

**CREATING AN ENABLING LEGAL ENVIRONMENT FOR MICRO-,
SMALL-, AND MEDIUM-SIZED ENTERPRISES: SIMPLIFIED
INCORPORATION AND REGISTRATION**

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EXECUTIVE SUMMARY

Micro-, small-, and medium-sized enterprises (MSMEs) are engines of economic growth and job creation throughout the world. In the Asian-Pacific Economic Cooperation (APEC) region, small businesses account for over 97% of enterprises and employ over half of the workforce. Yet, the vast majority of MSMEs in developing countries remain in the informal sector, despite the need for a formal legal status to operate and enter into contracts. Unfortunately, traditional formal business formation models are unsuitable for MSMEs because they: (1) are prohibitively expensive to set up (both in terms of money and time); (2) result in high compliance costs to meet complicated regulations; and (3) expose entrepreneurs to personal liability. Several international organizations, including the World Bank and United Nations Commission on International Trade Law (UNCITRAL), have identified best practices that provide a core framework for simplified business registration and incorporation. These core elements include: (1) permitting the creation of a simplified company by one or more persons; (2) providing for full-fledged limited liability; (3) establishing maximum freedom of contract; (4) providing a flexible organizational structure; (5) making minimum capital an optional requirement; (6) permitting a general-objectives clause; (7) providing fiscal transparency and simplified accounting; (8) establishing simple registration and incorporation requirements; and (9) allowing optional use of intermediaries (e.g., lawyers, notaries, or witnesses).

An enabling legal environment incorporating these core elements creates an effective gateway through which businesses can enter the formal economy. In turn, legal recognition gives micro and small businesses greater access to affordable credit and with it, to a growth mode characteristic of the formal business sector. As the World Bank has found, economies with modern business registration and incorporation grow faster, promote greater entrepreneurship and productivity, create jobs, boost legal certainty, and attract larger inflows of foreign direct investment.

I. INTRODUCTION

MSMEs are the engines of economic growth and job creation. MSMEs are crucial components of the post-2015 U.N. development agenda and are critical

to the advancement of sustainable development goals.¹ MSMEs are vital in the Pacific Rim where family-owned businesses and closely held companies abound.² In Mexico, for example, MSMEs account for some 99% of businesses, employ approximately 60% of the population, and are responsible for over 20% of the gross domestic product.³

Yet, as UNCITRAL reports, over 90% of MSMEs in developing countries operate in the informal sector.⁴ MSMEs often face legal barriers that prevent their formal establishment, growth, and ability to do business. In countries like the United States, the establishment of a business such as a sole proprietorship only requires a tax identification number from the Internal Revenue Service.⁵ In other countries MSMEs must have a formal legal status to operate and enter into contracts.⁶ Cumbersome, unclear, or unpredictable incorporation and registration requirements are often a key cause of informality.⁷ In countries

¹ See United Nations' Sustainable Development Goal 8, Target 8.3 GA Resolution A/69/L.85 (2015), at 19-20 ("encourages the formalization and growth of micro-, small-, and medium-sized enterprises").

² See Adrian Wooldridge, *Family Companies, to Have and to Hold*, THE ECONOMIST (Apr. 18, 2015), <http://www.economist.com/news/special-report/21648171-far-declining-family-firms-will-remain-important-feature-global-capitalism>.

³ *Resumen de los Resultados de los Censos Económicos 2009*, INSTITUTO NACIONAL DE ESTADÍSTICA Y GEOGRAFÍA 21, <http://www.inegi.org.mx/est/contenidos/espanol/proyectos/censos/ce2009/pdf/RD09resumen.pdf> (last visited Oct. 1, 2015). There is no commonly agreed-on definition of what constitutes a micro-, small-, or medium-sized enterprise (MSME), although the term micro-enterprise is for some purposes restricted to businesses with ten or fewer workers, a small-enterprise to 20 or fewer workers, and a medium-sized enterprise to 50 or fewer workers. See Boris Kozolchik & Cristina Castañeda, *Invigorating Micro and Small Businesses Through Secured Commercial Credit in Latin America: The Need for Legal and Institutional Reform*, 28 ARIZ. J. INT'L & COMP. L. 43, 44, 56-57 (2011).

⁴ Note by the Secretariat, *Reducing the Legal Obstacles Faced by Micro, Small and Medium-Sized Enterprises (MSMEs)*, ¶ 20, U.N. Doc. A/CN.9/WG.I/WP.92 (Aug. 12, 2015) (citing studies by the International Finance Corporation and the Global Partnership for Financial Inclusion finding that

[t]he total number of MSMEs worldwide is estimated to be between 420 to 510 million businesses, of which 360 to 440 million (around 86 per cent) are in emerging markets. Of these, 36 to 44 million SMEs globally (comprising about 9 percent of the total MSME population) are registered, i.e. they are operating within the legally regulated economy.

⁵ Kozolchik & Castañeda, *supra* note 3, at 74-78 (pointing out that in the United States formation of a legal entity with limited liability requires registration).

⁶ *Id.* at 47-48.

