

Doing Business Reform Memorandum

Croatia

May 2015



Introduction

Croatia's business environment has been identified as a priority area for reform by the Croatian Government. Under the Government Working Group for Business Climate and Private Investments, the Agency for Investment and Competitiveness has been designated to lead the dialogue with the private sector and coordinate the consultations with stakeholders, including international organizations on the design of a new wave of business environment reforms. This reform memorandum is prepared at the request of the Agency for Investment and Competitiveness and aims to provide a concrete set of short and medium term reform recommendations that will address some of the business environment challenges currently faced by the private sector in Croatia. The World Bank team is grateful for the coordination and technical assistance provided by the Agency during the preparation of this reform memorandum.

Croatia suffers from a number of shortcomings that entrepreneurs experience in the day-to-day running of their business operations. Some of the most burdensome challenges in the business environment are highlighted in the *2015 Country Report on Croatia*, prepared by the European Commission. Key challenges include regulatory instability; high administrative burden; low transparency and predictability in the working of administrative bodies; and long judicial proceedings.

Weak legislative planning has weighed down the quality of new regulations. In 2014, half of the laws passed were not planned. Although there is a *Regulatory Impact Assessment* (RIA) mechanism in place, in practice most legislations go through a fast track legislative process and circumvent RIA altogether. Even when performed, RIA is not properly done, due to weak quality control and lack of high level commitment. Poor legislative quality in turn leads to frequent amendments to address shortcomings and complications for SMEs. There is a plan in place to introduce the "two out, one in" check for new regulations and specific measures are being planned to improve the overall quality of impact assessment.¹

The administrative burden in Croatia is higher than in most EU member states. Despite a public wage bill close to 12% of GDP, Croatia scores low on the *EU Public Administration Scoreboard*, particularly on indicators on effective implementation, cost and time to export, and irregular payments and bribes. Businesses find that inconsistencies in decision making at the local level, as well as lack of strict timeframes for issuing opinions on tax issues are a key source of concern. These implementation gaps are often caused by high turnover rates, nonexistence of performance-based wage system, limited training opportunities, and lack of transparency in staff recruitment in public administration. Improving the efficiency and quality of the justice system also remains a challenge. In 2014, the length of trials was comparatively long at first instance both in civil and commercial cases (378 days) and in administrative cases (427 days). At first instance administrative courts, backlog increased by 17%, despite more cases being resolved. At the High Commercial Court, backlog

¹ Republic of Croatia, National Reform Programme, April 2015. The English version of the document can be found at: http://ec.europa.eu/europe2020/pdf/csr2015/nrp2015_croatia_en.pdf

increased by 16% and disposition time reached 1234 days in 2014, up from 1142 days the previous year.²

Croatia's business environment shortcomings are reflected in Croatia's performance on a number of international indices, including *Doing Business* and the World Economic Forum's *Global Competitiveness Report*. The 2014-15 *Global Competitiveness Report* ranks Croatia 87th as regards institutional quality overall and 141st (out of 144) in terms of the burden of government regulation. The value of the institutional quality index remained unchanged as compared with the 2013-14 report but the rank improved by six places. Croatia is the worst performing EU Member State in the *OECD Product Market Regulation Index*, which is largely due to a high degree of public ownership and government involvement in network sectors and in general business operations.³

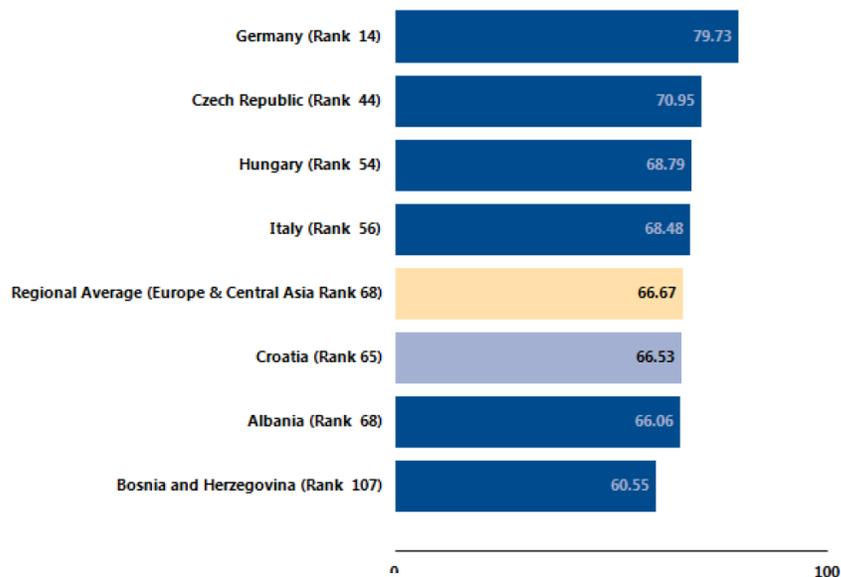
In the *Doing Business 2015* report, Croatia ranks 65th out of 189 economies worldwide and 15th amongst the 26 economies in Europe and Central Asia and 27th in the EU-28. Compared with 2014, Croatia improved its global ranking by two places but its position in the EU-28 context stayed the same. Relative to its neighbors, Croatia ranks ahead of Albania (68), Serbia (91) and Bosnia and Herzegovina (107), but behind others, including Italy (56), Hungary (54), Slovenia (51), Slovak Republic (37), Bulgaria (38), Montenegro (36), Austria (21) and Germany (14). Overall, Croatia's ranking in *Doing Business* is below the average ranking of other economies in the region (figure 1.1). On the *Distance to the Frontier (DTF)* metric which shows Croatia's performance relative to global good practice, Croatia scores 66.53 points in *Doing Business 2015*, 2.09 points higher than its score in *Doing Business 2014*.

The World Bank Group's *Doing Business* project provides a measure of the "ease of doing business" in 189 countries through a set of objective indicators that focus on the impact of laws, regulations and their enforcement on the ease of doing business for domestic firms in 10 areas from starting a business, operations to insolvency. While the overall business environment in a country depends on many factors, ranging from market size to macroeconomic conditions, regulations that are efficiently implemented, transparent, accessible, and strengthen property rights are important for growth and job creation. The *Doing Business* indicators cover an important, albeit not comprehensive, set of such regulations.

² "Country Report Croatia 2015, Including an In-Depth Review on the prevention and correction of macroeconomic imbalances", Commission Report Working Document, European Commission, Brussels, February 2015.

³ The measurement is not updated as of 2015 and, due to more recent acquis harmonization and privatizations, may not reflect the current situation for Croatia. For more information, please visit: <http://www.oecd.org/eco/growth/indicatorsofproductmarketregulationhomepage.htm>.

Figure 1.1. Croatia's position in the *Doing Business 2015* ranking

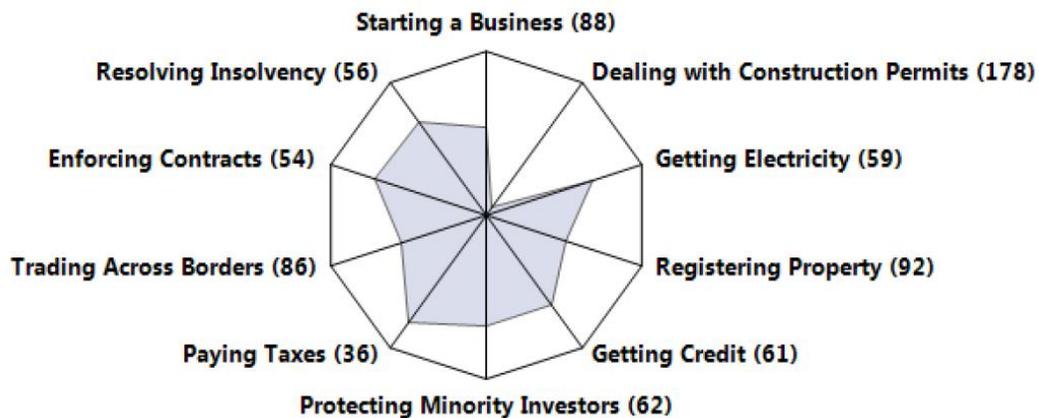


Source: World Bank *Doing Business 2015*

Distance to frontier score

Croatia's comparative performance across the *Doing Business* indicators is uneven (figure 1.2). The country performs relatively well on some indicators – paying taxes (36), enforcing contracts (54), resolving insolvency (56), getting electricity (59), getting credit (61), and protecting minority shareholders (62) - but lags behind in others, namely dealing with construction permits (178), registering property (92), trading across borders (86), and starting a business (88).

Figure 1.2. Business regulations in Croatia according to *Doing Business 2015*
(Scale: Rank 189 center, Rank 1 outer edge)



Source: World Bank *Doing Business 2015*

Several concrete measures have been undertaken to improve the quality of the business environment. The authorities have begun an audit of administrative burden, applying the standard cost model to the Trade Act and the Mediation in Immovable Property Transactions Act. The pilot phase has been completed in April 2015 and an action plan for

the simplification of the administrative burden will be presented soon. The initiative is led by the Ministry of Economy and is supported by the Agency for Investment and Competitiveness. Furthermore, there is an ongoing effort to improve the online communication between the public administration and citizens. Despite the introduction of the e-citizen web portal and the online services for business provided by HITRO.HR, the Chambers of Commerce, and the Financial Agency, challenges remain for the users having to familiarize themselves with the different interfaces. The authorities are planning the development of a new platform – a single contact point, which would integrate all existing services. In the area of the judiciary, the implementation of the reform of the judicial map could improve the efficiency of some courts. The reform aims to increase specialization and balance out the uneven workload of judges by merging courts. The reform also involves a change in the allocation of cases before second instance civil courts.

Although Croatia has implemented business reforms every year since 2006, and was among the global top ten improvers in Doing Business in 2008, the reform momentum in some areas has been stronger and more sustained than in others. Starting a business became easier with the introduction of HITRO.HR, a one-stop shop (OSS) for company registration, and with the subsequent expansion of its functionality, which allowed limited liability companies to file their registration applications with the court registries electronically through the notary public and HITRO.HR. In 2013 a new form of simple limited liability company with a lower minimum capital requirement was introduced, which further simplified incorporation procedures and in 2014, some notary fees, related to company incorporation, were reduced. The Dealing with Construction Permits indicator captured a series of reforms since 2007. In 2008, a new building code was put in place that eliminated several procedures for obtaining a building permit. In 2009, an OSS for construction permits was set up, which enabled the enforcement of the new building code. Further streamlining followed in 2010 and 2014, including the abolishment of the location permit and project design confirmation, reducing the requirements and fees for building permits, and speedier final building inspections. These improvements led to further simplifying and speeding up the overall construction permitting process. On the Trading Across Borders indicator, Croatia has considerably harmonized and streamlined its export and import custom procedures in preparation for the July 1, 2013 accession to the European Union. Important improvements were also introduced in its port infrastructure, resulting in further reductions in the time for exporting and importing. As reflected in the Resolving Insolvency indicator, Croatia made improvements in 2007 through amendments to its Insolvency Act regulating the profession of bankruptcy administrators and in 2013, introduced an expedited out-of-court restructuring procedure. Under Paying Taxes, in 2008, paying taxes became easier for companies through the wider use of online filing. In 2012, the health insurance contribution rate was reduced, followed by the introduction of an electronic system for social security contributions and by the reduction of rates for the forest and Chamber of Economy contributions in 2013. In 2014, the Chamber of Economy contribution was completely abolished. On the other hand, in 2010, a tourist fee was introduced, which made paying taxes more costly for companies and in 2014, Croatia made paying taxes more complicated by raising the health insurance contribution rate and introducing more detailed filing requirements for VAT.

In other areas, several major reforms were implemented in 2007 and 2008 but reform pace has slowed. The getting credit indicator captured the setting up of the new private credit bureau, HROK, and the launching of a unified and geographically centralized collateral registry in 2008. The time required to register property was reduced through improvements at the land registry. Since 2011, litigation proceedings were streamlined and enforcement procedures over cash assets transferred from the courts to state agency, FINA, as captured by the enforcing contracts indicator.

While the *Doing Business* indicators only show some aspects of the regulatory environment for firms in Croatia, they point to areas where the private sector could benefit from simplification of the regulatory burden or stronger legal protections. Within this context, it is advisable to identify concrete actions and policies for regulatory reform that encourage entrepreneurship and impact firm behavior and performance.

Scope of the Reform Memorandum

This reform memorandum highlights potential reform opportunities in the areas covered by the *Doing Business* project that would allow the Government to have a direct impact on business conditions by addressing some of these shortcomings through legal, regulatory or administrative reforms.⁴ The memorandum is based on Croatia's results in the *Doing Business* 2015 report. It does not provide a comprehensive overview of all the issues relevant to improving the investment climate in Croatia. Table 1.1 provides a summary of the short and medium-term reform recommendations which are described in more detail in this memorandum.

The reform recommendations do not address all obstacles to private sector development, but focus on:

- Easing business operations with a focus primarily on small and medium size domestic firms;
- Strengthening the regulatory and institutional framework and supporting easier access to credit (e.g. through a strong secured transactions framework, credit information sharing systems, and effective contractual enforcement mechanisms).

Some of the recommendations provided are actionable in the short term, without major legal changes. Other recommendations are implementable in a longer time frame. The suggested time frames are based on the experience in other countries and may be subject to adjustment based on the particular context of Croatia. All actions require consultations and coordination with different stakeholders. In this regard, the World Bank Group can provide assistance to the Government of Croatia in order to support implementation of regulatory reforms facilitating the ease of doing business.

It should be noted that it is difficult to predict whether or not the improvements in investment climate topics highlighted in this memorandum will impact the *Doing Business* rankings for Croatia (as this is relative to other countries' performance too). For these reforms to be captured by the *Doing Business* report it will be essential that they are fully implemented and enforced by the public sector and adopted by the private sector and the

⁴ The document uses *Doing Business* data as a baseline for its recommendations. For more information about the *Doing Business* methodology please see Table 1 or visit <http://doingbusiness.org/methodology>.

practitioners. Please note that the Doing Business project records reforms which are not only enacted into law but that are fully implemented. Rather than aiming at specific advancements in the rankings, emphasis should be placed in implementing key reforms to improve the investment climate. A rigorous reform effort will likely be reflected in those areas and —more importantly— provide a better business environment that is more conducive to private sector development and economic growth.

Consultation with the private sector is a crucial aspect of the reform process. Without understanding the private sector’s concerns and the barriers that prevent them from starting, operating and growing their businesses, no government can claim to set up a comprehensive reform agenda that will bring a real difference to its businesses.

Finally, strong reformers measure and communicate their success. Monitoring the implementation and impact of reforms highlights areas of success as well as areas where further effort is needed. Communicating reforms effectively to implementing agencies, the business and legal communities, and the general public ensures that changes are accepted and put in practice consistently. Enhancing the regulatory environment to facilitate the creation and growth of enterprises is a major undertaking, and the path is different in each country. There is no “one size fits all” for regulatory reform. Improvement to the business climate can, however, help set a foundation for the private sector’s sustainable development and the creation of a competitive and diversified economy.

