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MANAGER'S GUIDE TO USING

The Business Impact Test

BIT

Canada

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MANAGER'S GUIDE TO USING *BIT*

What is BIT?

- *a consultation tool*
- *a structured approach to analysis of regulatory impacts*

What can BIT do for you?

- *identify direct costs of regulation to business*
- *identify alternatives to regulation*
- *increase effectiveness of consultations, ensuring that government and industry are speaking the same language*

Purpose

This guide is intended to assist government managers in understanding the principles of the Business Impact Test (***BIT***) and how it can be incorporated into the regulatory review and consultative processes. The focus is on the federal regulatory environment; however, the process is applicable to other jurisdictions with similar regulatory review requirements.

Introduction

BIT is a process for consultation and analysis of the impacts of regulation on business. The process includes a software based survey (or equivalent analysis),[1] and separate costing methodology designed to isolate the true regulatory costs to business.[2]

The ***BIT*** methodology provides a consistent, structured framework for taking into account the concerns of business and is designed to increase the efficiency and effectiveness of existing consultation mechanisms through:

- understanding how businesses respond to regulation;
- learning about the regulatory costs to business so governments can better evaluate the available techniques and choose the approach that creates the greatest net social benefit;
- improving the willingness and ability of businesses to comply with regulatory measures;
- enabling businesses to provide input into the design of regulatory initiatives in order to reduce their costs, while helping the government achieve its public policy goals;

and, in pursuit of the above,

[1] A tailored survey which captures the same detailed, firm specific information and analysis as the software survey. Refer to the *Guide To Using the Business Impact Test and Developing Equivalent Analysis* available from Industry Canada.

[2] Refer to the *Guide and Manual for Determining the Impacts of Regulation on Business Activities and their Costs: A Functional-Based Approach to Regulatory Costing*, available from Industry Canada.

- ensuring that government and business are speaking the same language.

The ***BIT*** process was designed to be used with regulatory proposals. However, it is quite flexible and can be used throughout the various stages of policy development. It may be used in the early stage of policy development when various options are being considered; with detailed drafts of regulations as a final check for unanticipated impacts; during reviews of existing or proposed legislation to determine where opportunities exist to increase the efficiency of regulation; and, in the context of a sector competitiveness framework analysis, to identify opportunities for regulatory improvements in a particular sector.

The Regulatory Policy, Management Standards and Regulatory Impact Analysis

In 1986, the federal government adopted a formal Regulatory Policy which built on earlier efforts to evaluate the social and economic impacts of regulatory initiatives. Revised in 1992 and most recently in November 1995, the Regulatory Policy is intended to introduce analytical rigour into the documentation supporting regulatory proposals.[3]

The Policy is unique in that it requires publication of the impact analysis used by ministers in their decision as to whether or not to adopt a regulatory proposal. This transparency is a critical aspect of Canadian policy in which Canadians are to be consulted on changes to regulations and the foundation for decisions regarding regulatory proposals made public.

The Regulatory Policy requires that regulatory proposals undergo careful analysis, demonstrating that the benefits of a regulation are greater than the costs incurred and that alternatives to regulation have been carefully considered. Benefits and costs are not to be restricted to changes in the Gross

[3]Regulatory Policy 1995, Government of Canada. Available from the Treasury Board Secretariat.

Domestic Product, but rather should pertain to all issues/considerations that Canadians value, such as fairness of the legal system. This analysis is summarized for review by Cabinet in the Regulatory Impact Analysis Statement (RIAS). This is discussed later in the Guide.

Regulatory Process Management Standards (RPMS) were introduced in the latest version of the Regulatory Policy. Specifically, the RPMS require departments to show that their impact analyses produce effective and efficient regulations and that they have in place a formal process to ensure good quality analysis on a consistent basis. The RPMS further require that this process be documented and its effectiveness independently monitored.

