Law and Finance in India – An Overview

Rajesh Chakrabarti

Abstract

The central role of legal reforms in sustaining economic growth and financial development is widely recognized in India. Exactly what elements of the legal system affect the financial system and how, are less clear. We review the recent literature on law and finance and assess the state of India’s legal and judicial system as well as that of its financial system, particularly relative to the rest of the world. It appears that on paper Indian laws provide good to excellent protection to investor rights. Implementation of these laws, however, has been less than satisfactory. Public enforcement of securities laws has been weak and courts in India have been extremely slow and overloaded with cases. Even a decade and a half after the beginning of the reforms process, India still suffers from an excess of red-tape and bureaucracy (not to speak of corruption) poses hurdles to every major aspect of business. Indian financial markets have had limited though increasing depth and survey evidence reveals the preponderance of internal financing among India’s small and medium sector firms as well as marked reliance of Indian small businesses on informal networks and institutions like reputation and trust rather than the formal legal system to enforce contracts and settle disputes.
Law and Finance in India – An Overview

I. Introduction

Economists have long emphasized the pivotal role of laws and institutions in determining the economic destinies of nations. Indeed the Nobel-prize winning economist Douglass North’s explanation of varying economic experiences of societies around the world over centuries centers almost exclusively on institutions. Sanctity and low-cost enforceability of contracts lie at the heart of all economic transactions and hence constitute a basic pillar upholding the economy. Nevertheless, it is only lately that the central role of laws and institutions of governance in determining the evolution and structure of a country’s financial system is being probed empirically in a systematic manner. Since the late 1990s, “law and finance” is gaining ground as an important sub-field of finance (and law) and efforts are on to better understand the effects of legal system and the social institutions in determining the financial environment and the financial decisions of individuals and businesses.

Nowhere is this inquiry more relevant than in India today. For a decade and a half India has been shedding its decades-long practice of state-controlled economy in favor of greater market orientation. Liberalization is breathing new life into financial markets and private enterprise. Wide ranging changes have been brought about in financial and business regulations. Concurrently and arguably as a consequence, the growth rate has more than doubled from the infamous “Hindu rate” of 3.5%. Nevertheless, sustainability of this high growth rate depends on what is often called “second generation reforms” focusing on legal and labor reform. While macroeconomic policies have taken the center-stage in the first decade of reforms, there is widespread consensus that a significant overhauling of the legal system is imperative to sustain the initial impetus and to make growth more inclusive. The pace of the reforms process, as always and everywhere, is dictated by political realities and every single element of the reform process has its anticipated effects as well as unintended consequences. At this juncture it is imperative to have a clear understanding of the economic effects of India’s legal system and her socio-economic institutions, particularly their impact on the country’s financial system.
Small and Medium Enterprises (SMEs) have played a key role in the recent spurt in India’s economic growth. They have mushroomed all over the land, employing millions and accounting for a significant fraction of the national output and exports. The business practices of India’s SME sector, however, is far from completely documented and understood. As for all businesses, the choice of the extent and form of external financing for these firms, as well as their corporate governance mechanisms are determined to a large extent by the enforceability of the contracts they enter into. In the case of SMEs, however, business is frequently done through informal contracting with little or no paper trail. Courts of law rarely play a decisive role in settling their business disputes and informal mechanisms and social institutions play a key role resolving such disputes. A clear understanding of the grassroots reality of the SME business is essential to properly amend the legal and judicial system to serve them better.

While the laws themselves are doubtless crucial, poor implementation reduces wise legislation into a complete farce. The institutions of governance, therefore, play an equally important role in determining the development trajectory of the country. An assessment of the legal system therefore remains incomplete without a close look at the different institutions of governance and their impact on the financial environment.

The present chapter attempts an overview of the recent contributions in the law, institutions and finance literature, and to connect that literature to the situation in India. The following section provides a selective review of the emerging law and finance literature while the third section discusses the current state of the law and institutions of governance in India particularly relative to other countries and the state of its financial markets. The fourth section concludes with pointers towards future research as well as policy advice for legal and institutional reform.

II. The law, institutions and finance literature – major themes

Legal Origin, Investor Protection and Property Rights

squarely at the center of the finance research agenda. It is instructive to understand their basic argument.

LLSV argue that difference in the extent to which laws in different countries protect investors explain why firms are financed and owned so differently around the globe, why in some countries banks are more important than markets while the opposite if true in other cases, why firms in different countries have access to external finance to such starkly different degrees and why dispersion of shareholding is so different across countries. They demonstrate this empirically by creating measures of investor protection provided in the laws of different countries and regressing variables that represent the various issues noted above on these measures.

Importantly they note that countries almost never create a legal system from scratch. The legal structure of a country is, almost always, inherited or imported from some other system – voluntarily or otherwise (through conquest and colonization). Thus, while laws are unique to countries, legal systems stemming from the same origin are more similar than those that grow from a different foundation. Most countries around the world today have legal systems based on either the British common law or one of the civil law traditions that trace their origin to the Roman civil law coded by emperor Justinian. Among these civil law systems, the important ones are the Napoleonic French civil law and the German civil law written in 1897 after the unification of Germany under Bismarck. The Scandinavian countries seem to follow a third variant different from both these civil law systems. The primary difference between a common law system and a civil law system is that the former allows much greater role to jurisprudence as court decisions on specific cases are used as precedents for later cases, while the civil law system is more explicitly codified with less room for jurisprudence. Not surprisingly, the British common law and French civil law systems have seeded the present-day legal systems in countries that are former colonies of these powers. The German civil law has influenced the legal system of several European countries including Austria, former Czechoslovakia, Greece, Hungary, and former Yugoslavia and Asian countries like Japan, Taiwan and Korea. While these four systems of legal origin were studied in the initial papers, in later works a fifth origin – the socialist origin – was added to capture the legal origin of many formerly Communist countries. It is important to note that while the
legal systems of many countries are also shaped in part by religious traditions like Islamic law in Arab countries, Hindu law in India and Jewish law for Israel, typically these influences do not extend to the areas of commercial law and laws of contract and tort which directly affect legal rights of investors. These latter laws are almost always affected by the “secular” legal origin discussed before.