⁷ Aminur Rahman et al., *Reforming Business Registration: A Toolkit for Practitioners*, World Bank Group (WBG) 3 (2013), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/01/17/000461832_20140117142002/Rendered/PDF/840140WP0Box380business0Registration.pdf [hereinafter World Bank

where illiteracy rates are high, small obstacles quickly become impassible roadblocks. This is particularly true for female business owners, who tend to remain in the informal sector.⁸ According to the International Labor Organization, the informal economy represents over half of the economy in several regions of the world, including Latin America and East and South East Asia.⁹ Irregular forms of doing business render transactions costlier and discourages attempts to grow, hire employees, and seek credit.¹⁰ Informality also perpetuates “non-compliance with the law and work[s] against strengthening the rule of law. It could increase the risk of non-payment of taxes, increase corruption and constitutes a negative environment for foreign investment and trade.”¹¹

MSMEs have an unprecedented opportunity to engage in international trade through digital technology. Web storefronts, online marketplaces, and marketing platforms are used to acquire and serve customers around the world. EBay points out that in 2014, over 190,000 U.S. entrepreneurs and small businesses on its platform exported to consumers on at least four continents.¹² Entrepreneurs and small businesses that exported over 50% of their products grew 91% between 2010-2014, while the businesses that exported less than 50% of their products grew 58% over that same timeframe.¹³ Yet, only one percent of U.S. businesses export.¹⁴ In Asia-Pacific Economic Cooperation (APEC), MSMEs account for over 97% of enterprises and employ over half of the workforce, but they only account for 35% or less of direct exports.¹⁵ An enabling

Toolkit]; FRANCISCO REYES VILLAMIZAR ET AL., *LATIN AMERICAN COMPANY LAW FROM A COMPARATIVE AND ECONOMIC DEVELOPMENT PERSPECTIVE—A NEW POLICY AGENDA FOR LATIN AMERICAN COMPANY LAW: RESHAPING THE CLOSELY-HELD ENTITY LANDSCAPE* 27-28, 166 (2012).

⁸ INT’L LABOUR OFFICE (ILO), *Transitioning From the Informal to the Formal Economy*, at 6-7, ¶ 17, ILC.103/V/1 (1st ed. 2014), http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_218128.pdf. See also Recommendation 204—Transition from the Informal to the Formal Economy, (2015), Geneva, 104th ILC Session (recommending that ILO members facilitate workers’ transition from the informal to the formal economy), http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:R204.

⁹ *Id.* at 6, ¶¶ 15-16.

¹⁰ See Kozolchik & Castañeda, *supra* note 3, at 79-97.

¹¹ General Assembly, *Report of the United Nations Commission on International Trade Law (UNCITRAL)*, ¶ 319, U.N. Doc. A/68/17 (2013), <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V13/858/38/PDF/V1385838.pdf?OpenElement> [hereinafter Commission Report 2013].

¹² *2015 US Small Business Global Growth Report*, EBAY, at 10 (2015), <http://www.ebaymainstreet.com/sites/default/files/2015-us-small-biz-global-growth-report.pdf>.

¹³ *Id.* at 11.

¹⁴ See INT’L TRADE ADMIN., *Exporting is Good for Your Bottom Line*, <http://trade.gov/cs/factsheet.asp> (last visited Nov. 7, 2015).

¹⁵ *Small and Medium Enterprises*, ASIA-PAC. ECON. COOPERATION (APEC), <http://www.apec.org/Groups/SOM-Steering-Committee-on-Economic-and-Technical-Cooperation/Working-Groups/Small-and-Medium-Enterprises.aspx> (last visited Nov. 7, 2015).

legal environment that builds their capacity and provides a unified system for trade, including through simplified business registration and incorporation, is essential for MSMEs to effectively reach global electronic commerce markets.¹⁶

The World Bank, APEC, Organization of American States (OAS), and UNCITRAL are working to facilitate the development of an enabling legal environment for MSMEs, including through simplified business registration and incorporation. This introductory Article first reviews current efforts to standardize international best practices in simplified business registration and incorporation for MSMEs. The Article then analyzes the essential elements of simplified company law for MSMEs based upon the standards developed in these international efforts.

II. INTERNATIONAL EFFORTS TO HARMONIZE SIMPLIFIED BUSINESS REGISTRATION AND INCORPORATION FOR MSMEs

A. World Bank “Doing Business”

The World Bank’s *Doing Business Reports* are instrumental in the promotion of business law reforms and the development of international standards. One of the indicators of the Doing Business Methodology—Starting a Business—focuses on simplifying business registration and incorporation. The methodology calls for reducing the number of procedures, time, and cost for a small- and medium-sized limited liability company to start up, and for eliminating minimum paid-in capital requirements. These standards have proved crucial in promoting reforms for simplified business registration and incorporation around the world.¹⁷

The World Bank has found that “in many countries, the bureaucratic obstacles and high costs imposed by inefficient company registries deter people with good business ideas from embarking on the path of formal entrepreneurship.”¹⁸ According to the World Bank, “[c]umbersome regulations and administrative procedures for starting a business are found to be associated

¹⁶ Note by the Secretariat, U.N. GAOR, *Microfinance: Creating an Enabling Legal Environment for Micro-Business and Small and Medium-Sized Enterprises*, 18, ¶ 50, U.N. Doc A/CN.9/780 (2013) (citing the International Chamber of Commerce) [hereinafter UNCITRAL Colloquium]. sUNCITRAL has observed that “company law, where businesses are bound by the forms of legal entity created by the legislator, and the diversity of national forms of legal entity does indeed cause problems for SMEs.” *Id.* at n.70.

¹⁷ *Doing Business 2015 Going Beyond Efficiency*, WBG at 34, tbl. 4.1, <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Full-Report.pdf> (reporting an average annual number of 45 reforms for starting a business over the last five years) [hereinafter *Doing Business Going Beyond Efficiency*].