Competitiveness

BIT ASKS:

- *Does this initiative affect your markets, access to markets and/or demand for your products or services?*
- *Does this initiative affect your ownership structure, investment and/or growth strategy?*

Consulting effectively with all stakeholders on regulatory initiatives and conducting high quality cost-benefit analyses that examine net benefits and how to maximize them are central to meeting the Regulatory Policy and the RPMS. The incorporation of the ***BIT*** process into a department's consultation process can contribute greatly to the fulfilment of these policy requirements. To this end, the Federal Regulatory Policy requires that the ***BIT*** software survey (or equivalent analysis) be employed as part of the consultations on all major regulatory proposals to assess the impact they will have on Canadian business.

Competitiveness and the Cost of Regulation

The World Competitiveness Report defines business competitiveness as "the ability to design, produce and market goods and services, the price and non-price characteristics of which form a more attractive package than those of competitors." In its simplest sense, it means the ability to compete and stay in business over the long term. A precise measurement of competitiveness, however, is less straightforward. On the international level, there are many common economic indicators which are used to assess a nation's competitiveness such as Gross Domestic Product, disposable income, standard of living, real exchange rates, unit labour costs and consumer prices.

Compliance

BIT ASKS:

- *Is this requirement consistent with your present operating practices? Best business practices?*
- *What are the sources of the problems: lack of clarity and certainty; complexity; timeliness; ability to comply; and/or cost?*
- *What are the operating costs incurred by your business?*

While few may agree on the true measure of competitiveness, there is little argument that the ability of a nation's firms to compete in domestic and foreign markets is a central component of a nation's competitiveness. Measures that cost jobs and create unnecessary burdens on business affect the general business climate, the competitiveness of the nation as a whole, and ultimately its social climate and standard of living.

It is therefore important that Canadians have government policies and regulatory frameworks that promote competitive firms and industries, non-inflationary growth and an internal market free of unintended or unnecessary barriers.

The ***BIT*** process addresses competitiveness at the firm and, to a lesser extent, sector levels. Specifically it focuses on how regulations affect the ability to conduct business, addressing issues concerning price effects, access to domestic and international markets, quality and availability of workforce, research and development efforts, and the impacts on the types and quality of products or services offered. Understanding the issues and their effects is the key to developing regulatory frameworks which encourage business activity and facilitate the achievement of other social and economic objectives.

Compliance and the Determination of Net Benefit

Under current federal policy, it must be demonstrated that the benefits of a regulation are greater than the costs incurred. In other words, there must be evidence of a net benefit to society. To ensure that the benefit(s) will be realized and that the proposed regulatory measure will be effective, there must be a determination of the rate of compliance. In this regard, regulations are often thought to be the preferred instrument as it is assumed that because they are enforceable by law, the rate of compliance will be high. In actuality, there is always a degree of voluntarism with regulation. If affected parties ignore a regulation because it is too costly, lacks enforcement,

or because they are uncertain about what they should be doing, the net benefits will not be optimized and the regulation will be ineffective.

The ***BIT*** process examines the ability and willingness of business to comply with regulations. For one, the process permits affected parties to demonstrate and explain not only the economic costs they will incur with a regulation, but whether or not they will comply. In turn, the process helps governments determine whether affected businesses have the capacity and ability to do what is required of them.

Business does not challenge the responsibility of government for legislating requirements in areas such as workplace safety or the environment. However, it does take issue with a proposal when the desired effect is impeded because costs are being created without parallel benefits and/or the proposed measure can be designed in a less costly way.

Six Step BIT Process

- *Objective Setting*
- *Developing a Consultation Strategy and **BIT** Methodology*
- *Selecting Participants*
- ***BIT** Consultation*
- *Analysis*
- *Follow-Up and Verification*

The *BIT* Process and the Regulatory Process

Setting up a BIT Process/Using the Software Survey

Setting up an effective ***BIT*** process consists of six steps, each with its own specific objective and output. These steps include:

- Objective Setting;
- Developing a Consultation Strategy and ***BIT*** Methodology;
- Selecting Participants;
- ***BIT*** Consultation;
- Analysis; and
- Follow-up and Verification.

