage of BOI incentives from 1984 to 1988. However, the increase is small compared to the increase in the number of larger projects.

The Harvard Institute for International Development study revealed several problem areas in the country's regulatory control policies and these problems still persist today. Some observations cited in the study include the following:

- The general set of regulations on commercial banks covering resource requirements, agri/agro loan rules, gross receipts tax increase the cost of financial intermediation to the detriment of smaller firms.

- Transaction costs that boost the cost of financing, such as administrative costs associated with loan processing and collection as well as allowances for the risk of arrears and defaults - are perceived to be higher in the case of small business loans, relative to large enterprises.

- Customs laws and regulations allow excessive discretion to low-level authorities, resulting in the proliferation of "expediters" and "facilitators."

"The burdens of this system fall disproportionately on the smaller, less well-connected firms and firms that cannot afford a staff to deal exclusively with these problems." (Biggs, 1984)

The findings of the Harvard team are supported by the results obtained from consultations with small enterprise sector representatives. Those related to direct regulatory control policies include the following:

- Securing permits and licenses takes a long time, for both new businesses and renewals. Too much paperwork is a common complaint, along with unfamiliarity with the many rules and regulations, which a number of entrepreneurs perceive as frequently changing.

- Abuse of discretion and power among low-level government officials is prevalent. A related problem is government bureaucracy or red tape.

- A number of laws with good intent exist, but they are loosely enforced, to the disadvantage of small businesses. The Patent Law is a case in point. It does not seem to protect investors because action on applications takes too long, sometimes resulting in the abandonment of good products and projects.

- There is excessive centralization of administration and control in Metro Manila. This over-centralization has effectively made certain incentives and services available only to those establishments located in or near the National Capital Region or to those who can afford to send representatives there. There is often discrimination against enterprises in more distant regions, particularly small firms.

- Too many government agencies are charged with regulating business operations. The relative autonomy enjoyed by these institutions makes it possible for conflicting programs and policies to be formulated.

- Some legal provisions have been formulated without considering their possible consequences or the validity of assumptions they are based on. This is especially true when laws are patterned after those of developed countries.

- Local governments are often perceived by small firms as inefficient institutions prone to red tape and bribery. Entrepreneurs would rather deal with national government agencies such as the Department of Trade and Industry.

RECOMMENDATIONS

There is a need to continue encouraging small businesses especially in the countryside. Since one of the underlying causes of their present problems is government regulations, reforms in this area may improve the environment in which they operate. The following suggestions on the formulation of more effective measures are presented, although inevitably they will have to be considered in the broader context of economic, political, and social acceptability.

1. Review of Existing Laws and Regulations

The enforcement of existing laws and regulations could be enhanced if duplication of unnecessary parts of existing laws are removed, thus reducing the obstacles to small enterprise development. A thorough review of laws and regulations affecting small enterprises in the Philippines would be a first step toward achieving this goal. In addition, gaps in the system should be identified so that the need for new legislation can be better established.

It is important to consider the following points in this review:

- A number of legal provisions refer to agencies that have already been reorganized, abolished, or replaced. For example, PD 1517, PD 399 and PD

2016 make reference to the Ministry of Human Settlements and its satellite agencies.

- Some laws that are closely related could be consolidated for easier reference. Examples include:

  (1) PD 1893, PD 2016 and MMC Ord. 81-01 (Zoning)
  (2) PD 1151, PD 1152, PD 1121 and PD 1160 (Environmental)
  (3) RA 3931, PD 600, PD 1067 and CA 383 (Water Pollution)
  (4) RA 166, Commerce Adm. Order 2, DTI Adm. Order 1, RA 623, RA 3740, RA 71, CAO 1, CAO 2-C, 2-B and 2-C (Labelling/Price-Tagging)
  (5) CA 138, RA 5138, EO 64, EO 665, EO 666, GSA-SCO Memo (1986) (Government Procurement)

2. Decentralization and Deregulation

There is not enough decentralization of government line agencies. Although the Department of Trade and Industry has regional offices, other institutions with critical roles that affect small business operations have offices only in Metro Manila. Thus, the transaction costs of complying with the laws and availing of incentive programs are higher for enterprises in other regions. Transferring regulatory responsibilities to the regional or local governments or setting up satellite offices could allow the authorities to be in more direct contact with the small businessmen and their concerns. Another way of reaching the small enterprise sector is to expand assistance efforts delivered by NGOs and other grassroots level organizations.

3. Simplification of Procedures

The amount of paperwork and requirements associated with government regulations for registration, licensing or accreditation, is a disincentive for entrepreneurs to become formal sector firms. Many of these requirements have little benefit and could be eliminated to reduce processing time and compliance costs.