¹⁸ *Doing Business, Starting a Business, Why it Matters*, WBG, <http://www.doingbusiness.org/data/exploretopics/starting-a-business/why-matters> (last visited Nov. 7, 2015).

with a small number of legally registered firms, greater informality . . . a smaller tax base, and more opportunities for corruption.”¹⁹

On the other hand, “[t]he World Bank has found that economies with modern business registration ‘grow faster,’ ‘promote greater entrepreneurship and productivity,’ ‘create jobs,’ ‘boost legal certainty,’ and ‘attract larger inflows of foreign direct investment.’”²⁰ According to the World Bank:

A study of 97 economies found that cutting entry costs for businesses by 80 percent increases total factor productivity by 22 percent. Across 157 economies, the same reduction raised output per worker by 29 percent. Another study found that reducing registration costs from the seventy-fifth to the twenty-fifth percentile in Doing Business rankings increased the value added per worker by 14 percent—and higher productivity leads to increased wages.²¹

As the World Bank has pointed out, “the legal form under which a company is registered also matters.”²² *Doing Business* focuses upon a limited liability company:

A limited liability company—the most common form of business around the world—benefits from reduced liability. In addition, successful legal entities tend to outlive their founders, continuing to contribute to the economy without the need to rebuild capital stock from scratch in each generation. Forming a limited liability company, in addition, enables shareholders to join forces and build a company’s capabilities and capital.²³

This is a significant contribution to the registration discussion. Ease of registration is important, but so is the type of business form being registered. As discussed below, best practices may need to embrace both simplification of the registration process and simplification of the business forms being registered.

¹⁹ *Id.*

²⁰ UNCITRAL Colloquium, *supra* note 16, at 4-5, ¶ 10 (quoting *Doing Business 2013, Smarter Regulation for Small and Medium Sized Enterprises*, WBG, at 14, 21, 25 n. 16).

²¹ World Bank Toolkit, *supra* note 7, at 3.

²² *Doing Business Measuring Business Regulations*, WBG, <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Topics/starting-a-business.pdf> (last visited Nov. 7, 2015).

²³ World Bank Toolkit, *supra* note 7, at 1.

B. APEC “Ease of Doing Business”

APEC’s *Ease of Doing Business* initiative aims to improve APEC’s performance in five key areas of *Doing Business*, including starting a business.²⁴ Under the first *Ease of Doing Business Action Plan* (2010-2015), APEC’s performance resulted, thus far, in an average improvement rate of 38.7% for starting a business. This result was driven mainly by a lower minimum paid-in capital requirement to start a limited liability company. These requirements have been reduced by more than 80% since 2009.²⁵ Today, 19 out of 21 APEC member economies do not require paid-in minimum capital for starting a business.²⁶

C. OAS—Simplified Limited Liability Stock Company

The OAS Inter-American Juridical Committee has focused on another aspect of starting a business—streamlining the legal form of a limited liability company. The Juridical Committee recommends a Model Act for a Simplified Stock Company as a basis for legislative reform for countries in the Americas.²⁷ The Juridical Committee explains that:

The lack of a progressive legislative framework permitting simpler and more modern business associations is often described as a major impediment to economic development within our hemisphere. Under many national legal codes, only certain types of business associations are permitted, such as (i) regular general partnerships (sociedades en nombre colectivo),

²⁴ APEC’s *Ease of Doing Business Interim Assessment*, in APEC ECONOMIC POLICY REPORT 2012, APEC, at 1-6 (Sep. 2012), http://publications.apec.org/publication-detail.php?pub_id=1330.

²⁵ *Status of Progress, APEC’s Ease of Doing Business 2009-2014*, APEC, at 2-4 (2015); *APEC’s Ease of Doing Business—Interim Assessment 2009-2013*, APEC, at 8 (2014), http://publications.apec.org/publication-detail.php?pub_id=1554.

²⁶ *Doing Business 2015, Asia-Pacific Economic Cooperation* WBG, at 19, tbl. “Paid-in minimum capital (percent of income per capita)” (2014), <http://www.doingbusiness.org/reports/~media/GIAWB/Doing%20Business/Documents/Profiles/Regional/DB2015/DB15-APEC.pdf>. Also of significance is the work of the United Nations Conference on Trade and Development (UNCTAD). Over the last decade, UNCTAD has provided technical assistance to 28 countries to build business registration and administrative websites. With UNCTAD’s assistance, those governments have documented 1,936 procedures online, and reduced business registration steps, forms, and documents by 80% on average. See BUS. FACILITATION PROGRAM <http://businessfacilitation.org/> (last visited Nov. 7, 2015).

²⁷ Org. of Am. States, Inter-Am. Juridical Comm., *Project for a Model Act on Simplified Stock Corporation*, in ANNUAL REPORT OF THE INTER-AMERICAN JURIDICAL COMMITTEE, 81st Regular Session, CJI/Res. 188 (LXXX-O/12), 68-69 (2012) [hereinafter *Project for a Model Act on the Simplified Stock Corporation*].

(ii) limited partnerships (*sociedades en comandita*), (iii) joint stock companies or corporations (*sociedades anónimas*), whether of a fixed or variable capital, and (iv) limited liability companies (*sociedades de responsabilidad limitada*), which are often used as substitutes for family or closely-held corporations. These business forms have roots in European legal codes of the last century and often require businessmen to follow elaborate and costly notarial and administrative processes (“*trámites*”). These *trámites* supply missing formalities including the execution of verbose notarial *Escrituras Públicas* (public deeds) and numerous licenses often in the form of central or municipal taxes. *These formalities cannot be ignored, since failure to comply might lead courts or administrators to declare a micro or small business “relatively null”, “absolutely null” or even a “non-existent” legal entity devoid of its “legal personality” (personalidad jurídica).*²⁸

The Juridical Committee’s Model Act was based on the Colombian Simplified Stock Company (SAS). It blends features of two business forms: partnerships and corporations. By combining both corporate and partnership-like components, the SAS allows significant contractual flexibility while still preserving the benefits of limited liability and asset partitioning.²⁹ In Colombia, more than 200,000 companies incorporated under the SAS in the first five years following its adoption.³⁰ According to the Juridical Committee, the framework also served as a basis for legislative reform in a number of developed and developing countries, including the United States (Delaware, Wyoming and Texas); Japan; Singapore; China; Canada; Chile; India; France (*Société par Actions Simplifiée*); and the United Kingdom.³¹

D. UNCITRAL

UNCITRAL has focused on developing a legal standard for simplified business incorporation and registration. Following a Colombian proposal, the Commission at its 2013 session authorized “work on international trade law aimed

²⁸ *Id.* at 69-70 (emphasis added). For a more detailed discussion of this issue see Kozolchyk & Castañeda, *supra* note 3, at 45-48.