Table 1.1: Croatia's Performance on the Doing Business Indicators and Suggested Short and Medium-term Recommendations

Topics	Indicators (2015 DB Report)	Short-term recommendations	Medium-term recommendations
Starting a Business	Procedures: 7 Days: 15 Cost (% of income per capita): 3.5 percent Paid-in min. capita (% of income per capita): 26.6 percent Global rank: 88 out of 189 DTF (0-100): 85.43	<ul style="list-style-type: none"> ✓ Eliminate the requirement of obtaining a company seal and ensure that it is not required in practice (this recommendation can be addressed in the short-term but the impact, i.e. the full adoption by public and private sectors, might be medium-term); ✓ Give HITRO.HR full powers to handle all transactions at the Commercial Court and undertake an information campaign to publicize the services provided by HITRO.HR; ✓ Transfer the power to decide on company registration applications to qualified Court administrative personnel. 	<ul style="list-style-type: none"> ✓ Implement e-signatures for individuals and make all registration processes fully electronic with no need for submission of physical documents or physical interactions; ✓ Eliminate the paid-in minimum capital requirement for Limited Liability Companies (DOO); ✓ Make the notarization of the articles of association optional and introduce clearer fee schedules for notary services; ✓ Introduce single business identifier for interactions with all government agencies; ✓ Introduce a single platform for out-of-court business registration by integrating the incorporation process with the registration to (1) all taxes, the (2) the Croatian Bureau of Statistics, the (3) Croatian Institute for Health Insurance, and the (4) Croatian Institute for Pension Insurance.
Dealing with Construction Permits	Procedures: 21 Days: 188 Cost (% of warehouse value): 10.9 percent Global rank: 178 out of 189 DTF (0-100): 44.97	<ul style="list-style-type: none"> ✓ Engage stakeholders and private sector practitioners in an information campaign aimed at explaining the benefits introduced by the new legislation; ✓ Expedite integration of all the necessary IT systems and databases into the ISPU; ✓ Review the current statutory time limits for permit-related approvals, introducing - where necessary – stricter deadlines; ✓ Eliminate the requirement to stamp the copy of the cadastral plan at the County Office before it can be submitted as part of the application for the building permit. 	<ul style="list-style-type: none"> ✓ Further streamline construction-related approvals and clearances by improving the e-permitting system and extend its usage to all municipalities; ✓ Further enhance ISPU as to create a robust and fully functional GIS system.
Registering Property	Procedures: 5 Days: 72 Cost (% of property value): 5 percent Global rank: 92 DTF (0-100): 66.44	<ul style="list-style-type: none"> ✓ Complete the Land Registry and Cadaster data harmonization. ✓ Rollout the Joint Information System for Registry and Cadaster to all registry and Cadaster offices. ✓ Eliminate the requirement for attaching a special administrative duty stamp (<i>biljeg</i>) for any land registry requests; 	<ul style="list-style-type: none"> ✓ Consider institutional reform to: <ul style="list-style-type: none"> - Remove land registration from county courts as an administrative function. - Merge Land Registry and Cadaster functions into an administrative agency.

Topics	Indicators (2015 DB Report)	Short-term recommendations	Medium-term recommendations
		<ul style="list-style-type: none"> ✓ Introduce fast-track registration procedures at the Land Registry Court; ✓ Allow electronic Land Registry extracts to be considered as official documents and make them accessible through e-citizen government portal. 	
Getting Credit	Legal Rights index: 5 Credit Information index: 6 Credit bureau coverage (% of adults): 100 percent Global rank: 61 out of 189 DTF (0-100): 55.00	<ul style="list-style-type: none"> ✓ Expand the sources of information to include retailers and utility companies. 	<ul style="list-style-type: none"> ✓ Introduce credit scores; ✓ Allow businesses to grant a non possessory security right in a single category of movable assets, without requiring a specific description of collateral; ✓ Ensure that the priority scheme ranks secured creditors as high as possible, while respecting other critical national policy objectives; ✓ Create an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of 4 functional equivalents to security interests in movable assets: fiduciary transfer of title; financial leases; assignment or transfer of receivables; and sales with retention of title.
Protecting Minority Investors	Extent of conflict of interest regulation index: 5/10 Extent of shareholder governance index: 6.5/10 Strength of minority investor protection index: 5.8/10 Global rank: 62 out of 189 DTF (0-100): 57.50	<ul style="list-style-type: none"> ✓ Increase disclosure requirements of related-party transactions to the public and the market regulators; ✓ Require an external auditor's report before the approval of transactions between interested parties; ✓ Provide shareholders with rights to hold the directors liable for damages resulting from a related-party transaction; ✓ Limit cross-shareholding between 2 independent companies to 10% of outstanding shares; ✓ Require disclosure of information about board members' other directorships, as well as basic information on their primary employment; ✓ Require disclosure of managerial compensation on an individual basis; ✓ Facilitate shareholders suits by granting shareholders broader powers during a trial. 	
Paying Taxes	Number of payments per year: 19 Time (hours per year): 208 Global rank: 36 out of 189	<ul style="list-style-type: none"> ✓ Continue providing tax outreach--education and training--to small and medium enterprises to ensure compliance and carry out 	

Topics	Indicators (2015 DB Report)	Short-term recommendations	Medium-term recommendations
	DTF (0-100): 82.92	communications campaigns to further increase the use of electronic filing.	
Trading across Borders	Documents to export: 6 Days to export: 16 Cost to export (USD per container): 1,335 Documents to import: 7 Days to import: 14 Cost to import (USD per container): 1,185 Global rank: 86 out of 189 DTF (0-100): 74.25	<ul style="list-style-type: none"> ✓ Implement the Custom Agency's e-surveillance project. 	<ul style="list-style-type: none"> ✓ Establish an electronic single-window system for all trade related transactions.
Enforcing Contracts	Time (days): 572 Cost (% of claim): 13.8 % Procedures: 38 Global rank: 54 out of 189 DTF (0-100) 64.81	<ul style="list-style-type: none"> ✓ Assess court procedures to identify points of delay and formulate solutions; ✓ Strengthen efforts to promote Alternative Dispute Resolution (ADR). 	<ul style="list-style-type: none"> ✓ Continue improving the e-courts system by introducing e-filing and electronic service of process.
Resolving insolvency	Time (years): 3.1 Cost (% of estate): 14.5 percent Outcome (0 as piecemeal sale and 1 as going concern): 0 Recovery rate: 30.5 cents on the dollar. Strength of insolvency framework index (0-16): 12 Global rank: 56 out of 189 DTF (0-100): 53.92	<ul style="list-style-type: none"> ✓ Introduce moratorium provisions and develop a culture of reorganization; ✓ Encourage the extension of post commencement financing to the debtor during the course of insolvency proceedings; ✓ Introduce a liability structure that holds managers accountable for negligently engaging in transactions that result in a loss to the company; ✓ Do not allow closely-related parties to vote on a reorganization plan. 	<ul style="list-style-type: none"> ✓ Improve the institutional capacity of relevant institutions for handling insolvency cases; ✓ Establish a Chamber of Bankruptcy Managers; ✓ Make the relevant stakeholders more aware of the reorganization proceedings and thus more willing to consider them as a viable option.

Indicators and suggested reform recommendations in detail:

Starting a Business	page 11
Dealing with Construction Permits.....	page 177
Registering Property.....	page 233
Getting Credit.....	page 277
Protecting Minority Investors.....	page 344
Paying Taxes	page 388
Trading across Borders.....	page 39
Enforcing Contracts.....	page 422
Resolving Insolvency	page 46

Reform memo: Croatia

Starting a Business

Economies with the most efficient registration systems use simplified and standardized laws and documents, operate a single electronic interface between the user and authorities, a central database with interoperability between agencies involved, one single company ID, and one flat fee. In Canada, UK, Singapore or Slovenia, for example, an integrated IT system links the databases of relevant agencies (company registry, tax administration, social security system, and statistics institute). The entrepreneur submits the information and the payment electronically via the website through a single form and the company is automatically registered with all agencies. Legal formalities for company registration are embedded into the electronic system and if all requirements are met and the payment is received, the system automatically processes the information and issues the registration certificate instantly. Companies are issued a single ID number, which is used across agencies. This facilitates compliance checks throughout the life of the company and reduces the administrative burden of submitting information multiple times with different forms to several agencies. Norway even took this a step further. Since 2005, all public registers and public authorities have a legal obligation to use the data registered in the Central Coordinating Register for Legal Entities instead of requiring businesses to resubmit this data to the concerned agency.⁵

To achieve measurable results in the short to medium term, the Government of Croatia may want to continue reforming by focusing on eliminating outdated requirements through legal amendments, merging and streamlining the registration processes of multiple departments and agencies, and making all registration processes (including post-incorporation) fully electronic without any need for physical paper trails or physical interaction. For these reforms to be captured by the *Doing Business* report, it will be essential that they are fully implemented and enforced by the public sector and adopted by practitioners.⁶

The *Doing Business* ‘Starting a Business’ indicator measures the procedures, cost, time and the paid-in minimum capital necessary for a domestic entrepreneur to register and formally operate a new business. *Doing Business* 2015 reported that entrepreneurs must go through 7 procedures, which take 15 days and cost on average 3.5 percent of income per capita, to start a business in Zagreb. Globally, Croatia ranks 88th out of 189 economies in the ease of starting a business: ahead of Bosnia and Herzegovina (147), yet behind Romania (38), Bulgaria (49), and Greece (52). While Croatia’s cost indicator is below the average of the Europe and Central Asia, the number of procedures, time and paid-in minimum capital required to start a business are above the regional average (table 2.1).

⁵ Business Registration Reform Case Study Norway, Investment Climate, 2011, World Bank Group.

⁶ The *Doing Business* project records changes that not only impact the areas measured by the indicators but that are also fully implemented.

Table 2.1 Starting a Business in Croatia and best performers

<i>Doing Business</i> Indicator	Croatia	Regional best performer	Regional Average	Global best performer
Procedures (number)	7	Armenia; Georgia; Kyrgyz Republic; Macedonia, FYR; (2)	5	1 (New Zealand, Canada)
Time (days)	15	Georgia; Macedonia, FYR (2)	12.1	0.5 (New Zealand)
Cost (percent of income per capita)	3.5	Kazakhstan (0.5)	5.3	0 (Slovenia)
Paid-in min. capital (percent of income per capita)	26.6	19 economies in the Europe and Central Asia region have zero paid-in min. capital requirement	5.8	0 (135 economies)

Source: Doing Business database

Reforms efforts

Significant reform efforts have been implemented since 2005, when Croatia launched the HITRO.HR (or “single access point”) project and reduced the statutory terms for business registration. Later on, the country further eased business start-up by allowing limited liability companies to file their registration application with the court registries electronically. In 2012, the government of Croatia amended the Companies Act (see Official Gazette No. 111/12) introducing a new corporate form of Limited Liability Company (JDOO), with a reduced the minimum capital requirement of HRK 10. Due to the improvement of the e-registration systems, notary costs were also reduced. More recently, amendments to the Court Register Act (see Official Gazette n. 93/14) abolished the requirement of publishing in the Official Gazette the registration of new Limited Liability Companies (DOO) and Simple Limited Liability Companies (JDOO) with the Court Registry.

Short-term recommendations

Eliminate the requirement of obtaining a company seal and ensure that it is not required in practice (this recommendation can be addressed in the short-term but the impact, i.e. the full adoption by public and private sectors, might be medium-term). Entrepreneurs are faced with mixed messages regarding the need to obtain a company seal. Whilst the Court Registry Act mandates companies to obtain it, a recent ruling of the High Trade Court established that company seals are no longer needed to run a business. To be on the safe side, most entrepreneurs obtain a seal before they start operating. To fully implement the elimination of the company seal, the Government could pursue a two-prong approach. First, the Court Registry Act should be amended in order to eliminate references to the seal requirement. Second, the Government could engage in an outreach campaign targeting relevant stakeholders (such as banks, lawyers and accountants associations) to ensure that a company seal is no longer a requirement to conduct business transactions.

In other countries, modern legislation has replaced the company seal with provisions under which a company validly executes a document—none of the top-ranking countries on the

Doing Business' ease of starting a business indicator requires new companies to get seals. In the United Kingdom, for example, the Companies Act provides that a document is validly executed by a company if signed on behalf of the company by (i) two 'authorized signatories', or (ii) one director, in the presence of a witness who attests the director's signature. Further, the authentication of the person signing on behalf of the company can easily be verified through the commercial registry. Eliminating the need to use a common seal has been a popular reform in the region. In the past 4 years, countries like Georgia and Slovenia have abolished the requirement of obtaining a company seal in order to start a business and taken similar measures to ensure the reform's full implementation.

Give HITRO.HR full powers to handle all transactions at the Commercial Court and undertake an information campaign to publicize the services provided by HITRO.HR. HITRO.HR is an agency that has the mandate to help Croatian citizens and businesses in dealing with the public administration. At the moment, HITRO.HR officials can assist entrepreneurs in carrying out the steps necessary to complete a company registration, but in certain transactions, their power is limited. For instance, they can check whether the chosen company name is available and submit a name reservation request through the e-Company Service (e-Tvrtka), but if the request is rejected by the Court, HITRO.HR cannot retrieve the documents on their client's behalf. These limitations to HITRO's ability to complete the business registration process, reduces HITRO.HR's appeal to entrepreneurs, who often choose more expensive – but effective - intermediaries. HITRO.HR should be given the mandate to carry out the full business registration process. Subsequently, the government should carry out a communication campaign aimed at informing the general public about the services provided by the agency.

Transfer the power to decide on company registration applications to qualified Court administrative personnel. Currently company registration in Croatia is judicial procedure. The Commercial Courts in Zagreb, for instance, effectively employs 55 judges, 7 of which are tasked with procedures related to company registration.⁷ Such tasks could be performed by qualified court clerks (i.e. referendaries), with judges having only a supervisory role. Relieving judges from company registration duties and transferring such duties to (the more numerous) referendaries may decrease the time to start a business. Not only, it could also speed up the resolution of litigation and insolvency cases, since judges currently allocated to company registration could be used elsewhere. The Croatian Ministry of Justice is currently drafting an ordinance on this matter: it should be finalized and implemented as soon as possible.

In most countries around the world, company registration is a fully administrative procedure. Examples of successful reform abound. In the late 1990s, for instance, Italy had one of the most cumbersome regulation of any European economy, with the process taking 4 months. When registration was taken out of the courts, the time to start a business was reduced by 3 months altogether. Today, starting a business in Italy takes 5 days.

Medium-term recommendations

Implement e-signatures for individuals and make all registration processes fully electronic with no need for submission of physical documents or physical interactions.

⁷ The remaining judges are mainly tasked with litigation cases and insolvency cases. The information was collected by the team during a visit to the Commercial Court of Zagreb in March 2015.

Croatian entrepreneurs have different options to register their companies: they can use HITRO.HR, have a notary doing it on their behalf, or deal directly with the Commercial Court Registry. No matter which option they choose, supporting documents must still be submitted in paper format to the Court Registry.

At the moment, the biggest obstacle to the implementation of an efficient online registration system is the lack of a functioning e-signature system for individuals. The Ministry of Public Administration is working with the Ministry of Interior to create the necessary legal framework and ITC infrastructure. Such efforts should have priority as they will make electronic company registration possible.

In countries where fully-fledged online registration is available, physical interaction with the authorities or submission of hard copies is not required. For example, in the UK businesses can register online for VAT without visiting the HM Revenue and Customs (HRMC) authority.⁸ Similarly, in Canada businesses can apply online and register for a business number, as well as for four program accounts: corporation income tax, GST/HST, payroll, and import/export.

