

# **Business Licensing and One Stop Shops in Indonesia**

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**November 2006**

With thanks to Brasukra Sudjana and Adam Day of The Asia Foundation for inputs and comments to earlier drafts of this paper.

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## 1. Executive Summary

In 2001, Indonesia embarked on a decentralization process that has had a dramatic impact on the local political landscape, especially in relation to taxation and administrative processes. Rules and procedures that govern licensing, registration, some taxes and user charges have largely been devolved to local governments. A significant number of new licenses and charges have been created at the local level, and most licenses are issued through a complicated system of procedures and agencies. Licensing has become one of the most important barriers to business formalization and growth in Indonesia.

**The local licensing framework in Indonesia has three key problems, raising transactions costs and inefficiencies.** First, even though most main licenses are regulated by national decrees, local governments have significant freedoms to determine licensing procedures and requirements. There are important discrepancies between these regulations and associated local implementing regulations in terms of processing time, cost and requirements. Second, local governments have the freedom to create additional licenses and charges. In 2000 a typical local government issued approximately two or three new local regulations per year. In 2002, that number had increased to an average of more than 16 regulations per local government per year, and 90 percent of these created new taxes, licenses or fees. Many licenses have been created with an aim to increase local revenues and often introduce market distortions rather than solving market inefficiencies. Third, in the majority of licenses in Indonesia are processed at the district level through various local government departments often with limited coordination and low capacity.

Inefficiencies in the licensing framework create significant obstacles for growing firms. The revenue burden of licenses is not particularly important for companies, but the time to obtain licenses *is* significant for all. The World Bank's Doing Business Survey estimates that it takes up to 97 days to register a business in Indonesia. About one third of the time (29 days) is needed to obtain only two local licenses. A survey carried out by The Asia Foundation estimates that it can take up to 80 days only to obtain the five main licenses and most firms also need to secure various additional activity-specific licenses. In addition, most licenses require a substantial number of supporting documents which also take time to secure. Finally, bribes are positively correlated to the number of business licenses a firm must obtain in order to operate legally. Evidence suggests that the level of bribes paid by firms is about 40 percent of the taxes firms pay. One of the factors contributing to the existence of bribes is the lack of information on licensing processes. The Asia Foundation survey shows that 75 percent of entrepreneurs do not have information on licensing in their regions and because of this, almost half of the use the services of brokers.

**Licensing reform through One Stop Shops (OSS).** In order to address inefficiencies in the licensing administration and reduce the burden on business, the national government and a number of local governments, with support from international donors, have introduced One Stop Shop service centers. The OSS aims to simplify the licensing

process in a way that enterprises no longer need to visit several different local agencies to obtain permits. The centers aim to streamline business licensing by integrating the authority to issue licenses, commonly located in various disparate government offices, into one government department.

OSS are by no means yet universal throughout the districts in Indonesia. It is estimated that only twenty percent of the 440 local governments currently have an active OSS, and of these very few of these function effectively. One Stop Shops in Indonesia can take a variety of institutional forms with different levels of authority. Successful OSS generally have the authority to accept, process and approve license applications. They are often located in districts with progressive and strong leadership. Other important features of best practice OSS are standard operating procedures and minimum service standards, qualified human resources, standardized and transparent fees and broad awareness of the OSS in the local community

**The Asia Foundation OSS technical assistance program.** To help the government in its licensing reform efforts, The Asia Foundation developed an OSS technical assistance program at the district level. The program is part of an integrated economic reform program that combines technical assistance to local governments with private sector advocacy for policy reforms. The approach consists of four closely linked complementary programs: the One Stop Service program to simplify business licensing; a Regulatory Impact Assessment program to address the regulatory burden at the district level; a small business association strengthening program; and finally a regional business climate ranking.

The Foundation's One Stop Shop program consists of six phases including:

- 1) An assessment of local governments' commitment for reform
- 2) A diagnostic of existing local licensing procedures and practices
- 3) Design of licensing reforms
- 4) Implementation of reforms including institutionalization
- 5) OSS launching and socialization
- 6) Introduction of IT systems

The program strategy has two core elements that ensure sustainability of reforms. First, the technical assistance is delivered through local partner agencies which have been trained and are monitored by the Foundation. Partner agencies typically have a deep knowledge of local conditions, experience in participatory project design, community mobilization and facilitation techniques. Integrating local organizations in delivering the technical assistance ensures sustainability and replicability of the programs, which are primary concerns for the Foundation. Pairing NGOs with local governments during the program also creates pressures for reform that can be sustained after the Foundation's assistance ends. Secondly, the reforms are institutionalized through local decrees. Part of the program involves drafting regulations to formalize the OSS as an institution and to establish minimum service standards.

**The methodology has proven to be highly effective.** At both the immediate output and intermediate results level, technical assistance has driven significant reforms. Outputs of the program include the establishment or upgrading of the authority of the OSS, the development of minimum service standards, increased capacity of government staff to process licenses, complaints mechanisms and improved data management systems. An evaluation of the first phase of the program also shows a clear positive outcome in terms of time and cost. The assistance resulted in an average reduction in licensing time of 60 percent and cost of 30 percent.

**Lessons learned.** Based on its experience assisting local governments with licensing reform, the Foundation has identified a number of key ingredients for the success of the assistance programs:

- Political support from both executive and legislative agencies is essential.
- Local partner agencies support the reform process. While expert input from Jakarta is useful, it cannot substitute for on-the-spot local partner engagement.
- Local partners need a deep understanding of the technical issues. Investment in professional capacity-building is essential.
- OSS reform needs to be complemented with broader regulatory reform at local and national level

**Relevance to conference themes.** This paper contributes to three conference themes:

- Theme 1: Priorities for business environment reform in Asia
- Theme 3: Lessons learned from business environment reform
- Hot Topic 5: Sub-national business environment reform

## 2. Introduction

Indonesia's long awaited recovery from the Asian financial crisis, and its transition to democracy, has raised high expectations about the country's potential to become an emerging power in South-East Asia. Under the leadership of President Yudoyono, the government has taken a number of important initiatives to respond to longer term development challenges and to make reforms that domestic and foreign investors need to drive business and employment growth.

However, prospects for long-term success remain uncertain, in part because of Indonesia's radical decentralization in 2001. Today, while the central government remains a key part of the overall story, local governments now have a crucial role in establishing the regulatory environment and allocating public spending (more than half of all development spending takes place at the sub-national level). A few local governments have leveraged this new freedom to create dynamic business climates, but most have struggled with financial mismanagement, legal uncertainty and poor strategic planning. Capacity for basic government functions of planning, financial management, business promotion and regulatory design remain weak in most of the 440 districts and 33 provinces.

In particular, the decentralization process in Indonesia has had a dramatic impact on the administration of taxation and charges. Rules and procedures that govern licensing, registration, some taxes and user charges have largely been devolved to local governments. Local governments have used this freedom to create new sources of revenues. Locally generated revenues have grown substantially in the post-decentralization period. About 20 percent of the absolute increase in these revenues is derived from business licenses of various kinds, many of which were newly created by local governments under decentralization (World Bank 2006a).