²⁹ *Project for a Model Act on the Simplified Stock Corporation*, *supra* note 27, at 69.

³⁰ Note by the Secretariat, Comm. On Int’l Trade Law, *Observations of the Government of Colombia*, 13 ¶ 44, U.N. Doc. A/CN.9/WG.I/WP.83, (Oct. 19-23, 2013), <http://daccess-dds-ny.un.org/doc/UNDOC/LTD/V13/883/64/PDF/V1388364.pdf?OpenElement>.

³¹ *Project for a Model Act on the Simplified Stock Corporation*, *supra* note 27, at 69.

at reducing the legal obstacles faced by micro-, small-, and medium-sized enterprises, throughout their life cycle and in particular, those in developing economies.”³² The Commission directed that the work “start with a focus on the legal questions surrounding the simplification of incorporation.”³³ UNCITRAL, like the OAS Juridical Committee, found that:

“traditional” business models—including incorporated companies and partnerships—present possible barriers to the creation of MSMEs. Such models are often not “fit for purpose” for micro and small businesses as their establishment: (a) is too costly (both in terms of money and time); (b) results in over-regulation (with high compliance costs); and (c) exposes entrepreneurs to significant risks of liability³⁴

The colloquium that led to the new initiative stressed that “[c]onsidering the current absence of any internationally recognized standards . . . such a legal framework would significantly contribute to the formalization of thousands of enterprises that would otherwise remain in the informal sphere.”³⁵ It also emphasized that “an internationally recognized form of business registration could be expected to facilitate cross-border trade for MSMEs operating in regional markets, since it would provide a recognizable international basis for transactions and avoid problems that may arise because of a lack of recognition of the business form of the enterprise.”³⁶

III. CORE ELEMENTS OF SIMPLIFIED INCORPORATION

Work in UNCITRAL on the development of a legal instrument for simplified incorporation is ongoing. In the UNCITRAL Working Group, the delegations of Colombia, Mexico, the United States, Japan, the United Kingdom, Finland, and Croatia submitted a basic template for a Simplified Company Model Act. The core elements of the framework include: (1) permitting the creation of a simplified company by one or more persons; (2) providing for full-fledged limited liability; (3) establishing maximum freedom of contract; (4) providing a flexible organizational structure; (5) making minimum capital an optional requirement; (6) permitting a general-objectives clause; (7) providing fiscal transparency and

³² Commission Report 2013, *supra* note 11, at 72, ¶ 321.

³³ *Id.*

³⁴ UNCITRAL Colloquium, *supra* note 16, at 6, ¶ 15.

³⁵ *Id.* at 19, ¶ 51.

³⁶ Comm. on Int’l Trade Law, *Report of Working Group I (MSMEs) on the Work of its Twenty-Second Session*, 2, ¶ 3, U.N. Doc. A/CN.9/800 (Feb. 10-14, 2014), <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V14/012/88/PDF/V1401288.pdf?OpenElement> [hereinafter *Working Group of the Twenty-Second Session*]. See also UNCITRAL Colloquium, *supra* note 16, at 18-19, ¶ 50.

simplified accounting; (8) establishing simple registration and incorporation requirements; and (9) allowing optional use of intermediaries (e.g., lawyers, notaries, and witnesses).³⁷ These core elements were based on internationally accepted best practices, including those recognized by the World Bank and those that guide the Colombian SAS.³⁸ The Secretariat produced a draft model law based on this framework.³⁹

The following sections summarize the elements of the framework.

A. Possibility of One or More Persons Incorporating

UNCITRAL is developing “a single legal text that could accommodate the evolution of a business entity from a single-member model to a more complex multi-member entity.”⁴⁰ The Working Group Report explains that:

[S]uch an approach could have a number of advantages, including reducing transaction costs for single member entities wishing to grow, and that any text should be structured so as to permit smaller entities to access the rules relative to them easily, and to disregard more complex rules meant for multi-member businesses. In keeping with its earlier decision, there was general agreement in the Working Group that single and multiple member entities should be accommodated in the same text, and that there should be no maximum number of members required⁴¹

³⁷ Comm. on Int’l Trade Law, *Report of Working Group I (MSMEs) on the Work of its Twenty-Third Session*, 16, ¶ 66(b)(ii), U.N. Doc. A/CN.9/825 (Nov. 17-21, 2014), <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V14/081/43/PDF/V1408143.pdf?OpenElement> [hereinafter *Working Group Report on the Twenty-Third Session*].

³⁸ General Assembly, *Report of the United Nations Commission on International Trade Law*, 69, ¶ 340, U.N. Doc. A/70/17 (July 2015), <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V15/054/52/PDF/V1505452.pdf?OpenElement>. UNCITRAL also directed that the simplified company framework include consideration of the Colombian law that formed the basis for the work of the OAS Inter-American Juridical Committee on a Model Act for the Simplified Stock Company. *Id.* (WP 83 referred to therein is the Colombian proposal).