In order to assess the degree of investor protection in a country’s legal system, LLSV define seven binary dummy variables and one continuous variable to capture elements of shareholder protection in the law and four binary dummy variables and one continuous variable to capture those protecting creditor rights. The variables included in shareholder protection are: (1) whether the country follows the “one share – one vote” rule; (2) if shareholders are allowed to mail their proxy to ease voting; (3) if shares are not blocked for a period before a general shareholders’ meeting; (4) whether the country allows cumulative voting or proportional representation in the election of directors; (5) if the law grants a judicial venue for minority shareholders (holding 10% or less shares) to redress their grievances against management or requires company to buyback their shares in case of dissent with regard to some fundamental changes; (6) if the law grants the shareholders first right to new issues of stock; and (7) whether the minimum percentage of shareholding required to call an extraordinary general meeting is less than their sample median of 10%. All except the first of these variables are also summed up as “anti-director rights” and, as the sum of the constituent binary variable values, anti-director rights can range from zero to six. Another variable that LLSV consider in the category of shareholder rights is the proportion of net profits companies need to distribute among shareholders as mandatory dividend (zero in case of no such clause). The “anti-director index” construct of LLSV has been criticized by some for being ad hoc and ambiguous (Pagano and Volpin 2005, Spamann 2005). Djankov et al (DLLS, 2006) have sought to improve upon it by constructing an “anti-self-dealing” index, which measures the extent to which laws of a country prohibits or punishes dealings between firms that involve some conflict of interest.

For creditor rights, the binary elements are: (1) if the law imposes restrictions like creditors’ consent to file for reorganization; (2) if there is no automatic stay on secured assets on filing the reorganization petition; (3) if secured creditors are ranked first in the
distribution of proceeds of asset sales of a bankrupt firm; (4) if management is replaced by a representative of the court or creditors during the reorganization period. The “Creditors’ rights” index, the sum of the values of these four binary variables, therefore ranges between zero and four. The continuous variable considered in addition is the minimum percentage of total share capital mandated by law to be held as reserve to avoid dissolution of the firm (zero if no such provision). Together these variables constitute measures of the degree to which investors rights are protected in the laws of a country.

LLSV find that, on average, English common law-origin countries provide best shareholder protection in terms of the “antidirector rights” and the French and German civil law-origin countries the worst. In terms of “creditor rights” too, the English common law-origin countries provide the best protection, on average, while the French civil law-origin countries provide the least protection. The differences are statistically significant.

In addition to the provision in the laws itself, LLSV examined the efficacy of the implementation of laws in the different countries to check if the effect of poorer statutory investor protection in civil law countries is ameliorated through better implementation of the laws. Using country credit rating scores for dimensions like Rule of Law, Efficacy of Judiciary, Corruption, Risks of appropriation and repudiation of contract by government, they find, perhaps unsurprisingly, that the quality of law enforcement is primarily a function of wealth (or income) of a nation. However, after taking into account income, legal systems do have some systematic difference in enforcement with English common-law countries having best enforcement and French civil-law countries the worst. The same is true for accounting standards as well.

Armed with this comparative information about investor rights in the books as well as its implementation in different countries, LLSV then demonstrate that the countries with legal origin in systems that provide relatively less shareholder protection actually witness much more concentrated ownership, presumably because only the large shareholders can effectively protect their interests in such legal systems. They also show that such countries have smaller and narrower capital markets – both debt and equity markets – relative to the size of their economy. Legal origin evidently determines the ease of access to external finance in an economy. The difference in protection of
shareholders’ rights has led to completely different trajectories of financial and economic developments in the different countries. The English-origin systems spawn the largest number of firms per capita (on average 35.45 companies per million citizens as compared to 27.26 for Scandinavian-origin countries and 16.79 and 10.00 for German and French-origin countries respectively). They are also the best performers in mobilizing external finance. The ratio of the stock market capitalization held by minority shareholders (i.e. shareholders other than the three largest shareholders in each company) to the GNP of a country averages a remarkable 0.60 for the English-origin countries, substantially higher than the average ratio for German, Scandinavian and French-origin countries of 0.46, 0.30 and 0.21 respectively.

Finally, LLSV argue that investor protection lies at the heart of corporate governance. Strong investor rights protect the outside investor from expropriation by management and therefore lead to more effective corporate governance and greater investment and growth in the economy. Indeed Johnson et al (2000) have demonstrated that corporate governance failure – appropriation by controlling shareholders – lay at the heart of the Asian financial crisis. Corporate valuation (as measured by Tobin’s q) tends to be higher in countries with better investor protection in the laws, i.e. the English common-law countries. Djankov, McLiesh and Shleifer (forthcoming) use the LLSV creditor rights index to show that countries with better legal protection creditors rights experiences significantly larger credit as a proportion of its GDP. They also show that the presence of public credit registries in poorer countries and private credit bureaus enhance private credit.

While the LLSV papers have established the importance of legal origin in explaining the nature of financial system, there are more than a single theory about the exact mechanism through which laws affect the financial system and financial decision-making. Beck et al (2003) empirically evaluate two broad theories. The two “transmission channels” they seek to distinguish between are the “political channel” and the “adaptability channel”. The former contends that laws of different countries differ in their allocation of rights and power between the state and the private sector. Broadly speaking, the general bias is determined by the legal origin. Typically civil law countries give fewer rights to the private individuals and institutions vis-à-vis the state as compared
to the common law system. Financial institutions and markets develop best when private property and contracts are assured of freedom from state interference. As a result, civil-law countries lag behind their common-law counterparts in developing effective financial systems. On the other hand, the “adaptability channel” argues that effective functioning of financial markets and financial innovations require flexibility in the legal system to adjudicate over issues that have been unforeseen in past legislation. The common law system is marked by greater flexibility and adaptability to changes and innovations than the civil law systems because it gives more room to jurisprudence. This makes common law countries more suitable for financial development. Comparing the relative importance of these two channels in differentiating the financial development of countries with different legal origin, Beck et al (2003) conclude in favor of the adaptability channel. It seems legal origin affects financial development and the quality of financial institutions primarily because the legal system of countries with different legal origin are varyingly adaptable to changes in socioeconomic conditions and technology.

Protection of investor rights essentially implies securing property rights. Demirguc-Kunt and Maksimovic (1998) show that firms use more external funds in countries with better property right protection. Johnson et al (2002) probe the difficult question of which is more fundamental to private sector investment – secure property rights or better access to external finance. Carrying out a survey of businesses in five transition economies – Russia, Ukraine, Poland, Slovakia and Romania – they establish that between the two variables, perceived property rights security is both necessary and sufficient for higher private sector investment. In other words, private sector reinvestment declines with a perception of poor property rights protection but after controlling for property rights protection, private sector investment is not affected by access to external funds.