Eliminate the paid-in minimum capital requirement for Limited Liability Companies (DOO). Croatian entrepreneurs wishing to create a Limited Liability Company, must deposit HRK 20,000 (EUR 2,630) as paid-in minimum capital requirement – an amount equal to 26.6% of income per capita. Alternatively, they can create a Simple Limited Liability Company, which have share capital of only HRK 10 payable in cash and with the lowest nominal value of a shareholding amounting HRK 1. Simple Limited Liability Companies were introduced in October 2012 in order to avoid the migration of potential investors to countries with more flexible business registration rules. Although the registration costs of a Simple Limited Liability Company are much lower than those incurred to register a (standard) Limited Liability Company, any change in the company's features is quite expensive. A simple change of a director's name, for example, costs around 2200 HRK (300 EUR). Croatian authorities reduce the costs related to changes in the articles of association for simple LTDs and eliminate the minimum capital requirement for all LTDs.

Studies have shown that paid-in minimum capital requirements can significantly slow entrepreneurship,⁹ and can deter firm entry.¹⁰ The opportunity cost of tying up funds to pay for capital requirements in countries where the amount is sizeable is significant, as companies need to limit other needs such as hiring, training, investing in equipment or developing services.¹¹ Research shows that high capital requirements can be distortive to competition, as entrepreneurs with limited financial capacity are in a disadvantageous position when they are required to pay up capital instead of invest it to their business, and capital requirements may undermine a company's growth in some cases.¹²

⁸ For more information please visit: <https://www.gov.uk/vat-registration/how-to-register>.

⁹ VanStel, Storey and Thurik (2007); Blanchflower, Oswald and Stutzer (2001); Klapper and Love (2011); Dreher and Gassebner (2011).

¹⁰ Cumbersome procedures and high levels of minimum capital are negatively associated with firm entry. Stringent regulations go hand in hand with corruption (Dreher and Gassebner 2013).

¹¹ Chan, 2009.

¹² Chan, 2009.

At the same time, a paid-in minimum capital requirement does not fulfill intended goals such as creditor protection. Studies have shown that it does not provide effective protection of creditors—regardless of the legal system.¹³ In practice, once the company is registered, its owners can decide how much capital they want to invest and in what form. When creditors make an investment decision, they look at a wide range of protection instruments available through the company law, the insolvency law and/or clauses in negotiated contracts to mitigate risks. Fixed amounts of capital requirements also do not take into account differences in commercial risks. A small firm in the services industry does not present the same risk as a large manufacturing company in a volatile market. Some argue that minimum capital requirements protect creditors and investors from insolvency.¹⁴ However, lenders tend to assess investment decisions based on commercial risks and business opportunities rather than on government-imposed requirements.¹⁵ Accordingly, some countries have introduced other mechanisms to protect investors in limited liability companies. For instance, Hong Kong outlines solvency safeguards in its Companies Act and does not require a specific amount of paid-in minimum capital for business incorporations.¹⁶

Make the notarization of the articles of association optional and introduce clearer fee schedules for notary services. Presently, companies must notarize the articles of association with a public notary. This is the most expensive step in the process of company registration. Private sector practitioners state that the fee schedules used to calculate the notary fees are not transparent. The Croatian government could lower the cost of starting a business by developing standardized articles of incorporation that are flexible enough to accommodate the majority of small businesses, thus allowing entrepreneurs to draft and file deeds of incorporation themselves. Eliminating the requirement to notarize incorporation documents would represent a significant cost-saving measure, especially for small businesses. Larger companies, with more complex structures, could still resort to notary services, if needed.

Introduce single business identifier for interactions with all government agencies. To achieve greater integration of registration services, the Government of Croatia could introduce a single business identification number, which businesses would use as unique identifier for all interactions with government agencies. This would reduce the risk of errors in identifying the same companies and facilitate enforcement.

Today, newly created companies receive three separate IDs: the O.I.B number from the Tax Authority, the Statistical Number from the Croatian Bureau of Statistics, and a registration number from the Commercial Court. While information-sharing across agencies is also possible by mapping the various company IDs, a common ID can greatly

¹³ Elkind G. 2007. “Minimum Capital Requirements, a Comparative Analysis,” USAID. Other relevant studies include: Armour, J., “Legal Capital: An Outdated Concept?”, *European Business Organization Law Review* 7: 5-27 5 (2006); Kubler, F. “A Comparative Approach to Capital Maintenance: Germany” *European Business Law Review* 1031-1035 (2004); Simon, J. “A Comparative Approach to Capital Maintenance: France”, *European Business Law Review* 1037-1044 (2004); Mulbert, P. and Birke, M. “Legal Capital-Is There a Case Against the European Legal Capital Rules?”, *3 European Business Organization Review* 695-732 (2002).

¹⁴ Miola 2005.

¹⁵ Djankov 2009, Ewang 2007; Alonso Ledesma 2007.

¹⁶ *Doing Business* report, 2014.

facilitate this task. Electronic solutions may facilitate the necessary mapping, but they cannot exclude the duplication of entities. In New Zealand and Singapore, the business registration authority generates a unique business number or ID on behalf of all relevant government agencies.

In order to successfully implement the single ID, a common database and interoperable ICT systems of relevant government agencies has to be developed, which would transmit and share business information among all agencies. Such organization makes it easy for businesses to deal with different regulations, and for different government agencies to effectively monitor and regulate business activities and provide for government-to-business (G2B) services. When Norway introduced a single ID, the Ministry of Finance was a powerful supporter of the reform. The Ministry and the tax authorities aimed at a more efficient tax reporting system and saw that they would benefit from the exchange of business information by a common unique identifier.¹⁷ This kind of reform does not necessarily require introducing an entirely new ID. The Belgian government, for example, refrained from introducing a new number but rather changed the old VAT ID number into an enterprise number.¹⁸

Two approaches to implementing of this reform are most common. In one case, business registration is the initial step and includes the allocation of a unique ID, which is then reused by other authorities, such as the tax authorities or social security agencies. In Australia, for example, business registration is the first step in the process and includes the allocation of the company ID. Norway takes another approach, as entrepreneurs are allocated a unique ID before they proceed to register their business. The ID and the identifying information are then made available and re-used by all agencies involved in the registration process.¹⁹ Introducing a common ID for businesses requires mapping and conversion of existing identifiers. It is a comparatively complex and cost-intensive reform. Nonetheless, a growing number of countries have introduced such common IDs to increase efficiency within the public sector and reduce the administrative burden on businesses. In 2009, Singapore introduced a single identification number (SINGPASS) for all business-to-government transactions.

Introduce a single platform for out-of-court business registration by integrating the incorporation process with the registration to (1) all taxes, the (2) the Croatian Bureau of Statistics, the (3) Croatian Institute for Health Insurance, and the (4) Croatian Institute for Pension Insurance. Currently, entrepreneurs in Croatia have to interact separately with several agencies or intermediaries. Depending on the type of Limited Liability Company they choose to create, these may include the Commercial Court Registry, Notaries, HITRO.HR, the Croatian Bureau of Statistics, the Croatian Institute for Pension Insurance, the Croatian Institute for Health Insurance, and the Tax Authority (for VAT registration). Some of these interactions can be conducted online; others require that the entrepreneur appear in person before an agency as part of the process.

¹⁷ Business registration case study: Norway, World Bank 2011.

¹⁸ See

http://business.belgium.be/en/managing_your_business/setting_up_your_business/main_steps/company_number/

¹⁹ See <http://www.brreg.no/english/registers/entities/entities.html>

After having streamlined and modernized the registration systems with different agencies as recommended above, the Croatian government could create a single interface for all registration formalities. As a first step, staff at HITRO.HR could be given the authority to accept and process documents on behalf of other agencies. A single electronic registration form could be introduced to capture information required by all involved agencies. Other agencies could be given access to the registration database for the type of information they need.

After the introduction of a single registration form for all agencies, it is recommended that the systems and databases of multiple agencies be gradually linked to move towards a “single interface” for business registration, which would allow an entrepreneur to complete company creation in one interaction with the Government. Key to the success of the reform is giving officials decision-making power for their respective agencies, and ensuring a full interoperability among the databases of the different agencies involved. Without it, delays will continue as the approvals would still be done at each agency’s back-office. Countries that fail to do this see their one-stop shop become “one more stop” in the company registration process.²⁰

In Malaysia, after the introduction of the unique company identification number in 2010, companies that registers at the Companies Commission of Malaysia (CCM) complete company incorporation, and at the same time comply with registration to the Tax authorities, Employment Provident Fund, Social Security Organization, and the Inland Revenue Board. In addition, CCM provides now a post-incorporation package for sale, which includes the statutory books and share certificates. In Portugal, the platform “FastTrack” allows users to select a pre-approved name from the registry’s website, and proceed to the one-stop website to register one’s company. The registry then automatically processes the taxation, social security and labor registration, and publishes the incorporation notice.

In Estonia and Norway, systems are interoperable and interlinked with six other agency systems, namely e-procurement system for government agencies, and the land, labor, tax, pledges and citizen’s registries. Slovenia’s system is also interoperable with six systems: land, labor, tax, pledges and citizen’s registries and the trade database.

Dealing with Construction Permits

Reforms that make regulation of constructions more efficient and transparent can help reduce corruption and informality, while encouraging construction companies to go through formal channels and ensuring compliance with important standards, such as those impacting safety or mitigating climate change. Good regulations, combined with sound enforcement mechanisms, ensure safety standards that protect the public while making the permitting process efficient, transparent and affordable for both building authorities and the private professionals who use it. A recent study shows that long delays to obtain permits could lead to higher transaction costs and less transactions.²¹ However, the payoff of

²⁰ For more information on international best practices on one-stop shops see

<<https://www.wbginvestmentclimate.org/uploads/Howmanystopsinaonestopshop.pdf>>.

²¹ Sonia Hamman, “Housing matters, Volume 1,” Policy Research Working Paper 6876, 2014. In particular, the paper mentions that “Mayer and Somerville’s (2000) study of U.S. regulations estimates that a metropolitan area with a 4.5-month delay in approval and two different types of growth-control

construction permitting reforms can be significant. In 2005, a PriceWaterhouseCoopers study found that accelerating permit processes in the United States could permanently increase government revenues.²² Examining the impact of building permit reforms on new income generation, for every 10 jobs directly related to a construction project, another 8 jobs are created locally.²³ These impacts yield not only additional income for the community, but also additional investments and tax revenues for the Government. Beyond economic returns and the pay-off in attracting more investment, the most important benefit of building permit reforms is to protect public safety.

Efficient building permitting systems share key features. Clear building codes written with a consultative process are at the core of well-designed construction permitting systems, and countries like Canada and New Zealand are increasingly steering towards performance-based codes.²⁴ Germany, Singapore and Mauritius have incorporated risk-management tools to streamline the issuing of permits and optimize the effectiveness of inspections. Up-to-date land use and zoning plans improve transparency and predictability for developers.²⁵ Establishing sound licensing mechanisms for practitioners, in addition to well-functioning liability regimes and compulsory insurance systems, have become pivotal in order to introduce more efficient regulatory systems. Many countries are outsourcing building control procedures to the private sector. For example, France and the UK introduced inspections by accredited bodies, which in turn required improvements in their private liability and insurance regimes.²⁶

Doing Business records all procedures, time and cost required to build a warehouse and connect to utilities in Zagreb following all the official requirements. Croatia ranks 178th globally on the ease of dealing with construction permits and 24th out of 26 in the Eastern Europe and Central Asia region. This is Croatia's weakest ranking among all Doing Business indicators (table 3.1).

Reform efforts

Croatia has passed three new laws in January 2014: a Building Act, a Physical Planning Act, and an Inspection Act. The new Building Act introduced a new categorization of buildings (5 building categories based on complexity) and established a single building permit as the sole administrative act allowing construction, as opposed to the different type of permits envisaged by the previous legislation. The Building Act also enabled the

restrictions would have about 45 percent less construction than a metropolitan area with a 1.5-month delay and no growth management policy.”

²² For a single building project, accelerating permit processes provides a temporary acceleration of property tax collections. For a representative series of projects, the study shows that these revenue increases could reach 16% over a period of 5 years. “Economic Impact of Accelerating Permit Processes on Local Development and Government Revenues” PriceWaterhouseCoopers, December 2005.

²³ PricewaterhouseCoopers. 2005. “Economic Impact of Accelerating Permit Processes on Local Development and Government Revenues.” Report prepared for the American Institute of Architects, Washington, DC.

²⁴ Performance-based codes provide more flexibility and support innovation by focusing on outcomes to be achieved rather than prescribing how the building must be constructed. The use of performance-based codes, however, requires a higher level of technical competence to enforce than do other approaches.

²⁵ World Bank. 2013. “Urbanization beyond Municipal Boundaries: Nurturing Metropolitan Economies and Connecting Peri-Urban Areas in India.” Directions in Development. Washington, DC: World Bank, p. 44.

²⁶ For example in France, the Spinetta Act of 1978, required broad-based insurance and warranty coverage.

building permit to directly reflect zoning maps, thus eliminating the need for a location permit in the vast majority of cases.²⁷ Furthermore, it introduced disciplinary proceedings for non-performing municipal officials that resulted in more prompt processing of the usage permit. The Physical Planning Act created a Croatian Institute for Spatial Development, a national level body in charge of developing and implementing national zoning plan, and a Physical Planning Information System (ISPU), which – once fully implemented – will enable free and fast access to physical planning data for the whole country. Finally, the Building Inspection Act increased the authority of local governments to supervise in the construction of those buildings that do not require a building permit, the removal of simple buildings and the correction of construction deficiencies in existing buildings.

Table 3.1 Dealing with Construction Permits in Croatia and best performers

<i>Doing Business</i> Indicator	Croatia	Regional average	Regional best performer	Global Best Performer
Procedures (number)	21	16.1	9 (Cyprus; Georgia; Montenegro; Ukraine)	5 (Hong Kong SAR, China)
Time (days)	188	176.8	64 (Ukraine)	26 (Singapore)
Cost (percent of warehouse value)	10.9	5.0 percent	0.2 percent (Hungary)	0 percent (Qatar, Mongolia)

Source: Doing Business database

Short-term recommendations

Engage stakeholders and private sector practitioners in an information campaign aimed at explaining the benefits introduced by the new legislation. Croatia is undergoing a major overhaul of its physical planning, building permitting and inspection processes. Three new laws – Building Act, Physical Planning Act, and Inspection Act - came into force on January 1st, 2014. A large number of ordinances and bylaws came into force in the following 12 months, providing the implementing guidelines for the provisions of the acts.²⁸

²⁷ The location permits is now required only for exceptional situations, such as the construction on properties that have an unclear title or have to be expropriated.

²⁸ According to the documents to submitted to the Doing Business Reform Advisory team, recently implemented regulations include:

1. Instructions regarding the preparation of drafts in the procedure of issuance of acts on the basis of the Physical Planning Act and the Construction Act and regarding the implementation of such procedures electronically (OG 56/14);
2. Ordinance on the conditions and method of issuance of confirmation to Croatian citizens and legal entities for the fulfillment of the right to provide services of the regulated profession of energy certification and energy audit of buildings in parties to the Agreement on the European Economic Area (OG 47/14);
3. Ordinance on energy audit and energy certification of buildings (OG 48/14);
4. Ordinance on the content of written Statement of the contractor on performed works and maintenance conditions for buildings (OG 43/14);

These changes do not only affect the legal aspects of building permitting, inspections and planning. They also introduce major technological upgrades, which have the potential to greatly reduce the amount of paperwork for public administrations and private sector practitioners. Art. 36 of the Physical Planning Act, for instance, introduced a physical planning information system (ISPU) connecting the IT systems of several agencies, among which the Cadaster, the Land Registry and the Ministry of Finance (OIB database). An e-permitting facility connected to the ISPU system is also being introduced. As of January 2015, it was operational in 107 municipalities out of 260. The e-permitting facility allows entrepreneurs to access specific information online - such as updated laws and regulations, lists of licensed practitioners, and standardized application forms - and track the progress of their applications for building-related permits. Add-ons to ISPU system, including e-archives and e-inspection solutions, are currently under development and should be introduced by the end of 2016.

