

Doing Business

Getting credit

Credit is now more accessible in Panama, thanks to an ambitious reform of the credit bureau law in early 2006. Before the reform many of Panama's 300,000 small and medium-size businesses—employing 68% of the country's workers—were cut off from access to formal credit. So were more than 40% of Panamanian adults, mostly the poorest. They were forced to rely instead on pawnshops and street lenders.

This was despite advanced financial markets. With more than 80 national and foreign banks, Panama has one of the highest ratios of domestic credit to GDP in Latin America. But the 2002 credit bureau law prohibited collecting payment information from utility firms. That made it harder for poor people and small firms without bank loans or credit cards to build a credit history. And the system was opaque for borrowers: they could see the information stored in the credit bureau only by requesting a report in person at its main offices in Panama City or the city of David. “We were seen as the ‘bad guy’ who was denying credit to people,” recalls German Espinosa, an officer at the Panamanian Credit Association.¹

Lenders look at a borrower's credit history in deciding whether to extend credit and what interest to charge.² They also want to know whether they can recover their

money if a borrower defaults. The main way to recover bad debt is by taking collateral. By giving creditors the right to an asset on default, collateral also reduces a lender's costs of screening loan applicants.

Where credit registries and effective collateral laws are lacking—as they are in most poor countries—banks make fewer loans.³ Credit to the private sector averages 8% of GDP in the 10 economies ranking at the bottom on how well credit registries and collateral laws facilitate credit markets (table 6.1). In the top 10 economies it exceeds 130% of GDP.

TABLE 6.1
Where is getting credit easy—and where not?

Easiest	Rank	Most difficult	Rank
United Kingdom	1	Uganda	169
Hong Kong, China	2	Burundi	170
Australia	3	Lao PDR	171
Germany	4	Marshall Islands	172
Malaysia	5	Palau	173
New Zealand	6	Timor-Leste	174
Canada	7	Uzbekistan	175
Israel	8	Madagascar	176
Singapore	9	Afghanistan	177
United States	10	Cambodia	178

Note: Rankings are based on the sum of the strength of legal rights index and the depth of credit information index. See Data notes for details.

Source: Doing Business database.

Who is reforming?

Croatia was the top reformer in 2006/07, improving both its collateral regulations and the availability of credit information. In September 2006 a new collateral registry started operations—and creditors leapt at the opportunity to use this new resource in deciding on loans. In May 2007 a new private credit bureau started distributing information. Coverage of borrowers in credit information systems shot up from 0 to 72%. At that rate it won't be long before Croatia ranks among the economies with the most coverage (table 6.2).

Another 15 economies improved their credit information systems in 2006/07. Armenia and Russia saw new private credit bureaus get off the ground, both providing online access to credit data. The credit bureaus in India and Saudi Arabia now cover information on businesses, not just individuals. Egypt's first private credit bureau will soon start distributing information to clients.

The most popular reform to credit information was to expand the range of data available on borrowers (table 6.3). Georgia added payment information from electricity and telecommunications companies. Kenya incorporated data from retailers and telecommunications companies. Kuwait's credit bureau now includes information from furniture sellers—and those in Saudi Arabia and Trinidad and Tobago information from mobile phone companies. Bosnia and Herzegovina expanded the number of trade creditors providing information on firms, tripling coverage. Colombia's bureau membership jumped from 1,450 to 2,100 in a year after more trade creditors started contributing data. In Brazil credit unions and microfinance institutions started sub-

mitting credit information to the public registry. And Honduras tripled its coverage of borrowers by adding new suppliers of information and persuading existing ones to provide all their data.

Some countries revised their credit information regulations. Kenya's central bank issued new regulations requiring banks to report information on defaults to the private credit bureau. In Honduras the National Commission of Banks and Insurance certified the private credit bureau, guaranteeing that borrowers can access their data once a year for free. Serbia now requires lenders to request a credit report before giving a loan. South Africa requires lenders to check their customers' overall debt levels and guarantees borrowers the right to access and challenge their credit records. The public registry in Belarus issued regulations guaranteeing that borrowers can inspect their data.

The biggest pickup in reform was in the Middle East and North Africa (figure 6.1). Tunisia's credit registries now record all loans, expanding coverage of borrowers by 25%. West Bank and Gaza tripled coverage with a similar reform. In Saudi Arabia the public registry closed as the private bureau expanded coverage by 60-fold. Morocco now has legislation in place for a bidding process to establish one or more private bureaus. Egypt's new private bureau will use the data feed between commercial banks and the central bank, avoiding duplicate investments in data transmission technology.

