

Business Environment Patterns in India

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Long before India existed as a country, the Indian subcontinent was regarded as a source of innumerable riches and trading opportunities by the world's most powerful empires. Riding the monsoon winds, Roman ships would bring back from Tamil kingdoms and the main ports of Barygaza, Muziris, and Korkai gold, silver, red coral, and fine embroideries. Other trading nations—the Chinese, the Egyptians, the Carthaginians—established settlements on the subcontinent, followed in the 15th century by the Europeans, who had benefited from the opening of a sea route via the Cape of Good Hope.

Foreign trade proved a mixed blessing for India's economy in later centuries. The fall of the Moghuls and the rise of European chartered companies all but obliterated India's great merchants. After India's independence in 1947 a complex system of business regulations and high import tariffs—widely known as the “License Raj”—contributed to locking India into a “Hindu rate of growth” far below India's recognized potential.

Today, India owes much of its economic success to the liberalization reforms initiated in 1991. The reforms contributed to lifting the average gross domestic product growth rate to 8.5% in

2005–8 and 300 million people out of extreme poverty. Still, recent growth has failed to create enough jobs. A study by the Indian Ministry of Statistics shows that out of a total workforce of 397 million, only 28 million workers are employed in the organized sector.

Furthermore, an uneven pace of local growth leads to increasing inequalities between states. Promotion of inclusive growth is one of India's key development objectives stated in the 11th Five Year Plan. To help local entrepreneurs unleash their potential, national, state, and municipal governments need to create a regulatory environment that encourages firms to formally start up and grow. The World Bank's 2009 India's Investment Climate: Voices of the Poor study identifies red tape as a key constraint to improved productivity.

The National Manufacturing Competitiveness Council of India also emphasizes regulatory reform: "Government has a major role to play in providing the right market framework and regulatory environment as these provide invaluable impetus to the competitiveness... The framework should ensure fair competition, better access to markets, trade negotiations that ensure a level playing field for domestic manufacturers, review of existing regulations and reduce the burden of paper work and inspector raj in respect of existing laws."

Doing Business studies business regulations from the perspective of a small- to medium-sized domestic firm. Mumbai represents the country in the global Doing Business report, which compares regulatory practices in 181 economies. However, in large federal countries like India, local business regulations and their enforcement differ across locations.

Doing Business in India 2009 expands 7 of the 10 Doing Business topics (starting a business, dealing with construction permits, registering property, paying taxes, trading across borders, enforcing contracts, and closing a business) beyond Mumbai to another 16 locations across India.

These indicators have been selected because they reveal differences in national, state, and municipal regulatory policies and practices.

Doing Business in India 2009 ranks the 17 benchmarked cities based on their performance on each of the seven topics. The results are presented here. Doing Business is easier in Ludhiana(Punjab), Hyderabad (Andhra Pradesh), and Bhubaneshwar (Orissa). It is more difficult in Kochi (Kerala), and Kolkata (West Bengal). Mumbai, representing India in the global Doing Business report, does not rank highest among the benchmarked cities on the 7 topics measured. While it is quickest to start a business or export a container there, Mumbai lags behind other cities in the time required to enforce a contract, the ease to obtain a construction permit, the time to transfer a property title, the cost to start a business, or the total tax burden on businesses.

Still, Mumbai's ranking has improved in relation to other cities since the last Doing Business in South Asia. Hyderabad remains at the top of the ranking while other large business centers such as Bengaluru and Chennai dropped. Their ranking changed partly because the number of benchmarked cities increased from 12 to 17, and some of the added cities have competitive regulatory frameworks. The lower ranking may also reflect delays and higher fees due to demand for business services in fast-growing cities. On the other hand, Bhubaneshwar and Jaipur are examples of lower-income cities that make it easier to do business by increasing efficiency and the use of technology, while maintaining low costs.

Doing Business rankings do not tell the whole story about an economy's business environment. The indicators do not account for all factors important for Doing Business—for example, macroeconomic conditions, infrastructure, workforce skills, or security. But improvements in an

economy's ranking do indicate that the government is creating a regulatory environment that is more conducive to business.