Croatian authorities should press ahead so that all ordinances and regulations are consistently implemented across the country. In parallel, major efforts should be undertaken to inform private sector practitioners on the opportunities presented by the new legislation.

At the moment, not all the benefits of the new legislation are clear to the building sector professionals operating in the country. For instance, many of them still visit the Cadaster to obtain a list of neighbors that has then to be submitted to the Municipality together with the application for the building permit (i.e. geodesic study annex). Given the progress introduced by the ISPU, such procedure should no longer be necessary, since such list can be retrieved online.

Expedite integration of all the necessary IT systems and databases into the ISPU. The geographic information system (ISPU) represents a great leap ahead towards a fast and

-
5. Ordinance on the conditions and benchmarks for the issuance of authorization for the control of projects (OG 32/14, 69/14);
 6. Ordinance on the compulsory content and equipping of construction projects (OG 64/14);
 7. Ordinance on the control of projects (OG 32/14);
 8. Ordinance on basic and other buildings and works (OG 79/14);
 9. Ordinance on the content and design of the signaling board for construction sites (OG 42/14);
 10. Ordinance on the method of implementation of construction surveillance activities, on the form, conditions and method of use of the construction log book, and on the content of the final report by the supervising engineer (OG 111/14);
 11. Ordinance on the maintenance of buildings (OG122/14);
 12. Amendments to the Administrative Fees and Tariffs Act (OG 40/14);
 13. Regulation on the definition of construction works, other projects and surfaces of state and regional significance (OG 37/14);
 14. Ordinance on surveying designs (OG 12/14, 56/14);
 15. Ordinance on the mandatory contents of conceptual designs (OG 55/14);
 16. Instruction regarding the preparation of drafts in the procedure of issuance of acts on the basis of the Physical Planning Act and the Construction Act and regarding the implementation of such procedures electronically (OG 56/14);
 17. Ordinance on the contents and required spatial indicators in reports on the spatial status (OG117/12);
 18. Regulation on the assessment of real estate value (OG 74/14);
 19. Ordinance on methods of assessment of real estate value (OG 79/14).

efficient building permitting process. In order to fully reap the benefits of this important reform, Croatian authorities should press ahead with the harmonization of all the necessary databases that might contribute to its completeness. At the moment, the Ministry of Construction and Physical Planning is working to harmonize the ISPU system with the databases of Ministry of Maritime Affairs, Transport and Infrastructure and the Ministry of Culture. Also, additional work will be necessary to harmonize Cadaster and Land Registry entries, especially at the local level. Such measures should have priority.

Review the current statutory time limits for permit-related approvals, introducing - where necessary – stricter deadlines. A study in the United States estimates that accelerating permit approvals by 3 months in a 22-month project cycle could increase construction spending by 5.7% and property-tax revenue for local governments by 16%.²⁹ As the new ordinances and bylaws are finalized and implemented, and public officials operating at the local level grow familiar with the new procedures, Croatian authorities could consider monitoring processing times, and adjusting them to the new regulations when necessary.

According to the Administrative Procedures Act of 2009 (OG 47/09), for instance, the Municipality of Zagreb has 8 days to check whether the application for a building permit is complete (i.e. all the necessary documents have been submitted) and in line with the urban plan. This is only one of the first steps required for the issuance of a building permit, and a lengthy one. Considering technological progress brought about by the physical planning database, which allows a quick confirmation of the information provided in the application, the deadline for first formal check performed by the Municipality could be shortened to 48 or 24 hours. In order to make the new deadlines effective, their implementation should be accompanied by tighter monitoring of the performance of the municipal officials charged with document review.

Stricter deadlines could also be introduced in relation to issuance of the occupancy permit. As per article 140 and 144 of the new Building Act, the final inspection and the issuance of the occupancy permit should take 23 days altogether (15+8 days). In Lithuania, where the application for the occupancy permit can be submitted online, the issuance of the permit takes only 14 days. With the introduction of the online building permit platform, it would also be possible to issue the occupancy permit in a shorter time. A new time limit can be set for completing this procedure.

Another procedure that could be implemented faster relates to amount of utility and water fees that have to be paid by the investor after the building permit has been issued (as per art. 122 of the Building Act, OG 153/13). In Zagreb, Municipal officers currently issue their decision on the matter after 22 days. Processing times could be much shorter.

Eliminate the requirement to stamp the copy of the cadastral plan at the County Office before it can be submitted as part of the application for the building permit. Following the introduction of the Physical Planning Information System, cadastral maps

²⁹ PricewaterhouseCoopers. 2005. “The Economic Impact of Accelerating Permit Processes on Local Development and Government Revenues.” Report prepared for the American Institute of Architects, Washington, D.C.

can now be found online. The online system eliminates the need for architects and engineers to visit the Cadaster to finalize their projects.

The City of Zagreb, however, does not consider cadastral maps that have not been stamped at the Cadaster as valid documents when processing building permit applications. As a result, architects and engineers continue to visit the cadaster unnecessarily to obtain a stamp on a map they have downloaded online.

The stamp requirement could be easily eliminated by mandating City of Zagreb officials to check the cadastral map online in the Physical Planning Application System once the building permit application is received. All municipalities in Croatia have access to the ISPU.

Medium-term recommendations

Further streamline construction-related approvals and clearances by improving the e-permitting system and extend its usage to all municipalities. The application for a building permit is composed, among other documents, by a set of approvals that are a necessary condition for the building permit application to be considered valid (and thus processed by the Municipality). For a simple two-story warehouse, such approvals are issued by the Inspectorate for Fire (Ministry of Internal Affairs), the National Croatian Electric Grid, the Waste Collection Department, and the Water Authority.

Designers often consult with these agencies beforehand, in order to finalize their drawings, but must undergo a final review once the drawings are finalized. The necessary documents for such reviews must be submitted in paper format, as well as the applications for the building and usage permit, at least in Zagreb.

Although applicants can currently track the status of such applications online, a further degree of efficiency could be attained by turning the ISPU/e-permit platform into a system where building permit applicants can apply for all initial clearances simultaneously by submitting one online form along with the final drawings. This form would then be accessed by the various agencies, which could review their project and approve the designs electronically.

Several countries have already such computerized systems in place. Developers in Austria, Denmark, Iceland, Norway and Portugal can complete their building permit applications online. In Dubai, entrepreneurs can apply for pre-approvals and the building permit at the same time through the Municipality's online platform. In Singapore, the data management system, established in 2001, provides on-line submission of all documents, an easy access to the information needed for obtaining a building permit and allows for efficient permit processing. Today builders regularly receive updates on the status of their application either by e-mail or text messaging. As a result, the time for dealing with construction permits has been reduced by two-thirds. This reform saves time for builders and government officials alike.

Further enhance ISPU as to create a robust and fully functional GIS system. A fully functional Geographic Information System (GIS) is an integrated system of computer hardware, software, and trained personnel capable of assembling, storing, manipulating, and displaying topographic, demographic, utility, facility, image and other resource data that is geographically referenced. When accessible maps contain all relevant zoning,

infrastructure and construction information, designers can be allowed to proceed with their plans without having to contact authorities for further details (Box 1). If the Ministry of Construction and Physical Planning developed the ISPU system into a fully-fledged GIS system, applicants who produced their conceptual drawings electronically with a CAD system may be in a position to overlay these plans with the zoning, planning and utility requirements captured in the system. In certain circumstances, such as low risk applications, this may be able to have the effect of pre-approving some elements before being checked by City of Zagreb and the utility companies, thus saving time.

Box 1. An example of the GIS system in North Shore City Council, Auckland New Zealand

Key to the success of the NSCC GIS program has been their commitment to distribute access to the map data and associated council information to the various stakeholders. The online 'GIS Viewer' initiative has been especially well-received. Anyone with access to a standard web browser can create their own maps from available data including color aerial images, boundary lines, water pipes, manholes, hydrants and even property values and zoning information. North Shore City Council can have anywhere from 500 up to 10,000 maps being produced in a single day, typically from house hunters. Real estate agents, surveyors, designers, architects and lawyers are also high users.

Source: North Shore City Council

<http://www.northshorecity.govt.nz/SERVICES/PROPERTYINFORMATION/GISVIEWER/Pages/defa>

Registering Property

Registered property rights are important to support investment, productivity and growth.³⁰ Research suggests that property owners with secure ownership are more likely to invest in private enterprises and transfer land to more efficient users. The ability to easily access authoritative information on land ownership also reduces the transaction cost in financial markets, making it easier to use property as collateral.³¹ Land registries, together with cadasters that identify the location of a property, are institutions used around the world to map, prove and secure property rights. These institutions are part of the land information system of an economy. With land and buildings accounting for between half and three-quarters of the wealth in most economies, having an up-to-date land information system matters.³² The benefits of land registration go beyond the private sector. For governments, having reliable, up-to-date information in cadasters and land registries is essential to correctly assess and collect tax revenues. With up-to-date land information, governments can map out the varying requirements of their cities and strategically plan the provision of services and infrastructure in the areas of each city where they are most needed.³³

³⁰ Claessens, Stijn and Luc Laeven, Financial Development, Property Rights, and Growth, *Journal of Finance*, 58 (6): 2401–36, 2003.

³¹ Simon Johnson, John McMillan, and Christopher Woodruff, Property Rights and Finance, *The American Economic Review*, Volume 92, Issue 5, Pages 1335-1356, December 2002.

³² World Bank. 1989. *World Development Report 1989*. New York: Oxford University Press.

³³ Property information held in cadasters and land registries is part of the land information available to governments. Land information also includes other geographic, environmental and socioeconomic data related to land that are useful for urban planning and development.

Doing Business records the full sequence of procedures necessary for a business (the buyer) to purchase a property from another business (the seller) and to transfer the property title to the buyer's name so that the buyer can use the property for expanding its business, use the property as collateral in taking new loans or, if necessary, sell the property to another business. Croatia – represented by Zagreb - ranks 92 out of 189 economies in the ease of registering property and 22 out of 26 economies in the Eastern Europe and Central Asia region. While Croatia's indicators on the number of procedures to register property is currently aligned to the regional average, the amount of time required to register property is triple, while the cost is almost double (table 4.1).

Table 4.1 Registering Property in Croatia and best performers

<i>Doing Business</i> Indicator	Croatia	Regional best performer	Regional Average	Global best performer
Procedures (number)	5	Georgia (1)	5.4	1 (Georgia; Norway; Sweden; Portugal)
Time (days)	72	Georgia (1)	23.1	1 (Georgia; New Zealand; Portugal)
Cost (percent of property value)	5	Belarus (0.0)	2.7	0 (Belarus, Kiribati; Saudi Arabia; Slovak Republic)

Source: Doing Business database

Reform efforts

Since 2008, the time to register property in Croatia has decreased from 956 to 72 days. Such an astonishing result is due to legislative improvements introduced by the Land Registry Act of 2004 and the subsequent computerization efforts undertaken by the Croatian government. Such efforts, which have displayed their potential effect over a number of years, were accompanied by an empowerment of court's clerks, who were increased in number, given the authority to decide over transfer of title applications and asked to work overtime to reduce the case backlog.

Short-term recommendations

Complete Land Registry and Cadaster data harmonization. The Land Registry is under the jurisdiction of the Ministry of Justice while the Cadaster is managed by the State Geodetic Administration. Currently, the data contained in the two databases is not fully integrated, though the process is ongoing as the Joint Information System is rolled out and the data harmonized. The current lack of data harmonization contributes to delays and inconsistencies in Government to Business services. To solve this problem and give full implementation to the Land Registry Act, Croatian authorities should give priority to finalizing the Real Estates Registration and Cadaster Joint Information System (JIS) project – which will harmonize the two databases mentioned above.³⁴

Complete the rollout of the Joint Information System (JIS) for Registry and Cadaster to all Registry and Cadaster offices. While Croatia has had a digital land registry for a long time, not all records have been digitized. The two most lagging courts in the digitization process are the Zagreb court and the new Split courts.

³⁴ For more information, please visit: <http://www.uredjenazemlja.hr/default.aspx?id=22>

In Zagreb, the Legal Basis Archive, which contains all the sale contracts deposited at the Court and represents an essential source of information for Land Registry officials, has been digitized to a limited extent. At the moment, the documents that are digitized are scanned, which limits their searchability (i.e. they can be searched only through the case numbers – the “Z” number). The archival books contained in the Legal Basis Archive are paper based and have no duplicates. If a book is being used by one clerk, others may have to wait for days before they can use it. To reduce delays to a minimum, Croatian authorities should complete the rollout of the JIS system to all Registry and Cadaster offices.

The completion of the JIS rollout will sensibly improve the digitization of records; will allow property transfers to be completed online; will introduce re-engineered, joint processes and standard forms; will make electronic extracts easily accessible; and will allow e-conveyancing. The full implementation of the JIS platform will save resources for businesses and increase transparency.

Other countries with fully electronic systems today have progressively worked towards that goal over several years. As an example, in 2009 the Danish government began modernizing its land registry by digitizing and automating property registration. Processes had to be streamlined and reorganized. The centralized land registry initiated its computerization and records were progressively digitized. Once digitization was complete, the land registry introduced electronic lodgment of property transfers. By 2011 property transfer applications were only accepted online and the information technology system started screening applications in a fast and efficient way. As a result, over 5 years the time to transfer a property was reduced from 42 days to 4 days. With online access to a single source of land registration data, citizens and businesses can transfer property on their own, with no need for a third party. They can also get information on any property. And to facilitate access to credit as well as information, the Danish financial sector created a central hub allowing banks and the land registry to share land registration data.

New Zealand digitized its property records between 1997 and 2002 and subsequently introduced electronic registration. However, by 2005 only about half of property transactions were being submitted electronically. A final push was needed. In 2008 the law made electronic registration mandatory. Registration can now be completed in just 2 steps, at a cost of 0.1 percent of the property value.

Eliminate the requirement for attaching a special administrative duty stamp (*biljeg*) for any Land Registry requests. At the moment, applicants at the Land Registry are requested to attach a special administrative stamp duty to their requests. In order to reduce the burden on entrepreneurs and facilitate the introduction of improved e-government services, such a requirement could be lifted.