³⁹ Note by the Secretariat, Comm. on Int’l Trade Law, *Micro, Small and Medium-Sized Enterprises Draft Model Law on a Simplified Business Entity*, 2, ¶ 2, U.N. Doc. A/CN.9/WG.I/WP.89 (Apr. 13-17, 2015) [hereinafter *Draft Model Law on a Simplified Business Entity*].

⁴⁰ *Working Group of the Twenty-Third Session, supra* note 37, at 16, ¶ 67.

⁴¹ Comm. on Int’l Trade Law, *Report of Working Group I (MSMEs) on the Work of its Twenty-Fourth Session*, 6, ¶19, U.N. Doc. A/CN.9/831 (Apr. 13-17, 2015) [hereinafter *Working Group Report on the Twenty-Fourth Session*].

The UNCITRAL Secretariat earlier observed that:

Although historically the minimum number of members required for the formation of a closely held business entity has been the subject of some debate, the more recent trend in most legal systems is to permit the formation of a single member enterprise with limited liability.⁴²

B. Full-fledged Limited Liability

There is “broad agreement in the [UNCITRAL] Working Group that the [shareholders of the] entity should enjoy limited liability and that the [company] should be a ‘commercial’ privately held entity. . . .”⁴³ Correspondingly, it is agreed that the limited liability company should have a legal personality distinct from its shareholders with the capacity to sue and be sued in its own name.⁴⁴ As highlighted by the Secretariat:

Limited liability protection, in which the financial liability of an entrepreneur for the obligations of the business entity is limited to a fixed sum, usually the value of the entrepreneur’s investment in a business entity, has been a fundamental feature of public and private corporate business forms since the 19th century, and is no less important in terms of modern simplified business forms. *Limited liability can play a crucial role for an MSME in that it provides the means to separate the personal assets of its members from those owned by the business, thus protecting personal assets from exposure in the event that the business does not do well or becomes involved in legal disputes.* Of course, the business entity itself has unlimited liability to its creditors and all of the assets of the business are available to satisfy those claims; in addition, limited liability does not excuse the members of a business entity from their obligation to make the promised contributions to the capital of the entity.⁴⁵

⁴² Note by the Secretariat, Comm. on Int’l Trade Law, *Micro, Small and Medium-Sized Enterprises Legal Questions Surrounding the Simplification of Incorporation*, 12, ¶ 34, U.N. Doc. A.CN.9/WG.I/WP86 (Nov. 17-21, 2014) (footnotes omitted) [hereinafter *Simplification of Incorporation*].

⁴³ *Working Group Report on the Twenty-Third Session*, *supra* note 37, at 17, ¶ 69.

⁴⁴ *Working Group Report on the Twenty-Fourth Session*, *supra* note 41, at 12-13, ¶¶ 45-47.

⁴⁵ *A Simplification of Incorporation*, *supra* note 42, at 6-7, ¶ 14 (emphasis added) (footnotes omitted).

C. Maximum Freedom of Contract

In the UNCITRAL Working Group “[i]t was generally agreed that freedom of contract should be the guiding principle in terms of establishing the internal organization of the company. . . .”⁴⁶ As the Secretariat points out:

[T]he main focus of simplified business entities has been on creating flexible business forms that can be tailored to the needs of certain types of closely held businesses, including: MSMEs wishing to formalise and segregate personal and business assets; family firms; joint ventures; and professional service firms. This flexibility is achieved in part by allowing the founders of the enterprise to agree through contractual mechanisms (like joint venture or shareholder agreements) on the internal governance of the enterprise, to contract around the more superfluous and cumbersome protective requirements traditionally associated with publicly traded companies, and to tailor rights and duties that are more consistent with the needs of closely held businesses. Of course, most simplified business entity legislation also includes certain mandatory rules that cannot be contracted out of by agreement amongst the members.⁴⁷

D. Flexible Organizational Structure

The UNCITRAL Working Group agrees on the need for a flexible organization structure for MSMEs. The Secretariat points out that:

The accommodation of entrepreneurs wishing to form flexible legal entities is one of the reforms of a State’s legal framework that has been recommended as a supporting pillar for the establishment of best practices in business registration. . . . Reportedly, the availability of only rigid legal entities may be expected to hinder business entity growth, and States that do not offer a more flexible legal form experience a greatly reduced rate of business entry. . . .

[O]ne of the main goals of closely held businesses, including simplified business entities . . . could be said to be to function as

⁴⁶ *Working Group Report on the Twenty-Second Session, supra* note 36, at 16, ¶ 63.

⁴⁷ *Simplification of Incorporation, supra* note 42, at 8-9, ¶ 21 (footnotes omitted).

independently as possible from the strict rules that govern publicly traded companies.⁴⁸

Similarly, the World Bank Toolkit for Business Registration reports:

Entrepreneurs deciding whether to go formal base their decisions on the simplicity of the legal form. A rigid form—for example, one that sets limits on transferability and public trading of shares—might hinder a firm’s growth. Economies with rigid legal forms, such as limitations on the number of shareholders, have an entry rate less than half that of economies with more flexible requirements.⁴⁹

E. Optional Minimum Capital

“[T]here was broad agreement in the Working Group that the modern trend was to move away from minimum capital requirements.”⁵⁰ The Secretariat reports that:

Of the 189 economies reviewed in *Doing Business 2014*, 99 have no minimum capital requirement. Some economies never required businesses to deposit money for incorporation, while others have eliminated minimum capital requirements in the recent past. . . .

According to a study of selected European Union (EU) States, lowering or abolishing the minimum capital requirement has led to a marked increase in the number of registered business in four of the States considered: in the year after the reform, average daily incorporations in those States increased by as much as 85 per cent.⁵¹

The World Bank Toolkit further explains:

Minimum capital requirements achieve none of their intended goals. First, they do little to prevent insolvency because entrepreneurs can withdraw their capital from banks almost immediately after registration. Similarly, fixed amounts of

⁴⁸ *Id.* at 8-9, ¶ 22 (footnotes omitted).