Appendix 1 outlines each step in the process, its objective, output and uses of the output. *The Guide to Using the Business Impact Test and Developing Equivalent Analysis* further describes the process in detail.

The ***BIT*** software survey itself consists of a four part series of questions specifically designed to uncover how a proposed regulation will affect a firm's operating environment, its capacity to adapt and innovate, and its

immediate and future profitability and competitiveness. Depending on the complexity of the problem and the need for in-depth analysis, it may not always be necessary to use the software or all of the questions contained within. A tailored survey covering the same issues explored by the ***BIT*** software may be more useful. This is referred to as equivalent analysis.

The Regulatory Development Process — Incorporating the *BIT* Process

Under current federal policy, authorities must ensure that, among other things: a problem or risk exists, government action is required, regulation is the best alternative, the benefits outweigh the costs to Canadians, and all stakeholders are consulted.

To demonstrate how these and other requirements, including the use of the ***BIT*** survey/equivalent analysis and the Regulatory Impact Analysis Statement (RIAS), can and should be addressed, the regulatory decision-making process is presented below as five phases:

- Problem Identification;
- Solution Development;
- Detailed Proposal Design;
- Optimization and Refinement; and
- Gazetting.

The process is also summarized in Appendix 2.

Phase 1: Problem Identification

In addressing a perceived problem or risk, regulatory authorities normally (and should) consult at an early stage with stakeholders in order to consider the nature and extent of the problem, whether government action or behaviour modification is required, and the type of solution that may be needed. If action is required, early consultations allow stakeholders to anticipate the changes, determine the business issues that will need to be addressed, and to consider various forms of solutions or alternatives. More importantly, it enables regulators to seek the advice of persons most

knowledgeable about the problem as to how to resolve it in the most cost-efficient way.

The summary section questions in the ***BIT*** assist in the consultations in this phase.

Phase 2: Solution Development

Assuming that it has been determined that there is a need for government action, Phase 2 involves the evaluation and selection of a regulatory mechanism or other instrument to address the problem. At this stage, the regulatory analyst will begin to examine the relative merits of alternative ways of resolving the problem, taking into account the effectiveness, the benefits and costs, or pros and cons, of each alternative. Two types of alternatives should be looked at: innovative methods to solve a problem (e.g., voluntary standards) and design optimizations which involve improvements made within a chosen method.

Once a decision has been made as to the mechanism to be implemented, the reason(s) for selection and the key design issues, including considerations for cost-effective compliance, should be documented.

In this phase of the solution development process, the ***BIT*** survey can help identify the impacts and advantages of the various alternative mechanisms and designs from the business perspective. Primary level questions from the impact and summary section of the ***BIT*** survey will be used in these consultations.

Phase 3: Design of Detailed Proposal/Cost-Benefit Analysis

Phase 3 involves the design of a detailed regulatory proposal which will include clarification of the proposed regulation; government's objectives for taking action; how the regulation will work, including administrative requirements; what will be required of business; compliance procedures; and the anticipated impact of the regulation on business. It is in this phase

Exploring Alternatives

BIT ASKS:

- *Can you suggest better approach(es) to this requirement?*
- *Do you feel that this initiative could be better designed through: greater harmonization with regulations in other jurisdictions; alternative regulatory approaches; and/or approaches other than regulation?*

Designing A Regulatory Proposal

- *Full examination of business impacts*
- *Cost-effectiveness analysis*
- *Testing of regulatory design, alternatives and compliance procedures.*

that much of the detailed work for a full cost-benefit evaluation is conducted.

At this point, a broad consultation process is launched involving those who can contribute to understanding both the business and social issues. Whereas initial consultations in Phases 1 and 2 may have involved key senior, influential stakeholders and centred on determining the problem, the need for action and possible options, at this stage, consultations are carried out on the efficacy of a proposed regulatory measure.