Elsewhere, public registries expanded coverage by lowering or removing the threshold at which loans are included. Indonesia's public registry eliminated its minimum loan cutoff of 50 million rupiah (\$5,460), increasing

TABLE 6.2

Who has the most credit information—and who the least?

Borrowers covered as a share of adults

Most	%	Least	%
Argentina	100	Algeria	0.19
Australia	100	Mauritania	0.18
Canada	100	Rwanda	0.17
Iceland	100	Djibouti	0.16
Ireland	100	Chad	0.15
Israel	100	Ethiopia	0.15
New Zealand	100	Madagascar	0.08
Norway	100	Yemen	0.07
Sweden	100	Nigeria	0.04
United States	100	Guinea	0.02

Note: The rankings reflected in the table include only economies with public or private credit registries (122 in total). Another 56 economies have no credit registry and therefore no coverage. Source: Doing Business database.

TABLE 6.3

More credit information—the most popular reform in 2006/07

Expanded set of information collected in credit registry

Georgia, Honduras, India, Indonesia, Kenya, Kuwait, Pakistan, Saudi Arabia, Trinidad and Tobago, Tunisia, West Bank and Gaza

Established new credit registry or bureau

Armenia, Croatia, Egypt, Russia

Revised credit information regulations

Honduras, Kenya, South Africa

Allowed out-of-court enforcement of collateral

Ghana, Honduras, Romania, Vietnam

Established unified collateral registry

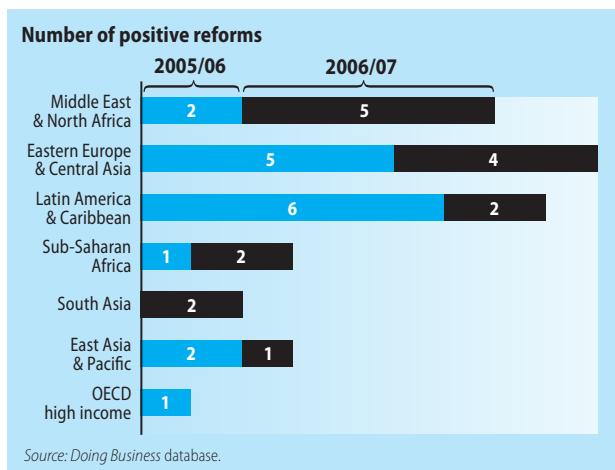
Croatia, France, India, Micronesia

Expanded range of assets that can be used as collateral

China, Croatia, Vietnam

Source: Doing Business database.

FIGURE 6.1

Credit information reform—faster in the Middle East

coverage of loans by 150%. Pakistan eliminated its loan threshold of 500,000 Pakistan rupees (\$8,350), boosting coverage by 20 times. Central Africa's monetary union computerized its registry, allowing information to be distributed on all loans above 10,000 CFA francs (\$20) rather than 5,000,000 (\$10,400) as before.

Sri Lanka slipped backward. It raised its minimum loan cutoff from 100,000 Sri Lanka rupees (\$900) to 500,000 (\$4,500) and restricted the availability of information on repaid defaults to 1 year.

Reforms also strengthened legal rights for borrowers and lenders. Nine countries made it easier to create and enforce collateral. China made the most progress, exiting the bottom 10 list on the strength of legal rights for borrowers and lenders (table 6.4). A new bankruptcy law gives secured creditors priority in receiving proceeds from their collateral if the borrower becomes insolvent. And a new property law expands the range of assets that can be used as collateral to include inventory and accounts receivable. Before the reform Chinese businesses held more than \$2 trillion in "dead capital"—assets that could not be used as collateral because of restrictions in laws. With the new property law, some of these assets

TABLE 6.4

Who has the most legal rights for borrowers and lenders—and who the least?

Strength of legal rights index (0–10)

Most		Least	
Hong Kong, China	10	Timor-Leste	2
United Kingdom	10	Tunisia	2
Albania	9	Bolivia	1
Australia	9	Burundi	1
New Zealand	9	Ecuador	1
Singapore	9	Egypt	1
Slovakia	9	Madagascar	1
Denmark	8	Rwanda	1
Ireland	8	Afghanistan	0
Malaysia	8	Cambodia	0

Note: See Data notes for details on the index.

Source: Doing Business database.

can be used for loans to expand businesses.