For governments committed to reform, it is the pace of reforms—not absolute ranking—that is the most important. The pace of reform is picking up. Doing Business 2009 identified 239 reforms that make it easier to do business in 113 countries. Other large emerging economies like Egypt, China, and Indonesia were among the reformers. With this competition, complacency is not an option.

CITIES ARE REFORMING—WHAT GETS MEASURED GETS DONE

Since 2004, India has introduced 7 major business-environment reforms in business entry, registering property, getting credit, paying taxes, and trading across borders, becoming the regional top reformer as reported in Doing Business 2009.

Trade is the area where India has reformed the most. India was the top reformer on the trading across borders indicator in Doing Business 2008 and continued reforming in Doing Business 2009. The implementation of ICEGATE (Indian Customs and Excise Gateway)—an electronic data interchange (EDI) system—at the country's major entry points has significantly facilitated trading. The system enables shipping lines to submit their cargo manifests electronically, initiating the clearance process even before the ship docks.

Another important milestone was the Ministry of Corporate Affairs' national e-government initiative, called MCA-21, introduced in 2006, which laid the groundwork for electronic business registration. As part of this program, the national government began computerizing company

registration offices across India and introduced an electronic filing system for company name approval and registration. As a result of these reforms, the registration time has been reduced. Company name approval now takes 2 days in all cities, down from 4 to 6 days in 2006.

The time to obtain the certificate of incorporation also dropped. The certificate is now available online in 2 to 3 days, as opposed to the 9 to 10 days it took in 2006. But the reform is not complete—the applicant must still wait to receive a physical copy of the certificate by mail before starting activities. Well aware that an affordable and efficient immovable property registration system reduces informality, the Ministry of Urban Development launched the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) in December 2005. It inspired important stamp duty reductions, making it cheaper to register property. The program also introduced land-record computerization programs across the country.

The national government initiated several programs to increase the efficiency of central and local tax systems. In 2005, it started implementing a uniform VAT rate in all states, eliminating some of the cascading effects caused by local taxes. By 2008, all Indian states adopted the VAT system. In 2007, the central sales-tax rate was decreased from 4% to 3%.

India's legal and regulatory framework in the areas of enforcing contracts and bankruptcy has advanced in the last two decades. In 2008, the Supreme Court allowed for electronic case filing.¹⁰ Efiling systems are being planned for the various state High Courts in the near future and eventually in the District Courts as well.¹¹ "Indiancourts"¹² is a new website that provides a single-point access to information related to the Supreme Court and all 21 High Courts. Litigants can verify case-status, and browse judgments, rules, and judges of each court.

The national government introduced Debt Recovery Tribunals (DRTs) to speed up the resolution of debt recovery claims due to banks and financial institutions in 1993. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act was enacted in 2002 and amended in 2004, with a view to making adequate provisions for the recovery of loans and to enforce security interests without the intervention of the court—or at least with minimum intervention.

These positive changes in the law have only taken full effect in practice in the past couple of years. Until recently, the validity of the SARFAESI Act and before that the validity of the DRTs were held up in court challenges, but now both acts are used by creditors. As a result, the DRTs of Mumbai have started working faster and more DRT judges were assigned recently. In Mumbai, debt enforcement through DRTs takes now on average 7 years.

Reforms at state and municipal levels have accelerated, too. There has been significant progress—9 of the 10 cities benchmarked in *Doing Business in South Asia 2007* and again in 2009 introduced local reforms in at least one of the areas of starting a business, dealing with construction permits, and registering property. As a result, the average time to start up a company dropped from 54 to 35 days, similar to Thailand. The time to obtain a building permit dropped by 25 days on average in the 10 cities. Four out of seven locations measured for the first time by this report reformed their local regulations and practices in the 3 areas, bringing the total number of reforming cities to 14 out of 17.