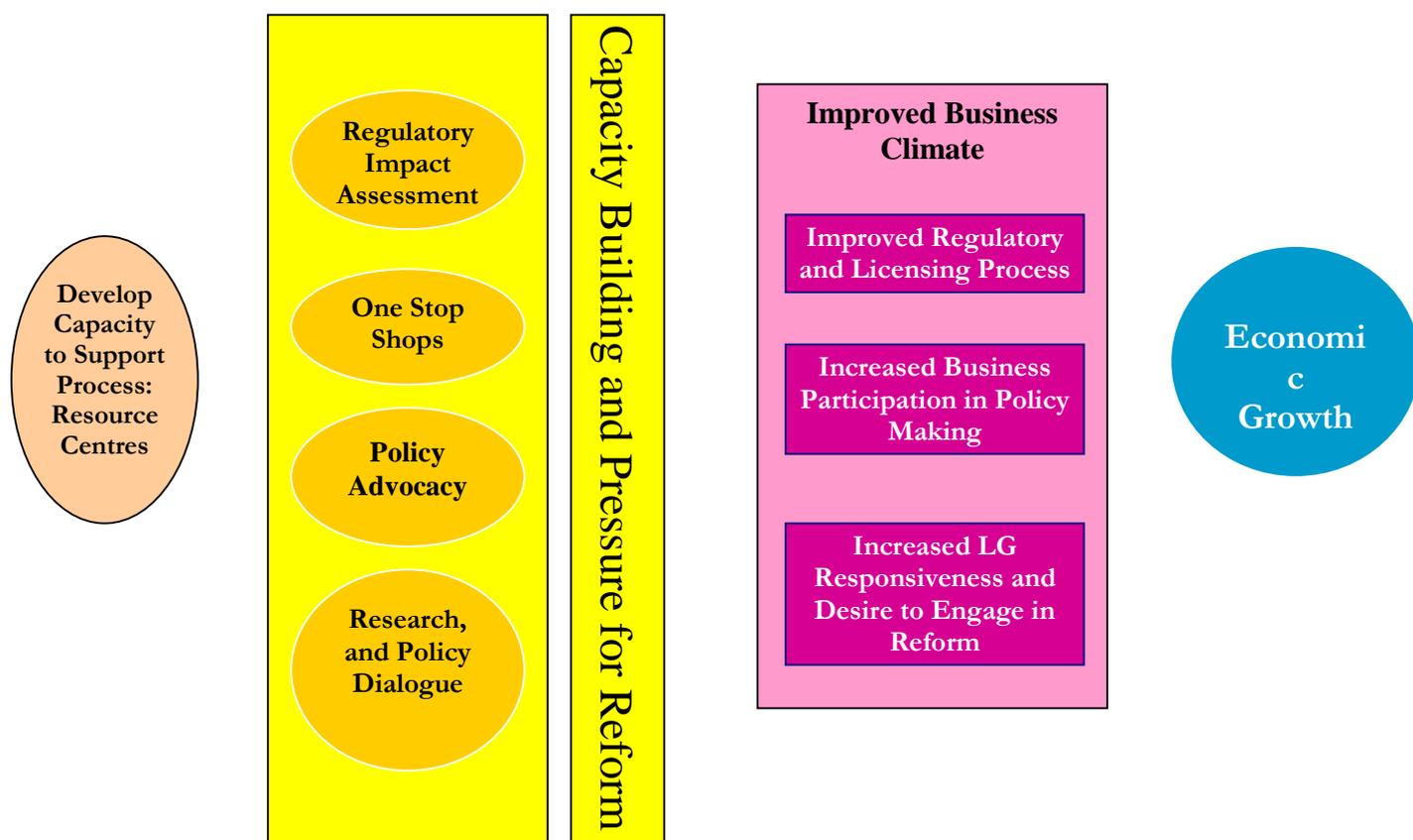
The number of local licenses and their associated procedures has created significant barriers for the local economy. Recent work indicates that local governments may have established as many as 6000 new taxes and charges during the period 2000 through mid-2005. The vast majority of the new revenue instruments would seem to be licenses and user charges (LPEM-FEUI 2005b). The difficulty of complying with licensing requirements is a major obstacle for businesses and as a result only a small share of enterprises has formalized their activities, which in turn has limited their access to financial resources and markets; and potential for growth.

While decentralization has raised transaction costs for the private sector, it has also provided an important opportunity to improve the business environment in Indonesia. Examples of best practices related to business licensing now exist domestically. The challenge facing donors is to find effective ways to support local governments in making reforms that reduce the complexity and cost of doing business in Indonesia. In response to this need, The Asia Foundation has developed an integrated economic development

program that combines technical assistance to local governments with private sector advocacy for reform. The approach consists of four closely linked and complementary programs:

- **One Stop Shops (OSS) program.** This program helps local governments to process licenses more efficiently through the introduction of One Stop Shops. These are new institutions that merge authority from disparate technical departments into one office where licenses and permits can be obtained quickly.
- **Regulatory Impact Assessment (RIA) program.** This program is supporting local governments to implement Regulatory Impact Assessments as a regular part of the drafting of new regulations. The RIA program complements and supports the OSS program as it helps governments to review regulations related to business licenses.

**Figure 1** OSS as part of a broader capacity building strategy



- **Business Association strengthening program.** The creation of a network of SME business associations (*Forum Daerah - Forda*) with a strengthened voice for reform constitutes the third component of the program. This component is

pertinent to build up the necessary pressures for reform and to keep governments accountable after technical assistance has ended.

- **Business Climate Ranking.** The fourth component includes an annual competitiveness survey that ranks cities and towns by the business friendliness of their infrastructure, public services and development policies. A key component of this survey is the quality and costs of licensing services at the local level.

In this paper we will focus on the One Stop Shop component of the program. In the next section licensing practices in Indonesia are discussed. We then turn to the role and structure of One Stop Shops in Indonesia. We close with a discussion of The Asia Foundation's technical assistance and lessons learned. Throughout the paper we will present data from a baseline licensing survey carried out in 17 districts, 13 of which are receiving support for their licensing reform program (TAF survey).<sup>1</sup>

### 3. Licensing in Indonesia: the challenges

In this section we discuss the structural and legal aspects of the licensing process. We then proceed with a discussion of business perceptions of licensing.

#### ***Business Registration and Licensing Process***

The importance of business licenses in Indonesia and their link to business registration and formalization can be seen in Figure 2. The process starts with the legal establishment of the firm, which involves obtaining and legalizing a company act and obtaining a tax registration number.<sup>2</sup> Up to two years ago, this process was one of the lengthiest in the world, taking up to 75 days to process. Reforms at the Ministry of Justice, however, have reduced this approval process to 22 days.<sup>3</sup>

After a company is formed and before it proceeds to register, it needs to obtain a number of permits such physical permits (e.g. building permit) and sectoral permits (e.g. trading permit or industrial permit). These steps are then followed by the actual registration of the firm, which happens with the local government. After the company is formally registered, further specific licenses and activity permits are obtained.

