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THE INVESTMENT CLIMATE IN SOUTH ASIA



The World Bank
Finance and Private Sector Development Unit
South Asia Region

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September 2006



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Washington, D.C. 20433, USA

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Washington, DC 20433, USA,
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Designed & Printed by;
Ari Investments Limited
19, St. Joseph Road,
Nugegoda, Sri Lanka.
Tel 0094-11-2852410
Fax 0094-11-2822615
e-mail ariyaw@sltnet.lk

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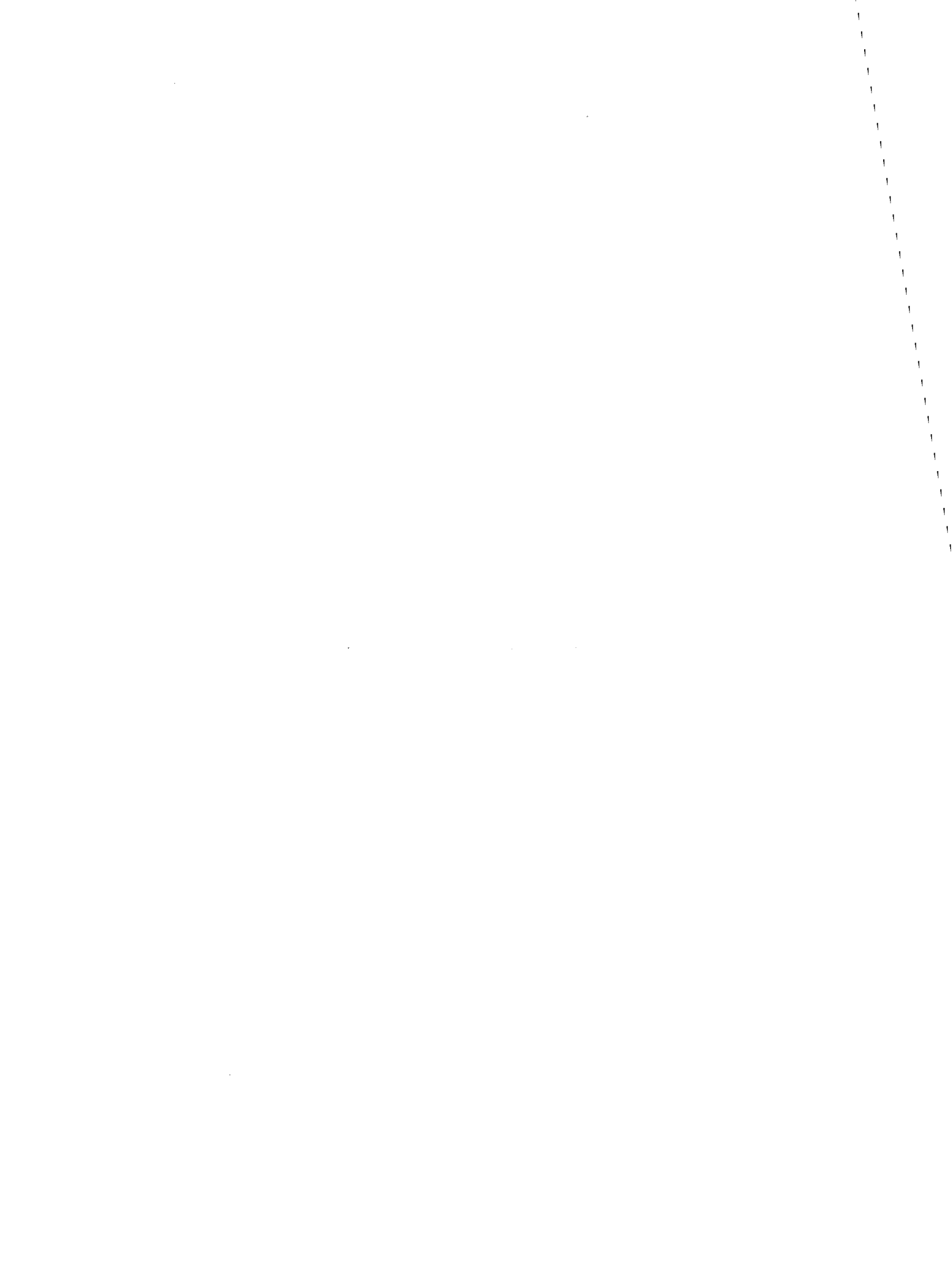
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ACKNOWLEDGMENTS

This report was prepared by Guillemette Sidonie Jaffrin, (South Asia Finance and Private Sector Development Department - SASFP,) and Syed A. Mahmood, SASFP, under the guidance of Simon C. Bell, sector manager, SASFP. Mona Mehta Steffen helped prepare individual country profiles based on a standardized set of investment climate data. Comments on earlier drafts were received from Asya Akhlaque, Nagavalli Annamalai, Simon Bell, Alain R. Locussol, Samuel Munzele Maimbo, and Vladislav Vucetic. Maria Espiritu and Kadija Jama provided valuable inputs to the preparation of the report. The report benefits from a short note prepared on the subject earlier by Eric Manes.

ACRONYMS AND ABBREVIATIONS

AISA	Afghanistan Investment Support Agency
BTTB	Bangladesh Telegraph and Telephone Board
DABM	Da Afghanistan Breshna Moassesa
GDP	Gross Domestic Product
GNI	Gross National Income
ICA	Investment Climate Assessment
IR	Indian Railways
NBFI	Nonbank Financial Institutions
NGO	Nongovernmental Organization
NWFP	North West Frontier Province
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
SEB	State Electricity Board
SMEs	Small and Medium Enterprises
TEWA	Termination of Employment of Workers Act
TFP	Total Factor Productivity
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax



EXECUTIVE SUMMARY

The investment climate of a country, province, or region describes the policy, regulatory, institutional and governance environment, both present and expected, that influences entrepreneurship, supports well-functioning markets, and affects the returns and risks associated with investment. Investment climate assessments (ICAs) have been carried out for all countries in the South Asia region.¹ This report summarizes the findings of these assessments. It compares South Asian countries to countries in other regions (Brazil, China, Indonesia, South Africa, Turkey, and Vietnam), analyzes similarities and differences within the region, and identifies the way forward in improving the investment climate.

South Asian Investment Climate in International Perspective

The first chapter of this report assesses the investment climate in South Asia vis-à-vis a number of comparator countries. In a number of areas, South Asian countries appear to be doing significantly worse than the comparator countries. These areas include electricity supply, access to finance, corruption, and formal training of staff. Electricity is the most striking area: in five of the eight South Asian countries, more than 30 percent of firms identify electricity as a major constraint for the operation and growth of their businesses. Among the comparator countries, only in China is the ratio greater than 30 percent. In Turkey and South Africa, barely 10 percent of firms rate electricity supply as a major constraint. In four South Asian countries (Afghanistan, Bangladesh, Maldives, and

Pakistan), more than 35 percent of firms identify access to finance as a major constraint. Among the comparators, only Brazil has more than 35 percent of its firms express a similar concern. Corruption is another problematic area. In four countries (Afghanistan, Bangladesh, Maldives, and Pakistan), corruption is a major constraint for more than 40 percent of the firms. In the comparator countries, only Brazil and Indonesia have firms that complain widely about corruption, with 67 percent and 42 percent, respectively, saying that it is a major constraint. South Asian firms also appear much less inclined to offer formal training to their employees than those in the comparator countries. In four countries (Afghanistan, Bhutan, Nepal, and Pakistan), less than 20 percent of firms offer formal training to their employees. In the comparator countries (with the exception of Indonesia), more than 50 percent of firms offer formal training. In other areas—such as transport, labor (regulations and availability of skilled labor), innovation, and technology—the average South Asia performance is comparable to the comparator countries.

While there are few areas where South Asia, as a whole, is doing better than the comparator economies, individual South Asian countries are good performers on several dimensions of the investment climate. For example, Sri Lanka and India do reasonably well with regard to access to finance. Shortage of skilled workers is a major problem in Bhutan and Maldives, but much less of an issue in India. In Bangladesh corruption is the 2nd most important constraint, but in Sri Lanka it is the 10th most important constraint. The

1 These countries are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

experience of firms with customs and trade regulations also varies widely within South Asia. In Afghanistan, Bangladesh, and Pakistan, more than 30 percent of firms consider these regulations to be a major constraint for business. At the other end of the spectrum are Bhutan and Nepal, where less than 5 percent of all surveyed firms cite excessive regulations as a major concern. Similarly, while only 34 percent of firms in Pakistan communicate with their customers or suppliers by e-mail, this figure stands at 62 percent in India and 97 percent in Maldives.

The surveys also highlight noteworthy differences in the investment climates of specific regions within South Asian countries. India is a good example with significant differences in the investment climate across states, because of differences in the level and quality of investment and growth rates. The factors affecting the investment climate also differ considerably within a particular country. For example, in Bangladesh there are important differences in the key factors affecting the investment climate in Dhaka from those cited as important for Chittagong. The same differences can be observed in Pakistan and Sri Lanka.

The Many Dimensions of the South Asian Investment Climate

The second chapter analyzes further the dimensions of the South Asian investment climate. In almost all South Asian countries, the quality of infrastructure is a major constraint. Businesses cite electricity as a major problem; they complain less about transport, telecommunications, and water supply. The two polar cases about electricity in South Asia are Afghanistan and Bhutan. In Afghanistan, grossly insufficient generation capacity and inadequate transmission and distribution capacities have led firms to cite power as the number one constraint to doing business. In

contrast, cheap, reliable electricity is among Bhutan's biggest competitive advantages over other countries in South Asia. Electricity prices in Bhutan are less than half those of its closest competitor in South Asia and only a fifth of the prices in other important locations in the region. Getting electricity connections are not easy. In India, it takes 45 days for a small-business start-up to get connected to the public grid. A business start-up in Pakistan expects a 40-day waiting period before getting an electrical connection-double the wait it faces in China. The quality of the power supply is another problem. In some areas of Nepal, firms report power outages of more than 30 times per month. In Bangladesh, firms report experiencing power outages and surges about 250 days a year on average-and many report outages and surges every day they operate. Inadequate and unreliable supply has led South Asian firms to resort to the more costly option of generators. The proportion of firms using generators is highest in Afghanistan (76 percent) followed by Sri Lanka, Bangladesh, Maldives, India, and Pakistan. The comparable figures for China and Brazil are 27 and 17 percent, respectively. Many factors are responsible for insufficient and poor-quality power supply, such as inadequate generation capacity and deficiencies in transmission and distribution (for example, in Sri Lanka and Bangladesh), insufficient cost recovery but high tariffs for industry (India, Sri Lanka), weak public sector capacity (Afghanistan), or inadequate regulatory framework to attract private investment (India).

Poor-quality roads, inefficient ports, and inadequate transport services are common features in South Asia. To be effective, entrepreneurs need a quick and easy way to get their goods to market. Many South Asian firms do not have appropriate road networks. For example, India currently has no interstate expressways linking its major economic centers, and only 3,000 kilometers of

four-lane highways (while China has built 25,000 kilometers of four- to six-lane, access-controlled expressways in the past 10 years). Because the freight transport system is unreliable, firms are forced to carry more stock than they need to deal with uncertain supply. Inefficiency in ports is another problem. This is particularly felt in Bangladesh where it has been said that the inefficiencies of the Chittagong Port have given Bangladesh all the characteristics of a landlocked country. Railways used to be an important means of transportation, but their use in South Asia has gone down with declining efficiency. With a network of 63,028 kilometers, the Indian Railways is the second-largest rail network in the world and one of the country's major national institutions. However, congestion on main lines is steadily increasing long-haul delivery times, and the rapidly deteriorating quality of rolling stock is undermining the railways' attractiveness as a transport provider.

The quality of telecommunications services draws fewer complaints from the business community in South Asia than does power or transportation. There have been significant improvements in telecommunications in South Asia in recent years, but they cannot fully make up for deficient fixed lines. The average business in Sri Lanka waits 61 days, and in Pakistan 42 days, before getting a new fixed-line telephone connection—three times as long as in China, Malaysia, and the Philippines. The quality of service also appears to be a problem in many South Asian countries. In Pakistan and Bangladesh the shortage of fixed-line connections has impeded the development of the information technology and software industries.

In water, as in electricity, poor supply from the national system forces firms to find their own supply sources. In Maldives, less than a third of the manufacturing firms surveyed complained

about the quality of water used in production, and in Nepal, nearly a third of the firms indicated that they have problems with the amount of water supplied. In Kathmandu, many firms receive service for only one hour per day. Firms have thus had to invest in alternative sources of water. In Nepal, many firms have either invested in wells or purchased water brought in by private tankers.

An inadequate financial system makes South Asian firms reliant on internal sources for funding. Access to finance is the most serious constraint affecting the investment climate in Maldives. In Sri Lanka, finance is one of the top three constraints to doing business. The situation is relatively better in India, where 27 percent of firms rate access to finance as a major-to-severe obstacle to business operations or growth. Most finance available is short term in all South Asian countries. Because of the poor access to external finance, many South Asian firms rely on retained earnings and equity as their most important sources of working capital. At one extreme is Maldives, where only 11 percent of working capital requirements and 17 percent of investment capital come from domestic commercial banks. The situation is better in India, where 54 percent of small businesses have active bank credit lines or overdraft facilities, which is much higher than the figure for China but lower than for Brazil. Within countries, access to formal finance varies by regions and sectors. Access to credit is also highly correlated with size; a much greater proportion of large firms than small firms have access to external finance.

A variety of factors limit access to finance for South Asian firms. The factors constraining finance for small and medium enterprises (SMEs) in India provide a glimpse of the root causes of the problem. Specific constraints include (i) difficulty in using land as collateral and nonrecognition by lenders of other types of

collateral, (ii) difficulty in collateral enforcement and loan recovery, (iii) insufficient credit information on SMEs, (iv) poor SME credit-assessment practices, (v) poor lending technologies and overreliance on collateral rather than cash flow analysis, (vi) a bankruptcy framework that prevents easy exits for troubled firms, and (vii) lenders' low confidence in the contract enforcement mechanisms of the courts. These constraints are exacerbated by the shallowness of financial systems in most South Asian countries (for example, in Sri Lanka, private-sector credit amounts to about 38 percent of gross domestic product (GDP), compared to 125 percent in China). Capitalization of equity markets in India is 30 percent but only 15 percent in Sri Lanka, compared to about 40 percent in China. In addition, in several South Asian countries, the public sector continues to dominate the banking sector. In Sri Lanka, the commercial banking sector is still dominated by the two state banks, accounting for about 45 percent of total banking assets. In addition, persistent budget deficits have led the government to borrow heavily from the banking sector, driving up interest rates and crowding out private sector access to financial services.

The efficiency of the land market, both as a factor of production and an asset that can be mortgaged, is not cited as a major obstacle in most South Asian ICAs. Fewer firms in South Asia than in China or Brazil report access to land and registering land as major deficiencies in the investment climate. An exception is Afghanistan, where it is exceptionally difficult for businesses to get clear title to new land, especially serviced land. The fact that in the rest of South Asia access to land is not cited as a major constraint is more a statement of the relative importance of other constraints than an indication of well-functioning land markets in the region.

The two major labor issues in South Asia are the rigidity of labor markets in several countries and the shortage of skilled labor in most countries. Labor regulations are a key constraint for firms in India, Nepal, Pakistan, and Sri Lanka, while they tend to be less of an issue in other South Asian countries—for example, few firms in Bangladesh believe that labor issues impede their growth. The absence of a well-functioning labor market can offset the benefits of a well-educated workforce, as can be seen from the experience of India and Sri Lanka. Many South Asian firms face a shortage of skilled workers, with the most severe complaints voiced in Bhutan, Maldives, and Nepal. The shortage of skilled labor has a variety of origins. In Bangladesh, illiteracy remains high despite recent improvements in school enrollment. Sri Lanka has among the highest levels of brain drain in a set of comparator countries. In Afghanistan, the skills shortage caused by war is exacerbated by the barriers to educating girls and employing women in most jobs outside the home. In Bhutan, the skilled labor shortage is the result of the government's absorption of most skilled and educated workers.

South Asian firms do not innovate much or make much use of modern systems of communication, which strongly undermine their competitiveness in the context of a globalized and knowledge-based system of production. For example, Bangladesh spends less on research and development (R&D) as a share of GDP than do most other developing countries in East and South Asia. The low level of R&D spending in Bangladesh is reflected in relatively low levels for other measures of innovation (such as the number of granted U.S. patents per capita). Sri Lanka is doing relatively better, with levels of R&D investment close to those observed in similar industries in developing countries such as China and India. Internet use is also low in South Asia. In India, there is relatively greater use of the Internet, but Internet connectivity

varies across states. Only 30 percent of businesses in Pakistan normally communicate with their customers or suppliers using the Internet—far fewer than the 71 percent of firms that do so in China. In Afghanistan, business use of the Internet is nearly nonexistent outside of a few of the largest cities. In Maldives, however, the penetration of telecommunications is very high among the business community compared to that in the other South Asian countries.

South Asian firms bear a heavy regulatory burden: starting a business can be a hassle; but running it is even more so. Surveys of the business climate in South Asian countries all point to heavy regulation and government unpredictability as a key constraint on private sector performance. An indicator of this constraint is the time senior managers spend dealing with officials of regulating agencies and the frequency with which officials inspect factory premises. The burden of regulation is, on average, smaller in India, at 7.4 visits a year for a typical business, than in China (26.7 visits a year). However, paradoxically, senior managers of small businesses in India typically spend a greater share of their time dealing with regulations (11.9 percent) than do their Chinese (7.8 percent) or Brazilian (7.2 percent) counterparts. Moreover, Indian industry suffers from more cumbersome and costly entry and exit regulations compared to not only China and Brazil but also other large-economy comparators, such as Mexico and the Russian Federation. Tax and customs administration is widely cited in South Asia as a major source of regulatory hassle. In Pakistan, tax and customs administration is the leading obstacle to a conducive investment climate, and 60 percent of business contacts with government officials are the result of visits by tax agents. An exception to the South Asian pattern of regulatory hassle is Sri Lanka, where businesses suffer much less from regulatory burdens.

Corruption is a major problem in many South Asian countries and can be traced to the discretionary power of government officials. Corruption is particularly serious in Afghanistan, where it has recently shot up in the list of constraints cited by firms, and in Bangladesh, where corruption has been a problem for many years. Bangladesh ranks the lowest (158th) in the 2005 Transparency International Corruption Perception Index; more than half of all surveyed firms reported corruption as either a major or very severe obstacle to their growth. Firms also complain about corruption in India, Nepal, and Pakistan. Two South Asian countries fare relatively better on this front: Sri Lanka and Bhutan. Bhutan contrasts starkly with its other neighbors. Its government is genuinely concerned with proper administration, and officials are seen as being honest and helpful.

South Asian firms have little faith in the judiciary and tend to bypass it. Bangladesh exemplifies the South Asian case—here a third of the firms surveyed reported that courts were never or seldom fair or honest. An exception is Sri Lanka, where more than half of rural nonfarm enterprises and urban manufacturing firms reported that the legal system is not a major constraint. The deficiencies in the judicial system render contract enforcement a big problem in most South Asian countries. Even in Sri Lanka, despite the overall positive perception of the legal system, enforcement of contracts still poses an obstacle to many businesses. It is thus common for South Asian businesses to bypass the judicial system. In Bhutan, only around 5 percent of firms in the survey reported hiring a lawyer or threatening to take a client to court for nonpayment. In Afghanistan, businesses do not rely on the formal judicial system but on informal mechanisms to resolve disputes.

Security is an actual problem in some South Asian countries; it is looming in others. In Afghanistan,

the investment climate survey carried out in 2005 reveals that insecurity figures relatively low in the list of complaints. While counterintuitive, this is explained by the improvements in the security situation in the major cities covered by the survey and by the mechanisms developed by firms to cope with insecurity, though at high cost. In Pakistan, businesses report being exposed to crime, ranging from petty theft to organized violence. In contrast, in India the incidence of crime seems to be low on the list of problems for private firms.

Much has been accomplished in South Asia in recent years with regard to trade policy, but problems remain. Most nontariff barriers have been removed, tariff rates across stages of production have become more uniform, and average levels are coming down. In particular, the process of trade liberalization in India and Sri Lanka has been critical in fostering the restructuring of the export base from primary products to manufacturing. However, onerous customs clearance procedures is one of the most commonly cited problems in South Asia. In Afghanistan, Bangladesh, and Pakistan, customs procedures are a serious problem, with more than 30 percent of firms citing them as a major constraint on doing business. At the other end of the spectrum are Bhutan and Nepal, where less than 5 percent of all surveyed firms cite customs procedures as a major concern. The average shipment of imported inputs takes 17 days to pass through customs in Pakistan. In Afghanistan, importing requires 10 documents and 57 separate signatures. Maldives requires fewer documents (12 for importing), fewer signatures (four for importing), and shorter processing time for both exporting and importing than do most countries in South Asia. Sri Lanka's ports and customs are also more efficient than those of some of its competitors.