In the area of starting a business, 7 out of the 10 states benchmarked in 2006 introduced administrative, legal, and technological reforms in addition to the national reforms affecting all states. Entrepreneurs in New Delhi and Ahmedabad can now pay the stamp duty on company

documents electronically and apply online for the value-added tax registration certificate and amendments to the registration certificate. Bhubaneswar and Hyderabad introduced single access points for value added tax and professional tax registrations and Patna and Ranchi reduced the stamp duty on incorporation documents.

Local governments also reformed their processes for dealing with construction permits. Among the most important initiatives, the Municipal Corporations of Ahmedabad and Chennai simplified building-permit applications by allowing online building-plan submission. Bengaluru, Gurgaon, and Hyderabad introduced an effective single-window system for building-permit applications. The Bhubaneswar Development Authority adopted a Geo-Information System that provides information on each revenue plot along with master-plan provisions such as land-use zones, roads, drains, and open spaces. Over the last few years, 11 out of the 17 cities revised their building bylaws and development rules and made them and the application forms available online. Twelve cities have improved their efficiency of handling applications through ongoing computerization and additional zonal offices, such as the new civic centers in Ahmedabad. Gurgaon, India's top performer for registering property, increased the speed of property transfers by developing customized software and training registry employees. Bengaluru computerized ownership records and property titles as part of the Karnataka Valuation and e-Registration project (KAVERI). Four states cut their stamp-duty rates. Bhubaneswar, Jaipur, New Delhi, Patna, and Bihar further computerized land records, making it easier for entrepreneurs to search for encumbrances.

WIDE VARIATIONS ACROSS CITIES AND STATES

If you were a graduate returning to India from her studies abroad with a great idea for a new business, obtaining authorization to start your company would be fastest in Noida, where it takes 30 days, and least expensive in Patna, at 38% of income per capita. In Mumbai, it would cost almost twice as much. Obtaining all clearances and permits to build a new warehouse and hook it up to utilities would take about 80 days in Bengaluru and Hyderabad, twice as fast as the OECD average of 161 days. It would take six months longer in Kolkata. If you decided to purchase a property in Jaipur, your new estate would be registered in 24 days, the same as in Johannesburg, South Africa. If in Bhubaneswar, transferring the property title would take five times longer. Resolving a dispute at the courts is generally time-consuming across states, but it would be faster in Guwahati at 20 months compared with 4 years in Mumbai. Exporting a container of textiles would take you on average 17 days through the Nhava Sheva port, but 11 days longer through the port of Kochi.

These examples show large variations in the way local government regulations enhance or restrain business activity across India. The economic reforms of the 1990s have given the states greater autonomy, especially in land and licensing matters. While local governments share the same basic legal framework, they also interpret and implement national regulations differently. Some states have made their processes more efficient with the help of technology.

More reform, at the national, state, and municipal levels is needed to reduce the number of procedures as well as the time and cost to do business. Global competition is becoming increasingly local in the sense that it is not only countries that compete with each other, but increasingly specific locations—Kolkata versus Monterrey (Mexico) rather than India versus Mexico. Indian cities and states must expedite their pace of reform to convince investors that it is more profitable to invest scarce capital in cities like Hyderabad rather than Cairo or Shanghai.

STARTING A BUSINESS

The number of procedures to formally open a business ranges from 11 to 13, of which 8 are national in nature and similar in all cities. The high number of procedures is due to requirements following business incorporation, such as multiple tax and social-security registrations. States like Andhra Pradesh and Orissa have simplified the process for entrepreneurs by consolidating registration for both value-added tax and profession tax at the Commercial Tax Office. The time required to start a business also varies among cities due to different local practices and different performance levels of the local branches of national agencies.

Starting a business is fastest in Noida and Mumbai (30 days) and lengthiest in Kochi (41 days). Differences in cost are pronounced. In Patna, Kolkata, and Bhubaneswar, entrepreneurs spend less than 40% of income per capita to open a business; for those in Bengaluru and Mumbai, the cost is almost double due to local government fees and taxes. Registration for value-added tax costs the equivalent of 12% income per capita in Mumbai, but is free in Jaipur and Ahmedabad. Similarly, entrepreneurs pay 15% of income per capita in Bengaluru to register under the Shops and Establishments Act, but pay nothing in Chennai.