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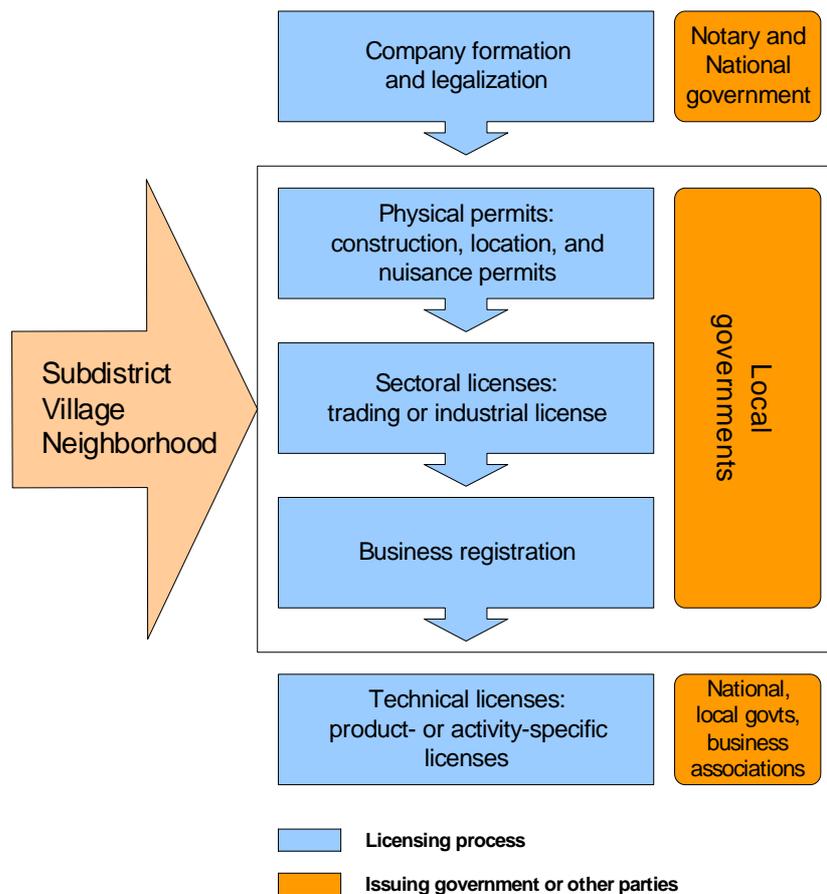
<sup>1</sup> The licensing baseline survey was carried out at the end of 2005 and is composed of a study of national and local level business regulations; a business perceptions survey on business licenses; and a survey of existing OSS centers. The study covered 17 districts, of which 13 have since received the OSS technical assistance from The Asia Foundation and 4 served as control sites. For further information and discussion of the survey results, see (TAF 2006).

<sup>2</sup> For foreign companies this step is preceded by obtaining approval from the Investment Board (BKMP).

<sup>3</sup> The entire registration process (i.e. up to obtaining a registration permit) for a Limited Liability was reduced from 151 days to 97 days in 2005 (World Bank 2006b).

The various steps in the registration and licensing process are administered by different levels of government. The first steps related to obtaining the legal deed and tax number are administered by national ministries such as the Ministry of Justice and Ministry of Finance. The subsequent steps, including obtaining the registration permit and other licenses, are mainly administered at the local (district) level. Licenses handled by the district may also require various recommendation letters, attestations, and signatures from sub-district or neighborhood level authorities. These documents require interactions with government officials at the sub-district level and even neighborhood levels.<sup>4</sup>

**Figure 2 – Business Registration and Licensing Process in Indonesia**



It is important to note that most companies in Indonesia do not have to go through the company formation and legalization procedures at the national level, as these are only required for more complex legal forms such as limited liability and shareholding companies. The majority of firms, and in particular SMEs, only interact at the local level to obtain licenses and local registration permits. This *local* licensing and registration process will be the focus of this paper.

<sup>4</sup> The Indonesian governmental administrative structure has a hierarchy that goes as follows: national government, province, district/municipality (kabupaten/kota), sub-district (kecamatan), village (desa/kelurahan), interneighborhood (Rukun Warga/RW) and Neighborhood (Rukun Tetangga/RT).

## ***The legal framework of licensing***

The regulatory authority to create licenses in Indonesia cuts across all levels of government. Licensing administration however has largely been devolved to local governments.

**National licensing regulations.** A number of licenses are mandated by national regulations, but implemented by local governments. The national regulations often stipulate *maximum* fees and requirements for the issuance of the licenses. The five main licenses—the nuisance, building, trading, industrial and registration permits— fall into this category. For example, the trading license and the registration permit are governed by a ministerial decree issued by the Ministry of Trade.

Most licenses that are required nationally are implemented at the local level through local regulations (*perda*), which specify the local conditions of the licensing process, including requirements, application procedures, validity of licenses, and administrative fees. The recent TAF survey of licensing practices in seventeen districts in Indonesia compares requirements in national and local regulations related to the five main licenses (see Table 1).

The table shows that local implementing regulations often require more supporting documents and set longer processing times for the approval of licenses than is stipulated in national regulations. Similarly, fees are also sometimes set much higher than national regulations mandate.<sup>5</sup> According to national regulations, a trading license should be obtained by submitting six supporting documents, paying a fee up to Rp. 300,000 and waiting a maximum of five days.<sup>6</sup> The survey of 17 districts shows however that some local governments require up to ten types of supporting documents, Rp. 1,000,000 processing fee and up to 15 days to process the license.

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<sup>5</sup> The discrepancy in national regulations and their local implementation relates to confusion with respect to the legal hierarchy of regulations. In Law 10/2004 ministerial decrees, which regulate licenses, are not included in the legal hierarchy. They, and other legal products, are only binding if they are mandated by a higher level regulation. This may cause local governments to disregard ministerial decrees regulating the issuance of licenses.

<sup>6</sup> Exchange rate: 1USD = Rp 9,500

**Table 1 – A Comparison between Ministerial Decrees and Local Regulations on the Five Business Licenses in 17 Districts**

Types of Licenses/ Permits	Number of requirements		Time (days)*		Costs (Rp)	
	Ministerial decree	Local Regulations (range)	Ministerial decree	Local Regulations (range)	Ministerial decree	Local Regulations (range)
Trading	6	2 – 10	Max 5	1 – 15	0 - 300,000	0 - 1,000,000
Industrial	3	3 – 10	Max 14	1 – 15	0	0 - 2,000,000
Registration	4 + specific permits	3 – 11	Max 10	1 – 15	0 - 500,000	0 - 1,000,000
Building	-	5 – 12	-	1 – 45	-	100 - 2,500,000/m <sup>2</sup>
Nuisance	-	1 – 12	-	1 – 30	-	50 - 2,000/ m <sup>2</sup>

\*) Calculated after submission of complete application

Sources:

- Decree of the Minister of Industry and Trade No. 590/MPP/Kep/10/1999
- Decree of the Minister of Trade No. 09/M-DAG/PER/3/2006
- Decree of the Minister of Industry and Trade No. 596/MPP/Kep/9/2004
- Decree of the Minister of Industry and Trade No. 597/MPP/Kep/9/2004
- Local Regulations in the 17 districts/cities surveyed

**Locally created licenses.** A key piece of legislation shaping licensing practices in Indonesia is Law 34/2000. The law authorizes local districts to levy different kinds of user charges and fees, including licenses of various kinds. The freedom given to local governments by this law has led to an explosion of additional local licenses and charges not mandated by national regulations. The scale of the problem is significant. A local research institute, Regional Autonomy Watch, found that in 2000 a typical local government issued approximately two or three new local regulations per year. In 2002, that number had increased to an average of more than 16 regulations per local government per year, and 90 percent of these created new fees or taxes (TAF- USAID 2003). In order to address this issue, the government has drafted a revised Law 34/2000. The revised law introduces a closed list of taxes and user fees that can be imposed locally, with specified maximum levels.