The Costs of a Deficient Investment Climate

The third chapter highlights the costs imposed by deficiencies in the investment climate. Power problems impose real costs on firms; they lower production and tie up scarce capital. The typical business in Pakistan estimates that it loses about 5 percent of annual sales to power outages. The problem is worse in India, where the average manufacturer loses 8.4 percent a year in sales, and extreme in Afghanistan, where 18 percent of merchandise value is lost because of power disruptions. The figure is less than 2 percent for the average manufacturer in China or Brazil. The use of generators to deal with unreliable power supply ties up scarce capital. *Poor transportation creates marketing problems and often leads to spoilage.* In Sri Lanka, urban firms report losing 7 percent of sales because of transport problems, and slow speeds spoil 40 percent of agricultural produce before it reaches market. In Afghanistan, firms reported losing 5 percent of their domestic merchandise value during transit because of breakage or spoilage and losing only 0.6 percent to theft. In Bhutan, the high costs and poor reliability of road transport make it almost impossible for industries heavily dependent on transport to be competitive except in the border areas.

Poor access to finance limits growth opportunities. Regression exercises show that, in Bangladesh, firms with better access to formal credit grow more quickly than firms that rely more on retained earnings, even after controlling for firm and industry characteristics. Regulatory hassles add to the cost of doing business. The number of inspections and visits by officials imposes a financial and nonfinancial (that is, time) cost on managers and dampens firms' performance. Regression analysis for Bangladesh shows that the number of inspections per employee has a significant negative correlation with investment and

productivity. Similar exercises for India also show that the time that management spends on addressing regulations is negatively associated with business profitability.

Inflexible labor markets add to cost and discourage adjustments-and they do not necessarily help the poor. Firms in Sri Lanka try to avoid restrictive labor regulations by hiring temporary workers, but this practice has its costs: survey results show that productivity falls with an increase in the share of temporary workers in a firm's employment. In Nepal, restrictive labor laws have caused many older firms to be overstaffed and unable to reorganize by hiring people with skills that better match their current needs. *Training raises productivity; yet, most firms do not invest in training.* In Sri Lanka, firms whose managers hold a tertiary or professional degree tend to be more productive. In Bangladesh, regression analysis shows that firms that ran training programs or sent employees to outside training programs saw higher sales growth, profitability, and investment. However, only 26 percent of Sri Lankan firms benefit from external training. In Bhutan, although they complain about lack of skills, virtually no firms

reported undertaking any significant staff training. Most firms in Nepal provide little training, preferring to hire already trained workers or to rely on technologies that do not demand highly skilled workers.

What to Do?

The analysis in the ICAs suggests a strong relationship between the investment climate in South Asian countries and their economic performance. On the basis of the theoretically sound and empirically supported relationship between a good investment climate, on the one hand, and higher productivity and firm growth, on the other, potentially significant gains can be achieved by policies and programs that address the constraints highlighted by the ICAs. The fourth chapter reviews the policy recommendations proposed by the various ICA surveys for the different dimensions identified: infrastructure (power, transportation), factors of production (finance, labor market and skills, technology), regulatory burden and corruption, and risk and uncertainty (policy predictability, judicial reforms, security).

Chapter I

SOUTH ASIAN INVESTMENT CLIMATE IN INTERNATIONAL PERSPECTIVE

The poverty reduction strategies for South Asian countries emphasize private investment as a vehicle for creating productive jobs. Policymakers in South Asia are also concerned about the relatively low integration of their economies with the global economy despite the considerable macroeconomic reform effort that has been underway in the region in recent years. Export and import orientation is low, inflows of foreign direct investment are modest (in fact negligible in most countries), and supply linkages with leading multinational companies are weak. Since a dynamic enterprise sector is important for creating jobs and exploiting the benefits of globalization, there is a need to take a hard look at the investment climate in these countries.

The investment climate of a country, province, or region describes the policy, regulatory, institutional and governance environment, both present and expected, that influences entrepreneurship, supports well-functioning markets, and affects the returns and risk associated with investment. Investment Climate Assessments (ICA) have been carried out for all countries in the South Asia region.² This report summarizes the findings of these assessments. It compares South Asian countries to countries in other regions, analyzes similarities and differences within the region, and identifies the way forward in improving the investment climate. Key data from the South Asian ICAs were used to draw comparisons between the

eight South Asian countries and selected comparators: Brazil, China, Indonesia, South Africa, Turkey, and Vietnam. These comparators were selected on the basis of their geographical position (at least one country in each region: Latin America, East Asia, Africa, and Europe) and on their economic performance.

The ICAs are based on a survey of a representative sample of private firms that seeks to shed light on impediments to daily business through quantification and comparison. The survey assesses conditions facing factor markets, product markets, infrastructure services, and firm performance. The use of a standardized, rigorous methodology to measure the principal determinants of the investment climate makes it possible to benchmark countries or regions against comparators.

However, comparisons of subjective ratings by firms across countries, regions, and sizes of firms require caution, as these comparisons involve the evaluation of distinct conditions by different observers at different times. The ranking of a particular deficiency over another does not necessarily mean that the cost of that deficiency, in terms of lost productivity and sales growth, is higher. In addition, there are natural limitations in the cross-country comparisons, as ICA reports themselves are structured to reflect specific country conditions and emphasize differing factors of

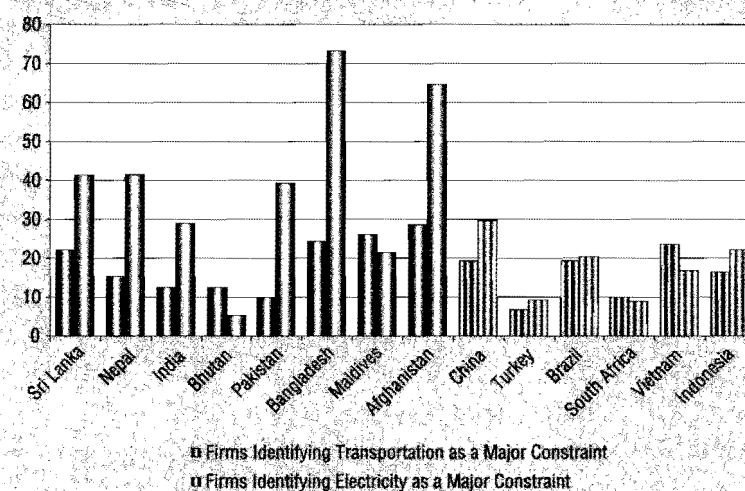
2 These countries are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

particular relevance.³ Moreover, the South Asian ICAs are based on firm surveys that were carried out over a period of six years, starting with the first India survey and the Nepal survey in 2000, and ending with the Afghanistan and Maldives surveys in 2005.⁴ Similarly, the surveys underlying the ICAs for the comparator countries span several years. As a result, the data presented might not be representative of the current situation in many countries. In addition, questions were asked slightly differently across the surveys (see the annex to chapter one). These caveats should be kept in mind in reading through the assessment of how South Asia compares with the selected comparator economies and how South Asian countries compare among themselves.

A. South Asian Performance in an International Perspective

In a number of areas, South Asian countries appear to be doing significantly worse than the comparator countries. **Electricity** is the most striking area: in five of the eight South Asian countries, more than 30 percent of firms identify electricity as a major constraint for the operation and growth of their businesses. In Afghanistan and Bangladesh, this figure is more than 60 percent (figure 1). The only

Figure 1
Percentage of firms identifying transportation and electricity as a major constraint



exceptions are Bhutan, Maldives, and India.⁵ The situation is much better in the comparator countries. In Turkey and South Africa, barely 10 percent of firms rate electricity supply as a major constraint. Only in China is the figure nearly 30 percent.

A comparison of China with India, one of the better performers in South Asia, is instructive. In the 2003 survey, Indian firms reported that it took them an average of 68 days to get an electricity connection, compared to only 10.4 days in China. In the year preceding the survey, Indian firms reported 154 days of power outage, which cost them 8 percent of sales. By comparison, Chinese firms reported 4.9 days without power the year before the survey, with a loss of 1.9 percent of their sales. As chapter three shows, inadequate and poor-quality

3 Therefore, the ICA methodology and reporting tool should not be interpreted as objective but rather as a lead to inferences about the priorities within a specific group of private-sector firms to provide a guide to policymakers.

4 The second India survey was carried out in 2003; much of the India-specific information in this report is based on this survey. A third survey is currently under way. Surveys for the second ICAs in Bangladesh and Pakistan are about to be launched.

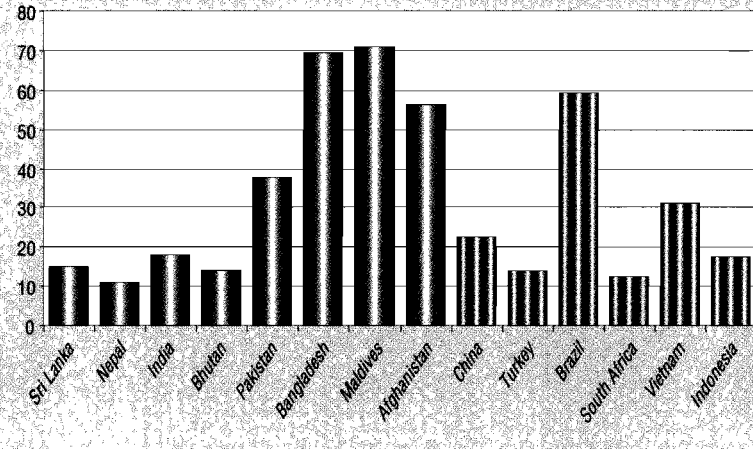
5 Cheap, reliable electricity is among Bhutan's biggest competitive advantages over other countries in South Asia. The total power output of Bhutan is 457 megawatts (in 2005), with a total domestic consumption of about 105 megawatts. Bhutan's hydro-electricity power potential is estimated at more than 30,000 megawatts. However, Bhutan's power situation is unique; therefore, it is difficult to transpose lessons from Bhutan to other South Asian countries.

electricity imposes substantial costs on South Asian firms, putting them at a disadvantage relative to their competitors.

Access to finance is another area where South Asia does not perform as well as the comparator countries. However, the difference between South Asia and the comparator countries is less striking than with electricity. For four South Asian countries (Afghanistan, Bangladesh, Maldives, and Pakistan), more than 35 percent of firms identify access to finance as a major constraint. Among the comparators, only in Brazil do more than 35 percent of the firms express a similar concern (figure 2).

This perception ranking is confirmed by the pattern of investment financing: for five South Asian countries (Afghanistan, Bangladesh, Bhutan, Maldives, and Nepal), more than 60 percent of firms' investments are financed by internal funds (no data are available for India). By contrast, in China and Vietnam the share of investment financed by internal funds is

Figure 2
Percentage of firms identifying access to finance as major constraint



respectively 15 percent and 30 percent (figure 3). In no comparator countries is more than 60 percent of firm investment financed by internal funds.

Corruption is another area where the performance of South Asia is a cause of concern. For four countries (Afghanistan, Bangladesh, Maldives, and Pakistan), corruption is a major constraint for more than 40 percent of the firms. In the comparator countries, only in Brazil and Indonesia do firms complain widely about corruption, with 67 percent and 42 percent, respectively, saying that it is a major constraint (figure 4). The poor performance of most South Asian countries in terms of corruption is confirmed by the 2005 Transparency International Corruption Perception Index, which ranks Bangladesh the lowest (158th

Figure 3
Patterns of investment financing

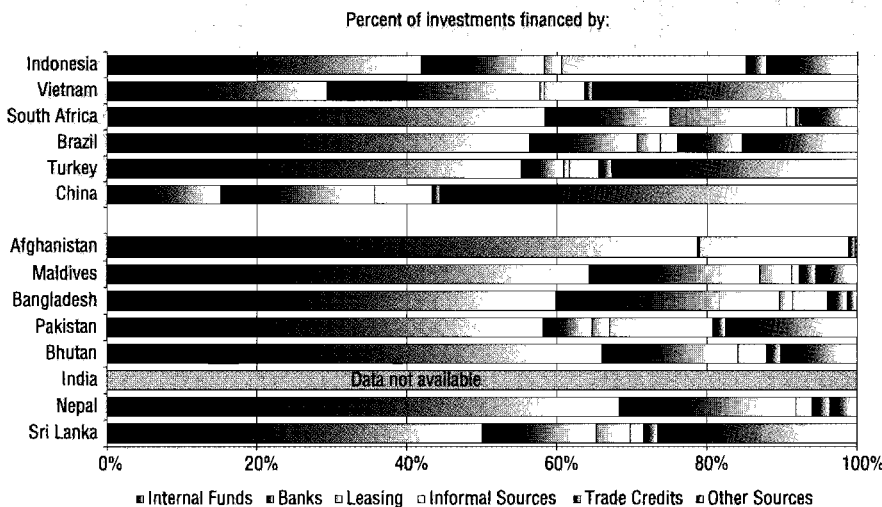
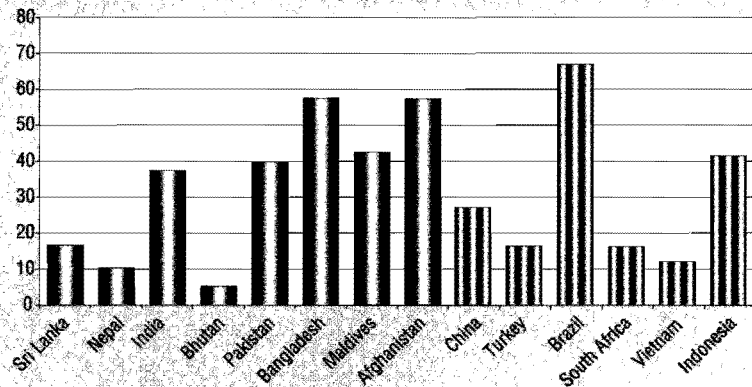


Figure 4
Percentage of firms identifying corruption as major constraint



position), followed by Pakistan (144th), Nepal and Afghanistan (117th), India (88th), and Sri Lanka (78th).

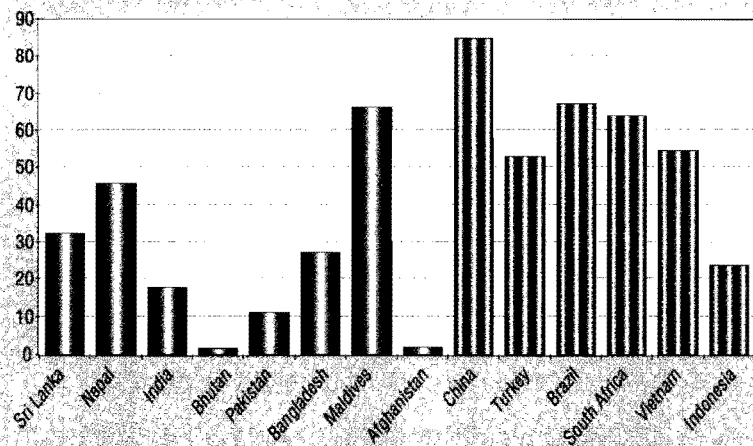
South Asian firms appear much less inclined to offer **formal training** to their employees than those in the comparator countries. In four countries (Afghanistan, Bhutan, India, and Pakistan), less than 20 percent of firms offer formal training to their employees. In the comparator countries (with the exception of Indonesia), more than 50 percent of the firms offer formal training (figure 5).

In other areas—such as, transport, labor (regulations and availability of skilled labor), innovation, and technology—the average South Asia performance is comparable to the comparator countries.

In one area, South Asia is actually doing significantly better than the comparator countries. In a number of South Asian countries

(such as Bangladesh, India, Pakistan, and Maldives) less than 10 percent of firms had **overdue payments** from buyers/suppliers/customers, while for most of the comparator countries, more than 50 percent of firms report having overdue payments (figure 6). However, this apparent good performance in South Asia might hide a less positive reality. For example, in Bangladesh most firms offer supplier finance to very few clients because they do not trust their suppliers or do not believe the court system will enforce contract and property rights.⁶ This is how firms manage to have low overdue payments. However, in Maldives overdue payments are low despite the wide use of supplier credit (63 percent of small enterprises and 95 percent of large enterprises report receiving input credits).

Figure 5
Percentage of firms offering formal training to their employees



6 In Bangladesh, only 17 percent of firms expressed confidence in the legal system to enforce contract and/or property rights disputes, while in India 71 percent of the firms expressed confidence in the legal system.

B. Performance Diversity across South Asian Countries

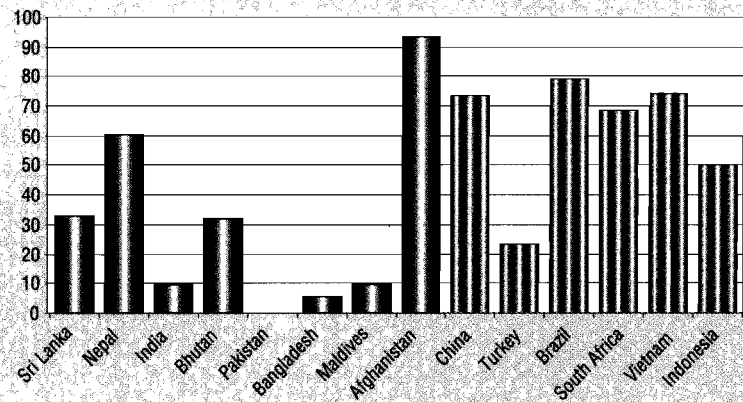
The common features in South Asia are one part of the story. There are wide divergences too. Even if South Asia, as a whole, is doing better than the comparator economies only on a few fronts, individual South Asian countries are good performers on several dimensions of the investment climate.

Comparing the countries of the region is a difficult exercise, considering their diversity. Afghanistan is just emerging from a long period of conflict and instability, which has destroyed its economy. Countries such as Bhutan and Maldives have unique economies, and it might be difficult to transpose their experiences to other countries. Nepal and Bhutan are relatively small economies in comparison with India, Pakistan, and Bangladesh, and they have also been affected by conflict in recent years. In addition, the data on Bhutan and Nepal need to be used with caution as these are the oldest surveys (2000 for Nepal, 2001 for Bhutan). The survey instruments have since then changed and Nepal, in particular, has been through much turmoil since the survey. Nonetheless, the analysis of divergence is instructive. With the above caveats in mind, one can still ask: If some South Asian countries can do well, why not others?

Conditions in the factor markets differ widely within South Asia.

An example of how South Asian countries differ is **access to finance**. In Afghanistan, Bangladesh, Maldives, and Pakistan, more than 30 percent of firms consider access to finance

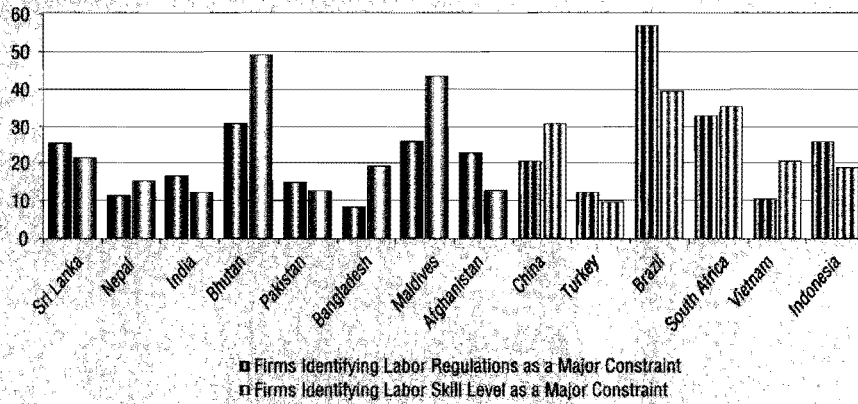
Figure 6
Percentage of firms with overdue payments from suppliers/buyers/customers



a major constraint. By contrast, in Sri Lanka, Nepal, India, and Bhutan, the proportion is less than 20 percent. Firms in Afghanistan are particularly credit constrained—not surprising considering its recent history. For 56 percent of firms in Afghanistan, access to finance is a major constraint, and 79 percent of firms' investments are financed by internal funds. Bank lending is virtually nonexistent (0.2 percent).

Labor market conditions vary even more. In two countries, Bhutan and Sri Lanka, **labor regulations** are a big problem (figure 7). In Bhutan, labor regulations are cited as the second most important constraint and, in Sri Lanka, as the fifth most problematic factor. About a third of the Bhutanese firms, and a quarter of Sri Lankan firms, consider labor regulations a major or severe constraint. Maldives presents an interesting case. Here, while 28 percent of the firms consider labor regulations a major or severe constraint, it is not cited as one of the top constraints by the firms (it ranked as the 12th constraint). At the other end of the spectrum is Bangladesh, where less than 10 percent of firms consider labor regulations to be a major or severe constraint.

Figure 7
Percentage of firms identifying labor regulations and availability of skilled labor as major constraints



Shortage of skilled workers is a major problem in Bhutan and Maldives, but much less of a headache in India and Pakistan. In Bhutan, every other firm (i.e., 49 percent) considers skilled labor shortage a major constraint, and in Maldives, the proportion is 43 (figure 7).⁷ But in India and Pakistan, only 13 percent of businesses cite lack of skilled workers as a major constraint.