When it is deemed that significant compliance costs are likely to be imposed, (i.e., a major regulatory proposal), then the process calls for a full ***BIT*** software survey (or equivalent analysis). This will include a full examination of the business impacts, and cost-effectiveness of the regulatory design. A full or tailored ***BIT*** software survey (equivalent analysis) can be used to identify: the key business issues for inclusion in cost-benefit analysis; the need to optimize the regulatory design; and alternative design considerations that lower the impact of the regulatory proposal or increase compliance. The work with the ***BIT*** will result in a report which reflects the opinions and comments of participants about the proposed regulatory action and can later be used to identify issues that must be verified and to build consensus.

Phase 4: Optimization and Refinement

Phase 4 focuses on the optimization and refinement of a regulatory proposal leading to a draft regulation for the Gazetting phase. Optimization refers to the process that will bring about the least intrusive and non-costly regulatory measure for compliance, accountability and oversight. Throughout this phase, consultations continue and involve reviewing, cross-checking and verifying the comments and opinions of stakeholders (or ***BIT*** survey report), and most importantly, building consensus on the proposal.

At this stage, the ***BIT*** software may be used to undertake firm level analysis to ensure cost-effective compliance. Key issues can also be confirmed through using the separate cost accounting, market analysis, and cost effectiveness analysis.

Phase 5: Gazetting

Phase 5 includes the completion of the Regulatory Impact Analysis Statement (RIAS) and obtaining approval for the regulatory action.

The RIAS presents a recommended course of action and justification for consideration by ministers. It summarizes the decision-making process as described above and must reflect that there was an examination of alternatives, a cost-benefit analysis and consultations with stakeholders.

If the ***BIT*** process has been used as part of consultations with business, preparing the RIAS is much easier. The section on consultations will basically write itself. The RIAS has six sections to which the ***BIT*** process can contribute. A brief description of the requirements of each section and the potential contribution of the ***BIT*** process is summarized below and in Appendix 3.

Description - outlines the regulation, defines the problem and shows why action is necessary. This is developed in the Regulatory Summary used in the ***BIT*** survey.

Alternatives - summary of the examination of alternatives and their pros and cons. The ***BIT*** process seeks business's suggestions for alternatives and/or its comments on alternatives identified by the regulator. These can be further tested/verified by the separate costing methodology.

Cost-Benefit Analysis - Benefit cost analysis is integral to both the RIAS and the ***BIT*** process. The ***BIT*** process, in particular the software survey, is able to identify key business issues for inclusion in benefit-cost analysis

and is a starting point for least-cost analysis and cost-effectiveness analysis.

Consultations - documentation of who was consulted and the results. The ***BIT*** provides a consistent, structured framework for taking into account the concerns of business and is specifically designed to increase the efficiency and effectiveness of consultations.

Compliance and Enforcement - outline of the procedures and resources that will be used to ensure that the regulation will be respected. The ***BIT*** process identifies barriers to compliance such as the cost and complexity of enforcement as well as oversight system(s).

Contact Person - Department hosting ***BIT***.

Considerations for Using the *BIT* Process

The most valuable lesson that has been learned from past uses of ***BIT*** is that to ensure effective consultations with good results, business must have a clear understanding of how a proposed regulatory measure will work. Small differences in the design of a regulation can have a substantial impact on firms in terms of what they must do to comply with the requirements and the costs associated with this.

In the ***BIT*** process, this information is provided in the Regulatory Summary. The Summary is really nothing different from what a regulator should be preparing as the basis for any consultation, although it follows a structured format to ensure that the material will be useful in consultations.

As with any consultative process, when employing the ***BIT*** process it is important to set the objectives of the consultations in order to avoid unrealistic expectations. This will involve deciding what is "on the table" for change and what is not. A formal commitment to the objectives and boundaries of consultation should be obtained from the senior management in the private sector.

Correctly selecting the participants for consultation is crucial to gathering significant information. The objective should be to reach a diverse range of stakeholders, including directly regulated firms, suppliers and customers representative of different sizes, structures, sectors and locations. This also includes special interest groups for whom there are no specific cost implications but who have a stake in the outcome of the situation.