**Licensing administration.** Most licenses in Indonesia, even those mandated by national regulations, are administered at the local level through various local government departments (*dinas*).<sup>7</sup> Prior to decentralization in 2001, licenses were already issued at the local level. However, issuing offices reported directly to central ministries and local governments had very little freedom to determine licensing administration or cooperate with the local offices of other line ministries. These local offices, as well as their areas of authority, were then transferred to the local governments after the 2001 decentralization and took the form of local government departments.

<sup>7</sup> With the exception of licenses related to large businesses, such as major natural resource permits, which are still administered at the national level.

## ***Objectives of Licensing***

Business licenses are designed to limit or prevent market excesses and protect the public interest. Licenses can have three functions:

- To provide protection for customers, workers, owners, investors, creditors and the environment;
- To control the functioning of certain markets or industries;
- To collect information

In Indonesia, functions of licenses are often confusing and overlapping and most licenses fail to achieve their stated objectives. The business registration permit illustrates this. In most countries, business registration has a pure information collection function and will precede licensing processes which generally have control purposes. In Indonesia, however, general and technical licenses must be obtained before a business registers. The business registration system is thus characterized by a high number of pre-registration requirements which aim to control economic activity rather than simply record it. As a result of this, the registration system is much more complicated and largely ineffective in achieving its objective of collection and provision of up-to-date company information. Only an estimated 15 percent of firms are registered.

The redundancy of licenses and their functions is also exemplified in the trading permit. This permit is required for all companies, not only trading firms, and records similar kinds of information as the registration permit. Moreover, trading companies are also controlled by domestic and foreign trade regulations through, for example, commodity licenses and transportation licenses. The lack of clarity in the functions of licenses has made many ineffective. For example, Table 2 illustrates how almost half of the companies in the industrial sector obtain trading licenses and less than 20 percent obtain industrial licenses. Similarly, more companies have the trading permit than the business registration permit.

**Table 2 – Possession of the Sectoral and Business Registration Permits across Sectors**

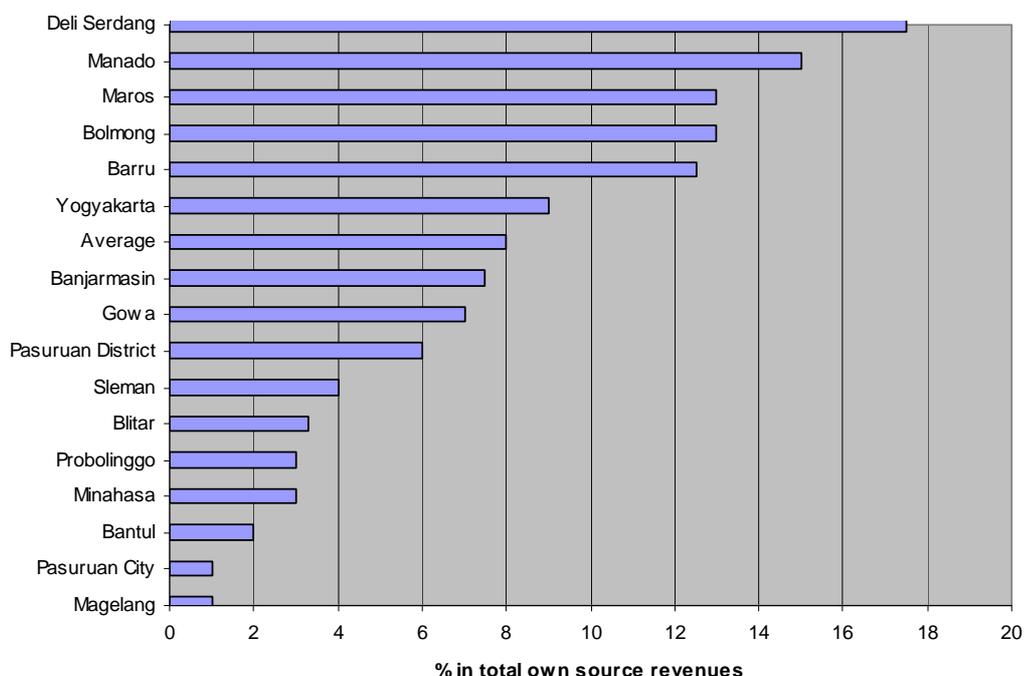
<b>Sector</b>	<b>Percentage of firms holding permits:</b>		
	<b>Industrial Permit</b>	<b>Trading Permit</b>	<b>Registration Permit</b>
Manufacturing	18%	47%	53%
Services	5%	53%	66%
Construction	29%	93%	49%
Utilities	0%	100%	33%
Trade	25%	78%	46%
Mining	80%	100%	80%
Farming	18%	70%	30%
Transportation	0%	75%	0%

Source: Primary data, processed

It is also important to mention that in Indonesia's decentralized context, licenses are often regarded by local governments as sources of local revenues. As mentioned above, with the authority given to them by Law 34, local governments have created numerous new licenses often with the main purpose of raising local revenues. This objective, however, is generally not articulated in local regulations and control and information functions are often used to justify the creation of new licenses.

In this context it is interesting to note that the contributions of local licenses in total local revenue are actually not that significant. Most licenses have relatively low revenue yields. In other words licenses have not been effective instruments for revenue generation. The The Foundation survey shows that in the 17 districts surveyed, locally generated revenues contribute, on average, only 8.4 percent to the total local government budget and 7.9 percent of those locally generated revenues are generated through licensing.

**Figure 3 Revenues from business licenses in 17 districts**



Source: 2006 TAF survey – Primary data - processed

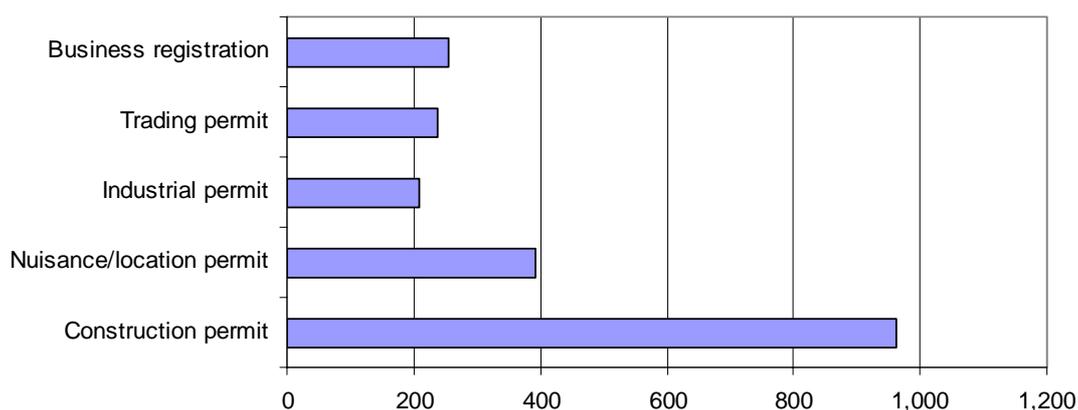
In summary, licenses have generally been ineffective instruments both to control market inefficiencies and generate local revenues. They have only created extraordinarily high compliance and transactions costs for local businesses, thus contributing to an anti-business climate at the local level.

## ***Business Perceptions of Licensing in Indonesia***

A number of surveys have shown that the regulatory burden and local licensing practices in particular constitute an important constraint for business (World Bank 2005; LPEM-FEUI 2005b). There are several aspects related to licensing that need to be considered here: official fees; costs related to time spent to process license applications and obtain required documentation; illegal charges and lack of information. These issues create significant burdens in particular for SMEs.