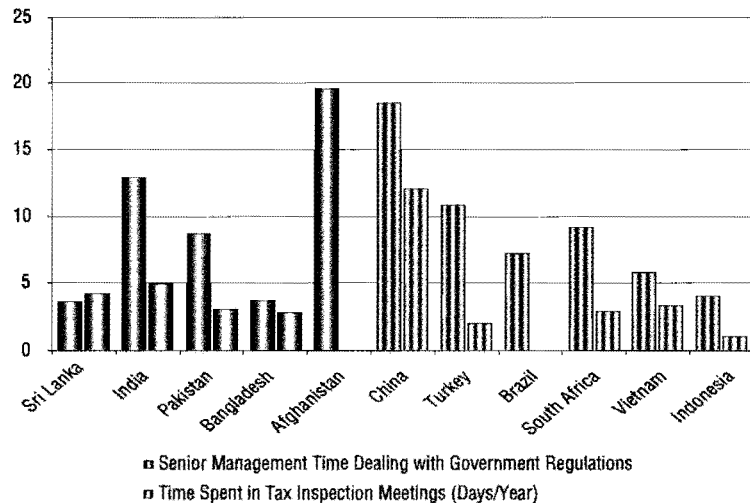
Interestingly the proportion is the same in Afghanistan (13 percent). However, in Afghanistan, firms are facing numerous pressing challenges, and they might not consider the availability of skilled workers as one of their most urgent challenges at present. In the rest of South Asia, the proportion of firms complaining about lack of skilled workers is between 15 and 21 percent.

In Maldives, firms are trying to address the skill shortage

problem by providing **formal training** to their employees. The proportion of firms doing so is 66 percent, lower than in China (85 percent) but quite high by South Asian standards. Other South Asian countries doing relatively well on this front include Sri Lanka and Nepal, with 33 percent and 45 percent, respectively, offering formal training.

However, in Bhutan, despite the complaints about skill shortages, barely 3 percent of firms' employees had received training in the 12 months preceding the survey. Even some of the larger countries are no better. In India, only 18 percent of firms offered formal training; in Pakistan, only 11 percent did so.

Figure 8
The hidden costs of government regulations



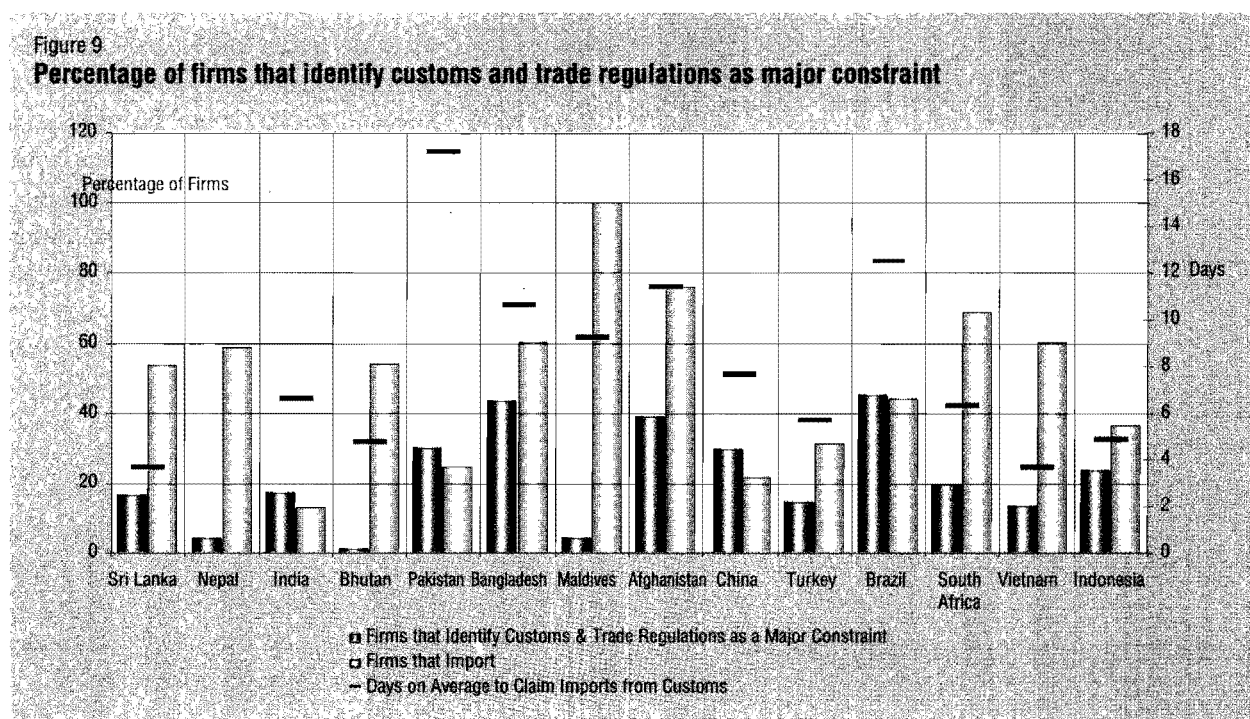
⁷ In Bhutan, where most educated people have a strong preference for working in the public sector, much of the skilled and educated workforce has been absorbed in government.

Corruption and regulations

Corruption is a problem in South Asia but not equally in all countries. Bangladesh and Sri Lanka offer contrasts. In Bangladesh, corruption is the 2nd most important constraint, with 58 percent of firms identifying it as a major constraint. In Sri Lanka it is the 10th most important constraint, with only 17 percent of firms complaining strongly. These firm-level perceptions are confirmed by the 2005 Transparency International Corruption

In Afghanistan, nearly 20 percent of senior management time is spent on **dealing with government regulations**. This figure is only 4 percent in Sri Lanka and Bangladesh (figure 8).

The experience of firms with **customs and trade regulations** also varies widely within South Asia. In three countries-Afghanistan, Bangladesh, and Pakistan-these types of regulations are a serious problem, with more than 30 percent of firms citing this issue as a major constraint on doing business (figure 9).⁸



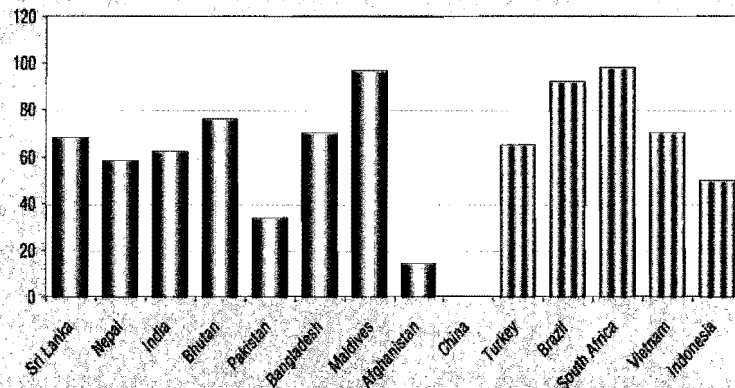
Perception Index, which ranks Bangladesh at the bottom in terms of corruption (158th) and Sri Lanka at 78th. Although corruption is admittedly a lesser problem in Sri Lanka compared to other South Asian countries, the country is far from being a best-practice example.

At the other end of the spectrum are Bhutan and Nepal, where less than 5 percent of all surveyed firms cite customs and trade regulations as a major concern.

While only 34 percent of firms in Pakistan communicate with their customers or suppliers by e-mail, this figure stands at 62 percent in

8 This is consistent with country rankings on the World Bank's *Doing Business Indicator on Trading across Borders* where Afghanistan, Bangladesh, and Pakistan rank at the 125th, 123rd, and 103rd position, respectively. See World Bank, *Doing Business in 2006: Creating Jobs*.

Figure 10
Percentage of firms that communicate by e-mail with their clients



India and 97 percent in Maldives (figure 10). The low rate in Pakistan might be due to the low level of demand for such type of communication, rather than the lack of access to e-mail services. It may also be symptomatic of a telecommunications sector that lacks the capacity to provide a sufficient range of services and has a shortage of fixed telephone lines. As the Maldives economy is highly reliant on the international tourism industry and has therefore developed a high-quality communications system, the high rate of e-mail use is not surprising.

C. Differences within Countries

Regional differences

An important finding of many of the ICA surveys is the noteworthy differences in the investment climates of specific regions within South Asian countries. Some provinces or states are lagging the rest of the country in terms of development.⁹ These observations are important for ensuring that the benefits from an improved business climate are shared across

a wide spectrum of the country. In both India and Pakistan, lagging states are associated with weaker investment climates. There are also some surprising results; in India, the cost of business regulation - particularly for labor- as well as corruption issues are in fact more severe in what businesspeople would typically rate as "better climate" states like Andhra Pradesh and Gujarat. On the other hand, the quality, availability, and cost of infrastructure is perceived to be

superior in better climate states. In India, on average, managers reported spending 13 percent of their time dealing with government regulations. This nationwide average hides huge discrepancies between states: Gujarat and Kerala (the worst performers with 24 percent and 21 percent, respectively) compared to Madhya Pradesh (the best performer with 7 percent).

In Bangladesh there are considerable differences in the key factors affecting the investment climate in Dhaka from those cited as important for Chittagong. In Pakistan, firms in the less developed North West Frontier Province (NWFP) are more concerned with electricity and corruption, and even though there are not statistically significant differences in the burden of regulation across provinces, both Punjab and NWFP have much higher frequency of regulatory inspections than Sindh has. The survey in Sri Lanka identified the top constraints for urban firms as electricity, government policy issues (including macroeconomic policy), and labor issues, while

9 For example, in India the income per capita difference between states is often greater than the income per capita for India and China as a whole.

the top constraints for their rural counterparts are transport, access to finance, and electricity. The factors causing variations in the investment climate within a particular country point to the need to (i) distinguish between federal and provincial aspects regarding regulatory burden and (ii) assess causes for different degrees of infrastructure services within a country.

Size differences

The well-known sentiment that smaller firms are affected more adversely by deficiencies in the investment climate because of their more limited access to factors of production and smaller cost structures is confirmed through the ICA surveys in South Asia, though there are important differences between factors faced by small firms and those faced by large firms. Certainly, in all countries, access to land, labor, and finance are more binding constraints to business for smaller firms. However, in Nepal bureaucratic burdens and labor regulations seem to be more of a concern for larger firms, possibly because SMEs often operate in an informal regime. Similarly, in Pakistan tax administration and other regulatory visits are much more frequent for large than for small firms. In contrast, in Bangladesh SMEs face a heavier burden of regulation, with more government visits and a higher share of total costs going to bribes than larger firms spend. On the other hand, poor infrastructure services seem to hamper smaller firms more than larger firms, in large part because of greater access to the power grid for larger firms and the ability of larger firms to produce their own electricity in-house.

Annex to Chapter I:

Data Caveats

The ICAs for the 14 countries under consideration were undertaken between 2000

and 2005. As a result, the situation in a number of countries may have evolved since the surveys were completed.

A number of caveats need to be underlined. First, the above analysis compares countries across different years; for example, Nepal (with data from 2000) is compared with Maldives (with data from 2005).

Second, the surveys used for these ICAs have changed over time. In some instances, questions are therefore asked differently, which affects the comparison across countries (see example next page). Three surveys varied significantly from the others: Nepal and Bhutan (which follow the same model) and India (which is unique).

Third, the survey in Maldives has specificities. The survey focused on four sectors: tourism accommodation, manufacturing, tour operators and travel agents, and transport logistics, with a total sample size of 147.

A fourth caveat is the relativity of the indicators, with firms in certain countries being more vocal regarding their constraints than in other countries. For example, in Bangladesh the top constraint (electricity) is expressed by about 75 percent of the firms (that is, about 75 percent of the firms consider electricity a major constraint). Similarly, in Maldives the top constraint (access to finance) is expressed by 71 percent of the firms. For Brazil, the top constraint (tax rates) is expressed by 85 percent of the firms. By contrast, in India the top

Country	Year
Afghanistan	2005
Bangladesh	2002
Bhutan	2001
India	2003
Maldives	2005
Nepal	2000
Pakistan	2002
Sri Lanka	2004
Brazil	2003
China	2003
Indonesia	2003
South Africa	2003
Turkey	2005
Vietnam	2005

constraint (telecommunications) is quoted by 37 percent of the firms and in Sri Lanka, the top constraint (electricity) is cited by 42 percent. However, the different percentages might not mean that the access to finance

problem in Maldives is more severe than the telecommunications problem in India, for example, but that firms in Maldives are more vocal in expressing their concerns.

Example of variations to the question "major constraints to doing business"

For Nepal and Bhutan, the question was asked the following way:

What are the three biggest obstacles to doing business in Nepal? The possible answers were the following:

- | | |
|--|---|
| 1. Ownership regulations | 11. Import regime |
| 2. Tax regulations and/or high taxes | 12. High collateral requirements |
| 3. Skilled labor shortage | 13. High interest rates |
| 4. Labor regulations | 14. Insufficient demand for my products |
| 5. Obtaining land and buildings | 15. Competition from imports |
| 6. Foreign currency regulations | 16. Crime and theft |
| 7. Lack of business support services | 17. Official corruption |
| 8. Inadequate supply of infrastructure | 18. Regulations for starting a business, new operations, or expansion |
| 9. Utility prices | 19. Bureaucratic burden |
| 10. Inadequate access to credit | 20. Other (specify) |

For most of the other countries, the question was asked as follows:

Please tell us if any of the following issues are a problem for the operation and growth of your business. If an issue poses a problem, please judge its severity as an obstacle on a four-point scale where 0=No obstacle, 1=Minor obstacle, 2=Moderate obstacle, 3=Major obstacle, and 4=Very severe obstacle.

- | | |
|--|--|
| 1. Telecommunications | 10. Obtaining or renewing permits |
| 2. Electricity | 11. Access to financing (e.g., collateral) |
| 3. Transportation | 12. Cost of financing (e.g., interest rates) |
| 4. Access to land for expansion/relocation | 13. Economic policy uncertainty |
| 5. Tax rates | 14. Macroeconomic instability (inflation, exchange rate) |
| 6. Tax administration | 15. Corruption |
| 7. Customs and trade regulations | 16. Crime, theft, and disorder |
| 8. Labor regulations | 17. Anticompetitive practices |
| 9. Skills and education of available workers | 18. Company registration |

Chapter 2

THE MANY DIMENSIONS OF THE SOUTH ASIAN INVESTMENT CLIMATE

A. Macroeconomic Environment

Though macroeconomic factors are often considered to be short-term and cyclical, the credibility and sustainability of the fiscal and monetary framework has an important influence on business confidence, investment decisions, and even daily transactions. Macroeconomic instability and policy uncertainty is generally not a major concern to private sector firms in **Pakistan, Bangladesh, and India**, because of recent success in maintaining macroeconomic stability as a centerpiece of the development framework. Fiscal constraints have, however, limited government's role in improving infrastructure services. In **Nepal**, recent turmoil has led to a recessionary period without macroeconomic pressures but with insufficient demand. Macroeconomic policy, and more generally, economic policy uncertainty, is however cited as a major obstacle and the second most important constraint for a significant percentage of firms (predominantly urban ones) in **Sri Lanka**.

B. Infrastructure

In almost all South Asian countries, businesses cite electricity as a major problem. They complain less about transport, telecommunications, and water supply. This does not mean that these are not problematic areas. They do constrain business, although not as seriously as electricity, and may become binding constraints as the economies develop. Demand for infrastructural services depend on the production technology used by the firm

and characteristics of the input and output markets. Technologically advanced enterprises might be more vulnerable to infrastructure problems than less advanced ones and thus be more likely to rate infrastructure as a significant problem. In other words, the extent to which firms complain may not always reflect the state of infrastructure but rather may be conditioned by their own requirements. This makes cross-country comparisons difficult.

Electricity

Electricity is a major problem in most South Asian countries.

With the exception of Bhutan, businesses throughout South Asia cite electricity as a major constraint. The problem has many dimensions. There are large areas in South Asia that are not covered by the national grid. Where there is coverage, enterprises often face long delays in obtaining connection. Once connected, businesses have to endure poor-quality supply, including frequent outages, and low and fluctuating voltages.

The two polar cases in South Asia are Afghanistan and Bhutan. In **Afghanistan**, grossly insufficient generation, transmission, and distribution capacities have led firms to cite power as the number one constraint to doing business. Even though 76 percent of the firms are connected to the power grid, they get very little power from the grid and have to rely on generators instead. In one city, Jalalabad, 97 percent of surveyed firms rely on generators. By contrast, cheap, reliable electricity is among

Bhutan's biggest competitive advantages over other countries in South Asia. Indeed, several firms, including Bhutan Carbide and Chemicals and Bhutan Ferro Alloys, were established in Bhutan because of this advantage. Electricity prices in Bhutan are less than half those of its closest competitor in South Asia and only a fifth of the prices in other important locations in the region. Electricity prices in Bhutan are subsidized. If subsidies are removed, the profitability of power-intensive industries in Bhutan will be reduced, but Bhutan's electricity prices will still remain well below regional levels. **Maldives** is not doing badly either. Only about 20 percent of firms in manufacturing think that electricity is a major constraint, while the proportions are 23 and 10 percent in the transport-logistics and tourism sectors, respectively. By 2005, all Maldivian islands had access to electricity and only three islands had fewer than six hours of power supply.

Other countries fall in between, but firms in these countries report electricity as a major, if not the top, problem. In Kathmandu, **Nepal**, about 40 percent of firms identified electricity as their biggest problem; in some places in Nepal the proportion was 90 percent. In **Bangladesh**, only 4 percent of enterprises reported that electricity posed no obstacle, and in **Pakistan** 21 percent considered it no obstacle. By comparison, in China 37 percent of enterprises reported that it was no obstacle. In **Sri Lanka**, many urban and rural entrepreneurs viewed electricity supply as the most serious impediment to investment and growth-because of poor access, high cost, and unreliability. Access to electricity is heavily concentrated in urban areas such as Western Province, leaving rural areas such as Uva

Province grossly underserved. Less than 70 percent of rural enterprises use electricity from the national grid.

Getting connections are not easy. In **India**, it takes 65 days for a small business start-up to get connected to the public grid; 26 days for businesses located in one of the metropolitan areas and 54 days for start-ups based in one of the smaller cities. A business start-up in **Pakistan** can expect a 40-day waiting period before getting an electrical connection-double the wait in China. Their Chinese counterpart needs only 21 days overall-32 days if in a metropolitan area, and just 15 days in a medium-sized city. Brazil's figures are comparable to China's. Maldives stands out among the South Asian countries-it takes only 5.5 days to get connected.

The quality of the power supply is another problem. In some areas of **Nepal**, firms reported power outages of more than 30 times per month. Such power outages are often unscheduled and erratic, thus preventing firms from planning adequately for outages. In Bangladesh, firms reported experiencing power outages and surges about 250 days a year on average-and many reported outages and surges every day they operate. For the average business in India, power outages occur almost every other day, compared to once every two weeks in China and once a week in Brazil. In Maldives, on average, the frequency of power outages is 2.8 days compared to 6 days in the Philippines and 14.5 days in Pakistan. Power fluctuations affect some sectors more than others.¹⁰ Thus, often poor-quality electricity supply discourages investment in particular activities even if they are otherwise viable.

10 Electricity is not as large a relative problem for all sectors. In Nepal, the fraction of firms that reported electricity as their biggest problem ranges from more than three-fourths for chemicals and metals to about a third for nonmetals and carpets. This difference reflects the technologies used in these industries.

Inadequate and unreliable supply has led South Asian firms to resort to the more costly option of generators. The proportion of firms using generators is highest in **Afghanistan** (76 percent) followed by **Sri Lanka** (75 percent for urban manufacturing firms), **Bangladesh** (72 percent), **Maldives** (64 percent), **India** (61 percent¹¹), and **Pakistan** (42 percent). The comparable figures for China and Brazil are 27 and 17 percent, respectively. In India, generators account in many cases for as much as 30 percent of a business's power consumption.

Many factors are responsible for inadequate and poor-quality power supply.

Inadequate generation capacity and deficiencies in transmission and distribution are serious problems in many South Asian countries. **Sri Lanka** and **Bangladesh** have far less generating capacity per capita than most of their regional competitors (0.03 kilowatts of capacity per capita). In Sri Lanka, this situation can be attributed in part to environmental concerns and interest groups working against power projects in certain locations. **India** has 0.10, **Pakistan** 0.12, and China 0.21 kilowatts of capacity per capita. In some countries, the problem is more in transmission and distribution than in generation. For example, serious underinvestment over the years in transmission and distribution infrastructure is at the root of the power supply problem in **India**. In **Afghanistan**, in addition to grossly insufficient generation capacity, there is inadequate transmission and distribution capacity. Most of the equipment in the Afghan power sector is old, dilapidated, and failing, and backup equipment is rare. Inadequate investment in generation, transmission, and distribution is the result of many factors, discussed below.

Insufficient cost recovery but high tariffs for industry.

In **India**, underinvestment in the power sector can be traced to the government-owned monopoly of enterprises operating under state electricity boards (SEBs)-at least until the early 1990s. Many of the SEBs adopted a deliberate and long-standing policy of underpricing the supply of electricity to households and farms. Industry bore the burden by paying tariffs that were excessive by international standards. Average tariffs for industrial use, at the time of the ICA survey, were about US\$0.08 per kilowatt-hour in India compared with US\$0.05 in Southeast Asia. There are significant interstate variations, ranging from Rs 6.64 per kilowatt-hour in Uttar Pradesh to Rs 3.00 per kilowatt-hour in Punjab.