Complete Land Registry and Cadaster data harmonization. The Land Registry is under the jurisdiction of the Ministry of Justice while the Cadaster is managed by the State Geodetic Administration. Currently, the data contained in the two databases is not fully integrated, though the process is ongoing as the Joint Information System is rolled out and the data harmonized. The current lack of data harmonization contributes to delays and inconsistencies in Government to Business services. To solve this problem and give full implementation to the Land Registry Act, Croatian authorities should give priority to

finalizing the Real Estates Registration and Cadaster Joint Information System (JIS) project – which will harmonize the two databases mentioned above.³⁵

Introduce fast-track registration procedures at the Land Registry Court. Each year the Land Registry Court sets its plan of activity. The plan distributes resources to each task performed by the Court and sets priorities, for instance giving particular urgency to the registration or cancellation of mortgages. When submitting their applications, entrepreneurs can also demand their cases to be treated with urgency. A large number of them do so, since the request has no extra cost. If the case is considered worthy of urgency by the Land Registry Court, referents/clerks try to accelerate the registration process as much as possible. Given the large number of requests, however, processing times are not much different. In order to effectively reduce processing times for those who really need it and help prioritize the work at the Land Registry Court, the Ministry of Justice should consider setting a formal fast-track procedures for an extra fee. Other European economies have introduced similar procedures with positive results. In Lithuania, the registration with the Real Estate Register normally takes 10 business days but entrepreneurs who wish to, can have their property registered in just 3 business days by paying a 30% mark-up on the registration fee (2-business days registration has a 50% mark-up, while 1-business day incurs in a 100% mark-up). In the Slovak Republic, the standard registration procedure takes 30 days and EUR 66 but entrepreneurs can choose to halve its time by paying EUR 266 instead. Similarly, Portuguese entrepreneurs can register their property in just one day if they pay a 50% mark-up on the land registry fee.

Allow electronic Land Registry extracts to be considered as official documents and make them accessible through e-citizen government portal. At the moment, only extracts obtained in paper directly at the Land Registry (or stamped by a Land Registry official) have legal standing. Considering the progress in the computerization of the Land Registry over the past years, these restriction could soon be abolished to allow electronic extracts to be used officially.³⁶ Also, extracts should be accessible through the e-citizen government portal.

Medium-term recommendations

Consider institutional reform in the county courts, the Land Registry and the Cadaster. Currently, the land registration function is carried out by the county courts. The courts are often insufficiently staffed and do not have sufficient resources to manage land transfers and registration efficiently. Authorities can consider removing the land registration from the county courts as an administrative function. To supplement this measure, they can merge the Land Registry and Cadaster functions into a single administrative agency, which is operationally independent, government supervised, and partially or fully fee-financed.

³⁵ For more information, please visit: <http://www.uredjenazemlja.hr/default.aspx?id=22>

³⁶ Article 7 of the Land Registration Act (Official Gazette No. 91/96, 68/98, 137/99, 114/01, 100/04, 107/07, 152/08, 126/10, 55/13 and 60/13) currently says “Extracts from the main register and copies or print-outs from the collection of deeds shall be issued by the land registries”. Additional information on why electronic extracts are not considered official documents can be found here: <http://www.uredjenazemlja.hr/default.aspx?id=101>

Getting Credit

Doing Business covers two aspects of the regulatory framework and infrastructure that affect the availability of credit: the depth of credit information and the strength of the legal rights of borrowers and lenders. The first aspect, measured by the depth of credit information index, includes the coverage, scope and accessibility of credit information available either through credit bureaus or registries. The second, measured by the strength of legal rights index, evaluates the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.

Both sets of measures have recently been expanded to cover more good practices. The strength of legal rights index has been expanded from 10 points to 12. One of the new points is awarded for having an integrated secured transactions system. Modern secured transactions systems are aiming at ensuring that a prospective creditor can easily determine not only whether an asset has already been pledged as collateral but also whether there is some other type of right over that asset. Such rights might be established by legal instruments that are functional equivalents to security interests. In an integrated secured transactions system these instruments are regulated under the same law as traditional security interests, an approach that provides greater transparency and predictability. Points are also awarded for having a well-functioning collateral registry, defined by several characteristics. One is that the registry must cover any type of secured transaction, regardless of the type of debtor, creditor or assets. Another is that the registry must be a notice-based registry, a type of registry that has lower running costs than a document-based registry. Finally, the registry must offer modern features. For example, secured creditors (or their representatives) should be able to register, search, amend and cancel security interests online.

The depth of credit information index has been expanded from 6 points to 8. One of the new points is awarded to economies where credit information can be accessed through an online platform or through a system-to-system connection between financial institutions and the credit information system. Online access can improve data quality and security, increase efficiency and transparency and ensure a high standard of service for users—and thus might increase the number of reporting institutions that share credit information.

With the methodological improvements introduced by *Doing Business 2015*, Croatia scored overall 61st on the Getting Credit indicator among the 189 countries measured by the report and 17th out of 26 in Europe and Central Asia region.

A. Credit Information

A credit reporting system is an integral part of a well-functioning credit market. Credit reporting systems help satisfy lenders' need for accurate, credible information that reduces the risk of lending and the cost of loan losses by providing a reliable indication of whether an applicant will repay a loan. The lack of credit information makes checking borrowers' credit history an onerous and uncertain process. This raises transaction costs for banks and, ultimately, increases the cost of credit to borrowers. Loans are made based on personal connections, not necessarily the likelihood of repayment.

Research suggests that bank risk is lower, while profitability is higher in countries where lenders share borrowers' information through credit bureaus and registries.³⁷ Well-functioning credit reporting systems can help to reduce adverse selection and moral hazard, and contribute to both an expansion of credit and a reduction in lending costs by facilitating the adoption of lending technologies based on credit scoring models. The development of credit registries and bureaus is particularly important for smaller firms, given the more severe problems of information opacity and asymmetry in these cases.

Table 5.1 Credit information ranking and best performers

<i>Doing Business</i> Indicator	Croatia	Regional Average	Regional best performer	Best global performer
Depth of credit information index (0-8)	6	6	8 (Armenia, Georgia, Lithuania)	8 (26 economies)
Private credit bureau coverage (percent of adults)	100.0	33.7 percent	100 percent (Serbia; Croatia)	100 percent (26 countries)
Public registry coverage (percent of adults)	0	19.3 percent	76.8 percent (Latvia)	100 percent (Portugal)

Source: Doing Business database

Table 5.2 Depth of credit information index

Depth of credit information index (0–8)	Credit bureau	Credit registry	Croatia's score:
Are data on both firms and individuals distributed?	Yes	No	1
Are both positive and negative credit data distributed?	Yes	No	1
Are data from retailers or utility companies - in addition to data from banks and financial institutions - distributed?	No	No	0
Are at least 2 years of historical data distributed? (Credit bureaus and registries that distribute more than 10 years of negative data or erase data on defaults as soon as they are repaid obtain a score of 0 for this component.)	Yes	No	1
Are data on loan amounts below 1% of income per capita distributed?	Yes	No	1
By law, do borrowers have the right to access their data in the credit bureau or credit registry? (Credit bureaus and registries that charge more than 1% of income per capita for borrowers to inspect their data obtain a score of 0 for this component.)	Yes	No	1
Can banks and financial institutions access borrowers' credit information online (for example, through an online platform, a system-to-system connection or both)?	Yes	No	1
Are bureau or registry credit scores offered as a value-added service to help banks and financial institutions assess the creditworthiness of borrowers?	No	No	0
Score (Number of "Yes" answers)			6

³⁷ Joel Houston, Chen Lin, Ping Lin, and Yue Ma, 2010. "Creditor rights, information sharing, and bank risk taking," *Journal of Financial Economics*, Volume 96, Issue 3, Pages 485–512, June.

Note: Prior to *Doing Business 2015*, the depth of credit information index covered only the first 6 features listed above. An economy receives a score of 1 if there is a "yes" to either bureau or registry. If the credit bureau or registry is not operational or covers less than 5% of the adult population, the total score on the depth of credit information index is 0.

Doing Business indicators over time

In 2007, Croatia set up a new private credit bureau - the Croatian Credit Information Registry (HROK) - that distributed positive and negative information only on individuals. Starting from July 2010, HROK expanded its coverage to firms. In December 2010, the bureau started distributing this information to financial institutions. Currently, the HROK database counts more than 3 million individuals and over 130 thousands firms.

Short-term recommendations

Expand the sources of information to include retailers and utility companies. In addition to the data provided by financial institutions, more advanced credit reporting systems also collect credit information from retailers or utility companies (electricity, water, and mobile phone providers) and include such data in the credit reports. This is the case in 58 of 189 economies covered by *Doing Business*, including Denmark, Germany, and the United Kingdom. Doing so is an effective way of expanding coverage by credit bureaus.

Collecting and distributing information on the payment of electricity and phone bills, for example, can help establish good credit histories for people without previous bank loans and credit cards. A study in Italy found that more than 83% of water customers, who lacked a credit history before the inclusion of repayment information from the utility provider, were able to have a positive history after the inclusion, solely by paying their utility bills.³⁸

Utility companies may also benefit. For example, in August 2006, the United States-based DTE Energy, an electricity and natural gas company, began full reporting of customer payment data to credit bureaus. DTE customers with no prior credit history—8.1% of the total—gained either a credit file or a credit score. And customers began to make payments to DTE a priority. Within 6 months DTE had 80,000 fewer accounts in arrears.³⁹

Expanding the sources of information to incorporate non-regulated financial institutions, however, can be challenging. For example, it may be necessary to amend the existing legal and regulatory framework concerning consumer and data protection so that retailers and utility companies may share consumer data with credit reporting service provider. Measures should also be taken to ensure the quality of data submitted by retailers and utility providers. Such companies may use different the consumer identification systems: both system and human errors are possible when data are transmitted for the first time.

The Croatian Credit Information Registry (HROK) is currently evaluating the possibility of expanding its sources of information to utility and telephone companies. A first round of discussions between its founders and owners, a set of 20 Croatian banks, was held in late March 2015. Another round of talks is planned for the end of April 2015, with a final decision to be taken by June of the same year. Given its political clout, the National Bank of Croatia may prove to be an important stakeholder in such matters. If the proposed

³⁸ Preliminary findings of ongoing internal study at CRIF SpA, Italy.

³⁹ World Bank Conference. Financial Infrastructure Week. Brazil, March 15-17, 2010.

expansion is accepted by the HROK board and meets the interest of telephone companies and utility providers, the Credit Registry will need to expand its handling data capabilities and banks will need to improve their online services.

Medium-term recommendations

Introduce credit scores. Another important tool in expanding access to finance is credit scoring, a statistical method of evaluating the probability that a prospective borrower will fulfill the financial obligations associated with a loan. Credit scores based on credit bureau or credit registry data pool information across many creditors as well as some public information sources. They therefore include characteristics otherwise unavailable to any individual creditor, such as total exposure, number of outstanding loans and previous defaults within the system. Credit scoring models typically incorporate historical data such as defaults, positive payment behavior and previous inquiries. To sharpen the predictive value of credit scores, credit bureaus and registries are also increasingly collecting data from a wider range of sources (such as bankruptcies and court judgments). As a result, credit scores generally have a higher predictive value than assessments derived from credit histories alone.⁴⁰

Credit scores may improve market efficiency and provide borrowers with more opportunities to obtain credit. The availability of credit scores allows lenders that would otherwise not be capable of analyzing the raw credit data to extend credit to underserved markets at lower cost. This value added product is most widely available in Latin America and the Caribbean and the OECD high-income group, offered in 80% of economies with a credit bureau or registry covering at least 5% of the adult population—compared with 40% in Europe and Central Asia, 38% in the Middle East and North Africa, 25% in East Asia and the Pacific and 24% in Sub-Saharan Africa.

Creating a credit score system involves large investments that Croatian Banks do not seem presently interested to consider. Such costs may be scaled if telephone and utility providers join HROK.

B. Legal Rights of Creditors and Borrowers in Secured Transactions

This section focuses on secured transactions and creditor's rights. In many developing countries, small and medium enterprises do not have access to land to use as collateral. However, they have moveable assets—such as machinery, inventory, accounts receivables, and equipment. The legal and institutional framework plays an important role in facilitating the use of such movable assets as collateral. Having to give up the possession of the asset pledged to a creditor would disable the debtor from using such asset, which could hamper the business's productivity and ability to operate. As a result, it is important to develop a legal system that would allow businesses to use all their moveable assets as collateral to secure loans without having to give up possession of those assets. This in turn may increase firms' likelihood of accessing credit and improve the terms of the credit.

Research suggests that an improved legal framework for collateral could contribute to:

⁴⁰ World Bank 2011a.

- **Increasing the level of credit availability:** In countries where security interests over collateral are enforceable against third-parties based on a predictable priority system in cases of loan default, credit to the private sector as a percentage of gross domestic product (GDP) averages 60 percent compared with only 30 percent to 32 percent on average for countries without these creditor protections.⁴¹
- **Decreasing the cost of credit:** In industrial countries, borrowers with collateral get nine times the level of credit given their cash flow compared to borrowers without collateral. They also benefit from longer repayment periods (11 times longer) and significantly lower interest rates (50 percent lower).⁴²
- **Increased access to finance:** Research found that in countries with registries for movable collaterals, the number of firms with access to bank finance increased on average by 8 percent and access to bank loans on average by 7 percent. These countries also showed lower interest rates and extension in loan maturity. The increase was even stronger for small firms, which often find it more difficult than bigger firms to access credit due to lack of fixed assets to be used as collateral.⁴³

In the *Doing Business* report, Getting Credit – Legal Rights indicator, Croatia scores 5 out of 12 (12 = highest score for strongest protections) on the strength of legal right index. Neighboring Montenegro is one of the 3 economies around the world that score 12 out of 12 in this index (table 5.3).

Table 5.3 Legal Rights of Creditors and Borrowers in Secured Transactions ranking and best performers

<i>Doing Business</i> Indicator	Croatia	Regional Average	Regional best performer	Best global performer
Strength of Legal Rights Index (0-12)	5	6	12 (Montenegro)	12 (Colombia; New Zealand); Montenegro)

Table 5.4 Legal Rights of Creditors and Borrowers in Secured Transactions score

Strength of legal rights index (0-12)	Croatia's score
Does an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets exist in the economy?	No
Does the law allow businesses to grant a non possessory security right in a single category of movable assets, without requiring a specific description of collateral?	No
Does the law allow businesses to grant a non possessory security right in substantially all of its assets, without requiring a specific description of collateral?	Yes

⁴¹ Investment Climate Advisory Services, *Secured Transactions Systems and Collateral Registries*, World Bank Group, January 2010.

⁴² Ibidem

⁴³ Love, Inessa, María Soledad Martínez Pería and Sandeep Singh, 2013. "Collateral Registries for Movable Assets. Does Their Introduction Spur Firms' Access to Bank Finance? Policy Research Working Paper n. 6477, The World Bank, June

Strength of legal rights index (0-12)	Croatia's score
May a security right extend to future or after-acquired assets, and may it extend automatically to the products, proceeds or replacements of the original assets?	No
Is a general description of debts and obligations permitted in collateral agreements; can all types of debts and obligations be secured between parties; and can the collateral agreement include a maximum amount for which the assets are encumbered?	Yes
Is a collateral registry in operation for both incorporated and non-incorporated entities, that is unified geographically and by asset type, with an electronic database indexed by debtor's name?	Yes
Does a notice-based collateral registry exist in which all functional equivalents can be registered?	No
Does a modern collateral registry exist in which registrations, amendments, cancellations and searches can be performed online by any interested third party?	No
Are secured creditors paid first (i.e. before tax claims and employee claims) when a debtor defaults outside an insolvency procedure?	No
Are secured creditors paid first (i.e. before tax claims and employee claims) when a business is liquidated?	Yes
Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors' rights by providing clear grounds for relief from the stay and/or sets a time limit for it?	No
Does the law allow parties to agree on out of court enforcement at the time a security interest is created? Does the law allow the secured creditor to sell the collateral through public auction and private tender, as well as, for the secured creditor to keep the asset in satisfaction of the debt?	Yes
Score (Number of "Yes" answers)	5

Source: Doing Business database

Reform efforts

Croatia considerably strengthened its secured transactions system in 2006 by launching a unified and geographically centralized collateral registry (Law on Register of the Judicial and Notary Public Insurance of Claims Over Movable Properties and Rights). Since then, the Croatian Financial Agency (FINA) has been keeping a public registry on the securities (pledge and fiduciary transfer of ownership) acquired over movables and rights. There are some exceptions. Securities (stocks, bonds, etc.) are registered with the Central Depository Agency. Planes and ships are treated as immovable property and have their special registry.