**Official fees.** Based on its survey of 17 districts, the TAF survey estimated the actual average cost of licensing for the five main business licenses that most businesses need to secure before they can legally operate (see Figure 3). The construction permit is by far the most expensive at an average of Rp. 960,000 (US\$106). The permit is more costly depending on the size of the company, with small companies paying an average of Rp. 750,000 and medium companies paying Rp. 1,200,000.

**Figure 4 – Average Processing Costs for Five Business Licenses (in Rp. 1000)**



Source: 2006 TAF survey – Primary data - processed

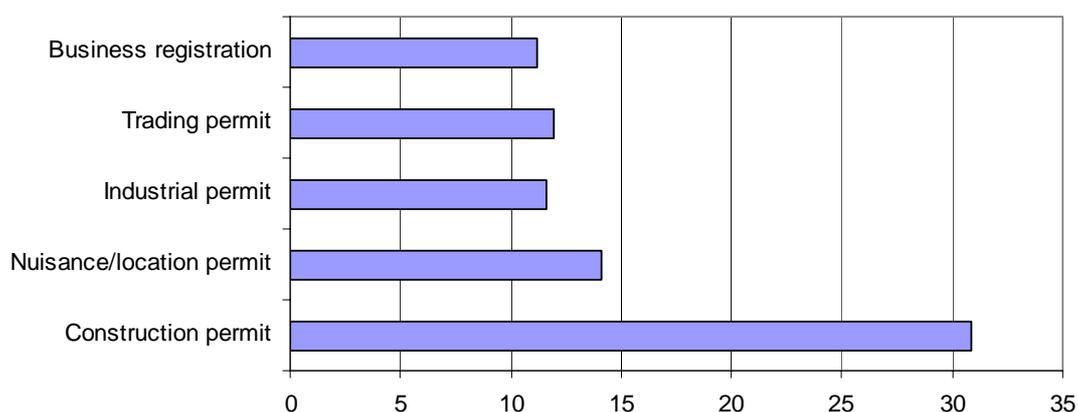
Despite the apparent costs of local licenses, evidence suggests that the revenue burden of local charges and licenses is actually not particularly significant for businesses. The total amount of revenue generated nationwide from all local taxes and charges (including licenses) was equal to Rp. 9.5 trillion (\$1 billion) in 2005, equivalent to about 0.5 percent of (non-oil and gas) GDP (World Bank 2006a). However, licenses represent charges on start-up businesses and hence are applied before they have income to allocate. License fees or taxes are thus more distortionary than income or sales taxes and are particularly detrimental for smaller companies with limited initial resources.

**Time cost to obtain licenses.** While the official revenue burden of taxes and licenses may not be particularly significant for some companies, the time to obtain licenses *is* significant for all. Opportunity costs tend to be measured in days spent in obtaining licenses and not in monetary amounts.

Various business surveys have tried to measure the size of these opportunity costs. The World Bank's Doing Business Survey estimates that it takes up to 97 days to register a business in Indonesia. A large share of this total time is taken up with satisfying central government requirements, especially those at the Ministry of Justice. About one third of the time (29 days), however, is needed to obtain only two local licenses. The TAF survey estimates that the time to obtain the five main licenses ranges from 30 to 80 days.<sup>8</sup>

Other permits may also be required, depending on the exact nature of the business. A survey conducted by LPEM of the University of Indonesia identifies an additional 20 permits that many firms need to secure in some districts (LPEM-FEUI 2005a). The time required to secure the multitude of permits and licenses is a far more significant constraint on business operations than the actual monetary amount of local taxes, charges, and fees that they have to pay.

**Figure 5 – Average Processing Time for Five Business Licenses (in days)**



Source: 2006 TAF survey – Primary data - processed

**Documentation requirements.** Most licenses require a substantial number of supporting documents, including personal and family identification, recommendation letter from community head, approval letter from neighbors, tax ID and even proof of other licenses. It should also be noted that requirements are not limited to the application process. For example, the trading permit requires companies to submit a business activities report every six months, apparently to control for fraudulent companies smuggling goods out of the country or taking advantage of double VAT rebates on exports. The time to comply with all these requirements is not included in measurements of the time to obtain licenses.<sup>9</sup>

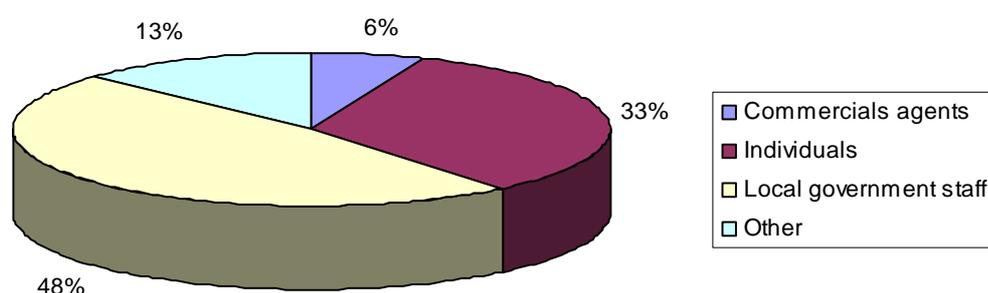
<sup>8</sup> It takes on average 30 days to secure a building permit, the longest amount of time spent for any of the permits listed. The sum of days required to obtain all six licenses is 80; this is the upper bound on time spent.

<sup>9</sup> Most surveys only measure the time from submission of complete documents to the issuance of the permit.

**Illegal charges.** A fourth aspect of licensing in Indonesia is bribes. These illegal payments are also closely related to the waiting times and opportunity costs described above. Bribes are often supplied to ameliorate the impact of regulations, such as waiting times for specific licenses. Bribes are often paid for each license so officials do not hold up the granting of the license. Kuncoro (2004) provides evidence that the level of bribes paid by firms is about 40 percent of taxes firms pay.<sup>10</sup> Bribes are positively correlated to the number of business licenses a particular firm must obtain in order to operate legally. Bribery also creates further time costs as firms have to spend time negotiating bribe payments.

**Lack of Information and Use of Intermediaries.** One of the factors contributing to the existence of bribes is the lack of information on licensing processes. In the TAF survey just under 75 percent of the respondents said that there was no detailed information available on licensing in their regions. The lack of information and associated uncertainty related to formal and informal charges has led to the emergence of brokers who offer services to arrange permits. Almost half of the businesses in the survey sought assistance of third parties (see figure 6). Interestingly, in almost half of these cases local government officials acted as intermediaries.