Decisions must also be made with regard to the format of the consultations (e.g., through interviews or workshops), and how to tailor the ***BIT*** survey to the subject matter, ensuring that efforts are focused on those issues that are most relevant to the understanding of the regulatory proposal. If a decision is made to develop an equivalent analysis, the regulator must ensure that it will produce the same detailed, firm specific information and analysis as the ***BIT*** software survey.

The analysis of the results of the consultation is key to the success of the process. It involves separating issues into those which can be easily or realistically resolved and those which will require more detailed consultation and analysis. It is often not the normal response that should be of interest, but rather the specific cases that fall outside the norm. Understanding why and when these cases exist is the key to identifying potential problem areas that need attention.

As the ***BIT*** process provides a wealth of information, it is important to extrapolate what is necessary and relevant to solving particular regulatory problems. The following questions will often need to be addressed:

- Are there ways to lower costs and still meet policy goals?
- Are there ways to increase benefits, either by improving compliance rates or using a different mechanism that permits greater benefits?

- Is the benefit/cost ratio in line with projections? Is the proposal still worth doing?

Lastly, an appropriate feedback mechanism must be put in place with industry to discuss the findings, suggested improvements and regulatory alternatives and, most importantly, one which demonstrates a willingness to work toward a reduction of negative impacts and costs. The last thing anyone wants is for industry to perceive the consultation process as simply another paper exercise.

BIT ASKS:

- How does this initiative affect your ability to compete within this country? In other countries?
- What are the administrative costs incurred by your business due to this initiative?
- How does this initiative affect your business with respect to: cash flow; profitability; dealing with financial fluctuations; and maintaining long-term return on investment?

Cost-Benefit Analysis

Independent of the use of the ***BIT*** process as part of consultations, the level and detail of cost-benefit analysis required is dependent on the importance and magnitude of the problem or risk at hand. The greater the economic and social implications of an issue, the greater the detail and level of analysis required. This can include full cost-benefit analysis, cost-effectiveness analysis or least-cost analysis.

Full cost-benefit analysis requires the benefits of an action to be evaluated with an attached dollar value. This allows alternative measures to be compared in terms of the greatest difference between benefits and costs. If positive net benefits do not exist, then regulatory action is not taken. Even if the ***BIT*** survey or equivalent analysis is used in the process, the cost-benefit evaluation should always incorporate other analyses such as environmental impact analysis or risk analysis.

In evaluating benefits, it is sometimes difficult to attach a dollar value even when the validity of the regulatory objective cannot be challenged. In these instances, at minimum, a **cost-effectiveness analysis** is needed wherein the most effective option or a function of cost is identified. This type of analysis often occurs when the value of life is at issue. Hence, dollar values are placed on the measures/actions which will save and protect the most lives rather than "life" itself.

Sometimes the policy objective is "fixed" and certain compliance activities must be adhered to, for example, ships having satellite communication capacity. In these instances, the issue is how the compliance activity can be achieved inexpensively. This approach to cost-benefit analysis is referred to as **least-cost analysis.**

Both cost-effectiveness and least-cost analysis have one fundamental weakness in that they do not involve comparison with alternative projects. As a result, it is unknown whether the same resources, if put to other uses, might be able to generate greater net value than when they are used alone.

In principle, cost-efficiency or cost minimization considerations should always be looked at when choosing between various design options. Specifically, it is important to obtain the least costly design that delivers the desired result.

As earlier mentioned, the ***BIT***, in particular the software survey questions, is able to identify the key business issues for inclusion in cost-benefit analysis and can be used as a starting point for least-cost analysis and cost-effectiveness analysis.

