



THE MULTI-DONOR INVESTMENT  
CLIMATE ADVISORY SERVICE  
OF THE WORLD BANK GROUP

## INVESTING ACROSS BORDERS

### Adding Measures of Policies on Foreign Direct Investment to the Doing Business Indicators

#### Concept Note

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#### Overview

The *Investing Across Border* (IAB) project measures the ease of establishing and operating a foreign-owned business in countries worldwide, and is designed to supplement the *Doing Business* (DB) indicators of the World Bank Group<sup>1</sup>. The *Investing Across Borders* indicators capture selected aspects of the investment climate targeted at foreign direct investment (FDI)<sup>2</sup>, as well as some aspects of the domestic business environment important to foreign investors, but not covered by other *Doing Business* topics. The combination of existing DB indicators and the proposed IAB indicators will then provide a profile of the investment climate in a country for foreign investors. The IAB indicators capture not only legal provisions and policies, but also their implementation and enforcement in practice. They aim to identify, stimulate, and advise investment policy reforms.

#### Motivation

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<sup>1</sup> The *Doing Business* project is an initiative of the World Bank Group providing measures of business regulations and their enforcement in 178 countries worldwide. More information is available at [www.doingbusiness.org](http://www.doingbusiness.org).

<sup>2</sup> FDI is defined as a category of international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise, and a significant degree of influence by the investor on the management of the enterprise. A direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.

Policies towards FDI are a prominent feature of a country's investment climate. Governments have recognized the developmental benefits of inward FDI in the form of transfers of capital, technology and management, and of market access, and therefore generally welcome FDI inflows. At the same time, inward FDI also raises nationalistic economic and political concerns, as well as opposition of some domestic industries. Consequently, policies often consist of a complicated mix of incentives and restrictions. These policies differ considerably across countries and have been modified quite often in recent years. Most countries have substantially liberalized restrictions on inward FDI, but some important barriers remain in force in almost all countries, and the issues remain highly controversial in many developing (as well as developed) countries.

Measurements of the environment for FDI in various economies have been conducted through various country reports (e.g. Economist Intelligence Unit reports and Country Commercial Guides), investors surveys (e.g. World Economic Forum's Global Competitiveness Report), quantitative studies on restrictions on FDI (e.g. Golub 2003 and Koyama and Golub 2006) focusing on OECD countries, UNCTAD 2006 focusing on service sectors, and the Heritage Foundation Index of Economic Freedom (IEF). For more information on the above, please refer to Annex 1.

While useful, none of the existing indicators provide a rigorous measure of policies towards FDI focused both on the quality of laws and regulations, and their application and implementation in practice. The Golub studies are limited to departures from national treatment while the IEF omits some important variables and appears to be based on a rather impressionistic method. Moreover, given the recognized importance of FDI in development and the dependence of FDI flows on the policy environment, the inclusion of a set of FDI-related indicators in the *Doing Business* database would be a valuable addition. The proposed IAB indicators will supplement the national treatment violations with a number of policies that bear importantly on inward FDI, even when no discrimination is present. In so doing, they will provide a reference point for judgments about policies towards FDI. The combination of existing DB indicators and the proposed IAB indicator will then provide a profile of the investment climate in a country for foreign investors.

### **Design of the *Investing Across Borders* Project**

The *Investing Across Borders* indicators focus on the following aspects of investment climates:

- foreign ownership restrictions
- investment promotion<sup>3</sup>
- pre-establishment procedures
- access to land
- currency convertibility and repatriation

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<sup>3</sup> The indicator on investment promotion will be developed through the *Investment Promotion Performance Review*, a separate FIAS project undertaken in parallel with the *Investing Across Borders* project.

- expropriation and investment arbitration

The indicators do not cover all policies that impinge on FDI as well as domestic investment, such as taxation, and product and labor market regulations, since these are already covered by other DB indexes. The focus of the IAB indicators is strictly on those policies that disproportionately affect cross-border investment. The indicators encompass measures of the quality of laws and regulations, as well as the administrative efficiency and transparency of their application and implementation.