⁴⁹ World Bank Toolkit, *supra* note 7, at 18 (footnote omitted).

⁵⁰ *Working Group Report on the Twenty-Third Session*, *supra* note 37, at 19, ¶ 75.

⁵¹ Note by the Secretariat, Comm. on Int’l Trade Law, *Best Practices in Business Registration*, 14, ¶¶ 29-30, U.N. Doc. A/CN.9/WG.I/WP.85 (footnotes omitted) (2014) [hereinafter *Best Practices in Business Registration*].

capital do not address differences in commercial risks, and recovery rates in bankruptcy are no higher in economies with minimum capital requirements. In poor economies . . . entrepreneurs must put up capital several times the average income per capita. These requirements undermine entrepreneurship.⁵²

F. General-Objectives Clauses

UNCITRAL decided “the purpose clause, if any, of the simplified business entity should be broad so as to provide maximum flexibility for MSMES.”⁵³ The UNCITRAL Working Group report explains:

[T]he modern trend in respect of general objectives clauses is to allow business entities to engage in all lawful activities . . . and

⁵² World Bank Toolkit, *supra* note 7, at 8. The World Bank continues:

In recent years substantial regulatory reform efforts have been undertaken by the 17 member states of the Organization for the Harmonization of Business Law in Africa, known by its French acronym OHADA. Among other things, the organization has encouraged member states to reduce their minimum capital requirements. Four member states passed national legislation to this effect in 2013/14. Seven did so in 2014/15, resulting in substantial decreases in the capital required. The Democratic Republic of Congo reduced its minimum capital requirement from 500% of income per capita in 2014 to 11% —and Burkina Faso reduced its requirement from 308% of income per capita to 29%. . . .

In 2015, the government of India adopted the Companies (Amendment) Act, which upon notification by the Ministry of Corporation Affairs, abolished the formerly imposed minimum capital requirement amounting to 111% income per capita. Similarly, Mauritania amended its law to eliminate this legal obligation—a reduction that used to be equivalent to 332% income per capita. Kuwait, in addition, lowered its minimum capital requirement by tenfold—from 74% of per capita income to only 7.4% today. These reforms significantly reduce financial barriers to entry for aspiring entrepreneurs seeking to formalize, allowing their available startup capital to be more productively invested in lucrative activities.

Doing Business, Starting a Business, Good Practices, WBG, <http://www.doingbusiness.org/data/exploretopics/starting-a-business/good-practices> (last visited Nov. 8, 2015) [hereinafter *Doing Business, Starting a Business, Good Practices*].

⁵³ *Working Group Report on the Twenty-Third Session*, *supra* note 37, at 17-18, ¶ 70.

to leave it open to the members of the entity to decide whether or not they wish to include a more restrictive purpose clause in the operating or formation document. Where a business has a general objectives clause, managers have a higher degree of discretionary authority to run the business entity and it is not necessary to amend a business entity's operating document or formation document each time that the enterprise wishes to take advantage of a new business opportunity or to reorient its operations. In fact, the adoption of a legal regime supporting general objectives clauses for business entities is seen as a desirable feature that should be achieved through legal reform and that is necessary to underpin the adoption of best practices in business registration.⁵⁴

Similarly, the World Bank Toolkit points out:

Governments allowing general-objectives clauses enable firms to change activities without reregistering. . . . A general-objectives clause in a firm's articles of incorporation states that a company's aim is to conduct any trade or business and that it has the power to do so. This basically means that the firm has similar capacities and powers as do natural persons and is not limited to what its articles state.

The main reason lawmakers require firms to specify objectives in their articles of association is to restrain firms from acting beyond the scope of their goals. This was meant to protect shareholders and creditors, helping them control how their assets were used. But this approach hampers business start-up. It also hampers firms' growth by limiting and slowing their ability to expand. . . . Many economies no longer require private companies to state objectives for registration purposes. Once registered, businesses can engage in any activity, except risky ones, which may require sector-specific licenses.⁵⁵

G. Fiscal Transparency and Simplified Accounting

There is general agreement on the need for fiscal transparency and simplified accounting.⁵⁶

⁵⁴ *Simplification of Incorporation*, *supra* note 42, at 10, ¶ 27 (footnotes omitted).

⁵⁵ World Bank Toolkit, *supra* note 7, at 18.

⁵⁶ *Simplification of Incorporation*, *supra* note 42, at 12, ¶ 32(d); *Draft Model Law on a Simplified Business Entity*, *supra* note 39, at 6, ¶ 15, n.17. See also APEC Policy Support Unit, Regulatory Reform: Case Studies on Improving the Business Environment

The disclosure requirements for SMSEs differ from publicly traded companies. The Secretariat explains:

While some States apply broad disclosure requirements to closely held entities (but allow exceptions to be made for small and medium-sized firms), others restrict mandatory disclosure to publicly held firms. In any event, minority shareholders of closely held entities are generally entitled to substantial information by using their right to inspect the company books and records.⁵⁷

Audit requirements for SMSEs also differ from those of publicly traded companies. The OAS IAJC Model Act (see discussion *supra*) stipulates that it shall not be legally mandated to establish or provide for an internal auditing organ for a simplified stock company.⁵⁸ As was explained:

The reasoning behind this deregulation is based on the limited usefulness of auditing bodies in the context of closely-held companies where the management and direction correspond to clearly defined majorities. This is the typical scenario in cases of ownership concentration, which are prevalent throughout Latin America. Instead, in this type of compan[y], minority shareholders may benefit from the direct control and supervision typically exercised by majorities over directors and managers (the so-called free riding phenomenon). . . . In turn, third parties—e.g., banks, possible acquirers of control, contractors and others—tend to prefer external auditing systems due to their greater independence vis-à-vis the company's management. . . .⁵⁹

for Small and Medium Enterprises (SMEs) 53 (2015) http://publications.apec.org/publication-detail.php?pub_id=1674 (“When it comes to accounting requirements, for example, most economies have different regimes for public and private companies, and size-dependent rules regarding audits and statutory accounts.”).