Securities Laws, Regulation of Entry and Courts

Apart from the question of legal origin, which in spite of its fundamental insight, has limited policy implications, the law and finance literature has also branched off into investigating, in detail, the specific laws that affect issuance and trading of securities as
well as the functioning of the legal institutions including the most important of all legal institutions, the courts themselves. This branch has also investigated the legal steps and processes required for starting a new business in several countries and measured the cost (in monetary terms plus the cost of the necessary delay) of this procedural obstacle ad its effects in different countries.

Perhaps one of the most fundamental areas of securities laws is the issuance of new securities. La Porta et al (2006) carries out a cross-country comparison of the nature of the laws and the power of the supervising authority and relates it to relative stock market development. Securities laws and institutions are compared on broadly two dimensions – the disclosure and liability standards that help bring out the most information about the issuer in a cost-efficient manner; and the nature and powers of the public enforcer of securities laws. Disclosure requirements are compared by measuring them using a “disclosure requirement index” which is the sum of six dummy variables. These variables indicate: 1) if a prospectus is required by law; and the level of detail in information required in the prospectus on 2) compensation of individual directors and executives; 3) identity of large shareholders of the issuing company; 4) share ownership by insiders of the company; 5) irregular contracts to which the issuer is a party; and 6) related party transactions involving the issuer. Analogously, a “liability standard index” is constructed is the mean of three multi-level dummies reflecting the procedural difficulty in recovering losses, in a civil liability case for losses due to misleading statement in the prospectus from 1) the issuer and its directors; 2) the distributor; and 3) the accountant. Finally the “public enforcement index” is the mean of five measures (indices) of the nature and power of the public enforcer of securities laws or the securities authority of the country. These five indices are: 1) the supervisor characteristics index; 2) the rule-making index; 3) the investigative powers index; 4) the orders index; and 5) the criminal index. The first index, in turn, is the mean of three binary dummies measuring the independence of the supervisor from the government in terms of i) appointment and ii) tenure of its members and iii) the separation between supervisors of banks and stock exchanges. The rule-making index measures the power of the supervisor to make rules regarding new issues and listing. The investigative powers index measures the supervisor’s power to command i) documents and ii) witness testimony when
investigating a violation of securities laws. The orders index measures the stop and do orders that may be issued, in case of a defective prospectus, against i) the issuer; 2) the distributor and 3) the accountant involved in the issue. Similarly the criminal index measures the criminal sanctions that may be issued, when the prospectus omits material information, against i) the issuer; 2) the distributor and 3) the accountant involved in the issue.

La Porta et al (2006) uses these measures for 49 countries to study their effect on seven measures of stock market development: 1) External Capital/GDP (average ratio of stock market capitalization held by small investors to GDP); 2) Logarithm of the number of listed firms per million people; 3) Average ratio of equity issued in IPOs (in thousand) to GDP (in millions); 4) Dyck and Zinagles (2004) measure of “block premium” in the share transaction; 5) survey response of level of agreement of business executives in the country to the statement “Stock markets are open to new firms and medium-sized firms”; 6) average percentage of shares owned by 3 top shareholders in the 10 largest non-financial, privately owned firms in the country; and 7) Liquidity (average total value of stocks traded between 1996 and 2000 as a percentage of GDP). Their first finding is that securities laws do matter. In other words, stock markets prosper significantly more in the presence of securities laws than without them. Among the three aspects of securities laws – disclosure, liability and public enforcement – they find that while disclosure and liability standards have a clear and substantial positive impact on stock market development, the effects of public enforcement on the various measures of stock market development are not consistent. Also, disclosure and liability standards have stronger influence on stock market growth than the “anti-directors rights” index though they are moderately highly correlated. The authors speculate that this may be because these standards are the “true” proxy for the effectiveness of private contracting, or that investor protection through securities and corporate laws both matter but the former is a cleaner measure, or that both of these laws depend on similar rules that ultimate protect private investors from expropriation by corporate insiders.

Another important area where laws directly affect business growth and economic development is the creation of new businesses. Countries around the world have vastly different levels of regulations for starting new businesses and presumably this has a
considerable impact on the flourishing of businesses and economic growth. Hernando de Soto was among the first people to conduct a systematic study of such regulations for a developing country (de Soto, 1990). More recently Djankov et al (2004) have carried out a cross-country comparison of such regulations and studied their association with economic growth.

In their sample of 85 countries, Djankov et al (2004) find that the number of procedures necessary to start a new business ranges from 2 (Canada and Australia) to 21 (Dominican Republic). The cost of these procedures range from a low of 1.16% of per capita GDP (Finland) to a high of 463% (Dominican Republic). The time the entire process takes ranges from 2 days (Canada and Australia) to 152 days (Madagascar). Thus regulations of entry vary considerably from country to country though rich countries (the top quartile in terms of per capita GDP) have relatively less regulation as a group. They find that greater regulation does not improve compliance of a country’s standards with international standards. In other words, quality of businesses does not improve with greater regulation. More regulation is associated with low levels of competition and high corruption and a larger unofficial economy and generally symptomatic of poor governance. The evidence seems to support the “public choice” theory of regulation that holds that regulations are a rent extraction device for politicians and bureaucrats.

Finally recent research has also delved into cross-country comparison of judicial efficiency by focusing on the functioning of the central institutions of law and judicial systems, the courts of law. Djankov et al (2003) compare the degree of procedural formalism in the courts in 109 countries and study its effect on judicial quality. To facilitate comparison and maintain consistency, they focus on two types of legal proceedings – eviction of a defaulting tenant and collection on a bounced check. In keeping with the approach popularized by them, they develop a measure of procedural formalism – “formalism index” – which is the sum of seven sub-indices: 1) professional versus laymen nature of court officials; 2) emphasis on written versus oral elements in the case; 3) necessity of legal justification of verdict; 4) degree of statutory regulation of evidence; 5) control of superior review; 6) engagement formalities; and 7) independent procedural actions. Each of these sub-indices is, in turn, created by combining innovatively defined dummy variables capturing various elements of the respective
dimension. The data is obtained through a survey of member firms of Lex Mundi, a
global association of law firms. The authors next put together data on judicial quality.
Data on expected duration of the two disputes in calendar days are obtained from the
participating Lex Mundi firms, while information on other variables like enforceability of
contracts, access to justice and corruption as well small firm survey data on fairness,
consistency, honesty and other aspects of the legal system are obtained from other
sources. Finally the authors also take into consideration incentives that different legal
systems provide for litigants and judges like mandatory time limits for various stages of a
case, contingent fee clauses for lawyers and the “loser pays legal costs” rule. The general
findings are, perhaps, along expected lines. Rich countries have better functioning courts.
Greater procedural formalism is associated with longer time for dispute resolution, lower
enforceability of contracts, higher corruption and lower honesty, consistency and fairness
of the system. To the extent that the French civil law system is more formalized than the
English common law system, the findings also imply that French civil law countries have
poorer quality legal system than the English common law. Importantly they also find no
clear evidence that the incentives they consider improve the quality of justice.