Most of the indicators are measured through a case study approach of a hypothetical investment project representative of a typical investment applicable to all countries. It has been designed to allow comparability of responses across respondents and countries. Given that many of the survey questions depend on the specific parameters of the investment (i.e. sector, size, legal form, etc.), detailed assumptions about the investment project have been developed in order to avoid ambiguity of questions and answers. All assumptions of the case study have been carefully designed to allow the project to capture “standard practice” faced by foreign investors when interacting with public authorities, and avoid capturing of “data noise” coming from extra-ordinary treatment of preferred investors. The case study presents a multinational beverage company seeking to enter a new market in order to manufacture and bottle its own brand of a fruit-based juice. It will be the company’s first investment in a country. The company aims to establish a new subsidiary incorporated in a country under the name GlobiDrink. GlobiDrink’s planned investment project (i.e. bottling plant) is to be located in a peri-urban area (i.e. perimeter/outskirts) of the country’s most populous (i.e. largest) city. Additional business assumptions are listed in the project’s questionnaire.

All data will be collected through a questionnaire administered by local agents. The questionnaire will be filled out by private sector intermediaries, i.e. consulting or law firms with practical experience in advising foreign investors on the legal and regulatory frameworks for FDI in their countries. This type of respondent will be able to provide not only information on the laws on the books, but also about their everyday application and implementation in practice. The questionnaires will also be submitted to the local investment promotion agency (IPA) or ministry responsible for administering foreign investment laws. In addition, other sources and previous studies will be consulted as a cross-check on the validity of the responses. Should inconsistencies in responses appear, the project will return to the local sources for clarification.

The following sections of the Concept Note describe each of the IAB indicators in greater detail.

#### Foreign ownership restrictions

Barriers to entry measured by the IAB indicators focus on market access restrictions which take the form of limitations on foreign equity ownership in specific sectors. Ownership restrictions specify permissible maximum foreign equity participation, ranging from a complete ban on foreign holdings to allowing 100 percent foreign ownership. Usually, ownership limitations are applicable to a particular industry. State

monopoly is in effect a de facto ban on FDI; industries reserved for the state are therefore scored as though ownership is banned.

This indicator distinguishes between limits on foreign ownership of shares for new, greenfield investments, as well as acquisitions of shares in existing local enterprises. Additionally, the project also includes regulatory barriers to foreign participation in various sectors, such as licensing and competition-based requirements and restrictions.

The project focuses on foreign equity restrictions in 11 industries, majority of which are services sectors. This reflects the fact that most of the overt restrictions on national treatment are in services (e.g. in telecommunications, finance, transport, or professional services, etc.). Furthermore, services constitute an ever growing share of global FDI flows. Agribusiness is included as an example of a manufacturing sector which continues to face foreign participation restrictions in many countries. Restrictions on mining of mineral resources complete the sectoral coverage of the indicators. While other sectors, especially in manufacturing, are in many countries significant targets for FDI inflows, they do not typically face sector-wide restrictions on foreign ownership, and are hence excluded from the project.

The following set of industries thus constitutes the sectoral coverage of the project:

- agribusiness
- air transport
- banking
- construction / real estate development
- electricity generation
- media
- mining
- professional services
- retail trade
- telecommunications
- tourism

### Investment promotion

Investment promotion activities are analogous to the marketing function in a private firm. These include building a favourable image in the minds of potential investors; “selling” the country as a location for investment and convincing companies to invest; providing services to investors – giving them information, guiding them through the investment process, and helping them avoid problems when they are in operation; and monitoring investors’ experiences and using feedback from contact with investors to advocate for changes that would improve the country’s investment climate. The IAB indicator measures the first of these investment promotion functions -- investor information access and guidance. Investor location search processes typically start at a broad (long-list) level where a number of locations are assessed against a specific set of criteria for each planned investment. Information search sources typically involve use of location search

agencies/services, searches on relevant websites, inquiries submitted to IPAs or other government agencies, etc. A location which does not perform well at this stage (i.e. which fails to provide sufficient quality information to allow the investor to make its assessment) usually drops out of contention for the investment. In other words, the location does not make the short list. This IAB indicator measure will be developed through the *Investment Promotion Performance Review*, a separate FIAS initiative undertaken in parallel with the *Investing Across Borders* project.

### Pre-establishment procedures

Foreign investments are often subject to official approvals. These approvals may or may not include requirements that foreign investors meet certain conditions (size of investment, economic benefits, employment creation, etc.) before they receive authorization to enter the domestic market. There is a wide degree of variation across countries in the types of pre-establishment procedures foreign investors must face before they are allowed to establish and operate. In some countries, the process is automatic, including simplified objective criteria under a strict time limit, while in other countries investment criteria may be vague and approval procedures cumbersome. Even in countries in which no approval is required the investor may still have to register the investment. This pre-establishment process can vary widely in its severity, from routine notification and automatic approval to a national-interest test where the foreign investor has to make a case for entry rather than the government having to justify denying entry.