⁵⁷ *Draft Model Law on a Simplified Business Entity*, *supra* note 39, at 21-22, ¶ 43 (footnote omitted).

⁵⁸ *Project for a Model Act on the Simplified Stock Corporation*, *supra* note 27, at art. 28.

⁵⁹ REYES ET AL., *supra* note 7, at 130-31 (footnotes omitted). Reyes continues:

Experts have criticized the excessive regulation of auditors throughout Latin America. Indeed, legislators have used a variety of terms to designate auditors: *síndico*, *comisario*, *revisor fiscal*, *junta de vigilancia*, etc. Over several decades, very few changes have been introduced to streamline this bureaucratic scenario. . . . Auditing rules based on mandatory legal requirements, not on the specific needs of shareholders, have resulted in costly and seldom useful internal control

Some jurisdictions allow small business owners to use a simplified single entry method of accounting. For example, the “auto-entrepreneur” laws for France⁶⁰ and OHADA (*Organisation pour l’Harmonization en Afrique du Droit des Affaires*)⁶¹ only require the business to maintain a ledger stating the amount and origin of the income it receives in the course of its professional activities. The OHADA Revised Uniform Act for General Commercial Law provides that:

[t]he entrepreneur must establish on a daily basis and as part of his activities a ledger detailing in chronological order the origin and amount of his income—distinguishing between cash and other forms of payment—on the one hand, and the purpose and amount of his expenses on the other hand. The ledger must be kept for at least five years.⁶²

Similarly, in the United States, nearly half of the small businesses use cash accounting. If general ledger accounts are needed then the bookkeeping records can be given to an experienced accountant for conversion into a double entry system and creation of a balance sheet and profit and loss statement. In addition, in some Latin American developing nations, such as Honduras, this cash, single method entry of accounting was successfully used to enable the MSME’s access to bank loans at reasonable rates of interest.⁶³

H. Simple Registration and Incorporation Requirements

The Working Group also agrees that registration and incorporation should be as simple as possible in order to encourage compliance, particularly in developing economies.⁶⁴ The Secretariat reports that:

systems.

Id. at 162.

⁶⁰ CODE DE COMMERCE [C. COM] [COMMERCIAL CODE] art. L. 123-28 (Fr.), <http://www.legifrance.gouv.fr/affichCodeArticle.do>.

⁶¹ Organization for the Harmonization of Business Law in Africa (OHADA), Revised Uniform Act for General Commercial Law, art. 31 (2011), <http://ohada.org/presentation-generale-de-lacte-uniforme/telechargements1/fr/download/file/19,documents-ohadaactes-uniformesdroit-commercial-general/116,telechargez-la-version-revisee-adopte-le-15-decembre-2010-a-lome-pdf.html>. OHADA was formed by an international treaty in 1993 between states of Africa’s mid-west and today has 17 member states. OHADA, <http://www.ohada.org> (last visited Nov. 8, 2015).

⁶² Revised Uniform Act for General Commercial Law, *supra* note 61 (translation by author).

⁶³ See, e.g., Boris Rosen, *Appendix A*, 33 ARIZ. J. INT’L & COMP. L. (2016).

⁶⁴ *Working Group Report on the Twenty-Fourth Session*, *supra* note 41, at 10, 17-18, ¶¶ 33, 69.

[B]est practices generated by the wave of reforms of business registration since the early 2000s . . . included: charging a fixed nominal registration fee, using standard registration forms and stipulating nominal (or no) paid-in minimum capital, assigning unique identification numbers and adopting information technology to facilitate the delivery of a range of business start-up services, minimizing judicial involvement in registration and making the use of notaries, lawyers and registration intermediaries optional, providing information on the registration process, developing single interfaces for business registration (i.e. one stop shops) and making public the registered information.⁶⁵

The World Bank Toolkit identifies the following international good practices in simplified business registration:

Establishing a Flat Fee Schedule

Registration fees should be set simply to cover the administrative and operating costs of the business registration system. Most economies in the top 10 of the Doing Business indicator for starting a business charge a fixed registration fee regardless of company size. Some . . . make business registration free of charge to encourage businesses to register. . . .

Standardizing Incorporation Documents

Standard incorporation documents enable entrepreneurs to ensure legality without resort to notaries or lawyers, ease the workload at registries, help prevent errors, and expedite registration. . . .

Making Registration Transparent and Accountable

The easier the access to information about registration, the easier for companies to comply with it. Transparent accountable registration reduces compliance costs and makes the outcome of applications more predictable. . . .

Instituting an Integrated Registration System and Unique Identification Denominator

Many top-performing economies in *Doing Business* rankings for starting a business have also introduced single registration numbers for businesses, referred to as unique identification

⁶⁵ Working Group Report on the Twenty-Third Session, *supra* note 37, at 4-5, ¶ 14.

denominators, which are used for all transactions with government authorities. . . .

Creating a Single Interface: The One Stop Shop

One-stop shops are single interfaces for business start-ups and have become popular in many economies. Today [100] economies have one-stop shops for business registration, including [39] established or improved [in the last five years]. . . .