The failure of the SEBs to protect transmission and collect payments has produced significant financial shortfalls, leaving maintenance and additional capacity wanting. In **Sri Lanka**, although low-cost hydro sources produce more than 70 percent of electricity, repeated droughts and rapidly growing demand met by expensive emergency power generation have led to some of the highest commercial power tariffs in the region. However, despite charging high prices to industries and businesses to cross-subsidize residential customers, the state-owned power company was able to recover only about 78 percent of its costs in 2002, leaving a huge shortfall to be covered by taxpayers. Selling electricity below the cost of supply provides a strong disincentive for the company to expand access to the grid or offer off-grid services for villages.

Weak public sector capacity. In **Afghanistan**, a state-owned power utility, Da Afghanistan Breshna Moassesa (DABM), is in charge of generation, transmission, and distribution of

11 These are figures from the 2003 survey and show a 10 percentage reduction in the proportion of businesses that rely on self-generated power compared to the 2000 survey. This change reflects some recent progress in the power sector in India.

electricity. Its several regional electricity departments are responsible for running electricity facilities in different parts of the country. Weak capacity in the Ministry of Water and Power and DABM remains a huge challenge to the implementation of the investment program. DABM has neither an appropriate governance structure nor financial resources to improve electricity services.

Inadequate regulatory framework to attract private investment. Several South Asian countries have tried to attract private capital to the power sector. However, an inadequate regulatory framework has discouraged large-scale private investment. **India** has tried recently to attract private investment in generation and distribution and has sought to unbundle SEBs into independent commercial agencies specializing in generation, transmission, or distribution only. However, most states have not developed a regulatory framework in which potential investors have confidence. Hence, the efforts have not borne much fruit.

Transport

Poor-quality roads, inefficient ports, and inadequate transport services are common features in South Asia.

Road transport. To be effective, entrepreneurs need a quick and easy way to get their goods to market. Many South Asian firms do not have this. In **Sri Lanka**, 20 percent of urban manufacturing firms, and 40 percent of rural firms, indicated that transport was a major or severe constraint. Urban firms complained that absenteeism due to the unavailability of transport was a cause of low productivity. Rural firms considered road quality as the biggest problem followed by access to roads and lack of available transport services.

Sri Lanka has a dense road network by regional standards, but the quality of its roads is poor relative to its Asian competitors. As much as 90 percent of the country's paved road network is in poor condition because of lack of maintenance. In **Bhutan**, where transport is the only infrastructure dimension that firms complain about, roads are in poor condition and are often cut off by landslides. These circumstances make transport costly and unreliable; for example, the cost of transporting timber can exceed the value of the wood. **India** currently has no interstate expressways linking its major economic centers, and only 3,000 kilometers of four-lane highways (while China has built 25,000 kilometers of four- to six-lane, access-controlled expressways in the past 10 years). The average speed of trucks and buses on highways in India is 30-40 kilometers an hour, about half the expected average.

Transport services are also problematic. Because the freight transport system is unreliable, firms are forced to carry more stock than otherwise needed, to deal with uncertain supply. The average small business in **Indian** industry has approximately a one-month inventory of its major inputs when it orders fresh supplies. For metropolitan area businesses this figure drops to 24 days, but rises to a staggering 37.5 days for businesses based in one of the smaller cities.

Complaints about transport services vary depending on firm characteristics. In **Nepal**, where a quarter of firms reported problems with obtaining trucking services, complaints came more from the larger exporting firms that need to ship goods expeditiously.¹² In Sri Lanka, large firms with a larger market area depend more on the road network and trucking

12 In Nepal, firms are also unhappy that they are not able to choose their own trucking operator and instead have to use the truck that is first in queue.

services than smaller firms, and hence complain more about the services. The same is true for Maldives. In Nepal, exporting firms were concerned about the major highways as well as the road network in India where they export to. But nonexporters were concerned primarily with the local road network. In **Maldives**, transportation problems seem to be a bottleneck only for tourism (23 percent) and transport-logistics sectors (32 percent). In **Afghanistan**, a relatively small proportion of firms (25 percent) reported transport as a major or very severe problem. However, it is noteworthy that when asked about factors constraining exports, a larger proportion (39 percent) identified lack of roads, air connection, railroads, and other infrastructure as a major constraint. In fact, this was the second most important factor inhibiting exports after lack of trade finance.¹³

Ports. Inefficiency in ports is another problem. This is particularly felt in **Bangladesh**, where it has been said that the inefficiencies of the Chittagong Port have given Bangladesh all the characteristics of a landlocked country. One of the most inefficient and costly ports in Asia, Chittagong is plagued by labor problems, poor management, and lack of equipment. The container terminal in Chittagong handles about 100-105 lifts per berth a day, well below the productivity standard of 230 lifts a day suggested by the United Nations Conference on Trade and Development (UNCTAD). Ship turnaround time is five to six days, compared with about one day in more efficient ports, and the port faces serious congestion. The median time required for imports to clear ports and customs in Bangladesh is seven days and for

exports, five days. Although this performance compares well with Pakistan's, it falls short of that in India and China. The average wait for imports to clear customs in Bangladesh was nearly 12 days, while the average longest wait was 23 days. For exports the average wait was nearly 9 days, and the average longest wait 14 days. These problems, compounded by inefficient customs procedures (see below), hamper export growth and investment.

Railways. Railways used to be an important mode of transportation, but their use has gone down with declining efficiency. India exemplifies this trend. With a network of 63,028 kilometers, the Indian Railways is the second-largest rail network in the world and one of the country's major national institutions. However, congestion on main lines is steadily increasing long-haul delivery times, and the rapidly deteriorating quality of rolling stock has led to declining safety standards. As a result, the Indian Railways is becoming unattractive as a transport provider. Long-haul goods traffic is steadily moving away from rail to roads. For instance, in 1991-92, the Indian Railways transported 57 percent of the cement produced in India. By 2002, the figure had dropped to 43 percent. The volume of iron steel transported by rail has dropped from 72 percent to 34 percent over the same period. Cross-subsidization of passenger fares, one of the highest in the world, has produced high cargo tariffs.¹⁴

The poor performance of railways spills over into other sectors. In **Pakistan**, for example, because of poor quality and unreliability of rail services, only about a quarter of businesses use

13 The first statistic may thus reflect the limited horizons of many private firms that operate mainly within a localized economy and may find the poor-quality transport infrastructure adequate for their needs.

14 In a situation of zero cross-subsidization, the ratio of passenger earning per passenger kilometer to freight earning per metric ton of freight kilometer should be 1. For India it is 0.3-compared with 0.65 in Thailand, 0.85 in Malaysia, 1.1 in China, and 1.4 in the Republic of Korea.

rail for freight transport, far fewer than the 87 percent of firms in Punjab and 99 percent in NWFP that use roads. With most demand for freight transport having been channeled to the trucking industry, the use of roads exceeds what the current system can replace and maintain. As a result, 70 percent of the national road network is in fair to poor condition, and provincial networks are in even worse shape. For example, 90 percent of the provincial network in Punjab is rated in fair to poor condition.

Telecommunications

The spread of mobile telephones has been impressive in South Asia ...

The quality of telecommunications services draws fewer complaints from the business community in South Asia than does power or transportation. In **Sri Lanka**, only 15 percent of urban manufacturing firms and 8 percent of rural enterprises cited telecommunications as a major or severe constraint.¹⁵ These results are not surprising since Sri Lanka fares well in comparison with competitor countries in providing telecommunications services—its combined fixed and mobile teledensity (telephones per 100 people) exceeds that of countries in South Asia and even fast-growing Vietnam. Enterprises in **Bangladesh** rated telecommunications a smaller constraint on enterprise operations and growth than do other

infrastructure sectors. In **Maldives**, where the telecom sector appears to be one of the high-growth sectors in the economy, only 4 percent of manufacturing firms thought it was a major constraint (the corresponding proportions are 27 percent for transport and logistics, and 18 percent for tourism).¹⁶ In **Afghanistan**, 26 percent of the surveyed firms mention telecommunications as a major or very severe problem.

There have been significant improvements in telecommunications in South Asia in recent years. **Sri Lanka** began reforming the sector in 1980 well before its neighbors. The reforms started with the separation of posts and telecommunications service provision, with successive reforms leading to greater private participation, competition, and investment. Since privatization in 1996, teledensity in the fixed-line sector has more than tripled, while in the mobile sector, always subject to private competition, it has increased from less than 0.1 to more than 5. Sri Lanka ranks ahead of India in terms of Internet hosts per million people, despite the latter's big successes in technology exports, but is far behind Malaysia, the Philippines, and other fast-growing countries in East Asia.¹⁷

The number of fixed-line telephones per 100 people in **Bangladesh** rose significantly in the past two decades despite relatively rapid population growth—from 0.11 in 1980 to 0.39 in

15 Urban and rural enterprises in the south (Uva, Sabaragamuwa, and Southern Provinces) were more likely than firms elsewhere to report problems with telecommunications. Interestingly, relatively few rural enterprises in North Eastern Province identified telecommunications as a problem, despite low connection rates. The reason may be that telecommunications are less important for their businesses—since rural enterprises in this area are significantly less likely to engage in trading or services—and thus are not perceived as a problem.

16 However, things can be better. For example, regarding combined fixed and mobile phone penetration rate, as well as the use of the Internet, Maldives ranks far behind other countries in East Asia (i.e., Singapore), even though it is performing better than its South Asian counterparts.

17 There is tremendous untapped potential for commercial use of the Internet, especially in rural areas, where less than 2 percent of firms reported using a computer and only 0.05 percent the Internet. The situation is more promising in urban areas, where more than 65 percent of firms reported using the Internet.

2001. But the most dramatic change has been in mobile telephony, driven by private investment. Introduced only in the 1990s, mobile phones surpassed fixed-line phones by 2001. In 2005, Bangladesh was served by 900,000 fixed lines and had approximately 3.5 million cellular service customers.¹⁸ In **Pakistan** too, recent deregulation measures have led to rapid growth in mobile phone use for business purposes. Ninety percent of large firms and 67 percent of small firms rely on mobile phones to conduct their business.

There has been progress in the smaller South Asian economies as well. Even in **Afghanistan**, the telecommunications sector has been developing very rapidly. Driven by a competitive market and US\$200 million in private investment, the mobile footprint covers as much as 50 to 60 percent of the country's population, providing services in 23 provinces. In **Maldives**, the rapid progress of communication, especially the introduction of mobile phones in 1997, has proved to be a backbone for socioeconomic development and has lessened the insular nature of the islands, opened up new economic opportunities, and contributed toward growth and expansion of business activities.¹⁹ With the introduction of mobile telephones in 1997, the accessibility of the outer islands improved significantly.

...but they can't fully make up for deficient fixed lines.

Greater access to mobile phones can substitute for fixed-line connections only up to a point, although advances in technology are enhancing the versatility of mobile telephony. Improving

fixed-line telecommunications remains an important agenda in South Asia.

Getting a fixed phone-line connection can be an arduous process in most South Asian countries. The average business in **Sri Lanka** waits 61 days, and in **Pakistan** 42 days before getting a new telephone connection—three times as long as in China, Malaysia, and the Philippines. The waiting list per 1,000 people in Sri Lanka is among the worst in Asia, with a wait for formal fixed-line connection of more than a quarter-million people. In Bangladesh, enterprises that obtained a telephone connection within the previous two years reported an average wait of 126 days, far longer than the 22 days in Pakistan and 7 days in China. A shortage of new fixed-line connections is an important reason for delays in getting connected. In Pakistan, for example, new fixed-line connections currently stand at a mere 0.5-0.6 million a year for the whole country.

Access costs in Pakistan **are** also high—they are more than six times as high as in Malaysia and four times as high as in India. Getting new fixed-line telephone connections is significantly more difficult for small businesses than for larger companies. The "speed money" that needs to be paid to obtain a connection also consumes a far greater proportion of the resources of small businesses.

Although difficult to assess accurately, the quality of service also appears to be a problem in many South Asian countries. **Bangladesh** had 208 faults for every 100 mainlines in 2002, according to the International

18 Bangladesh still lags behind other countries in both fixed-line and cellular telephony. In 2003, teledensity in Bangladesh was still the lowest in South Asia, according to the statistics of the International Telecommunication Union: only 1.56 among 100 people had access to telecoms facility.

19 About 150,000 mobile phones are available, while fixed lines total about 60,000. In Male, the capital of Maldives, two-thirds of the population have a regular phone at home and more than three-fourths have a mobile phone. In the atolls where fixed lines have been installed, one in six people has a telephone in the house. Mobile phones have spread wider: one-half of the population has at least one.

Telecommunication Union. In comparison, there were 203 faults per 100 mainlines in **India**, 99 in **Pakistan**, 38 in Malaysia, 29 in the Philippines, 15 in **Sri Lanka**, and 13 in Indonesia.

Although adequate for basic communication, mobile phones cannot provide the infrastructure for full-fledged Internet connectivity essential to a modern business. In Pakistan and Bangladesh, to give just two examples, the shortage of fixed-line connections has impeded the development of the information technology and software industries. In Pakistan, only 30 percent of firms report use of the Internet in **Pakistan** as compared to 45 percent in **India** and 71 percent in China.

Water Supply

In water, as in electricity, poor supply from the national system forces firms to find their own sources.

While **India** is making progress in developing its urban and rural water supply and sanitation infrastructure, the service provided is highly unreliable: water is typically distributed a few hours per day—regardless of its quality—and is not safe for drinking. It is unlikely that the situation can be improved without addressing the inadequate policies, outdated institutional arrangements, and perverse incentives in the sector. In **Pakistan**, the situation is fairly similar to that of India, although decentralization of the decision-making process that took place a few years ago may make water and sanitary service providers more responsive to the needs of customers. **Afghan** cities have one of the lowest connection ratios in the world. External financing has been made available to extend the service and set the basis for sound institutions and policies. A challenge in Kabul is to protect the limited groundwater resources against industrial pollution and potential over extraction by industries. In **Bangladesh**, while

availability of water is not a problem, its quality often is affected by high arsenic content, both in large cities where industrial pollution is not controlled and in rural areas.

In **Maldives**, nearly a third of the manufacturing firms surveyed complained about the quality of water used in production, while in **Nepal**, nearly a third of the firms indicated that they have problems with the supply of water. In Kathmandu, many firms received service for only one hour per day, and at an unscheduled time during the day. In **Sri Lanka**, enterprises did not identify water as a major constraint to doing business, but still nearly a third of firms in both rural and urban areas complained about their water supply. The industries most affected by the unavailability of water produce carpets, garments, and textiles, all of which require water in their washing and dyeing processes.

Firms have thus had to invest in alternative sources of water. In India, businesses have developed costly "substitutes" (individual, boreholes, pumping stations, storage tanks, and purification equipment). A recent survey of 10,000 households and businesses in Delhi—where water is seldom distributed more than six hours a day—shows that they spend an average Rs 150 on substitutes while they spend Rs 100 on their official water bill. In Nepal, many firms have either invested in wells or purchased water brought in by private tankers. In Sri Lanka, most firms have their own supply of water: 70 percent of urban firms and nearly 60 percent of rural enterprises have their own well or share one, while only 27 percent of urban firms and 21 percent of rural enterprises reported using water from the National Water Supply Development Board. Complaints about water problems are most common among those without their own supply.

In urban areas of Sri Lanka, greater private participation in the water sector is being

encouraged to ensure universal access to a piped water supply, which should reduce businesses' water supply problems. In rural areas, lack of autonomy in human resources and financial decisions, and the central government's continued involvement in "devolved" responsibilities, have until recently undermined the local governments' performance in many areas, including water supply. Moreover, competition for water among domestic, agricultural, industrial, and commercial users is increasing.

C. Factors of Production

Finance

An inadequate financial system makes South Asian firms reliant on internal sources for funding.

Capital is a key input into any business, and an efficient financial system, able to allocate financial resources quickly and cheaply to their most productive uses, is an essential part of a sound investment climate. Many countries in the South Asia region are undergoing structural reforms in their financial sectors, characterized by a shift from public to private ownership, commercial principles for the remaining public banks, and higher levels of discipline in risk management being enforced by supervisory authorities. In the medium term, well-functioning financial systems may become a strong characteristic of the investment climate in South Asian countries. Currently, however, in most South Asian countries firms cite poor access to finance, especially term finance, and the high cost of finance as major factors constraining investment.

Access to and sources of finance. Access to finance is the most serious constraint affecting the investment climate in **Maldives**. In **Sri Lanka**, finance is one of the top three constraints to doing business, especially in the rural areas: 60 percent of rural firms cited finance as a constraint. In **Bhutan**, firms cited finance as their fourth biggest business problem, and about 43 percent of firms reported being credit constrained, that is, wanting to borrow more at current interest rates. In **Nepal**, although the vast majority of manufacturing firms (77 percent) have access to at least some external finance, large collateral requirements and other factors prevent firms from obtaining as much finance as they need. In **Bangladesh**, 40 percent of firms reported that poor access to finance was a major constraint, although 66 percent of firms reported having an overdraft facility or line of credit.²⁰ The situation is relatively better in **India**, where 27 percent of firms rate access to finance as a major-to-severe obstacle to business operations or growth.

Most finance available is short term. In **Nepal**, despite the presence of a wide variety of lending institutions, the majority of finance is short-term bank credit, and most firms are unable to access long-term credit. Less than 28 percent of the sample had outstanding loans with a term length greater than a year. No commercial banks in Afghanistan offer long-term finance: the maximum tenure of financing is three years. Most focus on opening commercial letters of credit (see box on access to finance in Afghanistan, below). In Pakistan, as a result of the short-term nature of the funds borrowed, there is a mismatch of

20 This could be explained by the fact that banks in Bangladesh, especially the nationalized commercial banks, make extensive use of overdraft facilities, which are typically fully drawn by firms. For example, 60 percent of firms had exhausted their overdraft facility. Thus, many firms with an overdraft facility may still feel credit constrained. This is true for other regions as well. For example, in Brazil 60 percent of firms consider access to finance as a major constraint even though 74 percent of firms have an overdraft or a line of credit.

maturities, with short-term loans being rolled over to finance longer-term projects.

Because of the poor access to external finance, many South Asian firms rely on retained earnings and equity as their most important sources of working capital. At one extreme is **Maldives**, where only 11 percent of working capital requirements and 17 percent of investment capital come from domestic commercial banks. The contribution of international banks is even lower, 3 percent and 5 percent, respectively. In **Sri Lanka**, retained earnings account for 44 percent of working capital for urban manufacturing firms, followed by bank lending (23 percent) and trade finance (9 percent).²¹ Bank lending is even less for new

investment (15 percent) and declines markedly with enterprise size. More than 75 percent of the respondents had not applied for a bank loan. In **Bangladesh**, on average, around 55 percent of working capital and nearly 60 percent of investment capital comes from retained earnings, while only 30 percent of working and investment capital comes from banks. In **Bhutan**, about 30 percent have no bank credit.

Inadequate access to bank credit is an important impediment to starting or expanding a business in **Pakistan**. More businesses have access to overdraft facilities in Pakistan (22 percent) than in China (17 percent), but fewer Pakistani businesses have outstanding bank

Access to finance in Afghanistan

In Afghanistan, although 12 commercial banks are now licensed to operate, most are concentrated in Kabul and provide services primarily to international donors and businesses, foreign nongovernmental organizations (NGOs), and foreign government agencies. No commercial banks in Afghanistan offer long-term finance. The maximum tenure of financing is three years. Most focus on opening commercial letters of credit. Transactions are very secure because the importer has to deposit the total imported costs of goods in the bank before opening the letters of credit or a secured contract, such as for construction or other awarded contracts, which are financed by donor agencies.

A small but increasing number of nonbank financial institutions, including one credit union and 11 microfinance institutions provide limited services and small amounts of credit. In addition, a new leasing organization has just become active in Kabul and other areas. However, these institutions are nascent and able to provide only a fraction of what is needed. Thus, they are augmented by a wide variety of informal money lenders and other credit sources. There are no credit bureaus or credit rating agencies.

Because the financial system is so underdeveloped, Afghan firms are almost entirely reliant on internal funds and money from friends and family to fund their operations. Only three firms in the investment climate survey sample reported having bank credit, and on average nearly 94 percent of new investment by firms was funded by either internal funds or money from family and friends. Remittances are also important, and on average funds from family and friends outside of Afghanistan financed 3 percent of investment. Informal sources play an important part in supporting Afghan businesses. Many businesses rely on informal funds transfer systems generally known as hawala to make payments and transfer funds. Only 30 percent of the sample reported having a bank account. The hawaladars also provide short-term loans to finance working capital needs. Nearly 21 percent of firms responding to the survey reported having a loan from a hawaladar with an average term of 3.8 months.

Currently, the financial system provides little or no access to financial products and services for small urban or rural enterprises. Instead, an extensive array of informal money exchange dealers and some NGOs support urban and rural microenterprises with limited financial services.²² As the reconstruction effort progresses, there is a pressing need to address the burgeoning requirements of such enterprises, along with the needs of more formal enterprises and those of international investors.