The “Doing Business” studies of the World Bank

Based largely on the works discussed above as well as other works by Andrei
Shleifer and his co-authors, the World Bank has been publishing its annual “Doing
Business” reports (World Bank 2004, 2005, 2006) since 2004. These reports take a close
look at the nature of regulation of economic activities around the world and the effect
such regulation has on the growth of businesses and the economy in general. The 2004
report focused on describing the regulations in various countries while the 2005 and 2006
issues focus on legal reforms around the world. The “Doing Business” reports focus on
five broad areas of regulation: 1) Starting a business; 2) Employment regulation (hiring
and firing workers); 3) Enforcing Contracts; 4) Access to Credit; and 5) Closing a
business. Later they added two new categories: 1) Ease of registering property; and 2)
protection of investors.

Much of the findings of these reports are along the lines of studies mentioned
(indeed these academic papers constitute the main background papers for these reports).
Employment regulation is an area not discussed above. Employment regulation includes laws that regulate: i) part-time hiring; ii) number of working hours in a day and annual leave; iii) minimum wage; iv) grounds for dismissal. As in all other categories, there is considerable cross-country variation in employment regulations. The Doing Business reports are of the view that more stringent employment regulation limits job creation, reduces workforce flexibility and results in smaller firm size with less-than-efficient scale. More importantly, greater regulation appears to hurt employment and welfare of disadvantaged groups to rise from poverty.

The overall conclusions of the Doing Business reports are: i) poor countries regulate business the most; ii) greater regulation is associated with bad socio-economic outcomes; iii) there is indeed an “ideal” set of regulations or “best practices” that can be adopted and emulated across the globe with beneficial results. These reports have been a strong votary of legal reforms in countries around the world to bring about better economic effects.

III. Law and finance in India – a selective overview

Investor Protection in Indian Laws: An international comparison

The Indian legal system is obviously built on the English common law system. In terms of property rights protection, La Porta et al (2004) give India a score of 3 on an index ranging from 1 to 5. As for investor protection, on paper the Indian system provides one of the highest levels of investor protection in the world. India has a shareholder rights index of 5 (out of a maximum possible of 6), highest in the La Porta et al (1998) sample – equal to that of the USA, UK, Canada, Hong Kong, Pakistan and South Africa (all English-origin-law countries) and better than all the other 42 countries in the study including countries like France, Germany, Japan and Switzerland. Among the constituents of shareholder rights, India does not follow the one share-one vote principle, i.e. it is possible to different classes of shares with varying voting rights. India also does not allow proxy voting by mail. Other than these, shareholder rights are well protected in that shares are not blocked before a general meeting, voting for directors
does follow cumulative voting or proportional representation rules, there are laws protecting minority shareholders, existing shareholders do have a preemptive right to new share issues, and the percentage of share capital necessary to call an Extraordinary Shareholder Meeting is 10% – less than the sample average. There is no provision of mandatory dividends in India.

In terms of creditor rights, too, the Indian legal system seems to provide the best protection to creditors in the world according to the La Porta et al (1998) metric. With no automatic stay on assets in the reorganization phase, the requirement of secured creditors to be paid first in place, restrictions present for going into reorganization and the provision of replacing management in reorganization, India has a creditor rights index of 4 (the maximum possible) better than that in Australia, Canada, Ireland, New Zealand and the USA, not to speak of civil law countries.

The La Porta et al (1998) enforcement variables, constructed using figures obtained from private country risk rating agencies, however, paint a different picture of India. Take for instance the “Rule of Law” index. Most advanced countries have very high scores on this index while developing countries typically have low scores. India has a score of 4.17 on this index – ranking 41st out of 49 countries studied – ahead only of Nigeria, Sri Lanka, Pakistan, Zimbabwe, Colombia, Indonesia, Peru and Philippines. Thus it appears that Indian laws provide great protection of shareholders’ rights on paper while the application and enforcement of those laws are lamentable.

The corruption figures are even worse. On this dimension, India has a score of 4.58 as compared to the sample average of 6.90 ranking 44th out of 49 nations – better only than Egypt, Nigeria, Philippines, Pakistan and Indonesia. The risk of expropriation by the state in India has a score of 7.75 slightly worse than the sample average of 8.05. As for the risk of contract repudiation, India ranks 38th with a score of 6.11 as opposed to the sample average of 7.58. In terms of accounting standards, India appears to have the worst accounting standard among the English-origin countries (a score of 57) rated though several civil law countries fare worse. The sample average on this dimension is 60.93. Somewhat surprisingly for people with experiences of Indian judiciary, India gets a score of 8 out of 10 on the efficiency of judicial system variable, just behind the English-law average of 8.15 and better than the overall sample average of 7.67.
Red tape and regulations are among the leading deterrents for business and foreign investment in India and much of the economic reforms centers around reducing these obstacles. Perhaps a sense of India’s legal restrictions and institutions can be obtained from its latest ranking of 116 out of 155 in World Bank’s Ease of Doing Business indicator in 2006 (World Bank, 2006). Table 1 Panel A shows India’s ranking on the various aspects of business regulation. India features consistently in the second half of the sample for all but one aspect, and is out of the top 100 for most aspects. The one outlier aspects in this regard, interestingly, is investor protection. Panel B of Table 1 describes the various measures for India that leads to this state of affairs.

Panel B describes the hurdles and time costs in the way of regulation to carrying out various business processes. It is important to keep in mind that the figures reported here are the official costs and time necessary “under normal circumstances” and assuming that all “information is readily available and that all governmental bodies function efficiently and without corruption” (DLLS 2004). Given that India ranks 88th out of 158 countries surveyed by Transparency International in 2005, these figures are almost certainly gross underestimation of the actual costs and delays on the ground.

Starting a business in India is no easy affair. With close to twice the number of procedures to follow as in OECD countries, about three and a half times the time delay and close to nine times the cost (as a proportion of per capita income) (in the “best case” scenario for the last two, assuming no corruption and governmental inefficiency), it indeed subjects the convictions and heroism of an entrepreneur through an ordeal perhaps tougher than the that posed by the actual challenges of business. With delays and costs of dealing with licenses in India in roughly corresponding proportions with their respective OECD values, “License Raj” in India appears to be alive and well even after a decade and a half of reforms.