Utilizing information and Communication Technology

Today [114] economies use information and communication technology for business registration services ranging from online name searches to online registration, filing of annual returns, and electronic transmission and verification of information among government agencies. . . . More than [55] economies offer online business registration.⁶⁶

I. Optional Use of Intermediaries

As noted above, best practices include: making the use of notaries, lawyers, and registration intermediaries optional and minimizing judicial involvement in registration.⁶⁷ As explained by the Secretariat:

Requiring the use of such notarial services often represents a considerable burden for entrepreneurs, with costs that can constitute up to 80-84 per cent of the total cost of registration. A benchmarking exercise conducted by the European Commission in 2002 found that fees paid to lawyers or notaries because of their mandatory involvement was one of the two principal factors accounting for most of the differences in business registration costs among Member States. Many countries have thus eliminated notarization or have made it optional through the use of standardized documents or online procedures; in some cases, standardized articles of association have also been introduced. . . . A recent survey has noted that

⁶⁶ World Bank Toolkit, *supra* note 7, at 5-9 (footnote omitted), with updated statistics from *Doing Business, Starting a Business, Good Practices*, *supra* note 52. See also *Doing Business Going Beyond Efficiency*, *supra* note 17, at 49-52 (highlighting the online registries in Rwanda, Chile and the United Kingdom); Dobromir Christow & Andrei Mikhnev, *How Many Stops in a One-Stop Shop*, WBG, at 71 (2010), <https://www.wbginvestmentclimate.org/uploads/Howmanystopsinaonestopshop.pdf>.

⁶⁷ *Working Group of the Twenty-Third Session*, *supra* note 37, at 4-5, ¶ 14, and accompanying text.

only in Europe does the intermediation of a notary seem to be the most important pre-registration activity.⁶⁸

The World Bank Toolkit similarly points out that:

Business registration is typically most expensive in countries in which notarization of incorporation documents is required. Ironically, in some of the poorest economies (such as in West Africa), where micro-, small-, and medium-size enterprises account for the largest share of enterprises and most businesses operate informally, notarization is required to register a business, making registration extremely expensive. . . .

Notary costs for registration in Mexico are \$875, or about 80 percent of the total cost of registration. . . . Yet notaries typically perform simple verification services . . . which could easily be handled by business registry officials. Accordingly, many economies have eliminated mandatory use of notaries or have made use of notaries optional. . . .

Use of standardized registration documents may serve as a starting point for the process of removing or making optional the use of notaries and other intermediaries in the registration process.⁶⁹

With regard to minimizing the judicial involvement in registration, the World Bank Toolkit observes:

Business registration is an administrative process that need not require judicial attention. In many economies the court system is overburdened and lacking in technical and human capacity, resulting in huge backlogs of cases. Making business registration another duty for judges worsens this problem, delaying both registration and other activities, such as resolution of commercial disputes. . . . Several Latin American countries have also taken registration out of courts. . . . Moving the registry also helps to remove discretion, to facilitate unifying business information in one database,

⁶⁸ *Best Practices in Business Registration*, *supra* note 51, at 12-13, ¶ 26 (footnotes omitted). The World Bank continues, “OHADA also recommends that national governments eliminate the requirement for the use of notaries in company registration. The majority of member states have followed this recommendation, allowing companies to register at a one-stop shop either online or in person without resorting to the use of notaries.” *Id.*

⁶⁹ World Bank Toolkit, *supra* note 7, at 7-8.

and to make the registration system more accessible to the public. According to *Doing Business 2008*, entrepreneurs in economies where business registration is a judicial process spend 14 more days to register than do their counterparts in countries where registration does not involve the courts.⁷⁰

Efficient registration systems, such as those in Australia, Canada, New Zealand, and the United Kingdom, are essentially declaratory. Declaratory systems have the potential to deter bribes and to avoid risk that official decisions will be made with a view toward personal gain.⁷¹

IV. CONCLUSION

An enabling legal environment providing for simplified business registration and incorporation creates the gateway through which businesses enter the formal economy. In turn, legal recognition offers micro- and small businesses access to affordable credit, and with it, a growth mode characteristic of the formal business sector. It provides them with greater certainty of operation and access to previously unreachable markets and, with it, the capacity to compete and seek a fair treatment under the law. The benefits of simplified business registration and

⁷⁰ *Id.* at 7.

⁷¹ *Id.* at 18. The UNCITRAL Secretariat reached a similar conclusion:

Evidence suggests, however, that involvement of the courts seems to result in longer and more expensive registration procedures when compared with States in which registration is an administrative function. In States where registration is a judicial process, entrepreneurs are said to spend 14 more days to start a business and registration is said to average a cost of 32 per cent of income per capita, as opposite to 23 per cent income per capita in States where registration is an administrative process.

Best Practices in Business Registration, *supra* note 51, at 11, ¶ 25 (footnote omitted). It should also be noted that UNCTAD with the Kauffman Foundation's Global Entrepreneurship Network and the U.S. Department of State developed the GER.co index, which is intended to provide links to all online business registration websites in the world and a rating of each website's user-friendliness. GER.co aims to be the entrepreneur's first stop to register a business anywhere in the world. As of October 1, 2015, the site reported that 25 countries/economies had online single windows allowing simultaneous registrations with two or more ministries, and 127 countries/economies had information portals describing comprehensive business registration processes. GLOBAL ENTERPRISE REGISTRATION, <http://ger.co/> (last visited Nov. 8, 2015).

incorporation are not limited to the businesses themselves. Entering the formal sector obligates businesses to pay taxes and comply with labor laws. Easier start-up laws generate more businesses, lower prices, and increase product availability. Simplified business registration and incorporation has the potential to give millions of poor people around the globe a job, a future, and a hope.