Two other countries expanded the range of assets that can be used as collateral. Vietnam now allows businesses to use all types of assets and debt. Croatia's new law permits inventory to be used as collateral as long as the location of the goods is specified.

A big trend in collateral reforms was to set up collateral registries. France, the top reformer in getting credit in 2005/06, launched a nationwide online registry of movable collateral. India introduced an electronic registry for security rights granted by companies. Micronesia implemented its first secured transactions law and also launched an online collateral registry. The registry applies to all assets and all types of creditors and debtors.

Making out-of-court enforcement possible was another popular reform to collateral laws. Ghana's new insolvency act allows secured creditors to enforce their security directly rather than waiting for a judge to review their claims and order enforcement. Honduras now permits borrowers to agree with lenders on direct enforcement by notaries. Going through the courts used to take years.

What to reform?

Since 2004 *Doing Business* has recorded 79 reforms to credit information in 56 countries—and 42 reforms to collateral laws in 32 countries (figure 6.2). The experience of these countries points to 5 reforms that help entrepreneurs get loans:

- Expand the range of information available in credit registries.
- Eliminate legal obstacles to sharing credit information.
- Allow all types of assets to be used as collateral.
- Establish registries for all collateral.
- Permit out-of-court enforcement of collateral.

Expand the range of information available in credit registries

Include information on telephone and electricity payments in the credit reporting. That way, people who've never had a bank loan or a credit card can still build a credit history. And avoid limits on this coverage. Panama allows utility information to be included, but only after the consumers give their written permission—making data on such payments expensive to collect.

Credit reporting also is more valuable when it includes both data on defaults over the past 5 years and data on on-time payments. That allows lenders to evaluate the borrowing capacity of clients. And it lets good borrowers benefit from more and cheaper lending. For banks, past payment behavior is the best indicator of future payment behavior.

Eliminate legal obstacles to sharing credit information

Credit registries store sensitive information, making credit reporting an easy target for critics. The best way to counter their concerns is to introduce laws that safeguard borrowers' privacy and create incentives for registries to maintain high-quality data. Legislation can guarantee borrowers the right to inspect their data, obliging the credit bureau to send them the data for review once a year free of charge. Such legislation is under review in 13 countries.

Many countries—including Bolivia, the Dominican Republic, El Salvador and Honduras—have such regulations in place for private bureaus but not public credit registries. Costa Rica and Malaysia allow borrowers to check their files in public registries but not private bureaus. There is no reason for the different treatment.

Allow all types of assets to be used as collateral

Alejandro, an Internet service provider in Guatemala, describes getting a loan: "I was able to use my business equipment and frequencies as collateral. But they required detailed descriptions in the contract of each of our 6,000-odd units of equipment, including their serial number, brand and model. We hired a technician to help. The contract was 127 pages long! And when we update our equipment in a year, we'll need to renegotiate the loan."

Countries that require specific descriptions of assets in collateral agreements make it impossible for a borrower to use changing pools of assets (such as inventory or receivables), future assets (such as crops) or the entire business as collateral. This is especially costly for small firms, which are less likely to own real property and instead need to rely on receivables and movable property as collateral.

A better way is to permit general descriptions in loan agreements, allowing the use of all types of assets as collateral—present and future, tangible and intangible. Bosnia and Herzegovina, Denmark, France, Peru, Serbia, Ukraine and Vietnam have done so since 2004. When Slovakia allowed general descriptions, credit to the private sector jumped by 10%. More than 70% of the new credit was secured by movables and receivables. Even without such radical change, reformers can ease access to credit by broadening the range of assets that can be used as collateral to include such asset classes as accounts receivable (as China did in 2007), inventory (as Croatia did in 2006) and future assets (as Japan did in 2005).