The goal of this section of the survey is to measure the ease of satisfying the necessary approval procedures required to make a new greenfield foreign investment project. In doing so the questionnaire hopes to measure how much more difficult it is for a foreign investor to gain approval for a new investment than a domestic investor, as well as how the ease of gaining foreign investment approval varies across countries. Specifically the questionnaire is designed to help determine the types of approval procedure criteria used to regulate new investments by a foreign company, and to measure the administrative burden (duration of the process and number of procedural steps involved) these requirements have on an international investor.

### Access to land

Difficulties in gaining access to land can be an obstacle to foreign investment. The ability to acquire property, with secure rights of ownership or lease, at transparent prices and with limited restrictions is an essential ingredient of a foreign investors' decision whether to invest in a new market.

The goal of this section of the survey is to measure the ease of access to land for foreign invested companies. The survey helps gauge what types of ownership options are available, what type of land can be purchased or leased (private or state owned, etc.), and whether there are additional restrictions, regulations or administrative procedures a foreign-invested company may face compared to a local firm. This indicator is linked to

the *Doing Business* “registering property” indicator, and will therefore be able to measure discrimination between foreign and domestic investors in buying and leasing land.

### Currency convertibility and repatriation

Restrictions on currency convertibility are generally non-discriminatory, but are likely to impinge more on foreign than domestic investors given the cross-border nature of FDI. The questionnaire inquires about guaranteed access to foreign currency for purpose of making international payments, surrender requirements on export earnings, and legal rights to holding a bank account. Restrictions on repatriation of profits, salaries, damage awards, liquidation, sale of assets and depreciation interfere with foreign firms’ operations. The survey instrument asks about the nature of legal protection for repatriation, and about administrative and regulatory impediments to efficient transactions.

### Expropriation and investment arbitration

In developing countries with insecure or ineffective legal systems, legal protection against expropriation and guarantees of recourse to international arbitration are key to ensuring investor confidence in a particular investment location. The questionnaire seeks to establish the extent of protection of property rights for foreign investors, inquiring about the existence and nature of legal provisions limiting expropriation, and providing for fair and just compensation. It is a well recognized rule in international law that expropriation of private property is acceptable if it is done in the public interest, pursuant to the law, and in adherence to other legal provisions, in particular those governing non-discrimination and compensation. In order to assess whether compensation is just and fair, most developed countries refer to three key principles of promptness, adequacy and effectiveness. While these principles do not represent a binding international legal norm, they are the leading formulation of the full compensation standard expected of a host market by foreign investors.

Access to international arbitration is important to foreign investors in countries where they lack confidence in the local courts of law, especially when the economic outcome of business transactions involves an international dimension. The questionnaire asks about foreign investors’ rights of access to investor-state dispute settlement mechanisms, namely to international investment arbitration. International investment arbitration is based on provisions in multi- or bilateral agreements (treaties, conventions), national laws and investment contracts. It allows foreign investors to opt out of the national court system of the host state and pursue their rights before a neutral arbitration tribunal, and obtain a legally binding ruling. The questionnaire also examines enforcement of arbitral awards.

### **Project Schedule**

The IAB indicators are currently being tested in a set of 20 diverse economies. We expect to complete these pilot tests by summer 2008, and to launch the project in 100 countries in the fall of 2008.

The following table presents more detailed information on all project phases:

<b>Project Phase</b>	<b>Timing</b>	<b>Country coverage</b>
Design	Mar 07 - Oct 07	Preliminary design completed and currently under testing.
Pilot testing	Nov 07 - June 08	~20 countries (proposed: Argentina, Bangladesh, Bulgaria, Cameroon, Canada, Chile, China, Colombia, Egypt, Georgia, Ghana, Liberia, Madagascar, Mali, Mozambique, Nicaragua, Nigeria, Peru, Serbia, Singapore, Ukraine, USA, Vietnam, Yemen.)
Operation - 1st year	July 08 - March 08	80-100 countries. First <i>Investing Across Borders</i> project report available in spring/summer 2009.
Operation - 2nd year	April 09 - Dec 09	178 countries (i.e. current country coverage of the <i>Doing Business</i> project). Operation of the project undertaken jointly with a partner institution.

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## Annex 1: Existing Information and Indicators

Several types of information and studies are available.