One reform might be to minimize the number of times an entrepreneur must go back to the same agency. In the short run, better information can be helpful in providing applicants with a checklist specifying the requirements and timetable for approvals.

A more fundamental reform would be to establish a one-stop processing center for small enterprises. This center could be composed of representatives from various agencies and would serve the following functions:

- Perform preliminary evaluations of the project.
- Advise entrepreneurs on existing government programs that can meet their needs.
- Assist entrepreneurs in handling governmental procedures and requirements.
- Direct entrepreneurs to relevant private associations, support services, and other non-governmental programs. Preparation of a small enterprise program package could allow the entrepreneur access to all services in a smaller number of transactions.

Table 1

BASES FOR DEFINING SCALE OF BUSINESS OPERATION

Basis for Definition	Number of Countries Employing This Basis	
	Less Developed Countries	Industrialized Countries
Employment Size	6	9
Assets Size	10	1
Sales Turnover	1	-
Employment Size and Sales Turnover	1	2
Employment Size and Assets Size	16	3
Sales Turnover and Assets Size	1	-
Employment Size, Sales Turnover and Assets Size	4	1
	39	15

Source: Harper (1984).

Figure 1

SMALL - MEDIUM ENTERPRISES

Register the Business

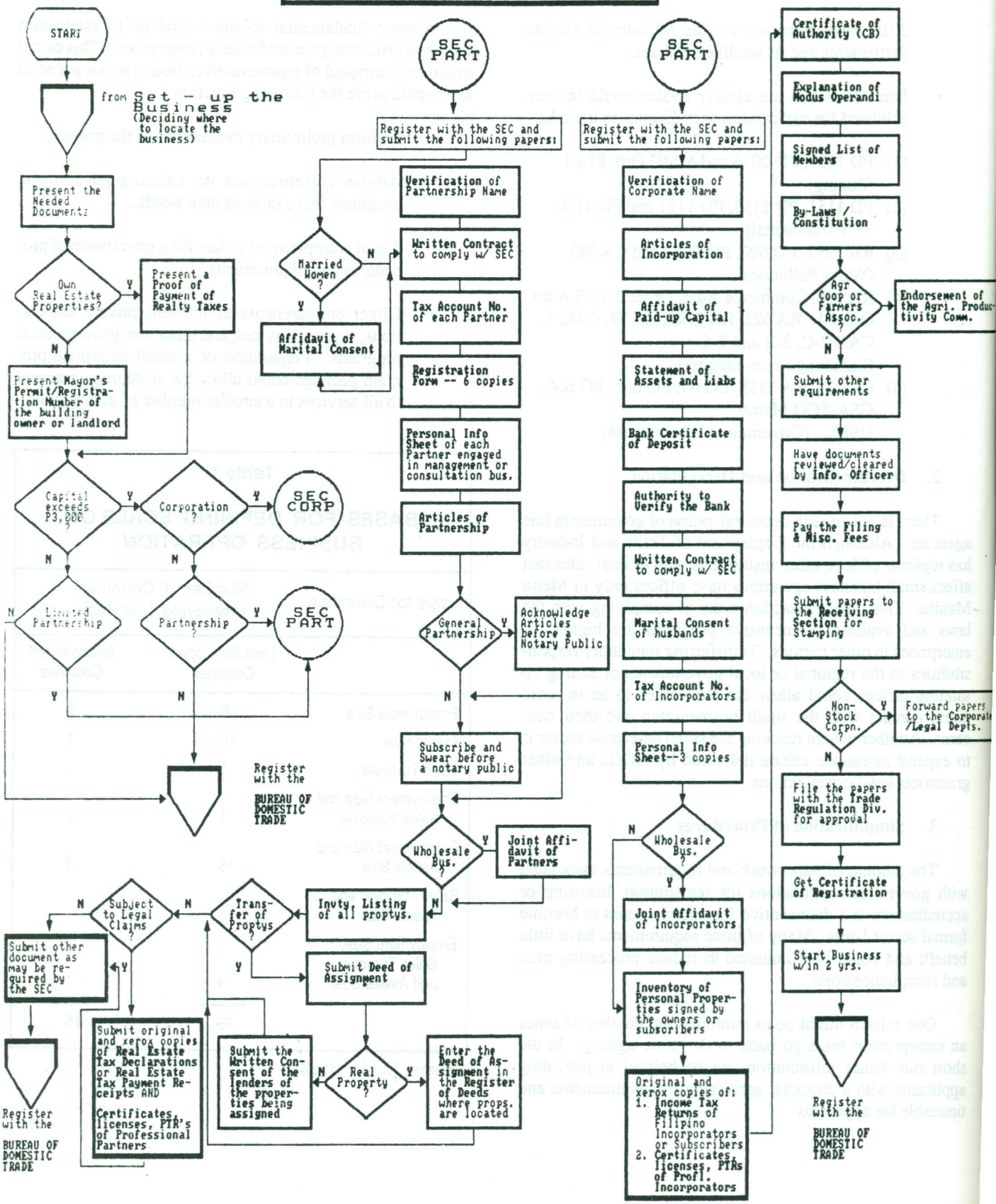

Figure 1, cont.