Hiring and particularly firing people are just as difficult. It is almost twice as hard to hire people in India as in OECD countries and almost three times as hard and costly to
fire them. Apparently labor-friendly regulations have proven costly to India in terms of development and growth, ironically, mostly for labor itself. Different Indian states have considerable variation in their labor laws. In an interesting study, Besley and Burgess (2004) show that during the three and half decades before liberalization began, Indian states that followed more pro-worker policies experienced lower output, investment, employment and productivity in the registered or “formal” sector and higher urban poverty. They have also been marked with an increase in informal sector output, which supports the findings of the cross-country analysis by Botero et al (2004).

As we noted before, the degree of investor protection in the laws is the strongest suit for India followed by “getting credit”. In the latter case, India lags behind not because of creditors’ rights (which is close to OECD standards) but because of the paucity of credit quality information through the use of public registry or coverage of private bureaus. However, to get a more realistic picture of India’s excellent investor protection provisions in the law, they must be viewed together with her performance in contract enforcement is where the number of procedures and time delays are about double that in OECD countries and the costs of contract enforcement over four times that in OECD countries.

An important area investor protection is obviously that of securities markets regulation. Using the framework of La Porta et al (2006) that focuses on disclosure and liability requirements as well as the quality of public enforcement of the regulations controlling securities markets, India scores 0.92 in the index of disclosure requirements. Only two countries in the La Porta et al (2006) sample of 49 countries – United States and Singapore – have a higher score. As for liability standard, India’s score is 0.66 while the sample mean is 0.47. Only four countries – Canada, USA, Netherlands, and Philippines – have higher scores. In terms of the quality of public enforcement, i.e. the nature and powers of the supervisory authority, the Securities and Exchanges Board of India (SEBI), India scores 0.67, higher than the overall sample mean as well as the English-origin average of 0.52 and 0.62 respectively and ranks 14th in the sample.

In terms of the constituent elements of the La Porta (2006) disclosure index, Indian share offerings do require a mandatory prospectus and the prospectus must list the remuneration of individual directors and the managing director (but not that of other
officers), the detailed shareholding of the ten largest shareholders as well as the promoters’ (insiders) shareholding in the company, any contract that the company is a party to except for those required for day-to-day functioning of the company, and all related party transactions. As for liability, the directors of the issuing company and the distributor (merchant banker) of the issue are liable for any untrue statements in the prospectus and the offence is punishable with fine and/or imprisonment but the standard of establishment of guilt requires proving that i) an untrue statement existed in the prospectus; ii) it led to losses for an investor relying on the statement; iii) it was not an “honest” mistake. The accountant to the issue is not directly liable to SEBI but is likely to face an inquiry from the Institute of Chartered Accountants of India for a serious omission or untrue statement.

As for the quality of public enforcement, all board members of the supervisor, SEBI, are appointed by the government and hold office largely at the pleasure of the government, so there is virtually no independence of the supervisor. Since SEBI does not supervise banks but only markets, it is focused in its role. SEBI has little independent rule-making power, since all its rules need to be sanctioned by the Parliament. It does have the investigative powers to command documents and summon witnesses in the course of an investigation. SEBI has the power to issue administrative orders against the issuing company and the distributor if it finds them in violation of its “Disclosure and Investor Protection (D&IP)” guidelines. The accountant does not come under SEBI’s purview but under that of the Institute of Chartered Accountants of India.

In comparing the regulatory powers and performance of SEBI with those of the SEC (Securities and Exchanges Commission) in the USA, Bose (2005) concludes that while the scope of Indian securities laws are quite pervasive, there are significant problems in enforcing compliance, particularly in the areas like price manipulation and insider trading. Between 1999 and 2004, Bose finds that SEBI took action in 481 cases as opposed to 2,789 cases for the SEC even though the latter regulates a significantly more mature market. As a ratio of actions taken to the number of companies under their respective jurisdictions, SEBI’s figure comes out to be an unimpressive 0.09 while that of SEC is 0.52. Also the ratio for action taken to investigations made is quite low for SEBI (e.g. 1 out of 24 cases of issue related manipulation in 1996-97, 7 out of 27 in the 5 year
period 1999-2004). As for appeals before higher authorities – the Securities Appellate Tribunal (SAT) or the Finance Ministry – in 30 to 50% of cases, the decision goes against SEBI. Though SEBI has had some success prosecuting intermediaries, it has failed to convince the SAT in its proceedings against corporate insiders and major market players. Thus the quality of public enforcement of securities laws appears to be a problem in India.

Two important recent developments in the area of creditors’ rights in India have been the institution of Debt Recovery Tribunals (DRTs) in the early 90’s and the passing of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act in 2002. In spite of the superior creditors rights in the laws, banks have had very little power against defaulting borrowers largely because of the slowness of the judicial process. The establishment of the DRTs sought to remedy that problem. Visaria (2005) estimated that the establishment of DRTs reduced delinquency in loan repayments by 3 to 10% and enables lenders to reduce interest rates by 1-2 percentage points. The SARFAESI Act paves the way for the establishment of Asset Reconstruction Companies (ARCs) that can take the Non-Performing Assets (NPAs) off the balance sheets of banks and recover them. Operations of these ARCs would be restricted to asset reconstruction and securitization only. It also allows banks and financial institutions to directly seize assets of a defaulting borrower who defaults fails to respond within 60 days of a notice. Borrowers can appeal to DRTs only after the assets are seized and the Act allows the sale of seized assets. The SARFAESI Act itself, however, does not provide a final solution to the recovery problems. With the borrower’s right to approach the DRT, the DRAT (Debt Recovery Appellate Tribunal) and, in some cases, even a High Court, a case can easily be dragged for three to four years during which time the sale of the seized asset cannot take place. It is perhaps too soon to evaluate its effects on reducing defaults but public sector banks have had some success recovering their loans by seizing and selling assets since the Act came into existence.