DEALING WITH CONSTRUCTION PERMITS

To comply with all the requirements to build a warehouse is not easy or cheap. Ahmedabad, Bengaluru, and Chennai have the least procedures—15—while the process requires 37 steps in Mumbai. Hyderabad is fastest with 80 days and Kolkata slowest with 258 days. Variations are due mainly to the time it takes to obtain pre-construction clearances and zoning permits, the building permit, and the electricity connection. In Kolkata, Guwahati, and Chennai, it takes at

least three weeks to obtain the zoning certificate. In comparison, the approved layout can be obtained on the spot in Bhubaneswar. Hyderabad and Bengaluru both process building tutorial time limits of 30 working days, while entrepreneurs in Patna have to wait more than 3 months to start construction. Obtaining the occupancy certificate is fastest in Kochi, where a 'silence is consent' rule automatically kicks in after 15 days. In Noida, the entrepreneur will have to wait 5 weeks longer. Regarding costs, construction-related procedures amount on average to 789% of income per capita, above the same cost in Brazil and China. The computerization of the building permit processes is most advanced in Ahmedabad, Bengaluru, Chennai, and Hyderabad, which set an example for other cities.

REGISTERING PROPERTY

The procedures required to register property are similar across the 17 cities. A potential property buyer must obtain a non-encumbrance certificate from the Subregistrar's Office, have a lawyer draft a sale's deed, register the sale's deed at the Subregistrar's office, and then officially transfer the property title at the Circle Revenue Office. However, the time and money required to complete these procedures vary substantially across cities. In Gurgaon, it would take an entrepreneur 26 days and 7.7% of the property value to transfer property, while the same process would last three times longer and cost 15.4% of the property value in Guwahati. Variations in time can be explained by different degrees of efficiency of the Subregistrar and Circle Revenue Offices. Offices that have computerized land records and are adequately staffed with qualified personnel conduct procedures faster, as the examples of Jaipur and Gurgaon show. Differences in cost stem mostly from differences in stamp-duty rates, set by the states, which account for an average of 69% of all costs incurred. Stamp duties can be as high as 12.5% of the property value in Kochi, or as low as 3% in New Delhi.

TRADING ACROSS BORDERS

Importing or exporting has become much easier in the past years. The implementation of an electronic data interchange system, the construction of inland container depots, and various ambitious infrastructure projects have significantly reduced both the time and cost to trade goods. Mumbai's Jawaharlal Nehru Port (JNPT) is the busiest port, handling nearly 60% of India's port traffic. At the subnational level, it is fastest to import and export from Bhubaneswar through the port of Vishakapatnam. The port of Chennai is close behind. Despite substantial achievements, important challenges remain. Improving and investing in railway and road infrastructure, reducing interstate checkpoints, and improving the Electronic Data Interchange systems are examples of how India's position as a regional trade hub can be further advanced.

ENFORCING CONTRACTS

Enforcing contracts is characterized by lengthy proceedings. The time needed to go through trial and judgment is the most burdensome among the three stages of the commercial dispute—service and filing, trial and judgment, and enforcement of judgment. It takes around two years to resolve a commercial dispute in Kochi, Bhubaneswar, and Hyderabad compared with almost 4 years in Mumbai. Case backlogs and an insufficient number of judges are reportedly the main source of delays in most cities. The cost to enforce a contract ranges from 16.9% of the claim value in Patna to 32.5% in Bengaluru and 39.5% in Mumbai. Differences in court fees, legal fees, and the cost of enforcement explain these variations. The national government introduced case management by allowing for electronic filing of cases at the Supreme Courts in 2008 and is planning e-filing systems at the High Courts and District Courts. The national government has

also recommended the establishment of commercial divisions within the High Courts to speed up enforcement of contracts.

PAYING TAXES

Cities do not differ much in terms of the total tax-burden impact on business, which ranges from 66.5% to 70.3% of commercial profits. The state and local governments play a major role in tax administration, although the central government collects the largest portion of taxes. Hence, a high variation in the number of payments and the time it takes to comply with all taxes across Indian cities.