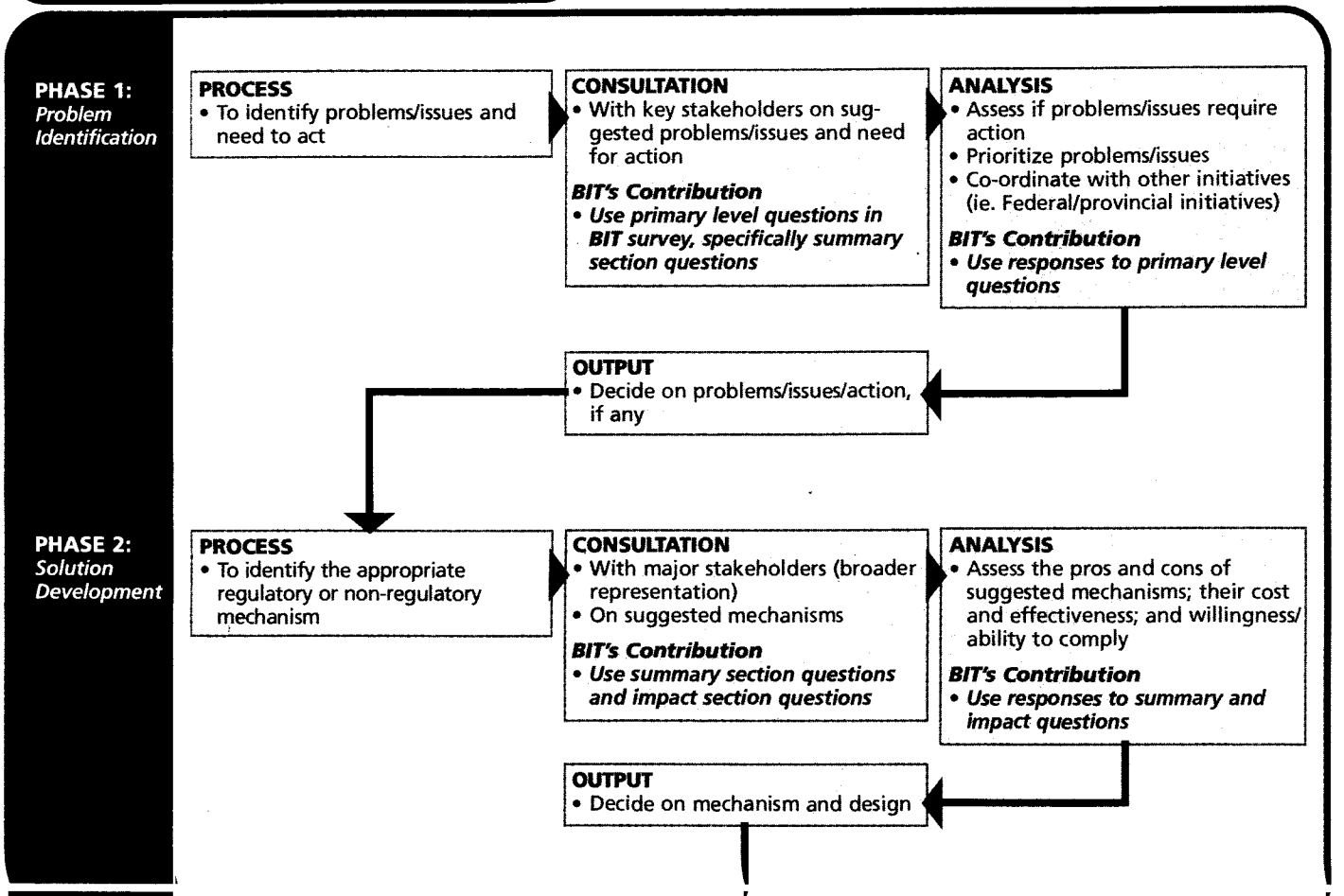
- Can you suggest better approach(es) to this requirement?
- Does this requirement(s) contradict or duplicate other obligations imposed on your business by: this government; other levels of government; other regulatory bodies; and/or international agreements?