**Figure 6 – Type of intermediaries (percent of total intermediaries)**

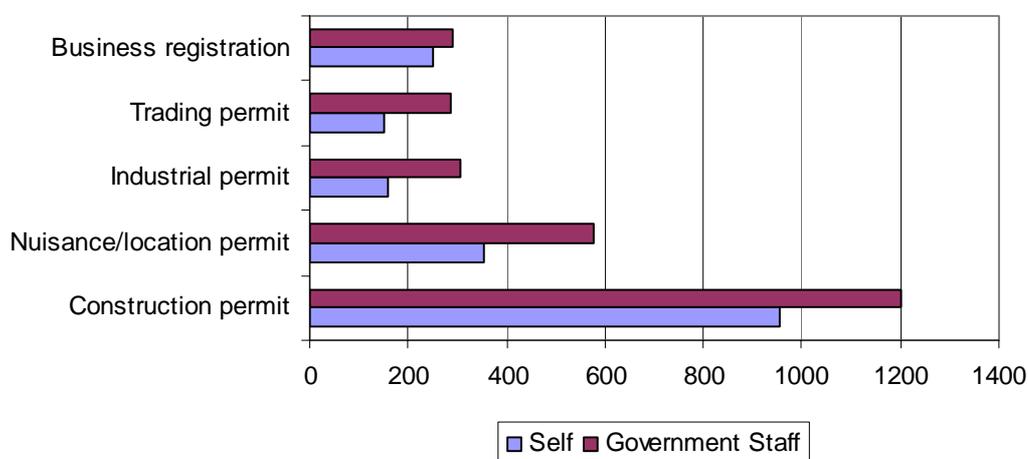


Source: 2006 TAF survey – Primary data - processed

The use of intermediaries increases the cost of obtaining licenses for all five main permits. Figure 7 shows that the use of government officials as intermediaries increases the cost of licensing by an average of 58 percent.

<sup>10</sup> Another study (KPPOD 2003) estimates that firms pay, on average 60 percent of their total taxes and charges in bribes to local officials.

**Figure 7 – Licensing cost by application arrangement (Rp 1000)**



Source: 2006 TAF survey – Primary data - processed

## 4. Licensing Reform at the Local Level: OSS

It is against this backdrop that the national government and a number of local governments, with support from international donors, introduced One Stop Shop (OSS) service centers for business registration and licensing. In principle, an OSS can be established at any level of government (and is common in many countries at the national level). In Indonesia, because of decentralization, OSS have been set up at the district level. The rationale for setting up OSS at the local level relates to the licensing structure discussed earlier. Most licenses, even those regulated by national decrees, are processed at the local level.

The OSS aims to simplify the licensing process so that enterprises no longer need to visit several different local agencies to obtain permits. The centers aim to streamline business licensing by integrating the authority to issue licenses, commonly located in various disparate government offices, into one government department. Despite the existence of national regulations that define many administrative processes, OSS reform offers an opportunity to simplify the local processing of national licenses, in addition to rationalizing locally created licenses. However, fewer than 20% of districts in Indonesia have established OSS and few of these function effectively. A vast majority of local governments still manage licensing services through the disparate technical departments, handling specific licenses. Addressing this need is the focus of the Foundation's OSS technical assistance program.

## **One Stop Shops**

One Stop Shops in Indonesia can take a variety of institutional forms. In order to understand the position of the OSS in the local administration, we need to consider three factors: the legal basis, the organizational level and the operational authority.

**Legal basis.** The move toward establishing OSS at the district/municipal level began in the mid 1990s. However, as license-issuing offices prior to decentralization were part of the national government structure, no real integration of business licenses were possible until after decentralization. The Minister of Home Affairs issued a circular in 1997 on the general guidelines in the establishment of the OSS in the regions. In 2006, as part of the national government's investment climate reform strategy, the Ministry also issued a decree providing specific guidelines on the set-up of the OSS. Local governments followed these national level regulations with one of their own. However, local governments' perceptions of the national legal basis for setting up an OSS vary. While national level decrees provide legal reference, local governments are by no means obliged to establish OSS.

Those that choose to establish OSS can do so by either issuing a Mayoral or Head of District Decree or by passing a Local Regulation (*Perda*) through the local parliament. Mayoral or Head of District decrees can be easily revised or repealed when there is a change of a local executive; whereas, a Local Regulation will be harder to change because it requires the approval of the local parliament.

**Organizational level.** OSS can take different organizational levels:

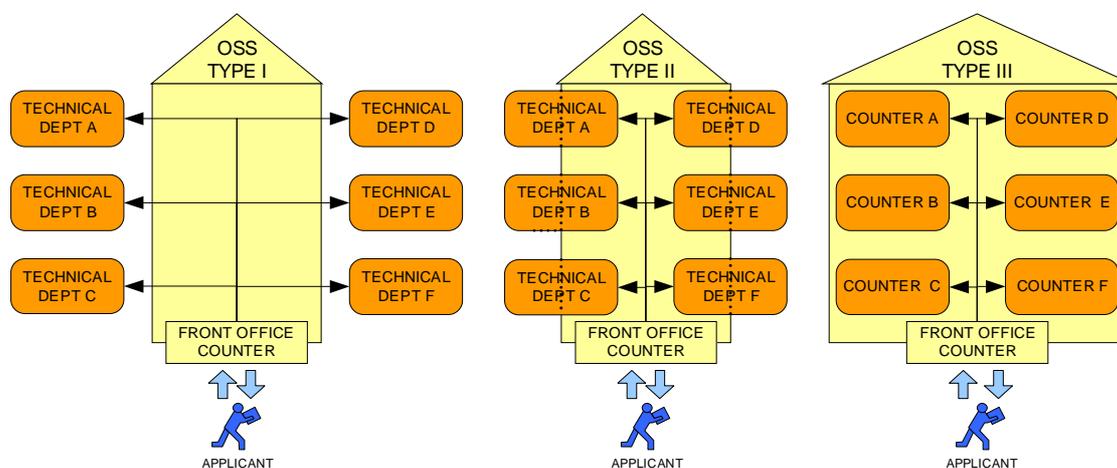
- The first is the *unit* form of OSS, which is the lowest level of authority and often the least effective. The unit is simply a front office for receiving license applications without the authority to approve them. The OSS still passes applications to the relevant individual departments, who have the authority to issue the licenses.
- The second is the "office" or *kantor* OSS. This form of OSS can usually receive applications and coordinate the processing of those applications, including field visits by technical departments.
- The third, and generally the most effective, type is the "department" or *dinas* OSS center that can receive, process, and approve the applications in-house. This last type would be endowed with the necessary administrative and technical personnel as well.

So far the experience with OSS in Indonesia has been mixed. This is due to the fact that local governments have freedom to determine which type of OSS they wish to establish, if any, with little guidance from the national government. Because of a lack of local capacity and guidance, and the inevitable resistance from vested interests within the bureaucracy, most governments have simply established a unit form OSS, which often

has no authority and in fact simply adds another stop to the already complicated licensing process. The 2006 national decree on One Stop Shops recommends establishing OSS of at least the *kantor* level and preferably of *dinas* level.

**Operational authority.** Unfortunately, form does not always follow function when it comes to actual operational authority. An OSS functions most efficiently if it has the authority to *receive, process and approve* license applications. This authority is generally, though not exclusively associated with the *dinas* form of OSS and a local regulation (*Perda*). However, *unit* and *kantor* level organizations can also wield greater processing authority depending on associated legal instruments and directives from government leadership.

**Figure 8 – Three Levels of OSS Authority (From left, Front Office, Coordination and Approval)**



#### BOX 1 – OSS in Other Countries

Other countries set up OSS in a somewhat different manner than Indonesia. Countries such as Portugal, France, and Ukraine have established national-level OSS that combine company, tax, and social security registration in one place. This cuts down the length of time and the number of processes required to legally register a business. However, a number of pre- and post-registration procedures still fall outside the OSS, such as obtaining a proof of address or IPR registration (World Bank 2006b). Nevertheless, a national level OSS in Indonesia can complement district-level OSS and can further reduce the burden of business registration. It can possibly merge company registration with the company act approval process by the Ministry of Law and Human Rights, the tax number registration by the Ministry of Finance, and the publication in the legal gazette. Local OSS can still be responsible for the post-registration licenses such as the physical and technical permits.