- 21 However, the experience of South Africa and Vietnam suggests that the indicator "percentage of investment financed by internal funds," by itself, may not be a good indicator to assess whether firms are credit constrained. In South Africa, only 13 percent of firms consider access to finance as a major constraint, but 58 percent of investments by firms are financed by internal funds and only 16 percent by bank financing. By contrast, in Vietnam only 30 percent of investments are internally funded and yet access to finance is identified as the top constraint by firms (with 40 percent of firms considering access to finance as a major constraint).
- 22 The development of rural financial markets is hindered by several factors: (i) dispersed populations and poor transport and communications facilities; (ii) high risks associated with rain-fed agriculture; (iii) absence of physical collateral and land-tenure systems that minimize the value and use of land as collateral; and (iv) past history of state involvement and subsidized lending, which led to low recovery rates. These problems, some of which may affect urban microenterprise finance, tend to be more acute in rural areas.

loans (20 percent against 43 percent in the China sample; however, China's financial sector is not the best even by emerging market standards, given its large levels of nonperforming loans). As indicated above, the situation is better in **India**, where 54 percent of small businesses have active bank credit lines or overdraft facilities. This figure is much higher than that for China, suggesting that India's investment climate is clearly better in this respect. But the India figure is lower than Brazil's by about 50 percent. A greater proportion of small businesses might thus have been rationed out of formal credit markets in India than could otherwise be the case even by emerging market standards.²³

Within countries, access to formal finance varies by regions and sectors. Thus, in **Sri Lanka**, new investments in rural enterprises are financed largely from internal sources (43 percent) and family and friends (35 percent), respectively. In **Bhutan**, companies in the service sector were more likely than manufacturing companies to be credit constrained, and fewer had bank credit.²⁴ Access to credit is also highly correlated with size; a much greater proportion of large firms than small firms have access to external finance. In **Nepal**, for example, about 60 percent of firms with fewer than 50 workers had access to credit, while 84 percent and 93 percent respectively of the largest two size

categories (in terms of employment) use some form of credit. This differential access is even more pronounced for long-term credit. Close to 30 percent of the firms in the two largest-size categories have access to long-term credit, while only 17 percent of firms in the two smallest-size categories do. In **Sri Lanka**, small firms are forced to rely more on internal financing, leasing, and informal and family sources. In **Pakistan**, 18 percent of small firms and 50 percent of all large firms have access to overdrafts.²⁵ Fifty-seven percent of new investment by SMEs and 67 percent of working capital finance comes from internal finance or retained earnings; only about 7 percent of funds for new investment or working capital come from banks or other financial institutions.

Collateral requirements are typically high (see figure 11). However, the analysis of the data on collateral—more specifically, the value of collateral as a percentage of loan value—can be misleading. A lower value does not necessarily mean a more efficient banking sector or an easier access to credit. Conservative banks have a strong preference for real estate collateral and will therefore exclude many potential borrowers, in particular SMEs, which often cannot provide such collateral. More dynamic banks will accept a wide range of collateral, such as machinery, inventory, vehicles, and consumer durables, but the

23 Even during their initial phase, Indian SMEs have traditionally relied much more on debt financing—from banks and nonbank financial institutions (NBFIs)—than their counterparts elsewhere. But the shrinkage of the NBFIs sector in response to policy and regulatory changes since 1997 has meant that SMEs no longer have access to finance from this source. And bank credit to SMEs has also dropped sharply since 1997. The limited debt financing available to Indian SMEs is of a short maturity (less than one year) and is relatively costly compared with options available to their counterparts in other countries.

24 This difference may arise because service companies generally have fewer physical assets to pledge for collateral—or because lenders are less comfortable in assessing the risks of such service providers as tour operators, transport firms, and computer training schools.

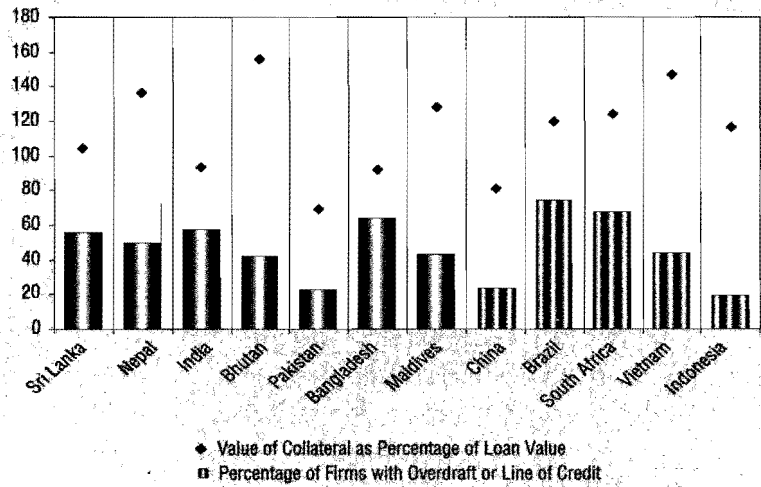
25 Higher interest rates and the lower share of loans extended to SMEs are not necessarily evidence of market failure. Smaller firms have a higher turnover rate than larger firms, making them riskier to lend to. Given the fixed overhead costs per loan, the smaller size of loans extended to smaller firms also makes lending to them less profitable for banks. Small firms also often have less collateral and less of a proven track record, making it harder for banks to assess their creditworthiness.

distressed value²⁶ of such collateral is usually low. Such banks will therefore cover their risks in taking a wide range of assets, which will translate to a higher value of collateral as a percentage of a loan (for example, this value stands at 134 percent in Ireland and 124 percent in South Africa).

Cost of finance. While access to finance is most commonly cited as a problem, in a few countries the cost of finance is a problem too. For example, in **Sri Lanka**, almost a third of urban firms and rural businesses cited cost of finance as a major constraint. Urban firms in Sri Lanka did not mention access to finance as a major problem but reported that the cost of finance is the fourth biggest constraint to expanding or operating their businesses. The problem is more serious for small firms and rural firms. Small urban manufacturing firms reported paying significantly higher average interest rates (18 percent) than did large ones (12 percent). Within the rural enterprises surveyed, 60 percent identified high interest rates on loans, and nearly 50 percent identified tedious loan procedures as major or severe constraints. In **Bhutan**, high nominal and real interest rates were a major concern for firms. Real interest rates ranged between 7 percent and 10 percent at the time of the survey.

Lack of innovative financial instruments. In **Bhutan**, for example, the banking system provides few innovative lending instruments. The survey team came across only one example of factoring services, in which the Royal Insurance

Figure 11
Patterns of lending and borrowing



Corporation of **Bhutan** provided loans to a private entity based on work orders. However, this practice does not appear to be common. Other services that are missing include leasing finance, private debt markets, electronic banking, automated teller machines, venture capital (or risk capital) for start-up enterprises, and even credit or debit card facilities.

A variety of factors limit access to finance for South Asian firms.

The factors constraining SME finance in **India** provide a glimpse of the root causes of the problem. A variety of credit market imperfections result in high transactions costs and default risk. Specific problems include the following: (i) problems in using land as collateral, lenders' nonrecognition of other types of collateral, and difficulty in collateral enforcement and loan recovery; (ii) insufficient credit information on SMEs; (iii) poor SME credit-assessment practices and poor lending technologies, such as inadequate use of credit scoring/rating tools; and (iv) a bankruptcy

26 The likely value of the asset if sold by the bank in case of the borrower's nonrepayment of the loan.

framework that prevents easy exits for troubled firms. A fifth possible contributor is the degree of confidence lenders have in the contract enforcement mechanisms of the courts. These problems recur in other parts of South Asia.

Heavy reliance on collateral. Collateral plays a vital role in the availability of finance, and lack of collateral is thus a major constraining factor. In **Sri Lanka**, being more productive does not help a firm obtain a loan. Banks are unable to discriminate on the basis of performance and instead rely heavily on the value of collateral when considering a loan application. For rural enterprises, land is important as collateral. Almost a quarter of loans to rural enterprises in Sri Lanka required collateral, and land was offered in 75 percent of these transactions. However, high levels of public landownership, unclear ownership records, and widespread restrictions on the use and transfer of land make it difficult to use land as collateral, limiting access to external finance. High collateral requirements were cited as reasons for not applying for loans by nearly all respondents in the **Pakistan** survey who needed a loan but did not apply for one.

Shallow financial system. The financial system in most South Asian countries is shallow. Although **Sri Lanka's** financial sector has developed and expanded over the past two decades, private sector credit amounts to about 38 percent of GDP, compared to 125 percent in China. The ratio is even less in other South Asian countries—27 percent of GDP in **Bangladesh**, 28 percent in **Pakistan**, and 29 percent in **India**. Capitalization of equity markets in India is 30 percent but only 15 percent in Sri Lanka, compared to about 40 percent in China. The financial sector of **Maldives** is very narrow and dominated by the banking sector, which consists of one locally owned commercial bank, branches of three

South Asian state-owned commercial banks, and a branch of a widely known international bank.

Public sector dominance. In some South Asian countries, the public sector continues to dominate the banking sector. In **Sri Lanka**, the commercial banking sector is still dominated by the two state banks, the Bank of Ceylon and People's Bank, accounting for about 45 percent of assets, although this proportion represents an important decline compared to that in the early 1980s. The significant level of nonperforming loans and inefficiencies of state banks contribute to high intermediation costs. This in turn results in high cost of funding for the banking sector as a whole as the more efficient private banks are able to operate with similar lending rates while enjoying high profits. In **Bangladesh**, at the time of the investment climate survey, 40 percent of industrial loans were nonperforming. In **Bhutan**, high interest rates are also blamed on the relatively large share of nonperforming assets in the banking system (interviews suggest that it is about 15 percent), which has further increased banking costs.

Crowding-out effect of government borrowing. Another cause for the high costs of finance is the crowding-out effect of government borrowing. In **Sri Lanka**, where high cost of capital is cited as a major constraint, persistent budget deficits have led government to borrow heavily from the banking sector, driving up interest rates.

Deficiencies in setting interest rates. Banks in South Asia often set interest rates based on the borrower's sector rather than its risk profile. Training bank credit officers to properly assess risk is an important step in moving banks away from using simplistic and less relevant criteria in determining interest rates—and in moving toward market-determined rates.

Weak information and enforcement. **Bhutan** exemplifies the case of weak information and enforcement, but the problem is widespread in South Asia. In Bhutan, banks attribute their reluctance to lend to two factors. The first is lack of information and of mechanisms to collect information, which makes it difficult to identify profitable projects in a risky environment. Most firms do not keep accurate, transparent financial accounts, and Bhutan has no credit rating agencies or other institutions providing information on borrowers. Bhutan's small, thin market, where few firms are diversified, is particularly vulnerable to shocks, and predicting earnings is difficult. Moreover, because banks lack information and well-trained loan officers, they are unable to adequately monitor the use of borrowed funds.

The second factor is inability to enforce contracts. In Bhutan, the legal code is improving rapidly and many new laws have been passed, but financial institutions still find it difficult to enforce agreements or seize collateral. While the laws may be adequate, they are not enforced. Courts are extremely slow and inefficient, and seizing the assets of borrowers who default is almost impossible unless the property is directly attached to the loan. Thus all banks demand high collateral, specifically tied to a loan, so that it can be seized to offset the cost of long court proceedings. That the courts are considered a very inefficient way to resolve disputes is evidenced by the fact that only about 5 percent of firms in the Bhutan survey reported hiring a lawyer or threatening to take a client to court for nonpayment.

In **Nepal**, the vast majority of external credit comes from commercial banks, and for various reasons banks face enormous difficulties obtaining information on clients, assessing their risk, and enforcing contracts. The way that the tax laws are enforced discourages firms from keeping accurate books that banks can rely on.

Money is fungible and it is difficult for banks to monitor how their loans are used. Once contracts are written the legal mechanisms for enforcing them are so weak that they cannot be relied upon. For these and other reasons, banks restrict the length of loans and demand high levels of collateral and personal guarantees.

Lack of insurance is a particularly serious problem in **Afghanistan**. Afghan firms are faced with an almost complete absence of insurance. Many managers and potential investors have cited the lack of insurance as a major reason that they are hesitating to invest. The insurance sector in Afghanistan is in dire straits. The sole insurance company, the Afghan National Insurance Company, is substantially undercapitalized and in a weak financial position. The Afghanistan Investment Guarantee Facility has been established to mitigate political risk and not life and nonlife commercial risks. But until there is a new insurance law, it is unlikely that there will be any new providers of normal business insurance. The existing insurance law is more than 40 years old (1962) and therefore requires substantial modifications or indeed replacement by a new law to be consistent with the new commercial environment.

Land

The efficiency of the land market, both as a factor of production as well as an asset that can be leveraged into capital through registration and mortgage, is not cited as a major obstacle in most South Asia ICAs. The subject of land issues is treated sporadically in the South Asia ICAs, as apart from **Bangladesh**, fewer firms in South Asia than in China or Brazil report access to land and registering land as a major deficiency in the investment climate. This result is more a statement of the relative importance than an indication of a well-functioning land market in South Asia.

An exception is **Afghanistan**, where it is exceptionally difficult for businesses to get clear title to new land, especially serviced land (see box below). The lack of certainty in land tenure discourages existing businesses from making large new investments and effectively prohibits new investors, especially foreign investors, from entering the market. The difficulty of obtaining new land is borne out by the survey. Nearly 56 percent of the firms who had tried to acquire new land in the past three years were unsuccessful.

The World Bank's *Doing Business* indicators show that registering property in **Pakistan**, **India**, and **Sri Lanka** takes longer and costs more than in China or Brazil.²⁷ In particular, although in **India** access to land is not considered as urgent as power supply, there is evidence that regulatory distortions and unclear property rights in the land market have caused the cost of land to account for a higher proportion of business costs in India than elsewhere in South and East Asia. Anecdotal evidence from **Pakistan** indicates that court

systems are dominated by cases over disputes involving land issues. For the other country for which land issues were addressed, **Sri Lanka**, land is a bigger issue for urban than rural firms, with 10 percent of urban businesses citing access as a major problem compared to only 2 percent in rural areas.

Labor Markets and Skills

The two major labor issues in South Asia are the rigidity of labor markets in several countries and the shortage of skilled labor in most countries.

Labor regulations vary across South Asia.

Labor regulations are a key constraint for firms in many South Asian countries, while they tend to be less of an issue for some of their neighbors. Regulations impinge mostly on the firing side and are relatively more flexible on the hiring side. According to the *Doing Business* study, the region has the lowest hiring cost in the world and also scores low on the index of

Voices of Afghan entrepreneurs: The challenge of getting land

"Obtaining land has been the main problem for us. The former Ministry of Light Industries had allocated a plot of land for us in the Pul-e-Charkhi area of Kabul. However, we are yet to get this government land and we are not sure we ever will. We have applied for a plot of land to AISA [the Afghanistan Investment Support Agency] but have not got a response yet. AISA has promised to help but we do not know if they have the capacity to allocate land. We thus rented a house in Kabul in March 2002 and installed my machinery. We pay a rent of US\$1,260 per month for the house. It has limited space and, being located in a residential area, it is not good for the local environment. Lack of land is constraining me in many ways. If we had the land we would construct a modern medicine production factory with modern systems used in Europe and North America; expand employment from the current of 30 to 150 by expanding production capacity, marketing network, and sales volume; and help reduce the country's dependence on imported medicine and perhaps even export to the neighboring CIS [Commonwealth of Independent States] countries." - Pharmaceutical company

"We approached the Ministry of Agriculture to obtain land. We did get an allocation from the Ministry and it was agreed that our project will be a joint venture with the Government with the Ministry owning 30 percent of the shares. While it was relatively easy to get the allocation letter from the Ministry, we are having a hard time getting the land title cleared. It is not enough to get the approval of the Ministry. We have to visit several offices to get all the clearances required and we do not think there is a single government office that we have not visited! Particularly difficult has been the Municipality, the Ministry of Water and Grid, and the Kabul Provincial Office. It does not matter to them whether you have a letter from the Minister or Governor. They will always find some problem with your documents. We would not tell you which offices we had to pay bribe but there are some where we had to pay a hefty amount. Finally, we got the title after one year." - Poultry farm

27 World Bank, *Doing Business in 2006; Creating Jobs*.

rigidity of hours worked.²⁸ However, as described in detail below, there is much less flexibility with regard to firing workers and, even on other aspects where the region on average does well, some countries have onerous regulations. The absence of a well-functioning labor market can offset the benefits of a well-educated workforce. This is evident, to some extent, in Sri Lanka and India.

Sri Lanka's labor regulations are ranked among the top five obstacles in the investment climate by urban manufacturing firms. Inflexible and arbitrary, these regulations create uncertainty about the costs of hiring and firing workers, thus discouraging investment. An example is the mandated payments for redundancy, which are many times those legislated in other Asian countries.²⁹ The Termination of Employment of Workers Act (TEWA) of 1971 makes it very difficult for firms to fire or lay off workers. Employers are most concerned about the discretionary and opaque administrative process for obtaining authorization to lay off workers. The government may refuse authorization, creating uncertainty about the ability to lay off workers. Lengthy procedures add to the uncertainty: many cases drag on for years while employers must explain their financial performance and business plans to justify the layoff. Labor regulations in Sri Lanka also mandate more

holidays and leave than in almost any other country in the world.

In **Bhutan**, the labor market is segmented with an estimated 50 percent of formal wage employment accounted for by non-nationals, mostly Indians. Recruitment of foreign workers is subject to stringent restrictions and, when permitted, entails time-consuming procedures. These factors may explain why a large proportion of firms in Bhutan (more than 30 percent) cite labor regulations as a major or severe constraint. Rules regarding employment of national workers are less stringent and are not well enforced; firms report some flexibility in hiring and firing employees, and in setting wages without any influence of organized labor.³⁰

In **India**, 17 percent of firms identified labor regulation as an impediment to growth. Regulations make it virtually impossible to fire a worker. India scores 90 out of 100 on the *Doing Business* Difficulty-of-firing Index, relative to 43 on average in South Asia, 23 in East Asia, and 27 in Organisation for Economic Co-operation and Development (OECD) member countries. Firms must pay 79 weeks of salary in notice, severance, and penalties to dismiss a worker—compared with a regional average of 75 weeks, and East Asia and OECD averages of 44 weeks and 35 weeks, respectively. Thirty

28 The cost to hire a new worker accounts for only 5.1 percent of a worker's salary. The rigidity-of-hours index for South Asia is also low, at 35 on a scale from 0 to 100 (where 100 is the highest rigidity), reflecting relatively few restrictions on overtime and annual paid vacation. This level even surpasses that of OECD countries (an average of 50) and trails only East Asia.

29 In 2004 Sri Lanka increased the maximum severance payments for workers with 20 years of service from 36 months of wages to 48, making it the most expensive place in the world after Sierra Leone to dismiss workers.

30 There have been some reform initiatives after the Bhutan ICA was written. The government has recently prepared a draft Labor and Employment Act to balance the legitimate needs of workers with the promotion of private-sector activity. Once effective, this act will (i) allow Bhutanese, particularly youths, to be employed in a wider spectrum of economic activities; (ii) allow for more-flexible working hours; (iii) allow night work in industries requiring a round-the-clock-work schedule; and (iv) help streamline processes and reduce the time required for recruiting foreign workers. The act is expected to be submitted to the Committee of the Council of Ministers before the end of 2006. A range of reforms to streamline the process for recruiting foreign workers were implemented recently. In particular, an online recruitment system has cut the time to obtain foreign worker permits from three months to three weeks. And a one-stop service center was established, allowing applicants to complete all the formalities required for foreign worker recruitment in one place.

percent of firms reported that they would employ fewer workers if they were free to choose their employment levels. Of those reporting excess labor, 30 percent attributed overstaffing to laws and regulations that limit firing of workers; 17 percent reported pressure from unions; and 13 percent reported government or political pressure. Absenteeism is also a problem, imposing costs on production and the potential profitability of enterprises. India's labor regulations are also unusually complex. There are 47 central government laws and 157 state regulations that directly affect labor markets. These laws are often inconsistent and at times overlapping. As a result, it is almost impossible for either firms or workers to be aware of their rights and obligations, or for enforcement authorities to ensure compliance with regulations.

Labor regulation in **Pakistan** is excessive by international standards, as can be seen from data on a number of indicators of labor market flexibility. According to the *Doing Business* indicators Pakistan's overall indicator for restrictiveness of employment laws is the highest in the South Asia region, and is much higher than indicators for the East Asian countries, including Malaysia and Singapore. Since the employment regulations are most applicable for permanent workers, Pakistani firms have resorted to large-scale hiring of temporary workers. According to the 2002 investment climate survey, the proportion of temporary workers in Pakistani businesses is one of the highest by any international standard, standing at about 36 percent compared to, for example, 15 percent in India and 3 percent in Bangladesh.

In **Nepal**, the most problematic regulation for firms is the retrenchment provisions for permanent labor. Twelve percent of firms identified it as the one of their top three business problems. Labor regulations require

firms to make all employees permanent after working 240 days. After they become permanent, workers cannot be laid off or fired without the consent of the labor department, a process that can take months or sometimes years. Market needs are not considered sufficient grounds for such consent.