**Country Reports.** Several organizations provide country-by-country assessments of policies towards FDI. These include the Economist Intelligence Unit *Country Commerce* and *Country Profile*, The United States Department of Commerce *Country Commercial Guide* (chapter on the Investment Climate), and the United States Special Trade Representative *National Trade Estimate Report on Foreign Trade Barriers*. The OECD and UNCTAD also issue periodic country *Investment Policy Reviews*. While these sources contain much useful information, they do not provide any cross-country summary indicators.

**Investor Surveys.** The well-known annual World Economic Forum *Global Competitiveness Report* and IMD *World Competitiveness Yearbook* both include policies towards foreign investors as one of the numerous indicators in the country rankings. These rankings are based on surveys of investor opinions rather than hard data, and as such can be criticized as subjective. The meaning of policies toward foreign investment is also not precisely defined in the surveys. The WEF asks business executives by the World Economic Forum to assess the “the impact of your country’s rules governing foreign direct investment” while IMF asks “whether foreign investors are free to acquire control in domestic companies.”

**Quantitative Studies of Restrictions on FDI.** In previous work for the OECD (Golub 2003, Koyama and Golub 2006) and for UNCTAD (UNCTAD 2006), Golub developed and implemented a method for quantifying barriers to inward FDI, drawing on previous work by Hardin and Holmes (1997). This work involves compiling and scoring policies towards FDI, resulting in indicators of overall openness. Restrictions on foreign investors can be classified into entry barriers and post-entry operational restrictions. Barriers to entry in turn can take the form of limitations on foreign ownership and screening procedures based on national interest tests. Operational restrictions include stipulations on the residency and nationality of managers or board members, domestic content requirements, differential tax treatment, etc. The Golub studies developed and used a system of scoring these various restrictions on a 0-1 scale. Restrictions can either be general, e.g., approval requirements for all foreign investments, or specific to a particular sector, e.g., limiting the proportion of foreign ownership in telecommunications. Golub therefore collected information on policies at the industry level and aggregated the sectoral results using a weighting system. See UNCTAD (2006) for the list of sectors covered in the UNCTAD study. Data sources include the country reports mentioned above as well as UNCTAD and OECD databases and surveys.

There are some important limitations to this approach, however. The focus is limited to statutory departures from national treatment rather than the business climate more generally. Thus, many other policies that impinge on foreign investors and informal barriers such as corporate governance practices were ignored. These other policies include: investment incentives; foreign exchange market restrictions; protection of

property rights; and regulations of labor and product markets and other policies that apply equally to foreign and domestic investors.<sup>4</sup> Also, the UNCTAD study was limited to the service sector, and the OECD studies omitted land, agriculture and mining. In short, the scope of the previous Golub studies is rather narrow and they do not attempt to cover all policies important to foreign investors.

**Heritage Foundation Index of Economic Freedom (IEF).** The IEF is a composite of 10 factors, one of which is openness to foreign investment. The IEF foreign investment factor in turn is based on 9 variables:

1. Foreign investment code
2. Restrictions on foreign ownership of business
3. Restrictions on industries and companies open to foreign investors
4. Restrictions and performance requirements on foreign companies
5. Restrictions on foreign ownership of land
6. Equal treatment under the law for both foreign and domestic companies
7. Restrictions on repatriations of earnings
8. Restrictions on capital transactions
9. Availability of local financing for foreign companies

The IEF foreign investment indicator, like the Golub indicators, mostly focuses on restrictions to national treatment (variables 1-4 and 6 above), ignoring incentives to investors (whether discriminatory or not) and the business climate more generally (protection of property rights, licensing, taxation, labor, etc.). The IEF does, however, encompass some policies not included in the Golub indicators, notably ownership of land and foreign exchange and financial restrictions. On the other hand, some factors included in the Golub studies are omitted from the IEF, notably restrictions on expatriate personnel and board members, and *de facto* limitations imposed by state ownership of business. Also, the IEF appears to be based on a much more judgmental method than the Golub indicators. The quantification of the various policies appears to be based on an overall judgment of the extent and severity of restrictions rather than a fully-specified computational method.

## **Description of Doing Business Indicators**

### Starting a Business

Doing Business records all procedures that are officially required for an entrepreneur to start up and formally operate an industrial or commercial business. These include obtaining all necessary licenses and permits and completing any required notifications, verifications or inscriptions for the company and employees with relevant authorities. After a study of laws, regulations and publicly available information on business entry, a detailed list of procedures is developed, along with the time and cost of complying with each procedure under normal circumstances and the paid-in minimum capital

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<sup>4</sup>State monopolies, which constitute *de facto* bans on foreign ownership, are included in the analysis, however.

requirements. Subsequently, local incorporation lawyers and government officials complete and verify the data. On average 4 law firms participate in each country.