Medium-term recommendations

Allow businesses to grant a non possessory security right in a single category of movable assets, without requiring a specific description of collateral. In addition, security rights should extend to future or after-acquired assets and extend automatically to the products, proceeds or replacements of the original assets. In order for the security interest to be effective, the debtor needs to have total freedom regarding how to use the assets as long as he takes proper care to preserve their commercial value. In some countries this is achieved through business charges, sometimes called enterprise charges or even

floating charges, making it easier for entrepreneurs to obtain credit by allowing them to use the entirety of their assets as collateral. These arrangement offers flexibility because it gives creditors both the incentive to extend credit, as well as the security of knowing that they will be able to realize their security interest if the debtor defaults.

Ensure that the priority scheme ranks secured creditors as high as possible, while respecting other critical national policy objectives. It is critical that creditors or potential creditors of a business be able to determine, with a high degree of predictability, where their claims against the business will rank. Given the important role that secured creditors often play in providing credit to businesses, their claims should have the highest priority reasonably possible, both within and outside of insolvency procedures, unless other claims were registered before the secured creditor’s claim. Claims that rank ahead of secured creditors are likely to increase the cost, or limit the availability of credit.

If secured creditors can predict their ranking vis-à-vis other types of creditors (including statutory creditors) with confidence, they will make credit available more easily and at a lower cost to the borrower. But when other types of creditors, such as the tax authority in the case of state income taxes or labor claims, have priority over secured creditors—especially if they came into existence after the registration of the security interest—secured creditors will be less able to predict their level of risk. Providing secured creditors with the highest level of priority possible based on the “first in time, first in right” principle will encourage more credit to be available to entrepreneurs at a lower rate.

There may be broader or more important policy objectives served by ranking certain claims higher than those of secured creditors. If so, both the nature and the scope of these priority claims should be very clearly defined. Many countries achieve this by narrowly defining the class of claims that rank ahead of secured creditors and limiting the amount of money that can be paid under these prior-ranking claims. Similarly, in bankruptcy, there may be the need to temporarily stay or, in some cases subordinate, the claim of secured creditors to provide the borrower with the potential to restructure and continue as a going concern. Secured creditors should have priority over other creditors when the debtor is the subject of a collective procedure or bankruptcy.

Create an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of 4 functional equivalents to security interests in movable assets: fiduciary transfer of title; financial leases; assignment or transfer of receivables; and sales with retention of title. Such unified legal framework may consist either of one law covering all types of security interest, including functional equivalents (ideal scenario). Alternatively, it may encompass various laws by linking them through the same requirement of registration of all type security interests, including functional equivalents, in central, geographically unified, collateral registry which would be noticed-based (no underlying security documents need to be provided for registration) and accessible on-line for registration, searches and modifications by interested parties.

Protecting Minority Investors

Corporate governance matters in all types of economies. Its ability to build trust and raise the attractiveness of firms to potential investors, whether domestic or foreign, is crucial in both established and developing economies. In established economies, ill-conceived corporate regulations can hamper the growth of the private sector. In developing economies, confidence in the institutions is sorely needed to encourage the creation of a strong flow of flourishing corporations.

Corporate governance is first and foremost an act of balancing. The immediate interests of four parties are at play: company managers, company directors, shareholders and public authorities. In an ideal setting, the seemingly contrary interests of one party become beneficial in the long run to that of another. For instance, empowering shareholders by granting them more control over major transactions and/or transactions with a potentially harmful conflict of interest reduces the risk on their investment and may allow managers and company directors to more easily raise the capital needed to grow, innovate, diversify and compete on the market.

Without investor protections, equity markets fail to develop and banks become the only source of finance. Economies that have dynamic capital markets tend to effectively protect investors. In these economies investors receive financial information they can trust, they participate in major decisions of the company, and directors are accountable for their managerial decisions. If the laws do not provide such protections, investors may be reluctant to invest, unless they become controlling shareholders.

Doing Business measures the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain through one set of indicators and the strength of shareholders' rights in corporate governance through another.⁴⁴ Such protections are important because gaps in legislation may allow company owners and directors to enter into transactions that are lawful and involve no fraud or deceit, but that nevertheless are unfair to minority shareholders. The existence of disclosure, director liability and shareholder suit provisions that prevent such unfair transactions is of concern both to foreign and domestic shareholders, and would help companies in Croatia to raise capital. The "protecting minority investors" overall index is computed by averaging two other indices related to protecting minority investors: conflict of interest regulation and the extent of shareholder governance. Each of these indices is comprised of an average of three more relevant sub-indices (see table below). On an index range of 0-10, Croatia scores 5.8, ranking 62 out of 189 worldwide and 17 out of 26 economies in the Europe and Central Asia region.

⁴⁴ The company that is measured by Doing Business 'Protecting minority investors' indicators is a publicly traded corporation on the economy's most important stock exchange. If the number of publicly traded companies listed on that exchange is less than 10, or if there is no stock exchange in the economy, it is assumed that the company is a large private corporation with multiple shareholders.

Table 6.1 Protecting minority investors in Croatia and best performers

<i>Doing Business</i> Indicator	Croatia	Regional average	Region's best performer	Global best performer
Minority Investor Protection (0-10)	5.8	5.9	7.3 (Albania)	8.2 (New Zealand)
Conflict of Interest Regulation (0-10)	5	6	7.3 (Albania; Georgia)	9.7 (New Zealand; Singapore)
Disclosure Index (0-10)	3	6.4	10 (Bulgaria)	10 (11 economies)
Director Liability Index (0-10)	6	4.8	8 (Albania; FYR Macedonia; Montenegro)	10 (Cambodia)
Shareholder Suits Index (0-10)	6	6.7	8 (9 economies)	10 (Mozambique)
Extent of Shareholder Governance (0-10)	6.5	5.9	7.3 (Bulgaria)	7.8 (France; India)
Shareholder Rights Index (0-10.5)	7.5	7.8	10.5 (Armenia; Romania)	10.5 (8 economies)
Strength of Governance Structure (0-10.5)	7	4.4	8 (Serbia)	8 (Serbia; France)
Corporate Transparency Index (0-9)	5	5.4	8.5 (Bulgaria; Kyrgyz Republic)	8.5 (4 economies)

Source: *Doing Business* database

Short-term recommendations

Increase disclosure requirements of related-party transactions to the public and the market regulators. Fifty-two of the 189 economies covered by *Doing Business* stand out for the strictest rules on disclosure of related-party transactions (both before and after the conclusion of the transaction). These include France, New Zealand, Singapore and Albania. Corporate scandals, investor activism, the global financial crisis and unification of accounting standards have prompted governments around the world to strengthen disclosure requirements.

In Croatia, neither the Companies Act, the Securities Market Act nor related regulations make any specific reference to the obligation of immediately disclosing information concerning a potential conflict of interest to the board of directors and directly to the public. A revised regulation should require detailed disclosure of the nature and the extent of the conflict of interest and all the relevant information regarding the transaction. This information should ideally be posted on the website of the company (if one exists) and also on the website of the Zagreb Stock Exchange (<http://zse.hr>).

Require an external auditor's report before the approval of transactions between interested parties. Currently, regulations do not require the review of the terms of a related-party transaction by an auditor before the authorization of the transaction by the board of directors. The auditor's report should evaluate the main terms of the transaction and present an opinion on whether the transaction is being concluded at market terms. To increase disclosure, such a review should be mandatory for large related-party transactions.

In addition, a liability regime should be incorporated in the law in case the independent auditor presents false or misleading information on the transaction.

To avoid being too cumbersome and costly, especially for smaller companies, this requirement can be circumscribed to certain transactions only: for instance, to all transactions representing 10% or more of the assets of the company. This measure increases shareholder protections from self-dealing and allows them to take well-informed decisions when voting on these deals.

Independent review of related-party transactions is required in France and in the United Kingdom. Similarly, Kuwait recently strengthened its investor protection legal regime by allowing minority shareholders to easily request the appointment of an auditor to review the company's activities.

Provide shareholders with rights to hold the directors liable for damages resulting from a related-party transaction. Currently minority shareholders have to prove the directors' negligence before a court of law. This more demanding standard—which requires shareholders to prove willful conduct, an intent to cause harm, or knowledge that one's conduct would be prejudicial, in addition to material damages—should be complemented so that minority shareholders may also hold directors liable for unfair or prejudicial related-party transactions solely because of the presence of a conflict of interest, so long as the transaction at issue caused damages. In this case, the law would require minority shareholders only to prove material damages and not the intention to cause damages, thus increasing the likelihood of recovery and consequently the level of protection.

In addition, in the case of a related-party transaction that is unfair, oppressive or prejudicial to minority shareholders, or entails a conflict of interest (i.e., not only in cases of fraud or bad faith), the law should offer the possibility of rescission of the transaction. Moreover, the law should allow for fines to be used against a director who engaged in a related-party transaction harmful to the company.

Thirty economies implemented rules which hold the directors liable when the transaction is unfair or prejudicial to the other shareholders even if the transaction is not fraudulent. In fact, economies such as Albania, Macedonia, FYR, Malta, Montenegro and New Zealand hold directors liable for the damage caused by the related-party transaction if the company's affairs are being or have been conducted in a manner which is unfairly prejudicial or oppressive to the interests of its shareholders.

Limit cross-shareholding between 2 independent companies to 10% of outstanding shares. Cross-shareholding can lead to double counting, whereby the equity of each company is counted twice when determining value. It restricts the market for control and discourages purchase of shares. Companies that have cross holdings are susceptible to confusion and management holdout; the identity of controlling shareholders and the extent of their ownership and control also becomes more difficult to ascertain. For example, one shareholder could control significantly more voting rights than the shares registered directly under his name might suggest, by also controlling indirect voting rights through participations in another entity, which is itself also partly controlled by the company. For those reasons, a recommended good practice is that independent companies should not hold more than 10% of each other's outstanding shares.

Require disclosure of information about board members' other directorships, as well as basic information on their primary employment. In order to promote better corporate transparency, annual reports of listed companies could be required to include details of all directorships held by their directors at any time in the 3 years immediately before the end of the financial year, and the period for which each directorship has been held. In addition, the filings should include their working experience and occupation(s) during the past 10 years. Further, key information regarding directors, such as directorships or chairmanships both present and those held over the preceding three years in other listed companies, and other principal commitments, should be disclosed in the company's annual report.

Require disclosure of managerial compensation on an individual basis. Financial reporting requirements for listed corporations could be broadened to include a remuneration report with details on the remuneration of each member of the key management personnel of the company. "Key management personnel" can be defined as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including and director of the entity, whether executive or otherwise. The remuneration report should also include the disclosure of primary benefits such as cash, salary and fees, cash profit-sharing and other bonuses, non-monetary benefits, post-employment benefits including pension, and long-term benefits such as incentive plans.

As best practice, companies are also encouraged to fully disclose the remuneration of the said top five key management personnel. The annual remuneration report should disclose the details of the remuneration of employees who are immediate family members of a director or the CEO and whose remuneration exceeds a predetermined amount during the year on a named basis with clear indication of the employee's relationship with the relevant director or CEO.

Facilitate shareholders suits by granting shareholders broader powers during a trial. Minority shareholders should be granted access to relevant company information when bringing suits against directors and managers. The scope of documents that can be requested during trial should be expanded to include any information that is relevant to the subject matter of the claim. Currently, the Civil Procedure Act requires specific identification of the evidence during trial (i.e. date, title, file number of the document, etc.). In order to ease access to evidence that is not easily identifiable, for example because the date of the record is unknown to the requesting party (e.g. how to determine which board meeting minutes contains the relevant discussion), the civil procedure law should allow parties to request categories of documents from the opposing party without identifying specific ones. Several economies offer such protections to minority shareholders, including New Zealand, Poland and Ireland.

Paying Taxes

Research shows that complicated tax systems risk high evasion and are associated with lower numbers of foreign direct investment.⁴⁵ High tax compliance costs are also associated with larger informal sectors, more corruption and less investment. In contrast, economies with well-designed tax regimes are able to help the growth of businesses and, ultimately, the growth of overall investment and employment.

The *Doing Business* “Paying taxes” indicators records the taxes and mandatory contributions that a medium-size company must pay in a given year, as well as the time it takes to meet the tax obligations of the 3 main taxes: corporate income tax, VAT or sales tax and labor taxes and mandatory contributions. Croatia ranks 36 globally out of 189 economies on the ease of paying taxes and is 6 out of 26 in Europe and Central Asia region (table 7.1).

Table 7.1 Paying Taxes in Croatia and best performers

<i>Doing Business</i> indicator	Croatia	Regional average	Regional best performer	Global best performer
Payments (number per year)	19	20.5	5 (Georgia; Ukraine)	2 (Hong Kong SAR, Saudi Arabia)
Time (hours per year)	208	234.3	52 (San Marino)	12 (United Arab Emirates)
Total tax rate (% of commercial profit)	18.8 percent	34.9 percent	N/A	N/A

Source: *Doing Business* database

Reform efforts

In 2012, Croatia made paying taxes easier for companies by successfully introducing an electronic system for social security contributions that is used by the majority of companies. Also, it reduced the rates for the forest and Chamber of Commerce contributions. The latter was subsequently abolished on January 2014.

Short-term recommendations

Continue providing tax outreach--education and training--to small and medium enterprises to ensure compliance and carry out communications campaigns to further increase the use of electronic filing. Often, the biggest obstacle in paying taxes for small businesses is the lack of basic accounting skills. The government can fill this gap by providing capacity building and training for small businesses. The benefits should be mutual: if well-trained entrepreneurs are able to prepare and file tax returns and pay taxes more efficiently, the government can ensure better compliance with the tax regulation. Tax education is particularly important following significant reforms of the tax system (that is,

⁴⁵ Complex tax systems are associated with lower numbers of foreign direct investment in an economy but do not affect its level. A high corporate tax rate, on the other hand, is negatively related to both the number and level of foreign direct investment. A 10% reduction in tax complexity is comparable to a 1% reduction in effective corporate tax rates (Lawless 2013).

the improvements of electronic filing and payment systems and required software and increased rates of some taxes/contributions).

Trading across Borders

Customs performance, other trade-related technical control regulations, the quality of infrastructure for trade, and the existence of trade barriers impact the ease of trading among countries. Economies with the most efficient trade logistics share common features. First, they allow electronic exchange of information with customs and other control agencies. The use of electronic systems to transferring and processing customs information has become widespread. Currently, 88% of economies around the world allow traders to submit at least some export and imports declarations, manifests or other trade-related documents to custom authorities electronically. Over the past 10 years, 127 economies – including Croatia - have introduced or improved such systems. Increasingly, countries are introducing electronic single windows that connect traders not only to customs, but also to other agencies involved in the import and export processes. The most sophisticated of these systems are moving to ‘paperless’ trade. Traders can electronically file through a single entry point information to fulfill all import and export requirements, and share it with all parties involved in trade, including customs and other government agencies, banks, freight forwarders, and insurance companies, among others. Second, economies with efficient trading environments use risk-based assessments which limit physical inspection to a small percentage of cargo, thus reducing customs clearance delays.