Conversely, few firms in **Bangladesh** believe that labor issues impede their growth; less than 10 percent of firms consider labor regulations to be a major constraint (see box below). When asked what ideal staffing levels would be if hiring and firing were costless, the median firm in the investment climate survey reported that its current staffing level was ideal. **Afghanistan** has made significant progress with regard to labor regulation (Afghanistan now ranks 25th in the 2005 *Doing Business* Index on Hiring and Firing). Regulations governing hiring, firing, and working hours all give Afghan firms significant flexibility. In **Maldives**, although 28 percent of the firms consider labor regulations as a major or severe constraint, it is not cited by the firms as one of the top constraints (it ranked as the 12th constraint). According to the *Doing Business* indicators, Maldives ranks fifth in the world on the ease of hiring and firing-and is by far the best-performing South Asian country on this indicator. The cost of hiring is zero-there are no social security taxes or payroll taxes associated with recruiting a worker. There are minimal restrictions on work conditions. Employees are prohibited from working more than 10 hours in a day, but there are no restrictions on night or holiday work and no mandated annual leave. Firing is more costly. Employers must pay 20 weeks of wages in severance, penalties, and notice to dismiss workers.

Many South Asian firms face a shortage of skilled workers.

Shortage of skilled labor affects South Asian countries at various levels. Firms in **Maldives**, **Bhutan**, and **Nepal** complain the most about

Labor market flexibility in Bangladesh

Bangladesh scores among the best in the region and ranks 22nd worldwide on the ease of hiring and firing. The cost of hiring is zero—there are no social security taxes or payroll taxes associated with hiring a new employee. By contrast, in India, Pakistan, and Sri Lanka, the cost of hiring ranges between 12 and 16 percent of salary. It is also relatively easy to fire a worker in Bangladesh. Employers are not required to notify, or obtain approval from, a third party before dismissing one redundant worker or even for collective dismissal. There is no legal requirement to retrain or replace workers before dismissal. Only four weeks' notice is required and there is no legally mandated penalty for redundancy dismissal. Severance payments can be costly though, amounting to 43 weeks. The rigidity of hours worked is also quite low in Bangladesh. Until recently, trade union activity was not allowed within export processing zones. The government recently enacted a law allowing limited trade union activities in the export processing zones.

Source: World Bank, *Doing Business in South Asia in 2006*.

shortage of skilled labor. Asked about their biggest business problem, firms in all sectors and locations in **Bhutan** overwhelmingly cited the lack of skilled labor. Managers report that the skills provided by most schools and training institutions do not match the skills needed by industry. So while a growing number of school leavers cannot find jobs, firms feel that their biggest problem is a shortage of skilled and experienced labor. Despite some improvements, inadequacy of local skilled labor continues to be a major problem in **Maldives**, where 45 percent of firms cited this inadequacy as a major or severe constraint. In **Nepal**, firms ranked shortage of skilled labor as their fourth main constraint.

Sri Lanka's labor force is well educated compared with those in other lower-middle-income countries. Yet the demand for technical, managerial, and computer skills still outpaces supply. In **India** and **Pakistan**, one in eight businesses identified skill shortages as a major obstacle to the expansion of their business; in Bangladesh, the proportion is 19 percent. Similarly, firms in **Afghanistan** do not express concerns about a shortage of skilled labor, despite high illiteracy and poor education. During the two-decade long conflict many of Afghanistan's best-qualified

workers, those with the best opportunities abroad, fled. Consequently, qualified management, skilled technicians, and educated professionals are scarcely available to today's enterprises. However, it is understandable that Afghan firms face many other challenges and might not yet consider skills shortage as their most pressing constraint.

As is the case with transportation, the way firms responded to questions about skills shortages depended on the industrial structure. This pattern is illustrated by the case of **India**, where a typical firm reported filling a skilled vacancy within three days, as opposed to six in Brazil. This comparison may suggest that skill shortages are not as ubiquitous or biting a problem in Indian industry as they appear to be in Brazil. However, this does not necessarily mean that India has a larger pool of skilled workers than Brazil. It means only that there are more skill shortages in Brazil, possibly because the demand for skills in those countries is greater, which would also be consistent with their higher investment rates in more skill-intensive industries. That India apparently faces fewer skill shortages than Brazil is not therefore necessarily a plus for the current investment climate in India.

The shortage of a skilled labor force has a variety of origins. In **Bangladesh**, illiteracy remains high despite recent improvements in school enrollment. This high incidence of illiteracy reflects the poor education results in the 1970s and 1980s and the difficulty of quickly reducing illiteracy among adults. In addition, there has been a "brain drain" of skilled workers. Brain Drain has also been the case in **Sri Lanka**. A ranking by the World Economic Forum in 2003 shows that Sri Lanka has among the highest levels of brain drain in a set of comparator countries. In **Afghanistan**, the skills shortage caused by war is exacerbated by the barriers to educating girls and employing

women in most jobs outside the home. In **Bhutan**, the skilled labor shortage is due to the government's absorption of most skilled and educated workers, which is compounded by the fact that most educated Bhutanese have a strong preference for working in the public rather than the private sector. However, this situation is slowly changing as the government absorbs fewer and fewer school leavers and graduates.

Innovation and Technology

Technology is another important factor affecting firm-level performance, especially in the present context of a highly globalized and knowledge-based system of production. To enter world markets and compete successfully with imports, firms must improve their productivity. That means not only upgrading their human capital but also adopting appropriate new technology. Technology is a general term covering a wide range of areas. Those most relevant to South Asia include management knowledge, market knowledge, production technology, design and product development, information technology, and management and quality systems. Use of the Internet is another dimension. The Internet has become one of the most efficient ways for firms to communicate and to conduct business with distant clients.

South Asian firms do not innovate much and face difficulties in acquiring technology.

Bangladesh exemplifies the typical South Asian pattern of firms' low investment in research and development (R&D). Bangladesh spends less on R&D as a share of GDP than do most other developing countries in East and South Asia for which data are available. R&D spending totaled about 0.03 percent of GDP in Bangladesh compared to about 0.2 percent in the Philippines and Malaysia and about 0.7 percent in China and India. The low level of R&D spending in Bangladesh is reflected in

relatively low levels for other measures of innovation. For example, companies and individuals in Bangladesh were granted fewer U.S. patents per capita than were those in other developing countries in East and South Asia. Similarly, basic research appears to be weaker in Bangladesh than in other countries in the region: authors from Bangladesh published fewer scientific articles per capita than did those from any of the comparator countries in East and South Asia except Indonesia. **Sri Lanka** is doing relatively better, but even there firms tend to invest little in R&D: 0.11 percent of sales, on average. However, levels of R&D investment are close to those observed in similar industries in developing countries such as China and India. Technology use in Sri Lanka, as measured by the share of firms using e-mail and computers, is also close to that in China. South Asian firms also face many difficulties in searching for, acquiring, and absorbing technology (see box).

South Asian firms do not make much use of modern systems of communication.

Internet use is low in South Asia. This is symptomatic of a telecommunications sector that suffers from shortage of fixed telephone lines and lacks the capacity to provide a sufficient range of services. In **India**, there is relatively greater use of the Internet but with variations in Internet connectivity across states. Forty-seven percent of SMEs in the good-climate states use the Internet to conduct business, while only 27 percent of SMEs in poor-climate states do so. Only 30 percent of businesses in **Pakistan** normally communicate with their customers or suppliers using the Internet—far fewer than the 71 percent of firms that do so in China. In **Afghanistan**, business use of the Internet is nearly nonexistent outside of a few of the largest cities. On average, 15 percent of the surveyed firms regularly use e-mail in interactions with their

Difficulties faced in searching for, acquiring, and absorbing technology

Searching for technology. Large firms generally rely on their equipment suppliers and buyers to identify sources of technology, but many recognize that they need more advanced technology that they cannot easily identify. Small companies often use guesswork to estimate their technology needs, which frequently leads to costly mistakes.

Acquiring technology. Acquiring technology is less problematic, though still time consuming, if companies use reliable suppliers who commission the equipment and provide training for operators. Firms acquiring used equipment, however, often find that it is incorrect or defective. Hiring consultants can also be problematic, since many may be inappropriate unless recommended by a supplier or buyer.

Absorbing technology. Absorbing or internalizing technology poses significant challenges. Once production technology is acquired, it often has to be adapted to meet orders from customers. Some firms reported that such absorption problems can increase the costs of technology transfer by one-third. Maintenance and spare parts add further difficulties.

clients and suppliers and 9 percent use Web pages. In **Maldives**, however, the penetration of telecommunications is very high among the business community compared to the other South Asian countries. The percentage of firms that use e-mail regularly to interact with clients stands at 98 percent in the tourism sector, 96 percent in the manufacturing sector, and 84 percent in the transport and logistics sector.

Firms do not innovate because they have little incentive or capacity to do so...

Bhutan is a case in point. In Bhutan, the preferential access to the Indian market, India's high tariffs, and the natural protection provided by Bhutan's remote location have led to little domestic competition and created few incentives for firms to innovate and seek productivity improvements. Few resources are devoted to improving production processes or introducing new products. Investment is low and directed mainly at increasing production or replacing worn machinery with existing technology, mostly from India. In **Nepal**, many of the "learning" mechanisms are weak or missing: direct foreign investment is low, few firms train workers, business and technical training institutions are underdeveloped, local technical consulting services are weak (although there is some opportunity to bring in technical experts from India), and in many industries, buyers and suppliers are not visiting Nepal on a regular basis, which limits the possibilities for technology transfer.

...but they would benefit if they did so.

Evidence from South Asia confirms that innovation and use of modern technology has a positive impact on firm performance. In **Nepal**, the weaknesses in technology transfer mechanisms contribute to low enterprise and worker productivity. Firms in Nepal that do have access to technology transfer or "learning mechanisms," such as training, foreign ownership, foreign licensing, and technical agreements have significantly higher productivity than other enterprises. In **Bhutan**, the low investment in improving production techniques, combined with the lack of worker training, has led to low productivity and a lack of competitiveness for most Bhutanese products, both globally and within South Asia. In **Maldives**, the proxy measure employed for technology (that is, regular use of e-mail and Web sites in business operations) was positive and significant as a determinant of productivity and sales growth. Foreign competition and use of e-mail and Web sites for business activities emerge as key determinants of enterprise performance.

D. Regulatory Burden and Corruption

Regulatory Burden

Starting a business can be a hassle; running it even more so.

In many countries bureaucratic red tape can slow the creation and growth of formal-sector businesses or drive them into the informal

economy. Generally, the regulatory burden faced by private sector firms consists of tax and customs administration, regulatory inspections, labor regulations, and other administrative interventions affecting the running of a business on a day-to-day basis. In addition to its role in the regulation of business start-up, closure, and provision of industrial incentives, government intervention manifests itself through customs inspections, visits by tax officials, and other inspections to enforce a variety of health, safety, and environmental standards.

While these inspections are not in themselves different in South Asia than in the rest of the world, the issue for most of the countries is that of discretion in enforcement as well as the frequent and arbitrary nature of the visits. Bureaucratic procedures required to do business are often seen as rent-seeking opportunities by corrupt public servants. As a result, such procedures can quickly mushroom, stifling even the most entrepreneurial individuals. Surveys of the business climate in South Asian countries, including **Bhutan, India, Nepal, and Pakistan**, all point to heavy regulation and government unpredictability as a key constraint to private sector performance.

Once started, firms bear a regulatory burden on their operations. An indicator of this burden is the time senior managers spend dealing with officials of regulating agencies and the frequency with which officials pay inspection visits to factory premises. A case in point is **India**. Here, most laws that regulate the private sector are federal. However, their administration is mainly the responsibility of state governments, which have considerable discretion in enforcement. State inspectors are the chief enforcers through

routine visits to business premises; they have the power to suspend plant operations if required for inspection purposes. The inspections enforce many rules and regulations that are not necessarily much different from those in developed economies. However, in India, as in much of the developing world, government officers have too much discretion in deciding which rules to enforce, on whom, when, and how.

The burden of regulation is, on average, smaller in India, at 7.4 visits a year for a typical business, than in China (26.7 visits a year).³¹ However, paradoxically, senior managers of small businesses in India typically spend a greater share of their time dealing with regulations (11.9 percent) than do their Chinese (7.8 percent) or Brazilian (7.2 percent) counterparts. Moreover, Indian industry does suffer from more cumbersome and costly entry and exit regulation compared not only to China and Brazil, but also to other large-economy comparators such as Mexico and the Russian Federation.

Firms in **Pakistan** reported that a large amount of time and energy is lost on regulation, as senior managers spend an average of 10 percent of their time dealing with regulatory agencies. This is compared with less than half that amount of time for firms in **Bangladesh** (4.3 percent) and three quarters of the time in China (7.5 percent).

Tax and customs administration is widely cited in South Asia as a major source of regulatory hassle. In **Pakistan**, tax and customs administration is the leading obstacle to a conducive investment climate, and 60 percent of business contact with government officials

31 Things have improved over time. The average number of inspections per year for the 2003 India-wide sample (7.4) represents an improvement over 2000 (11.7).

is because of visits by tax agents. In **India**, tax and customs issues are not as burdensome as for firms in China, Brazil, and other countries of South Asia, and in fact have improved during the past three years with fewer inspections and fewer days to clear customs.

An exception to the South Asian pattern of heavy regulatory burden is **Sri Lanka**, where businesses do not appear to suffer from these problems. In sharp contrast with neighboring countries, Sri Lanka has made big strides in reducing red tape, and it has improved the governance framework to the point where it no longer poses a significant obstacle to doing business. Procedures for registering a new firm are simple-and, unusually, more than half of rural enterprises are registered. Today it is not only easy to start a business (see box below), but also relatively easy to run a business once started. Less than 8 percent of all firms in Sri Lanka cited licensing and operating permits as a constraint to doing business. Less than 15 percent complained of being constrained by tax administration, crime, customs regulations, or corruption.

Corruption

Corruption is a major problem in many South Asia countries and can be traced to the discretionary power of government officials.

Corruption is associated with a heavy regulatory burden although the latter has other costs as well. Gathering reliable information on corruption is difficult, understandably, since firms may be reluctant to provide detailed answers on unofficial payments. Corruption is particularly serious in **Afghanistan**, where it has recently shot up in the list of constraints cited by firms, and **Bangladesh**, where it has been a problem for a while. Firms in **India**, **Nepal**, and **Pakistan** also complain about corruption. Two South Asian countries fare relatively better on this front: Sri Lanka and Bhutan.

It is relatively easy to start a business in Sri Lanka

Starting a business in Sri Lanka involves relatively little red tape. Nearly 74 percent of urban manufacturing firms reported that obtaining a business license or operating permit was not a problem, compared with 37 percent in India, 41 percent in China, and 51 percent in the Philippines. Less than 8 percent of urban manufacturing firms and 4 percent of rural nonfarm enterprises cited the procedure as a major or severe obstacle.

The administrative burden for start-ups in Sri Lanka has become lighter only in recent years. In 2002, entrepreneurs wishing to register a limited liability company had to undertake eight procedures taking at least 73 days and costing \$127, equivalent to 15 percent of per capita gross national income (GNI). In the past year the process was simplified, reducing the number of procedures to seven, the average time to 50 days, and the cost to just under 11 percent of GNI. Even so, Sri Lanka still trails behind more-dynamic East Asian economies in the time it takes to open a business. Further efficiency gains are likely, however, with the government planning to automate the company registry.

Corruption is endemic in **Afghanistan** and adds to the uncertainty facing businesspeople. It is especially threatening to foreign investors or Afghans returning from overseas who do not have powerful patrons or understand the system. In the 2005 Transparency International Corruption Perception Index, Afghanistan ranks 117th, which places it among the world's most corrupt countries. Nearly 58 percent of the sample covered by the investment climate survey cited corruption as a major or severe problem, which ranks corruption just behind access to land and electricity. Afghan firms report that on average they pay an amount in bribes equivalent to more than 8 percent of sales, which is more than four times the average reported in neighboring Pakistan. In addition, when Afghan firms obtain a government contract, they have to pay almost 8 percent of the contract value in bribes.

Corruption is also a key issue in **Bangladesh**, which ranks the lowest (158th) on the 2005 Transparency International Corruption Perception Index. More than half of all firms in the sample reported that corruption was either a major or very severe obstacle to their growth. The incidence of corruption varies

between agencies. The customs and tax agencies top the list, both in the frequency with which firms reported making payments to them and in the payments required. While a relatively small number of firms reported making unofficial payments to the gas company for connections, the payments were very large, averaging close to 100,000 taka for a connection.³²

A high proportion of businesses in **India** find corruption to be a major or severe obstacle to business success. Corruption is often greater where the system of regulation under which businesses operate is complex, lending greater room for discretion to functionaries who deal with enforcement. Individual government officers seem to have too much discretion in deciding which rules to enforce, on whom, when, and sometimes, how. In many cases inspection visits are arbitrary or excessive, and are viewed by business owners as punitive, or as a veiled demand for bribes. In **Nepal**, firms report that corruption is pervasive and exists throughout the government. It is rampant in places where public officials have discretion to interpret unclear laws. Firms noted that the introduction of new laws, such as the value added tax (VAT) and environmental laws, have created new opportunities for corruption.³³ Transparency International ranks **Pakistan** at 144th rank on its 2005 Corruption Perception Index. A third of firms in Pakistan reported having made unofficial payments. Tax and labor officials are far more likely than other officials in the country to seek such payments.

Measures of perceived corruption from Transparency International show that **Sri Lanka** has a much smaller problem of corruption than its South Asian neighbors, in keeping with its lower regulatory burden. Among urban firms in Sri Lanka, more than half reported that corruption was no problem, compared with 21 percent in India. Around 11 percent of rural enterprises that dealt with government agencies for registration, and 8 percent that dealt with agencies for licensing, reported making unofficial payments. These payments were equivalent to 5-6 percent of the official licensing or registration fee. Rural entrepreneurs also reported that laws and regulations are occasionally misinterpreted or manipulated by officials as a result of a lack of knowledge among officials or because of ethnic, social, or income biases. Thus, while less of a problem than in its South Asian neighbors, corruption nevertheless exists in Sri Lanka.

Bhutan contrasts starkly with its other neighbors. The government is genuinely concerned with proper administration, and officials are seen as being honest and helpful. But Bhutan has reached a critical point where it could easily lose this advantage. Many important government decisions have been made case by case, such as issuing a business license, determining allowable tax deductions, issuing permits for foreign workers, and approving applications for foreign direct investment. Laws and regulations have not been clearly publicized or consistently implemented. The discretion that the system

32 Obtaining a connection to a gas service is a rare event. Thus the small share of firms reporting payments for connections probably reflects the fact that most firms in the sample already have connections, not that unofficial payments for connections are rare.

33 However, most firms report that for many services, the "corruption mechanism" operates smoothly. The level of the bribe is fixed; red tape and delays are minimal. As a result, firms often consider the cost of corruption in a similar manner to a user fee imposed by the government. The difference is that corrupt officials pocket the revenues instead of the government.

allows could open the door to corruption and certainly to the appearance of favoritism. While this system has served Bhutan reasonably well, it will become a growing obstacle as the economy expands.

E. Risk and Uncertainty

Courts and the Justice System

Entrepreneurs and other investors want assurances that contracts will be honored, that disputes will be handled fairly and quickly by the legal system, and that its decisions will be enforced. Thus a country's legal system can support investment or seriously undermine it.

Justice delayed is justice denied: South Asian firms have little faith in the judiciary and tend to bypass it.

In most South Asian countries, businesses typically have little faith in the judiciary. An exception is **Sri Lanka**, where more than half of rural nonfarm enterprises and urban manufacturing firms reported that the legal system was not a major constraint. By contrast, in **Bangladesh** a third of the surveyed firms reported that courts were never or seldom fair or honest. More strikingly, nearly 70 percent of firms involved in legal cases in court in the previous three years reported that the courts were never or seldom quick. In **India**, although 75 percent of the firms were confident that the legal system would uphold their property rights, 88 percent of firms responded that courts were "never," "seldom," or only "sometimes" quick. Courts were also not ranked highly for their affordability, enforceability, and consistency. In **Maldives**, approximately 40 percent of the firms surveyed indicated that they lacked confidence in the

judicial system to enforce their property rights in business disputes. Only 37 percent indicated that the interpretations of the rules were predictable or consistent. In **Afghanistan**, the formal court system barely functions and suffers from a lack of qualified legal professionals, no method to hold judges accountable, and reportedly endemic corruption.

Because of the deficiencies in the judicial system, contract enforcement is a big problem in most South Asian countries. Even in **Sri Lanka**, despite the overall positive perception of the legal system, enforcement of contracts still poses an obstacle to many businesses. While the number of procedures and the costs involved in resolving a contract dispute in Sri Lanka are comparable to those in OECD countries, the process takes more than twice as long. In **Bhutan**, while the legal code is improving rapidly and many new laws have been passed, financial institutions still find it difficult to enforce agreements or seize collateral. Laws may be adequate but are not enforced.³⁴

It is thus common for South Asian businesses to bypass the judicial system. In **Bhutan**, where courts are extremely slow or inefficient, only about 5 percent of firms in the survey reported hiring a lawyer or threatening to take a client to court for nonpayment. In **Afghanistan**, which lacks formal alternative dispute resolution mechanisms such as arbitration or mediation, businesses do not rely on the formal judicial system but on informal dispute resolution mechanisms. The investment climate survey also revealed that in Afghanistan fewer than half the incidents of

³⁴ Banks reported, for example, that passing checks with insufficient funds is a violation of the criminal code, but no one has ever tried to enforce the law. As a result, even government agencies are reluctant to take checks. Courts are extremely slow and inefficient, and seizing pledged assets of borrowers who default is extremely difficult.

crime or theft were reported to police and less than 30 percent of those reported were solved. In **Nepal**, firms do not normally use the court system or go to the police to solve their disputes. They resolve conflicts by threatening to cut off relations with their customers either in the same business or in other businesses through quid-pro-quo deals made with other firms. Most small firms are unable to collect from their clients when they have a conflict and have to bear the losses themselves.