## Success Factors

Recent evaluations of OSS in Indonesia have identified a number of key characteristics of successful OSS centers<sup>11</sup>:

- **Strong local leadership.** The local government, and in particular the local leader, play a key role in the success of licensing reform and establishment of the OSS. This observation is also corroborated by a study of eight districts in Indonesia, which shows that good licensing and taxation practices strongly correlate with positive levels of governmental leadership (Von Leubke 2006). In some cases this requires local leaders to take decisions that are potentially in conflict with national regulations. The mayor of a progressive district with a best practice OSS in Central Java for example decided to provide the trading license for free to smaller businesses, in contrast to national provisions.
- **OSS has *authority to issue licenses; based on a local regulation.*** In principle, the law on the structure of the local government (PP 8/2003) stipulates the level and scope of responsibility of different levels of government. The ideal institutional form of OSS is *dinas*. The head of a *dinas* should have the authority to sign and issue permits, unlike the head of an *office* or *unit*, whose role is coordinating permitting services. However, the law is not always consistently applied when it comes to OSS and the effectiveness of the institution in streamlining licensing processes is much more dependent on the actual authority granted to the OSS rather than the *level* of the organization.

A number of best practice OSS in Indonesia (such as for example OSS in Sragen and OSS in Parepare) were still at *unit* level when the government already authorized the head of the OSS to sign and legalize licenses processed under this service. In order to be effective, OSS should have administrative level of *Office* (kantor) or *Department* (Dinas) **with** the respective level of authority to process and/or approve licenses.

In addition, successful OSS are generally established through local regulation, approved by parliament, rather than a mayoral decree. The regulation gives the head of the OSS the authority over licensing processes and establishes minimum service standards and enforcement measures. For office level OSS, it is important that OSS staff report to the OSS, and not to other local departments. Authority to approve licensing can remain with other local departments, but the OSS must control processing in order to enforce minimum service standards.

- **Clear regulations on working procedures.** Apart from the local regulation specifying the level and authority of the OSS, regulations specifying standard operating procedures and minimum service standards are also needed. This information should be widely available to customers, and OSS staff and

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<sup>11</sup> See (TAF and ITTS 2004) and (PSB-IPB and IFC-PENSA 2004)

management should clearly understand the sanctions for failing to meet these standards. There should be complaint or service evaluation mechanisms so that failures to meet the MSS are brought to management's attention. Some successful OSS in Indonesia have obtained ISO 9001 certifications for the quality of their services.

- **Qualified and professional human resources.** The development and efficiency of the OSS is strongly related to the quality and professionalism of human resources in the OSS. The OSS will not function properly without internal capacity building of its personnel. Simple tasks, such as customer service, advice on site plans, and data entry, may require extensive training. Successful OSS sites invest significantly (using the local budget) in staff training. Some also have rules on staff retention to avoid rotation of trained staff.
- **Transparent and standardized fees.** Entrepreneurs will be reluctant to deal with the OSS or any other government department if there is no standard and transparent fee schedule for license applications. Successful OSS generally distribute this information through public information boards in the OSS office, leaflets distributed to the public and websites. The availability of transparent standard information is important to reduce the role of intermediaries, as well as to reduce the extraction of unofficial rents. A number of OSS have introduced electronic payment systems so applicants no longer need to use cash.
- **Awareness of the OSS.** The success of an OSS is also determined by the public awareness. OSS can be promoted through radio, brochures, leaflets, a sign displayed in public places or direct information campaigns conducted by OSS staff in sub-districts. Good practice OSS centers have also made extensive use of information technology. Most have websites that provide information and licensing services.

## 5. The Asia Foundation's OSS TA Methodology

Since 2001, The Asia Foundation has been assisting local governments to implement new business licensing practices.<sup>12</sup> The first phase of the program (2001-2004) enabled the Foundation to pilot different approaches of assistance and to develop a sound methodology for OSS technical assistance, which formed the basis for a second phase (2005-2008).

### *Program phases*

The technical assistance consists of six main phases.

**Phase 1: Assessment phase - selecting districts and partners.** The first phase of the technical assistance involves an assessment of the local government's interest and readiness for licensing reform. The preparedness of regional governments can be evaluated from the strength or weakness of the commitment on the part of the local leadership (Regent/Mayor) to reform licensing services, and the existence of regional government staff/officials who are capable to serve as motivators of an OSS development program. This phase includes signing a MoU with the district, which lays out the responsibilities of each party during the assistance. The local government also passes a local decree that establishes the technical team that will be in charge of the reform effort.

In parallel with the assessment of the government's demand for assistance, the Foundation also assesses the local capacity available to deliver the technical assistance. This capacity can be measured from its administrative conditions and experience in working with regional governments/bureaucracy. The use of local partners is part of the Foundation's strategy to build up local resource centers, which can provide technical assistance to local governments in a sustainable way. These local organizations are trained and monitored intensively throughout the technical assistance.

**Phase 2: Policy and institutional analysis.** The second phase of the assistance involves an analysis of local regulations and policies related to business licenses. This includes an internal review of the authority and coordination of technical units issuing licenses, as well as a detailed diagnostic of the entire licensing process and related requirements. The business community is also consulted to identify the most burdensome aspects of the registration and licensing process. This data is collected through a baseline survey with business owners.<sup>13</sup> The results of this review are disseminated in a local workshop. The analysis phase involves an interactive process between the government, local partners and the business community. The study aims to inform local governments about current local practices and their impact on business. The results are good

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<sup>12</sup> With support from USAID and CIDA

<sup>13</sup> This baseline survey data is also used for monitoring and evaluation purposes.

motivators for reform, as governments are often unaware of the inefficiencies in the licensing processes and the burden it creates for business.

**Phase 3: Design of licensing reforms.** The third phase of the assistance is focused on the design of the new licensing procedures and OSS by the local partner and the government's technical team. This involves:

- Design of the authority of the new OSS including which licenses will be integrated in the OSS and to what extent the OSS will have full control over the licensing process i.e. receive, process and issue licenses.
- Design of standard operating procedures and minimum service standards. This involves specifying procedures and requirements for various licenses.
- Study tour to other successful OSS. The tour generally includes visits to OSS centers of different institutional and authority levels.
- Design of monitoring and evaluation system including a complaints mechanism.
- Staffing analysis and development of staffing plan. This includes developing criteria for the recruitment of staff for the OSS and a staffing plan. This also involves identifying training needs.

During this phase the momentum for reform is sustained and further stimulated by a number of local advocacy and promotion efforts. This includes radio and TV talk shows featuring the local government, partners and the business community.

**Phase 4: Implementation of reforms.** The fourth phase is aimed at the legal establishment of the OSS and implementation of staff training. This includes:

- Drafting local regulations for the establishment of the OSS, as well as the implementation of the standard operating procedures and the minimum service standards. The regulation for the establishment of the OSS has to be approved by local parliament. Decrees on SOP and MSS are approved by mayoral decree.
- Staff training. This can be either formal training or internships at other successful OSS.
- Development of information materials, such as public notice boards, application guides and brochures.