FIGURE 6.2

Collateral reform—Eastern Europe & Central Asia shows the way

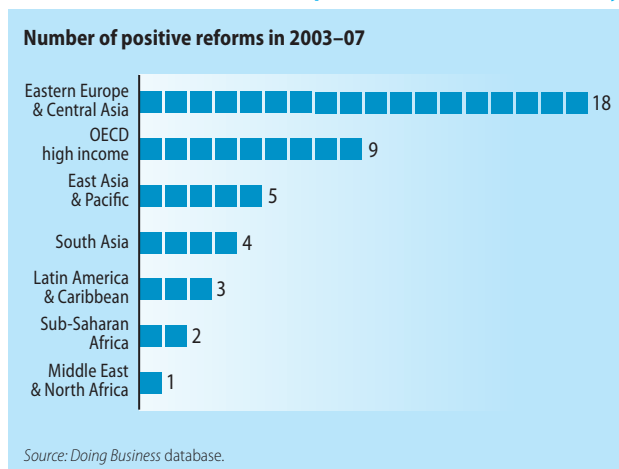
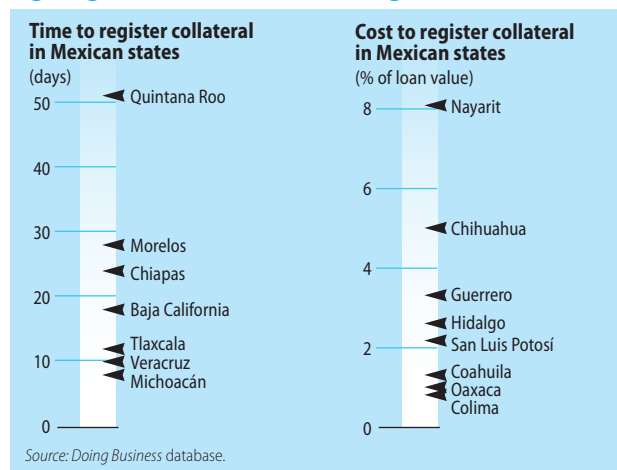


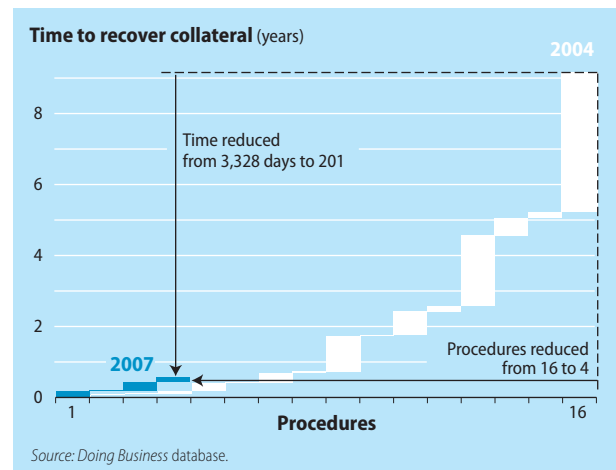
FIGURE 6.3

Big range in the time and cost to register collateral**Establish registries for all collateral**

In Syria charges over movable property are possible only if there is a corresponding registry—now the case only for vehicles, vessels and intellectual property. Turkey has a similar system. The solution: allow all types of assets to be used as collateral and create a unified registry enabling creditors to notify others of their claim. Eastern Europe has led the way in such reforms: in the past decade 12 of the region's 15 countries have created unified registries of charges over movable collateral. Other countries—from Nepal to Vietnam—are in the process of doing so. With the costs of technology falling, establishing a unified registry has never been easier.

Once established, the most efficient registries require only an administrative review for completeness of the application rather than a legal authentication, which stalls the registration process. The time and cost of registering can also be an obstacle. In Mexico, for example, it takes 8 days to register collateral in Michoacán but 51 days in Quintana Roo. And it costs 0.8% of the loan value in Colima but 8.1% in Nayarit (figure 6.3).

FIGURE 6.4

Easier to recover collateral in India**Permit out-of-court enforcement of collateral**

Allowing creditors to enforce collateral out of court is one of the toughest reforms, opposed by both borrowers and the judiciary. But the benefits can be great. Peru's recent reform to allow out-of-court enforcement reduced enforcement time from more than 2 years (longer than the economic life of many assets) to 3 months. Other reformers—such as Armenia, the Kyrgyz Republic and Slovakia—saw similar gains. Borrowers benefit the most. When creditors know they can enforce their collateral if a borrower defaults, they are more likely to lend in the first place.

Summary proceedings are an important backstop to out-of-court enforcement, which could wind up in the courts if debtors appeal. Only 2 pieces of evidence need to be presented to a court in a summary proceeding: a valid security agreement and proof of default. In the 56 countries with summary proceedings, enforcing collateral takes half as long as in the countries that rely on other judicial measures. When India introduced summary proceedings in 2004, the time to enforce collateral fell from more than 9 years to as little as 6 months (figure 6.4).

Notes

1. Bustelo (2007).
2. Djankov, McLiesh and Shleifer (2007).
3. Sorge and Zhang (2007).