The area of the Ease of Doing Business index where India fares worst is undoubtedly that of closing a business. India has the dubious distinction of being among the countries where it takes the longest time to go through bankruptcy in the world (10 years on an average). Consequently recovery rates are very low too – below 13% as
opposed to about 74% in OECD countries. Kang and Nayar (2004) point out that there is no single comprehensive and integrated policy on corporate bankruptcy in India in the lines of Chapter 11 or Chapter 7 US bankruptcy code. Overlapping jurisdictions of the High Courts, the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR) and the Debt Recovery Tribunals (DRTs) contribute to the costs and delays of bankruptcy. The Companies (Second Amendment) Act, 2002 seeks to address these problems by establishing a National Company Law Tribunal and stipulating a time-bound rehabilitation or liquidation process to within less than two years as well as bringing about other positive changes in the bankruptcy code. It is too soon to assess the actual impact of this Act in improving the desperate situation of the Indian bankruptcy code.

**Corporate Governance in India**

Enforcement of corporate laws remains the soft underbelly of the legal and corporate governance system in India. The World Bank’s Reports on the Observance of Standards and Codes (ROSC) publishes a country-by-country analysis of the observance of OECD’s corporate governance codes. In its 2004 report on India (World Bank (2004b)), the ROSC found that while India observed or largely observed most of the principles, it could do better in certain areas. The contribution of nominee directors from financial institutions to monitoring and supervising management is one such area. Improvements are also necessary in the enforcement of certain laws and regulations like those pertaining to stock listing in major exchanges and insider trading as well as in dealing with violations of the Companies Act – the backbone of corporate governance system in India. Some of the problems arise because of unsettled questions about jurisdiction issues and powers of the SEBI. As an extreme example, there have been cases of outright theft of investors’ funds with companies vanishing overnight. The joint efforts of the Department of Company Affairs and SEBI to nail down the culprits have proved to be largely ineffective. As for complaints about transfer of shares and non-receipt of dividends while the redress rate has been an impressive 95%, there were still over 135,000 complaints pending with the SEBI. Thus there is considerable room for
improvement on the enforcement side of the Indian legal system to help develop the corporate governance mechanism in the country.

Indian Courts – an assessment

A discussion of the legal situation in a country remains incomplete without an assessment of the functioning of its courts of law. Great laws can be brought to naught by an inefficient judicial system or a corrupt judiciary. Presumably one of the main reasons why Indian laws look better on paper than in practice is the inefficiency of the Indian judicial system.

Djankov et al (2003) in their analysis of “formalism” in the judicial process around the world, gave India a score of 3.34 on its formalism index, higher than the English-origin average of 2.76 but slightly lower than the average for all countries, 3.53. Among the 42 English-origin countries in their sample, India has the 11th highest level of formalism. The countries with higher levels of formalism are Bahrain, Botswana, Cyprus, Namibia, Pakistan, Sri Lanka, St. Vincent, Swaziland, Tanzania and the UAE. All other countries have lower levels of formalism. Interestingly enough India has the 16th longest process of evicting a tenant (212 days) among English common law origin countries (average 199 days). For collection on a bounced check, however, India has the 16th shortest duration (106 days) among English common law origin countries (average 176 days). In both cases India’s total duration of the process is significantly shorter than the overall mean duration of all the 109 countries considered (254 for eviction of tenant and 234 for collecting on bounced check). Thus, in spite of its formalism, Indian courts do not seem to perform that poorly (relatively speaking) on these two types of cases considered.

The DLLS assurance notwithstanding, things are far from all right in Indian courts. Case arrears and decade-long legal battles are commonplace. In spite of having around 10,000 courts (not counting tribunals and special courts), India has a serious shortfall of judicial service. While the USA has 107 judges per million citizens, Canada over 75, Britain over 50 and Australia over 41, for India the figure is slightly over 10 (Debroy (1999)). In April 2003, for instance, the Supreme Court of India has close to 25,000 cases pending before it (Parekh 2001). Hazra and Micevska (2004) report that there are about 20 million cases pending in lower courts and another 3.2 million cases in
high courts. A termination dispute contested all the way can take up to 20 years for disposal. Writ petitions in high courts can take between 8 and 20 years for disposal. About 63% of pending civil cases are over a year old and 31% are over 3 years old. Automatic appeals, extensive litigation by the government, underdeveloped alternative mechanisms of dispute resolution like arbitration, the shortfall of judges all contribute to this unenviable state of affairs in Indian courts. Since the same courts try both civil and criminal matters and the latter gets priority, economic disputes suffer even greater delays.

The Indian Financial sector – a brief overview

In a recent analysis of the Indian financial markets, McKinsey & Company point out (McKinsey, 2006, on the findings of which most of this sub-section is based) that even after a decade and a half of economic reforms and notwithstanding India’s long history of financial development, India’s financial depth as measured by the value of financial assets to GDP remains somewhat on the lower side compared to other fast growing Asian countries. In 2004, India’s financial assets accounted for 160% of her GDP as compared to 220% for China and 214% for Thailand. However it was higher than that of Philippines and Indonesia – countries with similar per capita income. Of this, currency and bank deposits accounted for 68% of the GDP, equity (before the phenomenal climb of the Indian markets) 56%, government debt 34% and corporate debt a meager 2%. The first decade of economic reforms saw virtually no financial deepening, though between 2001 and 2004 financial markets deepened at an average annual rate of over 14%, much of it (about 60%) stemming from rising equity values (even before the spectacular rise in 2005). Growth in bank deposits and government debt explained about 20% each, while the corporate debt market has stagnated at 2% since 1991. The household saving rate in India is an impressive 28% but only about a half of it is held in financial assets. Investments in housing, “unorganized sector” enterprises and gold account for the other half.

The banking sector, with a smaller share of GDP in deposits than most advanced and Asian countries, is marked by a dominance of public sector banks that account for about 75% of the assets (second only to China). At 61% in 2004, the ratio of loans to
deposits is smaller than most advanced and emerging market economies. India also has one of the lowest penetration levels of mortgage and banking products like ATM and debit and credit cards among leading emerging market countries. Banks tend to hold about 30% of their assets in government securities, one of the largest figures among advanced and emerging market economies, mostly because regulations require them to do so. Bank credit is also directed to priority sectors like agriculture and small scale industry. In 2004 37% of all loans went to priority sectors, which has a default rate 40% higher than the non-priority sectors. Lending rates have been rather rigid while deposit rates have fallen considerably in recent years. On the positive side, the ratio of nonperforming loans to total outstanding loans stand at below 5%, one of the best figures among emerging market countries.

Given the relative paucity of bank credit, particularly in rural areas, informal credit markets are particularly large in India – about a third of the credit from the formal financial system. In recent years, microfinance loans from banks to “self help groups” have also ballooned.