SMALL - MEDIUM ENTERPRISES

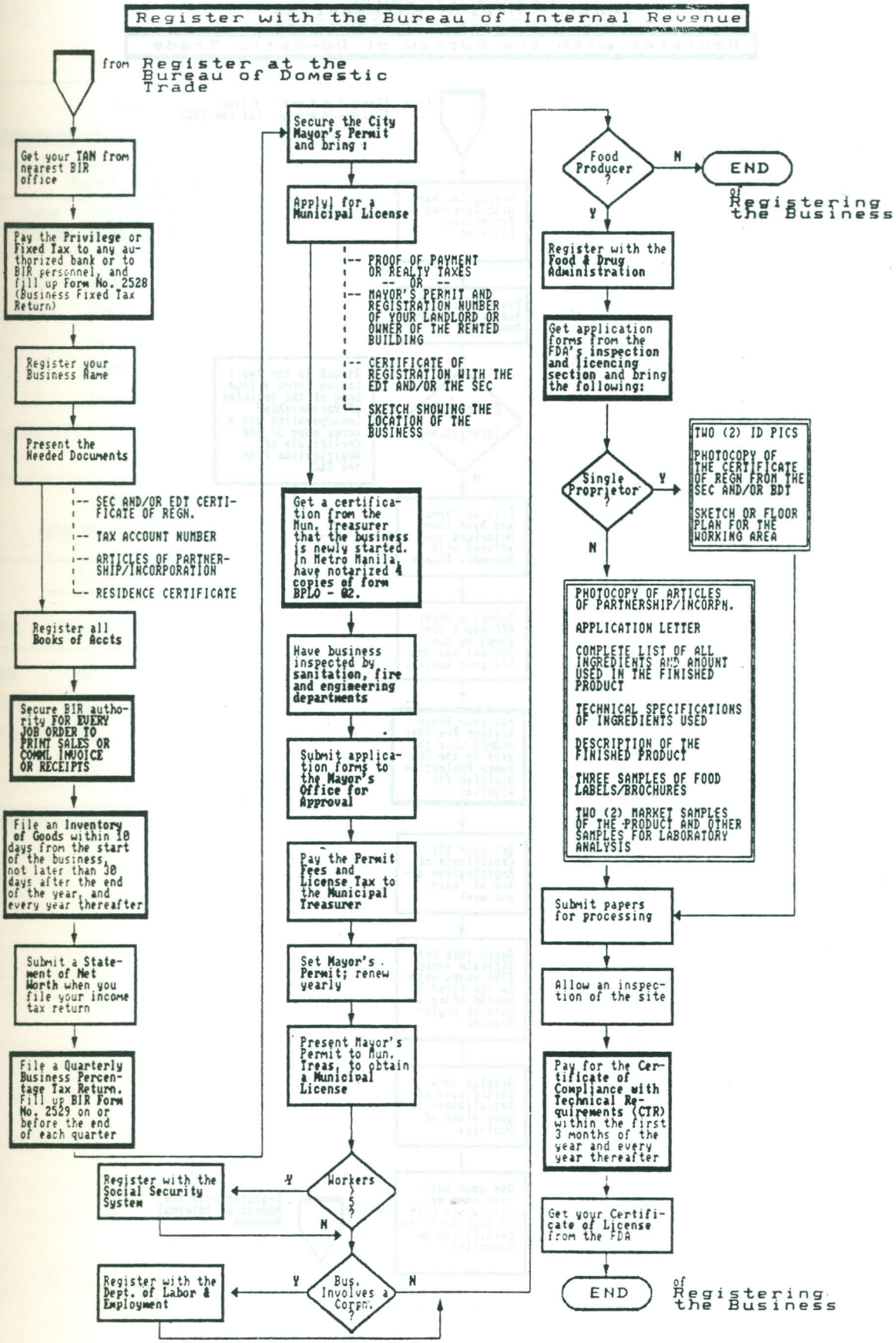

Figure 1, cont.