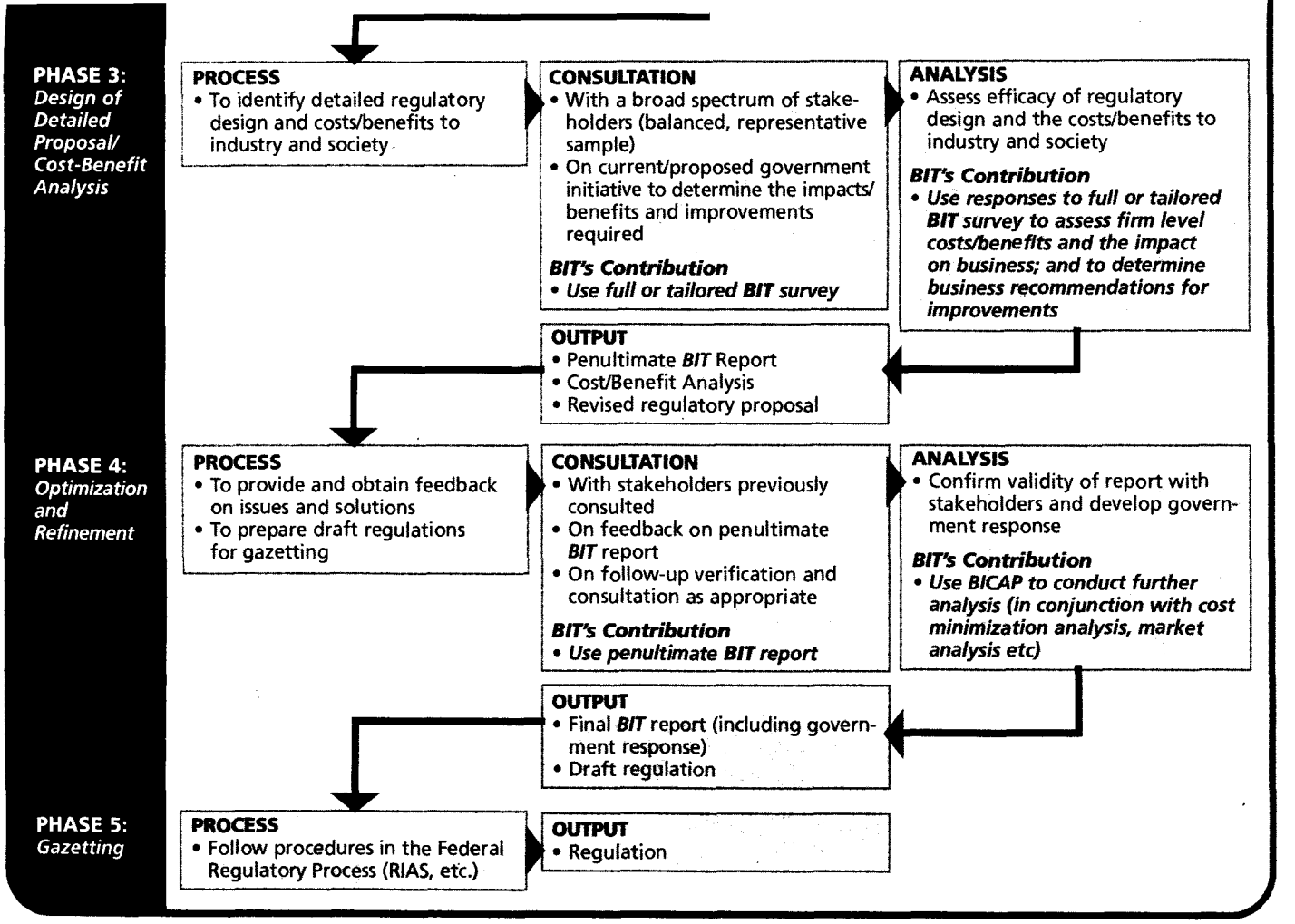
Appendix 1
BIT Process

STEP	OBJECTIVE
Objective Setting	To set boundaries and objectives for consultations with business about what is on the table for change and what is not.
Developing a Consultation Strategy and ***BIT*** Methodology	To establish the consultation process for workshops, provision of commentary, interviews, etc. Identification of process which will secure "buy-in" and participation of business and maximize consensus building. Outline and documentation of the process and who is involved.
Selecting Participants	To design a representative sample of potentially impacted firms.
BIT Consultation	Collect observations of business.
Analysis	To identify problems which can be pragmatically resolved and to complete analysis of remaining issues and suggestions for solutions.
Follow-up and Verification	To maximize "buy-in" and verify results/information.