The *Doing Business*’ Trading across borders indicator currently looks at the entire process for import or export, from contractual agreement to getting the letter of credit to arrival/departure of the goods from the port of entry/exit. On average, in Croatia it takes 16 days to export and 14 to import, with an associated cost of \$1,335 for export and \$1,185 to import. At present, 6 documents are required for exports and 7 for imports (table 8.1). While Croatia’s performance on this indicator is above the regional average in Europe and Central Asia, it lags behind other nearby economies, such as Hungary, Bulgaria, and Romania.

The *Doing Business*⁴⁶ report measures the time, cost (excluding tariffs), and the number of documents required to export and import a standardized cargo of goods by sea transport, while the *Logistics Performance Index*⁴⁷ (LPI), the *Enterprise Survey*⁴⁸ (ES) and the *Global Competitiveness Index*⁴⁹ (GCI) report business leaders’ perceptions about trade logistics, as well indicators on experience of firms while importing and exporting (table 8.2). Recommendations in this section are based on the results for Croatia in the *Doing Business* report, taking into account the results from other indices where applicable.

⁴⁶ <http://www.doingbusiness.org/data/exploreconomies/croatia/#trading-across-borders>

⁴⁷ The International LPI provides qualitative evaluations of a country in six areas by its trading partners—logistics professionals working outside the country. See http://d21a6b425f3bbaf58824-9ec594b5f9dc5376fe36450505ae1164.r12.cf2.rackcdn.com/LPI_Report_2014.pdf

⁴⁸ <http://www.enterprisesurveys.org/data/exploreconomies/2013/croatia>

⁴⁹ http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf

Table 8.1 Trading across Borders in Croatia and best performers

Report	Indicator	Unit	Croatia	Regional average	Regional best performer	Global best performer
	Ease of Trading Across Borders	Rank (1-189)	86	-	21 (Lithuania)	Singapore
	Documents to export	Number	6	7	4 (Lithuania, Georgia, Bulgaria, San Marino)	2 (France; Ireland)
	Time to export	Days	16	24	7 (Cyprus)	6 (5 economies)
	Cost to export	USD/ container	1,335	2,154	600 (Latvia)	410 (Timor Leste)
	Documents to import	Number	7	8	4 (Georgia, San Marino)	2 (France; Ireland)
	Time to import	Days	14	26	5 (Cyprus)	4 (Singapore)
	Cost to import	USD/ container	1,185	2,436	730 (Albania)	415 (Timor Leste)

Table 8.2 Other trade indicators

Report	Indicator	Unit	Rank/Score
			Croatia
LPI	Logistics Performance Index (general)	Rank (1-160)	55
	Logistics Performance Index (customs)	Rank (1-160)	50
ES	Customs & trade regulations identified as major constraint	percent of firms trading	3.2
GCI	Burden of customs procedures	Rank (1-144)	41

Reform efforts

Starting from 2005, Croatia has considerably improved its port infrastructure. In August 2011, the International Container Terminal Services Inc. (ICTSI) embarked on a €30M investment program to revamp the Adriatic Gate Container Terminal (AGCT) of Rijeka. As a result, significant infrastructure investments were made, including - but not limited to - repairs in the container yard, new gantries, reconstruction of the rail yard and the cleaning of the seabed in the southern pier. On the information system side, a switch was made from Wi-Fi to 3G technology for mobile devices used in the field and. Another important step ahead was the development of a NAVIS SPARCS N4 operating system for the

management of the movement of cargo through terminals. The system was installed in January 2012 and rolled out gradually during 2012. The system has led to important improvements in crane productivity, energy usage and idle truck times.

Since 2006, Croatia considerably harmonized and streamlined its export and import custom procedures in preparation for the July 1, 2013 accession to the European Union. Furthermore, the NAVIS system improved the transfer of orders and communication between forwarding companies and local government agents. More recently, the country made trading across borders easier by implementing a new electronic customs system - CARINA.HR.

Short-term recommendations

Implement the Custom Agency's e-surveillance project. At the moment, Croatian customs officials note down inspection results on paper forms and, once inspections are over, type their findings into the system. The Croatia custom agency is currently considering the implementation of an "e-surveillance" project that will allow custom officials to enter their findings directly into the system. This improvement will have a number of efficiency benefits, including saving customs officials' time by reducing the volume of their paperwork; allowing the customs agency to monitor more efficiently the performance of its employees through electronic tracking of their work; updating the database in real time, enabling other customs officials to be alerted immediately in cases of suspect goods, thus improving risk management and enabling customs to focus their efforts where needed.

Medium-term recommendations

Establish an electronic single-window system for all trade related transactions. Cross border trade involves controls by many agencies. A coordinated border management and clearance process is therefore an essential element of trade facilitation and may result in a sensible reduction in time and cost to trade across borders. Currently there is no fully functioning system that allows importers, exporters and custom brokers to make all the necessary applications for licenses or permissions electronically.

Since Croatia became a member of the European Union, Croatian customs operate in seven EU border posts with inspection services— two with Bosnia and Herzegovina, one with Serbia, one with Montenegro, the ports of Rijeka and Ploce, and the airport of Zagreb.⁵⁰ Arrivals to the border posts notify customs beforehand (1 hour prior if the goods arrive by road, 2 hours if they arrive by train, and 24 hours if they arrive by airplane). Customs then notifies other agencies involved in border control, such as the Ministry of Agriculture (in charge of veterinary and phyto-sanitary inspections) and the Ministry of Health (in charge of sanitary inspections). Unfortunately, since the IT systems of these agencies do not communicate with each other, inter-agency communication must take place in writing. As a result, delays may occur.

⁵⁰ Croatian customs are present at all border crossings for international traffic, not only the 7 mentioned above. The 7 border posts mentioned above are BIP, or Border Inspection Posts.

An electronic single-window system would allow trade professionals to carry out all their transactions through a single portal. The results of such applications could be fed automatically into the clearance system to inform all control authorities, and also advise the applicant. This would significantly speed up import and export processes, improve accuracy, and reduce opportunities for corruption.

Although electronic single window systems vary in their functionality and complexity, the best single windows systems link banks, licensing agencies and trade clearance agencies into a unique platform, and allow exchange of information in real time, speeding up approvals. Best practices require a paperless customs clearance system, which should accompany the electronic data interchange system. The electronic single-window system would allow traders to upload all documentation, pay the necessary fees and receive approvals online. In order to make such changes really possible, the changes to the legal framework and the improvements to the IT systems of all agencies involved must be aligned with EU standards as to make the systems interoperable with other European custom systems.

Singapore, through its TradeNet system has been a global leader in the implementation of such a platform/single window. TradeNet handles 20-30,000 trade declarations per day and links 35 government controlling units. Several economies have reported positive results from the implementation of single-window systems. The Korea Customs Service estimates that the introduction of its single-window system brought some \$18 million in benefits in 2010, part of the overall economic benefits that year of up to \$3.47 billion from the agency's trade facilitation efforts.⁵¹

Enforcing Contracts

Research in various countries around the world suggests that, in the absence of efficient courts, firms make fewer investments and business transactions while informal transactions become more attractive. A study of 27 economies found that the informal sector's share in overall economic activity decreased with better contract enforcement quality, evaluated by a country-wide measure of rule of law, as well as by the firm's perception of the fairness of courts.⁵² Improvements in court efficiency are associated with a lower share of the informal sector in the overall economic activity, increased investor confidence and with increased bank financing of firms for new investment.⁵³ For example, reforms in other areas, such as creditors' rights, can increase bank lending only if contracts can be enforced before the courts.⁵⁴

⁵¹ Korea Customs Service. 2011. *The Embodiment of Business-Friendly Environment by KCS Challenges*. Seoul.

⁵² Dabla-Norris and Inchauste Comboni 2008.

⁵³ Among other papers, see G.B. Ramello and S. Voigt, 2012. "The economics of efficiency and the judicial system," *International Review of Law and Economics*; Mehnaz Safavian and Siddharth Sharma, 2007. "When Do Creditor Rights Work?" World Bank Policy Research Working Paper No. 4296; John Ahlquist and Aseem Prakash, 2010. "FDI and the costs of contract enforcement in developing countries," *Policy Sciences*, Springer, vol. 43(2), pages 181-200, June; Inessa Love, 2011. "Settling Out of Court: How Effective is Alternative Dispute Resolution," Viewpoint Note No. 329, The World Bank Group, October.

⁵⁴ Safavian and Sharma 2007.

Doing Business measures the efficiency (number of procedures, time and cost) of the judicial system in resolving a standardized commercial dispute before the Zagreb Commercial Court. Globally, Croatia ranks 54th in the ease of enforcing contracts in among 189 economies, and 16th out of 26 in the Europe and Central Asia region. On average, entrepreneurs in Croatia pay 13.8% of the claim value in attorneys, court and enforcement fees and need 572 days to resolve a commercial dispute through the courts. In Singapore, entrepreneurs need only 150 days to resolve the same dispute (Table 9.1).

Table 9.1 Enforcing Contracts in Croatia and best performers

<i>Doing Business</i> indicator	Croatia	Regional average	Regional best performer	Global best performer
Procedures (number)	38	37.2	7 (Belarus)	21 (Ireland, Singapore)
Time (calendar days)	572	448.1	195 (Uzbekistan)	150 (Singapore)
Cost (percent of claim)	13.8 percent	25.2 percent	12.7 percent (Slovenia)	9.0 percent (Iceland)

Source: Doing Business database

Reform efforts

A new Enforcement Act came into force in October 2012. Its aim was to reduce the time needed for enforcement procedures by transferring certain procedures from the court to other bodies, such as the Financial Agency (FINA). Under the new Enforcement Act, FINA is competent to directly execute court judgments and court settlements on debtors' bank accounts. As a result, creditors no longer need to obtain an enforcement decision from the court in addition to the final judgment.

Moreover, Croatia approved significant amendments to the Civil Procedure Act (OG 25/2013) that entered into force on April 1, 2013. The amendments are designed to streamline the way the litigation process is administered, including the way litigants submit evidence. The new Law introduces time limitations and electronic submissions, and abolishes multiple referrals from lower to higher instance courts.

Short-term recommendations

Assess court procedures to identify points of delay and formulate solutions. In Zagreb, it takes almost 20 months on average to resolve a commercial dispute. During this time, plaintiffs have to wait more than a month between the filing of a complaint and serving of notice on the defendant. Going through the trial and obtaining a judgment takes one year, a large part of which is spent waiting for the first hearing and the subsequent adjournments. Once a judgment has been issued, it takes almost six more months for the judgment to be enforced through the public auction of the losing party's assets.

It is recommended to map out both the procedures required by the law and the steps required in practice by the court to take a case from filing through enforcement. This exercise would help identify unnecessary administrative tasks required by court staff, judges and court users as well as opportunities for improvement with (and without) legislative changes. It could also help identify needs for resource allocation to enhance efficiency and cost effectiveness. Such an assessment can be conducted upon the government's request and may foster the ongoing efforts to simplify the court proceedings undertaken by the Ministry of Justice.

Strengthen efforts to promote Alternative Dispute Resolution (ADR). Alternative dispute resolution has proven a valuable pillar in enhancing access to justice, bringing rapid consent-based dispute resolution to businesses in many economies. Promoting ADR measures could help reduce the current backlog in the Croatian courts. ADR, along with other measures aimed at speeding up judicial proceedings and their enforcement, can not only increase efficiency but also reduce the cost of legal fees entrepreneurs have to pay for dispute resolution. Inefficient processes often result in repeated and unnecessary appearances in court, and add up to the lawyers' bill. Limiting the time attorneys spend in court (or preparing for court) will lower the cost to clients but also free up their time to serve more clients. The Croatian Ministry of Justice is currently considering the promotion of ADR through court fees, following the example of other European countries, such as the United Kingdom. Such efforts should be strengthened.

Medium-term recommendations

Continue improving the e-courts system by introducing e-filing and electronic service of process. Since 2007, Croatia has achieved important progress towards the establishment of an e-court system. Over the past years, all county, commercial, and municipal courts have been connected to an Integrated Case Management System (ICMS/eSpis).⁵⁵ The data generated from the system may be tracked according to different predefined parameters (e.g. received, solved and unsolved cases, by type of a dispute, by judge, by efficiency of each judge, etc.). All courts connected to the ICMS system have an automatic case allocation process. Since 2013, a new web service - e-Predmet⁵⁶ - allows parties and attorneys to access basic information about the evolution of a case, thus relieving courts from inquiries relating to such matters. Starting from January 2015, FINA supports online auctions of real estate and movable assets.

In spite of these efforts, the process of computerization is not yet completed. E-filing and electronic service of process are not yet available. Similarly, the submission of evidence by the parties (as well as witnesses' opinions) must be carried out in paper format. Because of this, court staff, judges and users have to cope with a dual system where only a part of the information they are required to assess - e.g. minutes of the hearings and past court decisions - can be found online. As a result, the courts' premises are often cluttered with paperwork and files, court clerks are swamped with work, and delays ensue.

Adequate measures should be taken to gradually introduce a paperless e-court system. In Europe, countries with well-functioning e-court systems include Austria, Denmark, Finland, Norway, the Netherlands, UK, and Portugal. In Austria, all filings from lawyers in civil litigation and enforcement proceedings now go through an electronic data channel operated by the Ministry of Justice. Judgments are delivered by e-mail rather than by the old hard-copy notification process. The United Kingdom has successfully introduced electronic case management in the courts. This is how it works: court officers in the commercial courts set a timetable at the first case management conference for all the activities between filing and trial. Then, within a few days of the case management conference, the parties fix a date for the trial within a range of dates specified at the case management conference. Court officials actively monitor and manage each case in the

⁵⁵ The eSpis system was introduced starting from 2008, all courts were covered by August 2013.

⁵⁶ <http://e-predmet.pravosudje.hr>

court docket from the moment the action is filed until the moment it is finally decided. This allows them to track workload, predict trends and plan strategically. Another country that successfully implemented an efficient case management system is Korea. The introduction of a comprehensive e-court system enables Korean judges to adjudicate up to 3,000 cases a year, manage up to 400 a month and hear up to 100 pleas a month (box 2).

Box 2. Improving court efficiency: the Republic of Korea's e-court experience

Approaches to e-courts vary by economy depending on the capacities and priorities of the judiciary and the ability of court users to use such solutions. The tools available to court users in Korea have gradually expanded over time. Currently, the country ranks first in the world on the E-Government Readiness Index, a composite measure of the capacity and willingness of economies to use e-government for development.

The first case management system, launched in the mid-1980s, enabled internal court users to search for civil cases in the database. Now the system encompasses many features, most of which are dedicated to help judges (case management system and judge support system), facilitate the filing of cases for litigants (e-filing) and inform the public (publication of cases).

To further streamline procedures, a system facilitates payment of all submission fees electronically using credit card or wire transfers at the time of filing. In addition, users are notified by e-mail or text message of any submission of additional documents by the opposing party. And after the case allocation system assigns cases, the designated judge and the attorneys can view all their cases online, including PDFs of all documents filed in a given lawsuit.