### Dealing with Licenses

Doing Business records all procedures required for a business in the construction industry to build a standardized warehouse as an example of dealing with licenses. These procedures include obtaining all necessary licenses and permits, receiving all required inspections and completing all required notifications and submitting the relevant documents (for example, building plans and site maps) to the authorities. Doing Business also records procedures for obtaining utility connections, such as electricity, telephone, water and sewerage. Procedures necessary to be able to use the property as collateral or transfer it to another business are also counted. The survey divides the process of building a warehouse into distinct procedures and calculates the time and cost of completing each procedure under normal circumstances.

### Employing Workers

Doing Business measures the regulation of employment, specifically as it affects the hiring and firing of workers and the rigidity of working hours. The data on employing workers are based on a detailed survey of employment regulations that is completed by local law firms. The employment laws of most countries are available online in the NATLEX database, published by the International Labour Organization. The rigidity of employment index is the average of three sub-indices: a difficulty of hiring index, a rigidity of hours index and a difficulty of firing index. All the sub-indices have several components. And all take values between 0 and 100, with higher values indicating more rigid regulation.

### Registering Property

Doing Business records the full sequence of procedures necessary when a business purchases land and a building to transfer the property title from the seller to the buyer so that the buyer can use the property for expanding its business, as collateral in taking new loans or, if necessary, to sell to another business. Every required procedure is included, whether it is the responsibility of the seller or the buyer or must be completed by a third party on their behalf.

### Getting Credit

Doing Business constructs measures of the legal rights of borrowers and lenders and the sharing of credit information. The first set of indicators describes how well collateral and bankruptcy laws facilitate lending. The second set measures the coverage, scope, quality and accessibility of credit information available through public and private credit registries. The data on the legal rights of borrowers and lenders are gathered through a survey of financial lawyers and verified through analysis of laws and regulations as well as public sources of information on collateral and bankruptcy laws.

### Protecting Investors

Doing Business measures the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain. The indicators distinguish 3

dimensions of investor protection: transparency of transactions (extent of disclosure index), liability for self-dealing (extent of director liability index) and shareholders' ability to sue officers and directors for misconduct (ease of shareholder suits index).

#### Enforcing Contracts

Indicators on enforcing contracts measure the efficiency of the judicial system in resolving a commercial dispute. The data are built by following the step-by-step evolution of a payment dispute before local courts. The data are collected through study of the codes of civil procedure and other court regulations as well as surveys completed by local litigation lawyers (and, in a quarter of the countries, by judges as well).

#### Trading Across Borders

Doing Business compiles procedural requirements for exporting and importing a standardized cargo of goods. Every official procedure for exporting and importing the goods is recorded—from the contractual agreement between the two parties to the delivery of goods—along with the time and cost necessary for completion. All documents required for clearance of the goods across the border are also recorded. For exporting goods, procedures range from packing the goods at the factory to their departure from the port of exit. For importing goods, procedures range from the vessel's arrival at the port of entry to the cargo's delivery at the factory warehouse.

Local freight forwarders, shipping lines, customs brokers and port officials provide information on required documents and cost as well as the time to complete each procedure. To make the data comparable across countries, several assumptions about the business and the traded goods are used.

#### Paying Taxes

Doing Business records the tax that a medium-size company must pay or withhold in a given year, as well as measures of the administrative burden in paying taxes. Taxes are measured at all levels of government and include the profit or corporate income tax, social security contributions and labor taxes paid by the employer, property taxes, property transfer taxes, the dividend tax, the capital gains tax, the financial transactions tax, waste collection taxes and vehicle and road taxes.

To measure the tax paid by a standardized business and the complexity of a country's tax law, a case study is prepared with a set of financial statements and assumptions about transactions made over the year. Experts in each country compute the taxes owed in their jurisdiction based on the standardized case facts. Information on the frequency of filing, audits and other costs of compliance is also compiled. The project was developed and implemented in cooperation with PricewaterhouseCoopers.

#### Closing a Business

Doing Business studies the time, cost and outcomes of bankruptcy proceedings involving domestic entities. The data are derived from survey responses by local insolvency lawyers and verified through a study of laws and regulations as well as public information on bankruptcy systems.