Equity markets have a long tradition in India. Nevertheless, in 2004 equity market size was 56% of GDP, including the non-tradable equity. The tradable equity made up only 33% of GDP. Though the Bombay Stock Exchange itself listed over 5,000 stocks – the second highest number of listed companies in the world – over 40% of the companies are not traded at all. While members of the 30 stock Sensex have world class liquidity, the average Indian stock is highly illiquid. Top 10 companies accounted for 36% market capitalization in 2004. As late as in the 1990s, the market has been subject to manipulations on more than one occasion. About 56% of shares were held by insiders at the end of 2004, reducing the “free float” to below 45%. Institutional holdings accounted for about 17% of equity. About the same amount was held by the Indian public. Mutual funds make up a tiny part of the market though the sector is witnessing rapid growth in recent years. In general, the share of institutional investors in India is considerably less than that in advanced countries and other emerging markets.

While the government bond market account for 37% of GDP, the corporate bond market is rudimentary and virtually stagnant at 2%. Government bonds are also held mostly by institutions. The privately placed corporate debt is 10 times as large as the
publicly traded corporate bond market. Interestingly the size of international corporate bonds issued by Indian companies amount to more than 50% greater than the publicly tradable corporate bonds in India.

In terms of modern payment systems while over 70% of large-value payments are now handled electronically, the retail payment system is predominantly cash-based (about 97% of transactions). This is reflected in the relatively large amount currency in circulation in India, close to 12% of GDP.

In terms of the measures employed by the various La Porta et al studies (figures relate to mid-to-late 90s), India had 7.79 companies per million citizens in 1994, one of the lowest for English-origin countries but higher than many French-origin countries and even Germany. Nevertheless it is considerably short of the sample average of 21.59. As for the ratio of external capital to GNP, India has a score of 0.31 which puts it at about the middle of the pack of English-origin countries though the ratio is significantly less than the average English-origin figure of 0.6. It is also less than the overall sample average of 0.4. As for companies making IPOs, Indian firms made 1.24 IPOs during 1995-1996 per million citizen, less than the English-origin average of 2.23 but greater than the sample average of 1.02. Ownership concentration in India as measured by the median share of three largest shareholders in a firm India had a figure of 43% in between the English-origin and overall sample averages of 42% and 45% respectively. In terms of debt, Indian firms had an average debt of 47% of sales substantially higher than the English-origin and overall sample averages of 0.26 and 0.27 respectively.

Survey evidence on law and finance from India

An important question that needs to be answered in understanding the connection between law and finance in India concerns the extent to which the formal legal environment directly supports and regulates businesses, particularly small and medium enterprises which form an increasingly important part of the Indian industry. Allen et al (2006) carries out a survey of over 200 small and medium scale firms in Delhi and Hyderabad probing into the extent and nature of the relationship between the legal system and the functioning of these enterprises. The results are quite instructive. They indicate that the small firms sector operate in a system virtually governed through informal
mechanisms based on trust, reciprocity and reputation with little recourse to the legal system and deals with widespread corruption.

Over 80% of the firms surveyed needed a license to start a business, and for about 47% obtaining it was a difficult process. Government officials were most often the problem solved usually through payment of bribes (87% of responses) or friends of government officials to negotiate (23%). Clearly, networks and connections are of crucial importance in negotiating the government bureaucracy.

As for conducting day-to-day business, legal concerns are far less important to them than the unwritten codes of the informal networks in which firms operate. In cases of default, the primary concern is loss of reputation, followed closely by loss of property, while in situations of breach of contract, loss of future business opportunities ranks the highest, followed by loss of reputation. Significantly, in both cases, the fear of legal consequences is the least important concern lower than even threats to personal safety.

About 50% of the firms surveyed do not have a regular legal adviser and less than half of those that do have lawyers in that capacity. The most common reason cited was that lawyers are not necessary as the businessmen knew all their business partners and could deal with them fairly. For mediation in a business dispute or to enforce a contract, the first choice are “mutual friends or business partners,” followed closely by “settling out of court with the help of legal advisers”. Only 20% of the respondents mentioned going to courts as the first option indicating that the legal system, while not as effective as the informal mechanisms, is not altogether absent. As for the mechanism to ensure payment or repayment going to court leaving negotiation possibilities open was the most common response followed by better screening borrowers/clients. Some asserted they would seize the defaulters’ personal assets themselves. Clearly, the courts, while not the most popular method of conflict resolution, do have their utility as a negotiating tool.

The informal system, however, is not perfect in resolving disputes and has its costs. Over 48% of the respondents experienced a breach of contract or non-payment with a supplier or major customer in the past three years. 35% of them renegotiated while 43% did nothing but continued the business relationships with the defaulting parties.
In general, the business environment of the SME sector is marked by strong informal mechanisms like family ties, reputation and trust. Legal remedies though present, are far less important than the rules of the informal networks. Ownership and management are not effectively separated. Burkart, Panunzi, and Shleifer (2003) connect the distance between ownership and control to different legal environments, and show that family-run rather than professionally managed firms will dominate in settings with weak minority shareholder protection. Consistent with this environment, external finance for small firms in India comes mostly from family and friends, followed by trade credits.

IV. **Conclusion and future research**

Legal reforms are viewed to be among the most important “second generation” reforms for developing countries embracing the markets economy. The specifics of necessary legal reforms, which would lead to the flourishing of markets, however, are less widely understood. We review the recent literature on law and finance and assess the state of India’s legal and judicial system as well as its financial system, particularly relative to the rest of the world.

It appears that Indian laws provide good to excellent protection to investor rights, at least on paper. Implementation of these laws, however, has been less than satisfactory. Public enforcement of securities laws has been weak and courts in India have been extremely slow and overloaded with cases. Even a decade and a half after the beginning of the reforms process, India still suffers from too much business regulation and red-tape and bureaucracy (not to speak of corruption) pose hurdles on every major aspect of business. Consequently, it is perhaps not surprising that the Indian financial markets have had limited though increasing depth and that survey evidence reveals the preponderance of internal financing among India’s small and medium sector firms as well as a far greater reliance of small businesses in India on informal networks and institutions like reputation and trust rather than the formal legal system to enforce contracts and settle disputes.