SMALL - MEDIUM ENTERPRISES

Register with the Bureau of Domestic Trade

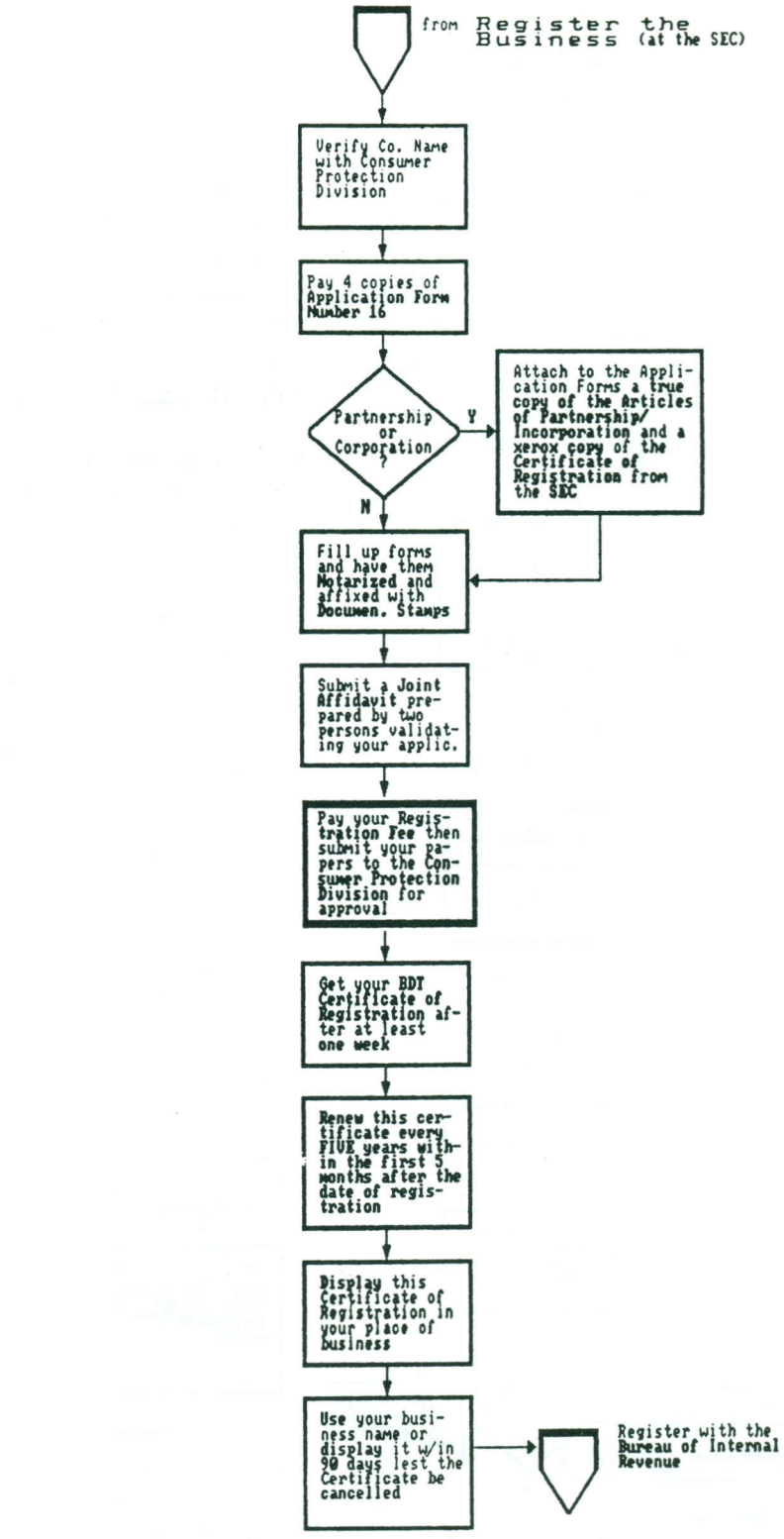

Table 2
ENTERPRISE CLASSIFICATION MATRIX

Employment Size	Assets Valuation: Below ₱50,000	₱50,000 - ₱500,000	₱500,000 - ₱5 M	₱5 M - ₱20 M	Above ₱20 M
Below 5	Micro	Cottage	Small	*	*
5 - 9	Micro	Cottage	Small	*	*
10 - 99	*	Cottage	Small	Medium	*
100 - 199	*	Small	Medium	Medium	Large
200 and >	*	Medium	Medium	Large	Large

Table 3
BOI REGISTRATIONS

Firm Size Assets Valuation	As of 1984 # of Firms	As of 1984 % Total	1986-1988 # of Firms	1986-1988 % Total
₱5 M and below	225	30.82	533	16.30
₱5.01 M - ₱20 M	203	27.81	391	11.96
Above ₱20 M	302	41.37	2,346	71.74
	730	100.00	3,270	100.00

Source: Board of Investments

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