For judges, the support system includes four main features:

- The case management system, which allows judges to organize their work based on the status of procedures and to separately manage cases for which special measures are needed.
- “My case history,” which allows judges to track cases they have disposed and the final determination of the cases.
- A scheduling system to organize cases by day, week or month that is integrated with the court registry.
- A writing support system with features such as automatic document formatting, multiple judgment editing in small cases and collaborative decision writing in panel cases. This system automatically creates a draft of the final judgment after the relevant case and desired template have been selected. Once completed, judges enter a digital signature and register the decision in a searchable database of judgments.

Online help centers featuring frequently asked questions and tools for pro se litigants were also created to allow the public to get fast answers on questions about the Supreme Court and its processes. One of the most important components of these help centers is the self-represented litigants webpage, which provides information and templates needed to file a case and respond to claims of counterparties without the help of a certified lawyer. In the first two months after the launch of the e-filing system for civil cases approximately 5% were filed electronically. This number almost decupled in 18 months. In fact, two years later, in June 2013, that share had soared to more than 45%.

According to Doing Business, in Seoul resolving a standard contract enforcement dispute takes 230 days, 32 procedures and costs 10.3% of the claim—making Korea the runner-up in Doing Business's ease of enforcing contracts ranking. In many countries, concerns about budget and technology limitations are among the most common reasons for not implementing e-court features. That should not prevent less developed economies from looking into e-court options. E-court options may provide for cost savings in the long run and up-front costs for development of such options can be implemented with donor assistance, supported by peer learning from courts in leading economies such as Korea.

If implemented carefully, e-courts can improve court document security and decision making transparency. In the long run, they also help countries save money. The implementation of Korea's e-court system, for example, resulted in savings of \$221 per e-filing. These savings result from a reduction in the use of paper, the time spent in court, cheaper service of process, lower transportation costs, easier archiving of documents, and easier payment of fees.

Source: Doing Business 2014.

Resolving Insolvency

The efficient regulation of business insolvency relates to the broader topic of access to credit. Studies suggest that where insolvency regimes are most effective, creditors—confident that they will be able to collect on loans—are more likely to lend, including to borrowers with whom they have not had a long-standing relationship with. A well-balanced insolvency system also functions as a filter, separating companies that are financially distressed but economically viable from inefficient companies that should be liquidated. By giving viable companies a chance at a fresh start to reorganize and continue as going concerns, insolvency law may also help sustain a higher overall level of entrepreneurship in a country, protect jobs and maintain suppliers' networks, among other benefits for the economy. Moreover, by facilitating the efficient business exit and liquidation of unviable companies, a beneficial insolvency framework supports the efficient reallocation of resources across the economy.⁵⁷

The *Doing Business* report's 'Resolving insolvency' indicators is composed by two measures: the *debt recovery in insolvency* and the *strength of insolvency framework index*. The first measures the time, cost, and outcome of insolvency proceedings for domestic companies. The indicator does not deal with situations where a business owner voluntarily winds up a company, but, rather, where businesses become "insolvent" (typically under one of two definitions): (1) the business is unable to pay its debts as these become due; or (2) the business has more liabilities than assets. The second index, introduced by *Doing Business* this year, evaluates the adequacy and integrity of the legal framework applicable to insolvency proceedings. Good practices are measured in accordance to the World Bank's *Principle of Effective Insolvency and Creditor/Debtor Regimes* and the United Nations Commission on International Trade Law's (UNCITRAL) *Legislative Guide on Insolvency Law*.⁵⁸ The data for the resolving insolvency indicators are derived from questionnaire responses by local insolvency practitioners and verified through the study of laws and regulations as well as public information on bankruptcy systems.

Croatia currently ranks 56 out of 189 economies in the Resolving Insolvency indicator, as measured by *Doing Business*. A secured creditor in Croatia - most typically a bank that accepts real estate as collateral - will follow an individual enforcement procedure (foreclosure) to collect on his debt upon default of the debtor. A foreclosure would be applicable to the case study assumed by the indicator since neither the 1996 Bankruptcy Law nor the 2012 Settlement Act impose a moratorium on secured creditors (see below), who are entitled to proceed separately against the assets of the debtor. According to *Doing Business*, an average foreclosure procedure in Croatia takes a bit more than three years and costs 14.5 percent of the debtor's estate, with the company being sold piecemeal as a result of the procedure. Creditors recoup 30.5 cents on the dollar through the foreclosure (table 10.1). The process is longer and more expensive than the Europe and Central Asia region's

⁵⁷ See Djankov, Simeon. 2009. "Bankruptcy Regimes during Financial Distress." Mimeo, World Bank Group; Funchal, Bruno. 2008. "The Effects of the 2005 Bankruptcy Reform in Brazil." *Economics Letters*, 101: 84–86; Klapper, Leora 2011. "Saving Viable Businesses." *Viewpoint* 328, September 2011, The World Bank Group; Visaria, Sujata. 2009. "Legal Reform and Loan Repayment: The Microeconomic Impact of Debt Recovery Tribunals in India." *American Economic Journal: Applied Economics*, 1(3): 59-81.

⁵⁸ World Bank 2011b; UNCITRAL 2004.

average and the OECD high-income economies' averages while the amount on the dollar recovered by the creditors is lower than the regional average.

In the *strength of insolvency framework* index, Croatia scores 12 out of 16 points.⁵⁹ The country fare particularly well in the commencement of proceedings sub-index (3 out of 3 points) and in the reorganization proceedings sub-index (3 points out of 3) while the score in the management of debtor's assets sub-index (4 points out of 6) and in the creditor participation sub-index (2 out of 4 points) could be improved. In particular, the Croatian insolvency framework currently does not offer the possibility for the debtor to obtain credit after the commencing of the insolvency proceedings. As a result, post-commencement financing does not have priority over ordinary unsecured creditors during distribution of assets. As for creditor participation, the insolvency framework does not require approval by the creditors for sale of substantial assets of the debtor and individual creditors do not have the right to request information from insolvency representatives. The Croatian insolvency framework is considerably better than the regional average (9.2 points out of 16) and substantially aligned with insolvency framework of OECD high-income economies (12.2 points out of 15) but worse than the insolvency framework of Bulgaria that, with 15 point out of 16, ranks among the best practices at the global level.

Table 10.1 Resolving insolvency ranking and best performers

<i>Doing Business Indicator</i>	Croatia	Regional Average	Regional best performer	Global best performer
Time (years)	3.1	2.3	1.4 (Montenegro)	0.4 (Ireland)
Cost (percent of estate)	14.5	13.3	5 (San Marino)	1 (Norway)
Recovery rate (cents on the dollar)	30.5	37.7	70.5 (Cyprus)	92.9 (Japan)
Strength of insolvency framework index (0-16)	12	9.2	15.0 (Bulgaria)	15.0 (5 economies)

Source: Doing Business database

Reform efforts

Insolvency regulations in Croatia are contained in two bodies of law: (i) the Bankruptcy Law, which regulates fully court supervised proceedings, and (ii) the Court Financial Operations and Pre-Bankruptcy Settlement Act, which regulates the Pre-Bankruptcy Settlement Procedure (PBS).

The Bankruptcy Law, amended several times since its introduction in 1996⁶⁰, sets out a detailed and modern system of corporate reorganization, allowing debtors to restructure as a going concern while at the same time protecting the interests of creditors and ensuring their full participation in proceedings.⁶¹ The Settlement Act, enacted in 2012, introduced

⁵⁹ It is important to mention that in the case of Croatia the procedure analyzed under this index is not the Pre-Bankruptcy Settlement Procedure (PBS) but the judicial bankruptcy procedure regulated in the Bankruptcy Law (1997).

⁶⁰ The last amendment was approved in 2006.

⁶¹ As mentioned in the previous section, provisions relating to this procedure are the ones considered under the methodology of the Resolving Insolvency Indicator for the purposes of the scoring.

an additional proceeding: the Pre-Bankruptcy Settlement Procedure (or PBS). Designed to allow debtors to address situations of financial distress at an early stage without having to resort to a formal court intervention, the PBS runs in parallel to court-supervised insolvency and is administered by the Croatian Financial Agency ('FINA'). Among other features, the PBS allows debtors to propose and agree on a restructuring plan with creditors through an expedited procedure with tight deadlines.

Since its introduction in 2012⁶², some implementation issues regarding the PBS have arisen, mainly due to the excessively tight deadlines contemplated in the Settlement Act and issues of institutional coordination between FINA and the courts with jurisdiction over insolvency cases. With the aim of addressing these issues and enhancing the PBS's effectiveness, the Government of Croatia decided in 2015 to merge all existing insolvency procedures into a single body of law. Once approved, the draft law will repeal the 2012 Settlement Act and will consolidate all insolvency regulations applicable in Croatia.

The Government of Croatia is encouraged to take advantage of the upcoming insolvency reform and consider the following recommendations in order to further improve the insolvency regime in the country. In addition to the reforms already underway, implementing the recommendations described earlier in the Enforcing contracts section, targeted at improving efficiency of the court system will also benefit insolvency cases, which are seen by the same court—the Zagreb Commercial Court.

Short-term recommendations

The draft law mentioned above, which should be passed before the end of 2015, is focused on reforming the PBS procedure, leaving the judicial bankruptcy procedures largely untouched. Improving the draft may represent a unique opportunity to amend the provisions regulating fully court supervised proceedings (judicial reorganization and liquidation), which have not changed since 2006. In this regard, the following recommendations could be considered:

Introduce moratorium provisions and develop a culture of reorganization. The current Croatian bankruptcy framework does not encourage reorganization. Under Croatian law, there is no moratorium in case of bankruptcy. As a result, the debtor may file for insolvency and propose reorganization but individual creditors can enforce their claims outside the bankruptcy process. This strongly reduces the chances of having successful reorganizations. Additional steps could be taken to increase the flexibility of reorganization proceedings, for example by increasing the number of tools available to creditors and debtors to make reorganization work. Slovenia is an interesting example. In recent years, authorities in Ljubljana adopted several amendments to the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act and the number of companies opting for the reorganization proceedings is increasing.⁶³

⁶² The demand for PBS is evidenced by the fact that between October 2012 and January 2013, the Financial Agency, the entity that administers the Settlement Act, received 3,000 requests for initiation of pre-bankruptcy settlement procedures.

⁶³ A first set of amendments introduced special rules on increasing share capital of the debtor during insolvency proceedings, including through debt-equity swaps. They introduced limitations on the powers of debtor's corporate governance bodies during insolvency proceedings and gave greater authority of the creditors to remove an insolvency representative appointed by the court. Finally, they simplified reorganization procedures for micro enterprises and individual entrepreneurs.

Encourage the extension of post commencement financing to the debtor during the course of insolvency proceedings. For reorganization to be possible, the debtor will generally need some type of financing to maintain liquidity and continue its operations during the restructuring process. The law can facilitate the extension of post-commencement credit by providing appropriate incentives to lenders such as administrative priority of their claims or senior security interests on assets of the estate.

Introduce a liability structure that holds managers accountable for negligently engaging in transactions that result in a loss to the company. Under the Bankruptcy Law, the owners and managers of a company are not subject to liability for malfeasance or negligible conduct of business that damages the estate and undermines creditors' rights. Director and officer liability is a regular tool of modern insolvency regimes preventing the unjust enrichment of managers at the expense of the estate and ensuring that enough value remains in the insolvency estate for the collective benefit of creditors.

Do not allow closely-related parties to vote on a reorganization plan. The Bankruptcy Law currently does not restrict the voting rights of closely related parties during the voting process of a plan of reorganization. More specifically, the provisions specifying the voting rights of creditors do not prevent insiders or other affiliated parties from voting on the plan. By allowing such parties to vote on the reorganization plan, the law paves the way for serious abuses of the process, such as the manipulation of the classification of creditors in order to obtain the necessary votes for the plan approval.

Medium-term recommendations

Improve the institutional capacity of relevant institutions for handling insolvency cases. Many of the barriers that cause bankruptcy systems to fail or that discourage their usage are institutional. The courts and tribunals are the ones in charge of insolvency proceedings, and are responsible for protecting the rights of creditors and debtors. The efficient processing of cases is extremely important to insolvency proceedings, where prolonged delays can cause business assets to lose their value and negatively affect businesses' ability to continue functioning as viable enterprises. To ensure proper implementation of any initiative of this nature, the courts will need the knowledge and ability to implement that law. Within the Zagreb Commercial Court, several judges could be trained and designated to handle insolvency cases, allowing them to develop specialized expertise in this area. This could lead to qualitative improvements in the court rulings, in the administration of complex insolvency cases and in the management of important issues such as relief from the stay of enforcement and interim financing.

Establish a Chamber of Bankruptcy Managers. In order to be included in the Ministry of Justice Registry and practice their trade, Croatian bankruptcy managers must possess certain minimum qualification requirements set by the Insolvency Act of 2007. Such

Later on, additional amendments made small companies eligible to apply for the simplified reorganization procedure and introduced a new preventive restructuring procedure for large and medium-size enterprises that are likely to become insolvent in the following 12-month period. Creditors, and especially banks, were given significant powers during the preventive procedure. Creditors holding 20% of financial claims against the debtor were eligible to initiate reorganization and propose a reorganization plan that would have priority over any plan proposed by the debtor. Finally, the requirement that 50% of claims under reorganization plan must be repaid within a four-year period was eliminated.

requirements are not enough in today's economy. As a result, courts often have to remove incompetent managers and appoint new ones, a process that increases the duration of bankruptcy procedures. A Chamber of Bankruptcy Managers could be created with the goal of enforcing standards of training and ethics in the profession.

Make the relevant stakeholders more aware of the reorganization proceedings and thus more willing to consider them as a viable option. Judges, insolvency representatives, creditors and debtors should know how reorganization proceedings work and what value they bring to all participants. Creditors and debtors will undertake reorganization only if they trust the process. Judicial workshops may be helpful in this area. Because banks often act as creditors, raising awareness among banking institutions is also important. Economies that reform successfully in this area often set up special government agencies to supervise insolvency representatives and review reorganization plans, ensuring that insolvency representatives are well trained, experienced and know all the rules and regulations. This also helps ensure that the reorganization plans accepted by court and creditors are truly workable.

Acknowledgments

This memorandum was prepared by Alessio Zanelli (Private Sector Development Specialist, World Bank Group) and Iva Hamel (Senior Private Sector Development Specialist, World Bank Group), under the general supervision of Sylvia Solf (Global Product Specialist, Trade and Competitiveness, World Bank Group) and Christine Zhenwei Qiang (Manager, Trade and Competitiveness, World Bank Group).

Input was received from Erica Bosio, Maika Chiquier, Fernando Dancausa, Baria Nabil Daye, Marie Delion, Heike Gramckow, Joyce Antone Ibrahim, Violane Konar-Leacy, Jean Michel Lobet, Nan Jiang, Herve Kaddoura, Olena Koltko, Igor Matijevic, Sanja Madzarevic-Sujster, Frederic Meunier, Joanna Nasr, Nadia Novik, Mika-Petteri Torhonen, Hana Sahatqija, Valentina Saltane, Gunjan Sharma, Victoria Stanley, and Richard Stern.

For questions or comments, please contact Iva Hamel:

ihamel@ifc.org

tel: + 39 333 4602506

Via Labicana 110

Rome, Italy 00184