OUTPUT	USES OF OUTPUT
Formal senior management commitment, statement of objectives and boundaries for consultation.	Sets stage for components of consultations and "buy-in" from community to ***BIT*** process.
Detailed outline for consultation plan which includes: steps, time-frames, feed-back mechanisms, explanation of how consensus building will be promoted, who the targeted participants are and key priorities. ***BIT*** tailored to subject matter. Documentation of consultation strategy and ***BIT*** methodology	Primary tool for collection of private sector observations on impacts and solution. Used in formal consultations.
Formal explanation of selection criteria. Justification for who is involved and committed participants.	Contact list and selection criteria used for workshop participants and senior management.
Commentary	Analysis (see next step)
BIT Report	Where solutions are clear — fix the problem. Where priority issues remain — set the stage to investigate issues through further consultation and analysis.
Finalized report with departmental response.	Implementation of report findings, recommendations and solutions. Feeds into the RIAS Process.

APPENDIX 2
*Integration of the **BIT** into the Decision-Making and Consultation Processes*




PHASE 3:
Design of Detailed Proposal/ Cost-Benefit Analysis
PROCESS
• To identify detailed regulatory design and costs/benefits to industry and society
CONSULTATION
• With a broad spectrum of stakeholders (balanced, representative sample)
• On current/proposed government initiative to determine the impacts/ benefits and improvements required
BIT's Contribution
• Use full or tailored BIT survey
ANALYSIS
• Assess efficacy of regulatory design and the costs/benefits to industry and society
BIT's Contribution
• Use responses to full or tailored BIT survey to assess firm level costs/benefits and the impact on business; and to determine business recommendations for improvements
OUTPUT
• Penultimate BIT Report
• Cost/Benefit Analysis
• Revised regulatory proposal
PHASE 4:
Optimization and Refinement
PROCESS
• To provide and obtain feedback on issues and solutions
• To prepare draft regulations for gazetting
CONSULTATION
• With stakeholders previously consulted
• On feedback on penultimate BIT report
• On follow-up verification and consultation as appropriate
BIT's Contribution
• Use penultimate BIT report
ANALYSIS
• Confirm validity of report with stakeholders and develop government response
BIT's Contribution
• Use BICAP to conduct further analysis (in conjunction with cost minimization analysis, market analysis etc)
OUTPUT
• Final BIT report (including government response)
• Draft regulation
PHASE 5:
Gazetting
PROCESS
• Follow procedures in the Federal Regulatory Process (RIAS, etc.)
OUTPUT
• Regulation

Appendix 3
RIAS AND *BIT* PROCESS

SECTION OF RIAS	CONTRIBUTION OF *BIT* PROCESS
1. DESCRIPTION	Developed in the Regulatory Summary of the ***BIT*** survey.
2. ALTERNATIVES	Identified in the Regulatory Summary, used in the ***BIT*** survey report and tested/ verified using the separate costing methodology.[4]
3. COST-BENEFIT ANALYSIS	***BIT*** software survey identifies key business issues for inclusion in benefit cost analysis and is a starting point for least-cost analysis and cost-effectiveness analysis. The separate costing methodology provides micro-analysis of business for inclusion in benefit cost analysis.[5]
4. CONSULTATION	The ***BIT*** process provides a consistent structured consultative framework designed to increase the efficiency and effectiveness of consultations.
5. COMPLIANCE & ENFORCEMENT	***BIT*** raises key issues and identifies barriers to compliance including costs of enforcement and oversight system(s).
6. CONTACT PERSON	Usually the Department hosting ***BIT***.

[4]Refer to the *Guide and Manual for Determining the Impacts of Regulation on Business Activities and Their Costs: A Functional-Based Approach to Regulatory Costing*, available from Industry Canada.

[5]ibid.