A slow judiciary compounds cumbersome regulatory procedures to make exit difficult. In **India**, for example, bankruptcy procedures involve outdated and ineffective laws that have led to large-scale inefficiencies in the system, often resulting in high costs of credit and high accumulation of nonperforming assets. Recent estimates show that it is entirely common for proceedings to take more than two years, and more than 60 percent of liquidation cases before the High Courts have been in process for more than 10 years. According to the World Bank's *Doing Business* indicators it typically takes 10 years in India to close a business compared to 1.5 years in OECD countries. There is also no proper formal and informal rehabilitation mechanism for financially troubled companies. Lack of formal and informal workout mechanisms leads to inefficient use of assets and usually to an increase in the cost of lending or winding-up process.

Security

Security is an actual problem in some South Asian countries; it is looming in others.

Although security is not cited as a leading concern for private sector firms in South Asia, it represents a real cost burden and a deficiency because of the need for firms to provide in-house security services. Though considered longer-term objectives, security concerns are a

significant characteristic of commercial systems in South Asia.

In **Afghanistan**, until recently, firms cited poor security as the most important constraint to doing business. The investment climate survey carried out in the summer of 2005 reveals a different picture, with insecurity figuring much lower in the list of complaints. It is counterintuitive that most managers in the survey did not rank crime and disorder as a major or severe constraint. But this result can be explained. There have been real improvements in the security situation in the major cities covered by the survey. At the same time, existing firms have developed mechanisms to cope with insecurity, though at high cost. The surveyed firms reported spending 15 percent of sales for security infrastructure, significantly more than did firms in neighboring countries. Many firms have formed close ties with powerful elements in society, including warlords and government officials, to obtain protection in addition to resources. Security is thus a lesser concern for them. However, new entrants and potential investors who do not have established contacts with powerful figures find the environment much more daunting and are often discouraged from investing.

In **Pakistan**, businesses report being exposed to crime, ranging from petty theft to organized violence. One in three managers is concerned about extortion or intimidation of the company's employees, a somewhat higher percentage is concerned about arson, and more than three-quarters fear theft. One in five respondents reports that its business was the target of at least one crime during 2000-2002. The share is highest in NWFP, where one in three businesses report having been victimized by crime. In response, businesses in NWFP spend 4.5 percent of their revenue on security, with firms in Sindh and Punjab spending 1-2

percent. In **Nepal**, security was not cited as a major concern in the 2000 survey, but it is clearly a bigger headache now.

In contrast, in **India** law enforcement and crime seemed to be low on the list of priorities for private firms. In **Sri Lanka**, only 14 percent of urban firms identified crime, theft, and disorder as major constraints while rural enterprises, apart from those in the north and east, for the most part did not face law and order problems.

F. Trade

External trade regimes that foster competition, efficient import substitution, and production for export play a key role in supporting a country's investment climate. Import competition, access to globally traded goods, and a neutral incentives regime promote higher factor productivity and improved competitiveness. In addition, with globalization many countries of the South Asia region are seeking to integrate into production chains led by large multinational firms, which themselves seek firms that are able to compete on a global level.

The extent to which firms may reap the benefits of international trade depends on a number of factors including, in particular, the nature of the trade policy regime, trade-related infrastructure (especially port infrastructure), and customs administration. Port-related infrastructure has been discussed above. This section discusses trade policy issues and customs administration.

Trade Policy

Much has been accomplished in South Asia in recent years with regard to the tariff regime. Most nontariff barriers have been removed, tariff rates across stages of production have become

more uniform, and average tariff levels are coming down. In particular, the process of trade liberalization in **India** and **Sri Lanka** has been critical in fostering the restructuring of the export base from primary products to manufacturing. There do remain some concerns on the part of business in particular countries. In **Pakistan**, some binding import restrictions remain and exports have stagnated relative to those of neighboring countries, raising questions regarding international competitiveness. Firms in **Nepal** cited negative effective protection for manufacturing and a general bias toward trading over manufacturing in the trade regime as severe obstacles to business. In **Afghanistan**, manufacturers argued that the tariff structure is such that they often pay more duty on imported inputs than traders do on imports of the finished goods. **Bangladesh's** average tariffs remained higher than those in many other developing countries in Asia.

Illegal trade is also a problem. For example, **Afghan** manufacturing firms complain about the unfair competition from smaller informal firms that can smuggle goods into the country and do not pay taxes. In **Nepal**, many firms are concerned about the lax enforcement of customs, which encourages smuggling operations by traders.

Customs Administration

Onerous customs clearance procedures are one of the most commonly cited problems in South Asia. However, as mentioned in chapter one, the experience of firms with customs and trade regulations also varies widely within South Asia. In **Afghanistan**, **Bangladesh**, and **Pakistan** customs procedures are a serious problem, with more than 30 percent of firms citing them as a major constraint on doing business.³⁵ At the

35 This result is consistent with the ranking of these countries on the *Doing Business* Indicator on Trading Across Borders. Afghanistan, Bangladesh, and Pakistan rank respectively at the 125th, 123rd, and 103rd position on this indicator.

other end of the spectrum are **Bhutan** and **Nepal**, where less than 5 percent of all surveyed firms cited the clearance process as a major concern.³⁶

In Bangladesh, 43 percent of firms involved in trading identified **customs and trade regulations** as a major constraint (which represents the sixth most important constraint for Bangladesh) Firms reported that it took on average 11 days to claim imports from customs. The World Bank Document *Doing Business* reports that a firm needs 16 documents and 38 signatures to import a good. In Afghanistan, 39 percent of firms identified customs and trade regulations as a major constraint (which represents the sixth major constraint for Afghan firms). It takes on average 11 days to claim imports from customs. Pakistan needs 12 documents and 15 signatures to import.

The average shipment of imported inputs takes 17 days to pass through customs in **Pakistan**, 11 in **Bangladesh**, 7 in **India**,³⁷ and 7 in China. Delays on imports are greater than those on exports, but export delays hurt firms more. Foreign buyers with many suppliers to choose from put a premium on reliable delivery. Delays in customs can mean that a consignment literally misses the boat, jeopardizing the export contract. In **Afghanistan**, importing requires 10 documents and 57 separate signatures. Businesses reported that customs officials

continue to use wide discretion on the valuation and inspection procedures, which leads to corruption and delays. Customs procedures in Afghanistan are significantly slower than among its neighbors, which further erode the competitiveness of Afghan products. On average it took firms nearly 10 days to clear exports last year and about 11 days to clear imports.

Two countries fare better. **Maldives** requires fewer documents (12 for importing), fewer signatures (four for importing), and shorter processing time for both exporting and importing than do most countries in South Asia and compared to other small-island economies and the OECD countries. It is ranked at the 52nd position by the *Doing Business* Indicator on Trading across Borders and is the best-performing South Asian country on this front. Broadly speaking, Sri Lanka's ports and customs are more efficient than those of some of its competitors. In a World Economic Forum survey of port quality, Sri Lanka's ports outperformed those of China, India, and the Philippines, though they ranked below those of Malaysia and Thailand. The relatively high efficiency of Sri Lanka's ports is due in part to reforms that introduced competition in the Colombo port in the mid-1990s by allowing the private sector to build and operate a new terminal, the South Asia Gateway Terminal. The rankings of port

36 The apparent discrepancy between the ICA data on "percent of firms that trade identifying customs and trade regulations as a major constraint" and the *Doing Business* Indicator on Trading Across Borders has several potential explanations. The Nepal and Bhutan ICA surveys asked the question on major constraint differently than the other surveys: these surveys asked firms to assess whether the "import regime" (and not customs and trade regulations) is one of the three main constraints. In addition, the Bhutan survey was undertaken in 2000 and the Nepal survey in 2001. The *Doing Business* data are from 2005.

37 Clearing customs has shown improvements over time: the average number of days needed for a shipment of inputs to clear customs was 10.3 days in 2000. For small businesses in low-tech industries in Mumbai, this figure fell from 16.5 in the 2000 survey sample to 13.6 in 2003. Similar changes were reported for "maximum delays" in customs clearance. In international comparative terms, India's national average for customs clearance dropped below China's in 2003.

quality are broadly consistent with the results of investment climate surveys that show that clearing imports through ports and customs takes 3.5 days in Sri Lanka. However, port tariffs remain high, resulting in burdensome shipping costs, and moves per hour could be significantly increased (Sri Lankan ports average 25 moves per hour, compared with 100 in Singapore). Sri Lanka is ranked 92nd on the *Doing Business* Indicator on Trading across Borders.

Typically, South Asian firms face the following problems in clearing goods through customs: (i) procedural delays and red tape (clearing customs is a time-consuming process); (ii) inaccurate classification of goods (the tariff rates on some imported goods can vary based on how the good is classified under the different headings of the harmonized codes, which provide opportunities for arbitrary decisions, delays, and corruption); (iii) inaccurate valuation of goods (for fear of

under-invoicing, custom officials do not use the actual invoice value, but rather a "reference value"); (iv) difficulties with the duty drawback scheme (delays and rigidity of the scheme); (v) lack of enforcement; and (vi) smuggling (which creates unfair competition).

Trade Facilitation Services

Lack of trade facilitation services is another important constraint. **Afghan** exporters, for example, identified the lack of trade finance, insurance, and lack of cold storage and other storage infrastructure, along with inefficient customs and clearance procedures, as the biggest impediments to increasing exports. Moreover, no independent agencies ensure standards or certify quality. The high cost of shipping is another impediment to trade in Afghanistan. Responsibility for inspecting shipments beyond the border is not delineated among different agencies, causing shippers delays and raising costs.

Chapter 3

THE COSTS OF A DEFICIENT INVESTMENT CLIMATE

Power problems impose real costs on firms; they lower production and tie up scarce capital.

Inadequate and poor-quality electricity supply imposes real costs on firms, seriously constraining business operations and growth. Power disruptions often cause damage to materials in process—materials that cannot be used when power is restored and production resumes. Power disruptions also damage equipment, adding maintenance and repair costs that are directly attributable to the outages.

Revenues are forgone because of the downtime forced by outages. The typical business in **Pakistan** estimates that it loses about 5 percent of annual sales to power outages. For **Bangladesh**, regression results show that, even when industry and firm characteristics are controlled for, sales and investment both suffer as the number of power disruptions increases. Firms reported losing more than 3 percent of production on average as a result of problems in the electricity grid. The problem is worse in **India**, where the average manufacturer loses 8.4 percent a year in sales, and extreme in **Afghanistan** where 18 percent of merchandise value is lost because of power disruptions (30 percent in the city of Kandahar). The figure is less than 2 percent for the average manufacturer in China or Brazil. In **Sri Lanka**, lack of reliable electricity reduces the productivity of urban manufacturing firms by almost half, while among rural firms the productivity of those without connections to the grid is 25 percent lower than those with connections.

The use of generators to deal with unreliable power supply ties up scarce capital. In **India**, **Pakistan**, and **Sri Lanka**, tied-up capital represents 11-12 percent of fixed assets for businesses that run generators. This is one reason Pakistani firms use more capital but produce less output than Chinese firms. The heavy reliance on generators in Bangladesh means that the reported losses seriously understate the true costs of the poorly performing electricity grid. Generators are costly to buy and run. In **Bangladesh**, while power from the grid costs about four taka per kilowatt-hour, it costs more than six taka per kilowatt-hour for businesses to use their own generators. In some countries, the relative cost of generators is higher.

Poor transportation creates marketing problems and often leads to spoilage

Poor transportation has its costs. For rural firms in **Sri Lanka**, the poor quality of roads and lack of transport services create marketing problems and raise transport costs, reducing productivity. Urban firms report losing 7 percent of sales due to transport problems. Slow speeds spoil 40 percent of agricultural produce before it reaches market. In **Afghanistan**, firms reported losing 5 percent of their domestic merchandise value during transit because of breakage or spoilage and losing only 0.6 percent to theft. The proportions are not much different for international shipments from Afghanistan: 4.6 percent (breakage or spoilage) and 0.9 percent (theft). Firms rarely receive any compensation for such losses; only 2 percent

said they were ever compensated by the transport operators.³⁸

In **Pakistan**, most urban centers of industrial concentration are located far from the coast. Thus, high transport costs lower competitiveness of most firms. Dependence on a poorly maintained and thin road network as the primary mode of transport only adds to this cost. High freight handling costs at the ports of Karachi and Qasim—estimated to be several times higher than those of comparable ports in the region—also raise the cost of Pakistani goods.³⁹ A recent review of trade in selected commodities estimates that Pakistan could save up to 16.5 percent of the value of exports by improving its trade and transport logistics systems. Inefficiency in transport alone is estimated to cost the economy Rs. 320 billion a year. In **Bhutan**, the high costs and poor reliability of road transport make it almost impossible for industries heavily dependent on transport to be competitive except in the border areas.⁴⁰

The waits at the port can also be costly to firms. For **Bangladesh**, regression analysis controlling for industry and firm characteristics suggests that each day that exports are delayed in customs is associated with a 0.3 percentage point reduction in investment and a 0.2 percentage point reduction in sales and employment growth. In **Bhutan**, deficiencies in airline transport affect the ability of companies to ship raw materials and finished products in a timely way. High-cost, unreliable

air transport is among the main obstacles to penetrating markets beyond India and developing service industries (such as information technology) and niche export markets (such as fresh mushrooms).

Poor access to finance limits growth opportunities.

With inadequate access to external finance, firms have limited opportunities for growth. Reliance on their own funds limits specialization, adoption of better technology, growth in productivity, and thus economic growth and development. For example, regression exercises show that in **Bangladesh**, firms with better access to formal credit grow more quickly than firms that rely more on retained earnings, even after controlling for firm and industry characteristics. In **Maldives**, poor access to finance is associated with low labor productivity, while cost of finance is a significant negative determinant of labor productivity and investment rates. In **Sri Lanka**, empirical analysis for rural firms indicates that greater access to informal finance and location in communities with more efficient financial sectors (as measured by the time taken to clear a check) are associated with higher productivity.

Regulatory hassles add to the cost of doing business.

In **Bangladesh**, firms receive about 17 visits a year from all government agencies. The most frequent visits come from the customs agency (7.5 a year) and the tax agency (2.7). Dealing with these visits can be costly, not only in fees

38 In Nepal, a firm in the beverage industry indicated that the firm incurs losses of 2 to 3 percent as a result of breakage in bottles when they are transported to and from retail outlets. Similarly, a carpet manufacturer in Kathmandu reports that because of the poor quality of the local roads, the firm has to repair one of its vehicles every week and spends Rs.100,000 per year on maintenance.

39 One estimate puts these costs at 1.5 times those in Bombay and 4.5 those in Colombo.

40 The road network can make a great difference in their ability to compete. Firms that are competitive in the border areas (because they export to India) might not be competitive in the center of the country. Most enterprises import raw materials from India, send finished products to that country, or both. As a result, the road network creates a big cost disadvantage for producing goods anywhere except along the border.

and payments but also in the resources firms must expend to satisfy inspections.⁴¹ In **Pakistan**, firms reported spending 10 percent of management time dealing with government officials. Businesses in Pakistan receive an average of 36 inspection visits per year, also above levels in Bangladesh or India. Slightly more than 60 percent of the contact that businesses in Pakistan have with government officials is with agents of the Central Board of Revenue, the agency responsible for assessing and collecting all inland revenue and customs duties. Forty percent of small businesses and more than 70 percent of large businesses in the survey sample claimed to have been audited by tax authorities at least once within the previous three years.

The number of inspections and visits by officials imposes a financial and nonfinancial (time) cost on managers, and dampens firms' performance. Regression analysis for **Bangladesh** shows that the number of inspections per employee has a significant negative correlation with investment and productivity. Similar exercises for **India** also show that the time that management spends on addressing regulations is negatively associated with business profitability, thereby having an adverse effect on location of economic activity. In many cases inspection visits are arbitrary or excessive, and business owners view them as punitive or as a veiled demand for bribes. But firms often pay up because the costs of not doing so can be high. Inspections may be more frequent or more intrusive, leading to disruptions to production plans or loss of valuable staff time. Regulations and corruption are important determinants of

business locations across Indian cities. Cities where firms in general face lower regulatory burdens are likely to receive more investment and have higher shares of manufacturing activity.

Inflexible labor markets add to costs and discourage adjustments-but they do not necessarily help the poor.

Firms in **Sri Lanka** try to avoid restrictive labor regulations by hiring temporary workers, but this practice has its costs: survey results show that productivity falls with an increase in the share of temporary workers in a firm's employment. In addition, workers are paid a salary that takes into account the high costs of retrenchment. As a result, Sri Lankan workers are paid much less than workers at the same skill level in other parts of South Asia, despite the country's relatively high per capita GDP. Besides, contrary to public opinion, TEWA does not protect the poor, since they work mainly in the informal sector and as casual laborers in agriculture or on plantations and are not covered by the law.

In **Nepal**, restrictive labor laws have caused many older firms to be overstaffed and unable to reorganize by hiring people with skills that better match their current needs. Firms have devised many ways to overcome these restrictions, including adopting capital-intensive production methods, using casual labor, subcontracting their production, or splitting their production between various sites (to reduce the risk of labor disputes spreading). All these raise costs and lower productivity.

Excess regulation of industrial relations is a major drag on the international

41 Managers reported spending nearly 5 percent of their time on average dealing with regulatory matters. With a reported average compensation for managers of around 1 million taka, the management cost alone amounts to close to 50,000 taka annually. More than a third of firms reported using facilitators to help with regulatory issues, at an average annual cost of more than 600,000 taka.

competitiveness of many of **India's** labor-intensive industries. Labor market rigidity has not only kept the growth rate of exports low, but may also account for the "shockingly low" share of formal-sector employment in India's economy. Only 8.5 percent of India's labor force, or 27 million people, are in formal-sector employment, of whom 70 percent work for government agencies.

Labor market restrictions also reinforce exit barriers. For example, the Industrial Disputes Act of 1947 requires establishments with more than 100 workers to secure state government permission before plant closure or a retrenchment of workers. This permission is rarely granted, thus adding to protracted insolvency procedures. Labor regulations, including but not limited to the Industrial Disputes Act, also reduce the flexibility of firms to respond to changes in market conditions. The Industrial Employment Act has made it difficult for businesses to shift workers not only between plants and locations, but also between different jobs in the same plant. Indian labor laws give firms significantly less control over their hiring and firing decisions than China's labor code provides.

It is interesting then that only about 17 percent of the Indian sample identified labor regulation as an impediment to growth, which is comparable to the percentage reported for Chinese businesses but much smaller than that for Brazil. This could mean much of Indian

industry has already adjusted itself beyond the reach of the law through its choice of lines of activity and scales of operation. The respondents to the India investment climate survey indicated that, on average, their staffing levels exceeded the desired levels by 11 percent.⁴² This proportion compares with 19 percent for China, suggesting that India's industrial labor market could be significantly more flexible than China's in allowing firms to adjust their workforce to changes in market conditions. However, India's labor market also seems to be far less flexible than Brazil's on the same criterion.

The usefulness of labor market flexibility is borne out by the experience in **Bangladesh**. Regressions controlling for industry and firm characteristics show that the share of a company's labor that is temporary (rather than permanent) is positively correlated with sales and employment growth. That is, firms that can adjust their staffing levels more quickly seem to grow more quickly.⁴³

Training raises productivity; yet, most firms do not invest in training.

In **Sri Lanka**, firms whose managers hold a tertiary or professional degree tend to be more productive. A manager's prior experience in exporting firms also raises productivity. The survey also shows that the type of training matters: external training increases a firm's productivity, while formal in-house training

42 Not all the overstaffing is likely to be involuntary on the part of firms. Employers normally retain workers in excess of current needs if they anticipate an upturn in their sales in the near future and if the combined cost of firing, hiring, and training that would be involved in adjusting manpower through the market to a particular phase of the business cycle exceeds the cost of retaining some workers at wages exceeding their marginal product. Indeed, more than 60 percent of respondents who reported overstaffing at the time of the survey cited anticipated growth in demand as a reason for their decision to retain workers in excess of their current needs. However, there is also clear indication that a substantial part of the reported overstaffing has been forced on employers by existing labor laws as shown by the fact that 29 percent of overstaffed businesses cite labor laws to be the reason they are retaining more workers than they need.

43 However, assigning causality here is difficult: it may be that firms hire temporary labor because they are growing so quickly, not that firms grow more quickly because they use temporary labor.

does not. In **Bangladesh**, regression analysis shows that firms that ran training programs or sent employees to outside training programs saw higher sales growth, profitability, and investment.