Much still remains unknown. The identification of the specific shortcomings of main legislations and a clear understanding of the mechanism through which they have hindered development of financial markets in India are lacking. This can be done through
a careful analysis of past court judgments in cases involving these laws – a focus that cannot be expected in cross-country studies that have to, to some extent, sacrifice depth of analysis for the sake of comparability across countries. A sense of the seriousness of the problems identified in terms of value lost or growth rate reduced can be estimated as well using international benchmarks, so as to prioritize the areas for legal reform. The specific regulations that can be reduced or eliminated for the Special Economic Zones (SEZ) can also be identified through this process. These findings would help set the agenda for legal reforms in India that could spur further growth and development in the Indian financial markets.
References


27

Table 1: Ease of Doing Business in India

Panel A: India’s Rank on different components of the Ease of Doing Business Index

<table>
<thead>
<tr>
<th>Topics</th>
<th>India's rank (out of 155)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ease of Doing Business</strong></td>
<td><strong>116</strong></td>
</tr>
<tr>
<td>Starting a Business</td>
<td>90</td>
</tr>
<tr>
<td>Dealing with Licenses</td>
<td>124</td>
</tr>
<tr>
<td>Employing</td>
<td>116</td>
</tr>
<tr>
<td>Registering Property</td>
<td>101</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>84</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>29</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>103</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>130</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>138</td>
</tr>
<tr>
<td>Closing a Business</td>
<td>118</td>
</tr>
</tbody>
</table>

Source: World Bank
## Panel B: Business Realities in India

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>India</th>
<th>South Asia</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Starting a Business (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procedures (number)</td>
<td>11</td>
<td>7.9</td>
<td>6.5</td>
</tr>
<tr>
<td>Time (days)</td>
<td>71</td>
<td>35.3</td>
<td>19.5</td>
</tr>
<tr>
<td>Cost (% of income per capita)</td>
<td>61.7</td>
<td>40.5</td>
<td>6.8</td>
</tr>
<tr>
<td>Min. capital (% of income per capita)</td>
<td>0.0</td>
<td>0.8</td>
<td>41.0</td>
</tr>
<tr>
<td><strong>Dealing with Licenses (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procedures (number)</td>
<td>20</td>
<td>15.7</td>
<td>14.1</td>
</tr>
<tr>
<td>Time (days)</td>
<td>270</td>
<td>195.3</td>
<td>146.9</td>
</tr>
<tr>
<td>Cost (% of income per capita)</td>
<td>678.5</td>
<td>385.9</td>
<td>75.1</td>
</tr>
<tr>
<td><strong>Employing Workers (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Difficulty of Hiring Index</td>
<td>56</td>
<td>41.9</td>
<td>30.1</td>
</tr>
<tr>
<td>Rigidity of Hours Index</td>
<td>40</td>
<td>35.0</td>
<td>49.6</td>
</tr>
<tr>
<td>Difficulty of Firing Index</td>
<td>90</td>
<td>42.5</td>
<td>27.4</td>
</tr>
<tr>
<td>Rigidity of Employment Index</td>
<td>62</td>
<td>39.9</td>
<td>35.8</td>
</tr>
<tr>
<td>Hiring cost (% of salary)</td>
<td>12.3</td>
<td>5.1</td>
<td>20.7</td>
</tr>
<tr>
<td>Firing costs (weeks of wages)</td>
<td>79.0</td>
<td>75.0</td>
<td>35.1</td>
</tr>
<tr>
<td><strong>Registering Property (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procedures (number)</td>
<td>6</td>
<td>6.9</td>
<td>4.7</td>
</tr>
<tr>
<td>Time (days)</td>
<td>67</td>
<td>124.0</td>
<td>32.2</td>
</tr>
<tr>
<td>Cost (% of property value)</td>
<td>7.9</td>
<td>6.3</td>
<td>4.8</td>
</tr>
<tr>
<td><strong>Getting Credit (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal Rights Index</td>
<td>5</td>
<td>3.8</td>
<td>6.3</td>
</tr>
<tr>
<td>Credit Information Index</td>
<td>2</td>
<td>1.8</td>
<td>5.0</td>
</tr>
<tr>
<td>Public registry coverage (% adults)</td>
<td>0.0</td>
<td>0.1</td>
<td>7.5</td>
</tr>
<tr>
<td>Private bureau coverage (% adults)</td>
<td>1.7</td>
<td>0.6</td>
<td>59.0</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Protecting Investors (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disclosure Index</td>
<td>7</td>
<td>4.1</td>
<td>6.1</td>
</tr>
<tr>
<td>Director Liability Index</td>
<td>4</td>
<td>4.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Shareholder Suits Index</td>
<td>7</td>
<td>6.4</td>
<td>6.6</td>
</tr>
<tr>
<td>Investor Protection Index</td>
<td>6.0</td>
<td>5.0</td>
<td>5.9</td>
</tr>
<tr>
<td><strong>Paying Taxes (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payments (number)</td>
<td>59</td>
<td>25.8</td>
<td>16.3</td>
</tr>
<tr>
<td>Time (hours)</td>
<td>264</td>
<td>331.7</td>
<td>197.2</td>
</tr>
<tr>
<td>Total tax payable (% gross profit)</td>
<td>43.2</td>
<td>35.3</td>
<td>45.4</td>
</tr>
<tr>
<td><strong>Trading Across Borders (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Documents for export (number)</td>
<td>10</td>
<td>8.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Signatures for export (number)</td>
<td>22</td>
<td>12.1</td>
<td>3.2</td>
</tr>
<tr>
<td>Time for export (days)</td>
<td>36</td>
<td>33.7</td>
<td>12.6</td>
</tr>
<tr>
<td>Documents for import (number)</td>
<td>15</td>
<td>12.8</td>
<td>6.9</td>
</tr>
<tr>
<td>Signatures for import (number)</td>
<td>27</td>
<td>24.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Time for import (days)</td>
<td>43</td>
<td>46.5</td>
<td>14.0</td>
</tr>
<tr>
<td><strong>Enforcing Contracts (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procedures (number)</td>
<td>40</td>
<td>29.9</td>
<td>19.5</td>
</tr>
<tr>
<td>Time (days)</td>
<td>425</td>
<td>385.5</td>
<td>225.7</td>
</tr>
<tr>
<td>Cost (% of debt)</td>
<td>43.1</td>
<td>36.7</td>
<td>10.6</td>
</tr>
<tr>
<td><strong>Closing a Business (2005)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time (years)</td>
<td>10.0</td>
<td>4.2</td>
<td>1.5</td>
</tr>
<tr>
<td>Cost (% of estate)</td>
<td>9</td>
<td>7.3</td>
<td>7.4</td>
</tr>
<tr>
<td>Recovery rate (cents on the dollar)</td>
<td>12.8</td>
<td>19.7</td>
<td>73.8</td>
</tr>
</tbody>
</table>

Source: World Bank