**Phase 5: OSS launching and socialization.** The implementation of reforms is capped with a public launching of the new OSS. This launching event is then succeeded by further promotion activities to raise community awareness. Activities include: radio and TV talk shows, distribution of flyers with information on the OSS, among other outreach efforts. Continued involvement and monitoring by the Asia Foundation's partners and the local business community is essential for ensuring the sustainability of licensing reforms.

**Phase 6: Introduction of IT systems (optional).** An important part of license-processing improvements is the implementation of Web-based systems that allow governments to maximize service standards and efficiency, and to disseminate information widely and transparently. IT-enabled services include downloadable

applications and application status queries processed via SMS and email. This phase of the Foundation's technical assistance, however, can only leverage the improved systems and procedures developed during the earlier technical assistance.

Some advanced OSS have already invested in database and Intranet systems for their offices. However, even these systems often require further improvements in data base management and on-line access. Most OSS still have limited IT resources. In addition, the varying technology standards among OSS have created potential obstacles toward the eventual integration of business services and data sharing at the local and national levels. These are opportunities and challenges that the Foundation engages with its most successful government partners.

### ***Impact of the Program***

The second phase of the program started in the last quarter of 2005 and complete results of the new approach and methodology, in particular in terms of actual time and cost, are not yet available. These results will be measured by a monitoring survey that will be conducted six months after completion of the program. Results of this survey will be compared to the baseline survey data collected at the start of the program (as part of Phase 2). Initial results however show strong improvements in the program sites and licensing services. Table 3 gives a snapshot of the changes in three districts following the technical assistance.

**Table 3 Program impact of OSS technical assistance (Phase II)**

	Pasuruan		Probolinggo		Blitar	
	Before	After	Before	After	Before	After
Authority	front office	approval	front office	approval	front office	approval
Number licenses	13	15	13	15	10	17
Documents for key licenses	48	25	23	16	39	34
% reduction in # documents		48%		30%		13%
Time to process key licenses	55	47	31	26	38	30
% reduction in official time		15%		16%		21%
Public information available	no	yes	no	yes	no	yes
Complaint mechanism	no	yes	no	yes	no	yes
IT system	no	yes	no	yes	no	yes

While data on the actual reduction in time and cost related to current programs is not yet available, an independent evaluation of the earlier pilot phase of the Foundation's OSS technical assistance program indicated strong improvements. The existence of the OSS reduced the burden on local businesses both in terms of time and cost of obtaining licenses. Even with increases in the official fees to obtain legal status, the total costs expended (official costs, unofficial costs, transportation costs, etc.) generally declined.<sup>14</sup>

<sup>14</sup> Equally significant decreases in time and cost of licensing registration were also observed in other countries implementing One Stop Shop programs at the local level. The Ukraine BIZPRO project reported

**Table 4 Average program impact of OSS technical assistance (Phase I)**

<i>Type of service</i>	<i>Pre OSS</i>	<i>Post OSS</i>	<i>Change</i>
Nuisance/Location Permit			
a. Time (days)	50	16	-68%
b. Total cost (000 Rupiah)	282	191	-32%
Industry Registration			
a. Time (days)	45	14	-69%
b. Total cost (000 Rupiah)	336	239	-29%
Trading Business Permit			
a. Time (days)	25	13	-48%
b. Total cost (000 Rupiah)	300	249	-17%
Company Registration			
a. Time (days)	32	13	-59%
b. Total cost (000 Rupiah)	349	203	-42%

The evaluation also provided evidence of the potential sustainability of the program and the continuing role of local partners after the assistance ends. The cooperation between local NGO partners and the regional government has in some instances turned into a healthy partnership. The local NGOs have become increasingly aware that their desire to protect the public interest cannot be served simply by applying pressure, but must be accompanied by a willingness to work with the bureaucracy to manage change. This awareness has instilled a desire to upgrade their own institutional capabilities in technical matters to support cooperation with regional governments. On the side of regional governments, an understanding has grown that cooperation with NGOs can provide very significant benefits.

The second phase of the program involves broadening the scale and scope of activities. In this new phase, the program is also moving towards a more rigorous monitoring and evaluation strategy. Program impact will be evaluated based on a combination of baseline and monitoring surveys.

### ***Lessons learned***

Based on its experience assisting local governments in licensing reform, the Foundation has identified a number of key ingredients for the success of the assistance programs.

- **Political support is needed from executive and legislative branches.**  
The readiness of regional governments and local communities plays a key role in the successful implementation of the technical assistance and the establishment of the OSS. There needs to be strong support from the top leadership to ensure success in achieving the form of OSS that is desired. The commitment of the local leadership is

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reductions in registration times of nearly 50 percent and declines in costs of nearly 60 percent (USAID 2005).

not sufficient, however, as a successful OSS requires the buy-in of a variety of stakeholders. The local parliament, for example, plays a key role in the passing of local regulations related to the OSS and needs to be supportive of the new institution.

Equally important is the support of the second most powerful bureaucrat in the district (*sekda*). The relevant technical departments also need to buy into the OSS. They may be forced into transferring their authority to the OSS, but without a clear understanding that the OSS actually helps them in conducting one of their main tasks, resistance will persist and often impede the sustainability of the OSS. An important part of the assistance involves building communication channels for the government to present their programs to the users of the service (business operators), the local legislatures (DPRD), local media and the relevant central government agencies. It is necessary to understand the culture of the existing bureaucracy in the government in order to accurately recognize and overcome resistance to the changes that are being made.

- **Full authority for the OSS is often hard to achieve.** Establishing OSS with the highest level of authority (*approval*) and organizational level (*dinas*) are often fraught with difficulties as power and authority within the local government needs to be re-distributed—often with a loss of rent seeking opportunities. In some local governments, these institutional changes need to go hand in hand with changes in public servants' pay and incentive mechanisms. This is currently not part of the technical assistance.
- **Local government has to own the program, local partners assist.** Success of the program is also highly dependent on the involvement and capacity of local partner institutions implementing reform. Local partners are expected to oversee the day-to-day implementation of the technical assistance. A role that must be avoided is that the local institution becomes the implementer or the owner of the OSS development program. The local partner plays a role as initiator, motivator, facilitator and technical assistant. These roles should be performed dynamically, in the sense that the roles taken are dependent on the readiness of the local government and the readiness of the community and users of the OSS services.
- **Local partners need deep understanding of technical issues.** Full understanding of the substance of permitting services, and the direction and form of desired changes, is imperative for the partner institution. Partners need to be able to explain: (i) the licensing situation, the problems with it and the development alternatives the government could choose; (ii) the substance of the changes with respect to the new OSS institution; (iii) who will receive the benefits, and what form these will take; (iv) how local governments will receive indirect benefits, and what form these will take.
- **OSS needs to be complemented with broader regulatory reform at local and national level.** The development of an OSS is focused on streamlining

existing licenses and does not necessarily address broader regulatory issues such as the existence of overlapping and distortive licenses. The establishment of the OSS should ideally be accompanied by a systematic review of the different types of licenses, their purpose and impact on the business community. This can be done at the local level for licenses and procedures under the control of the local government. The Foundation has been working with local governments to implement Regulatory Impact Assessments (RIA) as a regular part of regulation making. RIA is an analytical tool that helps government identify whether a regulation (such as a license) is needed, what the costs and benefits of the proposed regulation are, and whether there are alternative solutions to regulation. In some cases changes in national regulations need to be advocated. Advocacy work in Indonesia is already ongoing to propose merging two of the two main licenses, the trading permit and business registration permit.

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