While a business owner in Jaipur needs 233 hours a year to comply with all tax obligations, she would spend 405 hours to do the same in Patna. Differences are also evident in the number of payments annually ranging from 59 in Ludhiana, Mumbai, Noida, and Bengaluru to 78 in Hyderabad. The national government has undertaken several initiatives, most of which are still ongoing, to harmonize the tax system across states. The most recent example is the unification of the value-added tax (VAT) rate among all Indian states.

CLOSING A BUSINESS

Among the cities benchmarked, Hyderabad has the highest recovery rate in insolvency cases at 15.9 cents on the dollar—far lower than Japan’s rate of 99.5 cents on the dollar. It takes 7 years to close a business and costs 7% of the value of the claim. In Kolkata, a business will only recover 9.13 cents on the dollar—it takes almost 11 years and costs 10% of the value of the claim. India’s legal framework on insolvency and debt recovery has been at the core of reform discussions for several years. Some of the concerns have been addressed through the Recovery of Debts Due to Banks and Financial Institutions Act 1993 and the SARFAESI Act 2002,

amended in 2004. What is now needed is to build consensus to further implement reforms in this area and create capacity to deal with insolvency and debt recovery more efficiently. Bankruptcy laws are national but there are local differences in the functioning of the tribunals.

LEARNING FROM EACH OTHER: ADOPTING GOOD LOCAL PRACTICES

Publishing comparable data on the ease of Doing Business inspires governments to act.

Comparisons among cities within a single economy are even stronger drivers of reform. That was the case in Mexico, where a subnational Doing Business study covering 12 states was first published in 2005. The study inspired competition to reform, as governors and mayors had a difficult time explaining why it took longer or cost more to do business in their city compared to their neighbors. States that have not been benchmarked asked to be measured in subsequent reports. The second round expanded the analysis to all states and updated indicators for the first 12 cities, showing that 9 of the 12 states implemented reforms in at least one of the areas covered by Doing Business. The third Doing Business in Mexico report, launched in 2008, shows that the impetus to reform continues—28 of the 31 states introduced a total of 40 reforms.

Cities in India can learn from each other and adopt good regulations and practices that already exist elsewhere. If a hypothetical city called “Indiana” were to adopt the best practices found in the benchmarked cities, it would rank 67 out of the 181 economies measured by Doing Business 2009. By reforming in these 7 areas, India (as represented by Mumbai) could improve its ranking by 55 levels, placing the country well ahead of China, Brazil, or Russia. This would reduce the time to start a business to the 30 days of Mumbai and Noida. The cost would be 38.5% of income per capita as in Patna, same as the cost in Ecuador. Cutting the time to get construction

licenses to build a warehouse to the level of Hyderabad—80 days—would put India ahead of Germany. Adopting the time to register property in Jaipur—24 days—would put the hypothetical city Indiana at the 49th ranking worldwide, the same as South Africa. The cost of enforcing contract of 16.9% of the claim value, as in Guwahati, would be below the OECD average of 18.9%. The total tax rate would be reduced to 66.5% as in Noida and similar to France. The import time would drop to Bhubaneswar's 16 days, the same as Croatia. The hypothetical city would adopt Hyderabad's practices for closing a business with a recovery rate of 15.9 cents on the dollar, 2 cents higher than Indonesia. With these regulations in place, Indian entrepreneurs would face a business environment similar to that of Taiwan, China, or Turkey.

Payoffs from reform can be large.

Higher rankings on the ease of Doing Business are associated with more growth, more jobs, and a smaller share of the economy in the informal sector. In Mexico, reforms cut the time to start a business from 58 to 27 days. A recent study reports a boom in new business entry: the number of registered Mexican businesses rose by nearly 6%, employment increased by 2.6% and prices fell by 1% because of the competition from new entrants.¹⁷ Simplified regulations also encouraged entrepreneurs to start their own business in Egypt. Studies from other countries suggest that 85% of reforms occur in the first 15 months of a new administration. For India, there is no better time to reform than now.

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