However, only 26 percent of Sri Lankan firms benefit from external training. In **Bhutan**, although they complained about lack of skills, virtually no firms reported undertaking any significant staff training (only 3 percent of firms' employees had received training in the 12 months preceding the survey).⁴⁴ Most firms in **Nepal** provide little training, preferring to hire already trained workers or to rely on technologies that do not demand highly skilled workers. In **Pakistan**, while the high proportion of "temporary" workers may have given businesses greater flexibility to adjust

their workforce, this has come with a price. Both employees and employers are deprived of the benefits of stable and longer-term employment relationships, such as the constant upgrading of skills needed to remain competitive. Heavy reliance on temporary employment undermines the incentives of workers and firms to participate in, or sponsor, on-the-job skill formation. Thus, although a far higher proportion of Pakistan firms reports skill shortages, only 15 percent of them sponsor on-the-job training. This is very low, even by developing country standards. This low proportion is particularly worrisome because with low average levels of schooling, on-the-job training is important for alleviating skill shortages.

44 Contrary to expectations, firms did not cite high labor turnover as an important reason for not extending formal training to workers. Large enterprises and those based in Colombo are much more likely than others to offer formal, external training. For managers private and public institutes are the primary sources of external training, while for skilled workers institutes and industry associations are the main sources. Firms that use outside training rated private institutes as more effective than public institutes or industry associations.

Chapter 4

WHAT TO DO?

POLICY RECOMMENDATIONS

The previous chapters suggest a strong relationship between the investment climate in South Asian countries and their economic performance. Based on the theoretically sound and empirically supported relationship between a good investment climate on one hand and higher productivity and firm growth on the other, policies and programs that address the constraints analyzed by the ICAs can achieve potentially significant gains (see box below). This chapter provides a rich flavor of the recommendations contained in the various ICAs.⁴⁵

Gains from improving the investment climate

- In India, it is estimated that a 10 percentage point reduction in indicators of deficiency in power supply, tax and customs administration, and improved factor markets will lead to an increase in firm-level productivity and sales growth rates of 160 percent and 41 percent, respectively.
- In Pakistan, the ICA estimates that leveling up Pakistan's indicators in infrastructure, customs, and finance to those in China will raise sales and employment growth by 8.5 and 3.1 percentage points, respectively.
- In Sri Lanka, for rural firms, having access to and using electricity from the grid is associated with total factor productivity (TFP) 25 percent higher than that of firms not connected to the grid. Owning a phone or having access to more-efficient financial services is associated with a higher TFP by 33 percent and 6 percent, respectively. On the other hand, poor road quality reduced the level of TFP by 44 percent.

A. Infrastructure

Power

Some South Asian countries have an advantage that their neighbors do not. For example,

Bangladesh has sufficient energy resources (mainly natural gas) that can be converted into electricity more competitively than many of its neighbors and peers can generate. But this requires reforming the power sector. In India, the enactment of the Electricity Act (2003) is a very positive development, but much more needs to be done to make the enabling legal and structural environment work. In Sri Lanka, although the Electricity Reform Act 2002 provides for the restructuring of the Ceylon Electricity Board and Lanka Electricity Company, implementation of these reforms has been pending since October 2003.⁴⁶ A regulatory agency, the Public Utilities Commission, has been established and staffed and it has prepared licenses and regulations; however, to date it has no legal mandate to regulate the power sector.

These are just three examples of an issue that is a regional challenge. In general, radical and systematic restructuring of the power sector is needed in most South Asian countries in order to reduce inefficiencies in the public sector and encourage private investment. As indicated in the ICAs and as summarized below (see box), this restructuring will require work in a number of areas (see also box on power sector reforms in Pakistan, below). The relevance, relative

45 This chapter does not discuss trade policy. A rich set of recommendations for trade policy reforms in South Asia is in World Bank, South Asia Region PREM; *Trade Policies in South Asia: An Overview*, 2004.

46 The objective of the proposed reforms is to introduce competition and managerial focus. The Ceylon Electricity Board is to be restructured into a holding company with the following subsidiaries: one generation company, one transmission company (and single buyer), and two or more distribution companies. The current government (elected November 2005) has made a commitment to implement the reform and has tabled amendments to the Electricity Reform Act in Parliament.

Power sector reforms for South Asia: Illustrative examples

Define a vision and strategy

- Further clarify the government's vision of the power sector, including its strategy regarding tariffs, investments, and private sector participation (Afghanistan).
- Develop a rural energy strategy to bring electricity to rural areas (in Afghanistan, in the medium term).

Invest in the power sector

- Invest in transmission and distribution systems to improve the quality and reliability of the power supply (Sri Lanka).
- Minimize delays in implementing a plan for expanding least-cost generation capacity (Sri Lanka).

Improve sector and public enterprise governance

- Reduce transmission and distribution losses arising from theft and leakages (India).
- Commercialize the sector and strengthen its financial and operational performance; phase out capital and operation subsidies to reduce the sector's fiscal burden (Sri Lanka).

Restructure public sector entities

- Undertake financial restructuring (Bangladesh).
- Corporatize the power utility, Da Afghanistan Breshna Moassesa; strengthen its managerial, technical, and financial capacity; and restructure it in the form of regional business units (Afghanistan).
- Undertake organizational and financial reform of the state electricity boards (India).

Carry out tariff reforms

- Rationalize power tariffs, depoliticize tariff setting, and implement a phased reduction in cross-subsidies that operate against industrial customers (India).
- Embark on a relatively ambitious power tariff reform program (Afghanistan in the medium term as the quality of power supply is improved and the power network is expanded)
- Introduce transparent and efficient subsidy mechanisms to help expand access to electricity in rural areas (Sri Lanka).

Establish a good regulatory framework

- Introduce independent regulation (Bangladesh).
- Establish truly independent, technically competent, and fully professional state-level electricity regulatory commissions (India).
- Provide open access to SEB grids (India).
- Enable the Public Utilities Commission to implement sector regulations, especially the tariff regulations aimed at achieving cost recovery (Sri Lanka).

Phase in competition and private entry

- Attract private sector involvement in utility operations to help improve efficiency (Sri Lanka).

Develop alternative energy sources

- Prepare a policy to promote the development of small-scale distributed renewable energy in rural areas (Sri Lanka)
- Promote renewable energy sources such as solar, hydro, biomass, and wind as part of the national energy strategy (Sri Lanka).

Power sector reforms in Pakistan

Pakistan needs to invest heavily in distribution and transmission capacity, but that investment will not be forthcoming without a successful restructuring of the Water and Power Development Authority, a real opening of the sector to private capital, and assignment of a significant role for the market in tariff determination. Reform of the power sector must open distribution and transmission businesses, as well as generation, to private capital. There is a need to strengthen the government's policy development and implementation capacity. Such reforms have been on the government's agenda for some time; what seems lacking is the political commitment to implement the agenda aggressively. Some important reforms have taken place, such as the privatization of the Karachi Electric Supply Corporation in 2005, which will help achieve the fundamental goal of improving efficiency in the sector. However, more needs to be done. The price of continued failure may not be limited to losses in industrial productivity; failure could also create another fiscal crisis, driven by the financing needs of a bottomless pit of failing state-owned utilities.

priorities, pacing, and sequencing of the various measures are not the same across the countries, and the various countries indicated in parentheses are to illustrate a point rather than to say that a particular point is most important for that country or only to that country.

Transport

An important agenda is reducing the state's role in transport or at least ensuring a level playing field. For Afghanistan, where private transport companies (both freight and passenger) have expanded rapidly since the end of the conflict, the ICA expressed concern about the possible distorting effects of the state's involvement as an operator in the sector. It said, for example, "though the government has licensed a number of private airlines, any government favoritism to Ariana (*the state-owned airline company*) will undoubtedly impede the development of private airlines and competition in the air transport sector."

Some countries face unique challenges. For example, Bhutan's physical characteristics pose such a constraint on road transport that the country faces a choice between investing heavily in roads and focusing the development of transport-dependent industries solely in the border areas. Choosing the second option would mean that only niche industries relying little on transport could be profitably developed in the center of the country. In the short to medium term, while industries relying heavily on transport are likely to be profitably developed only along the border with India, the development plan for the center of Bhutan will probably need to focus on niche-type industries with less need for cheap, reliable transport. At the same time, there is need to think "outside the box," such as using private charter airlines from India and Nepal to bring tourists into Bhutan and developing helicopter services to

ferry goods and passengers into and around Bhutan.

Telecommunications

The public sector will continue to play an important role, especially in providing fixed-line services in many South Asian countries and of course, in regulating the sector. Hence, strengthening the public sector entities is an important item in the reform agenda. The Bangladesh ICA, for example, recommended the corporatization of the Bangladesh Telegraph and Telephone Board (BTTB) into a public limited company, with professional management and a more independent board of directors. In Afghanistan, where the public sector telecom company, Afghan Tel, had recently been corporatized, the ICA argued for its strengthening.

While it is important to strengthen the public sector entities, there are limits to how much can be achieved through public sector reforms. For Bangladesh, the ICA notes that while the proposed corporatization of BTTB will improve the company's operational flexibility, it may not fully isolate the company from political influence. That suggests a need to consider privatization for the medium term. International experience over the past two decades has proved the importance of competitive markets and broad private participation for successful expansion of telecommunications services. That lesson has been borne out in Bangladesh and in other South Asian countries, where private investment has driven the rapid expansion of mobile phones.

The next challenge is to attract private investment into fixed-line telephony while continuing to improve the environment, especially the regulatory environment, for private investment in mobile telephony. The Pakistan ICA, for example, talks about the need

for an adequate regulatory framework for the telecom sector, including licensing regime and radio frequency management, to generate private sector investment. The Afghanistan ICA recommends the strengthening of the regulator, the Telecommunications Regulatory Authority.

B. Factors of Production

Finance

Although South Asian countries have made important strides in developing their financial systems, in most countries the system still falls far short of what the private sector needs to become internationally competitive. The financial systems' weaknesses will become even more evident as the private sector grows and especially as foreign investors enter and local firms attempt to break into world markets. The ICAs recommend a set of actions to promote access to finance. These are the following:

Improve credit information. Establishing credit information bureaus, or expanding them to incorporate positive information and smaller firms, could go a long way toward reducing information asymmetries and thus lowering the risk premia applied to small borrowers. In this context higher interest rates do not necessarily indicate market failure, but they may reflect greater risks or costs. Banks often charge higher interest rates from smaller firms for a variety of reasons: (i) small firms have a higher turnover rate than larger firms, making them riskier to lend to; (ii) given the fixed overhead costs per loan, the smaller size of loans extended to smaller firms also makes lending to them less profitable for banks; and (iii) small firms also often have less collateral and less of

a proven track record, making it harder for banks to assess their creditworthiness.

Increase competition. Encouraging competition and innovation would help improve the cost and efficiency of banking services. Lack of competition as well as innovation and creativity reduces market orientation in the banking system. The two are linked. Thus, increasing competition for depositor funds and lending opportunities is likely to be the best way to promote innovation, creativity, and market orientation. In small, underdeveloped banking systems the most effective competition often comes from nonbank sources—such as leasing companies, insurance companies, venture capital, and private debt instruments (see below).

Introduce a wider range of products. An example of a new product is leasing, a potentially powerful yet relatively simple financial service that is increasingly offered in the developing world. Leasing has several important advantages for SMEs. Most important, the leased equipment (such as a vehicle or machinery) belongs to the finance company throughout the lease period, so repossession in the case of nonpayment is simple and requires no long legal process. Indeed, the leased equipment usually forms the collateral for the transaction, doing away with the need for the "borrower" to provide large amounts of security.⁴⁷ In many countries leasing companies have provided not only important new financial instruments but also effective competition for commercial banks. In **Maldives**, the government has supported the creation of a leasing finance and a housing finance institution, which has somewhat deepened the market.⁴⁸

47 These two advantages are particularly powerful in environments such as Bhutan's.

48 With the entry of the Maldives Finance Leasing Company (MFLC) in 2002, enterprises have access to medium- and long-term capital equipment finance for various economic sectors. This was one of the government's initiatives to strengthen and introduce more sophistication and depth into the financial sector.

Develop private debt markets and intercompany borrowing. Another potentially effective way to increase competition for banks is to develop private debt markets, allowing companies with sound financials to issue their own debt in the domestic market. Like a government debt market, a private debt market provides funding directly to an enterprise without channeling funds through the banking system. Commercial banks receive fewer deposits as a result (reducing excess liquidity). Furthermore, because the intermediation mechanism squeezes interest margins more effectively than intermediation through a commercial bank, savers benefit through higher rates while borrowers benefit through lower ones.

Reduce discrimination against small players. Policies or practices that discriminate against small firms should be tackled. A relatively simple but effective step would be to develop credit rating agencies to help firms build records of their credit histories in order to break the cycle of not being able to obtain credit because they have no record of having handled it well in the past.

Improve the legal system. Successfully making finance available for firms requires an effective legal and regulatory framework that instills confidence in the rights of lenders and borrowers and facilitates efficient and verifiable financial transactions. Improving and streamlining the laws governing the corporate sector and enhancing the effectiveness and efficiency of an enforcement mechanism for creditors' rights (including the judicial system) would help improve access to capital and probably also lower its cost. Further, improving the legal system would also facilitate trade by encouraging firms to extend more trade credit. Legal and regulatory reforms are

a drawn-out process that requires government persistence and strong political will.

Labor Market and Skills⁴⁹

The Sri Lankan government has taken some early steps to increase flexibility in the labor market, though the effects have yet to become apparent. Some stroke-of-the-pen reforms can be accomplished quickly if the government has the political will to do so. These measures include reducing mandated severance payments in line with international best practice and abolishing the need to obtain approval of the commissioner of labor every time a company seeks to fire an employee. The procedures for worker separation can also be streamlined.

Pakistan has embarked on some labor market reforms. At the federal level, the government is revising the labor code to increase flexibility in the labor market and lower the cost of employer compliance. The reforms are expected to improve considerably the flexibility of hours as well as the rigidity of hiring. The available number of hours for workers, particularly for females, will be increased. Term limits for contracts will also be lengthened. At provincial levels, enforcement of the new legislation will be enhanced through more professional and less intrusive inspection methods. Labor disputes, clogged in the high courts at the appellate level, will find a new appeal venue in the Labor Appellate Tribunal. However, Pakistan can do more. It can remove the requirements to retrain or replace workers before a dismissal. Severance pay, currently one month per year of service, can be cut to at least be in line with more flexible regional benchmarks; for example, Bangladesh and India require only a half-month's severance per year of service.

49 The section on labor regulations is largely based on World Bank, *Doing Business in South Asia in 2006*.

India needs to simplify regulations, with special emphasis on improving industrial relations, smoothening dispute resolutions, and removing ambiguity. It also needs to reduce the rigidities in labor markets. Specifically, four main reforms are needed: (i) consolidating and simplifying labor laws from the current 47 laws to about 4 covering the main areas of dispute resolution, conditions of work and welfare, wages and benefits, and social security; (ii) modernizing the Industrial Disputes Act to reduce the bias toward adjudication in disputes and to increase flexibility for employers in hiring and firing in a way that also protects workers' rights; (iii) resolving ambiguities concerning the Contract Labor (Regulation and Abolition) Act to introduce greater flexibility; and (iv) improving the labor law enforcement and inspection system.

Regarding the shortage of skilled labor, South Asian countries will need a better supply of educated workers as they seek to move up the technological ladder and diversify into new economic sectors. In Bangladesh, despite significant progress in enrollment ratios over the past decade, illiteracy remains relatively high: at 58 percent, the rate is higher than that in any of the comparator countries in East and South Asia and slightly higher than the average for low-income countries (46 percent). Bhutan needs to recognize the considerable advantages offered by the country's ready access to a large pool of skilled, experienced, and relatively low-cost workers in India. Mandating reductions in the use of non-national labor is an ineffective way to promote the private sector or to generate the employment for which Bhutanese are most suited. Instead, policies should focus on increasing the productivity of Bhutanese workers through a mix of management training, worker training, and technology transfer.

In reforming its labor markets, South Asian countries can look to other countries for guidance (see box).

Actions to improve labor market flexibility in South Asia

Allow redundancy as a fair ground for dismissal. India, Nepal, and Sri Lanka bar employers from using redundancy as a ground for dismissal. If a firm cannot fire excess workers in times of low demand, it is less likely to hire in high times. This situation hurts both the worker and employer with fewer jobs overall and less flexibility for the firm to grow. Australia, Denmark, Malaysia, Taiwan (China), Thailand, and Vietnam are some of many examples of economies that permit redundancy firing.

Cut the mandated notice period and the severance payment for redundancy dismissal. The notice period for firing a worker is 12 weeks in India. Sri Lanka requires a severance payment of 48 months. When such tight restrictions are placed on a firm's ability to fire, that firm necessarily becomes wary to hire. While political reaction to suggested labor reforms can be severe, the reforms work. Colombia cut severance payment from 26 to 11 months, and the mandated notice from eight to two weeks. These reductions helped create 300,000 new jobs. South Asian countries could also look to Armenia, Hong Kong (China), and Uruguay for examples on how to reduce severance pay for redundancy.

Remove time limits on term contracts. Pakistan permits term contracts for a maximum of only nine months; Bhutan permits only one year. Bhutan further prohibits part-time jobs. Such inflexibility in the timing and use of employees limits companies' ability to grow and thrive. Both countries can look to China, Malaysia, Singapore, and New Zealand, which place no limits on the duration of fixed-term contracts, and in so doing increase job opportunities for workers.

Source: World Bank, *Doing Business in South Asia in 2006*.

Technology

As discussed in chapter two, South Asian firms face many difficulties in searching for, acquiring, and absorbing technology. These countries thus need to improve the efficiency of technology transfer mechanisms. This effort would include programs to increase direct foreign investment, make work permits for expatriate experts easier to obtain, raise the level of manager and worker training, improve firms' access to technical consultancy services, and assist managers to visit suppliers and buyers.

C. Regulatory Burden and Corruption

A variety of initiatives are needed to reduce the regulatory burden and address the problem of corruption:

Improve investment facilitation services. In Afghanistan, the Afghanistan Investment Support Agency has helped many investors

negotiate the regulatory maze without paying bribes, but this function is still limited in scope. For Nepal, the ICA identified the need to improve the working of the one window service. Suggested actions include first limiting its scope and sharpening its focus to deal with a limited group, such as exporters in Kathmandu, and then expanding its scope to include other types of firms and extending its reach outside Kathmandu. In all countries, an important implementation issue is to foster coordination of all ministries in making the one window service operate effectively.

Simplify regulations. There are many short-term opportunities for streamlining regulations, eliminating unnecessary ones, and reducing the scope for informal payments. Procedures for the entry of new firms could be simplified, for example, reducing unnecessary costs and delays and encouraging informal firms to enhance their legal status and thus improve their access to finance. The benefits of simplifying regulations are evident from the Indian experience, where the cost to industry of entry and exit regulation has come down considerably as a result of policy reforms implemented since 1991. Early reforms included the removal of a policy reserving certain industries for the public sector and the abolition of licensing requirements for private investment in many industries. However, the long-standing policy of reserving many labor-intensive industries to small-scale operators has yet to end. It also takes significantly longer in India to obtain approval for a new business than in comparable economies. The Pakistan ICA recommended decreasing the discretion of inspectors and tax collectors and moving to greater automation of processes to help speed procedures and reduce unnecessary regulatory hassles and corruption.

Improve the tax administration. Improving the tax administration is a major challenge in South

Asia but one that needs to be addressed as a priority. This is a multidimensional agenda, including more and better training for tax officials, improvements to the system for resolving tax disputes, and improvements to customs administration (see box). The Pakistan ICA listed reforms of the inspection regime of the Central Board of Revenue as a priority to reduce the overall regulatory burden on industry.

Make exit easier. Reducing exit barriers is an important agenda, particularly in India. Bankruptcy procedures take much longer in India than in countries whose regulatory environment is otherwise not much different from India's. Exit barriers in India's industries are strongly reinforced by the excessive regulation of industrial relations (Industrial Disputes Act of 1947). Very little progress has been made at amending any part of the law at the federal or state levels, probably because of the constraints imposed by electoral politics.

Implement broader public administration reforms. At the end of the day, many fundamental reforms will be required in public administration. This is exemplified by the case of Bangladesh, where the ICA argued that "broader public administration reform will be required to create a new governance framework, which includes rationalizing cadres and revising the skill mix while introducing better compensation packages and performance-based salaries."

D. Risk and Uncertainty

Policy Predictability

It is important to make policies predictable and easy to understand. Access to clear and concise policy information could also play a crucial role. For Nepal, the ICA argued for stability in tariff rates and currency regulations so that firms could effectively plan and said that changes should be made with adequate notice and

Reforming customs administration: A top priority in South Asia

The need for reform of customs administration has long been recognized in Pakistan, but progress has been slow. Cost gains can also be made by improving customs procedures, information flows, documentation-related legislation, and distribution and collection systems, none of which are currently geared to accommodate the needs of businesses operating internationally on the basis of just-in-time deliveries. The government is taking steps to improve customs administration in the context of a broader trade and transport facilitation program.

In Bangladesh, efforts are under way to improve customs administration procedures—an important bottleneck to trade. The establishment of the Automated System for Customs Data has already speeded clearance of goods at the internal customs depot and reduced opportunities for informal payments. Initial reforms of tax administration are also under way. Bangladesh needs to further simplify customs procedures, including fully implementing the new duty drawback and bonded warehouse scheme.

In Sri Lanka, there is a need to improve customs operations, which remain outdated despite reforms in the 1990s. The government is now giving serious consideration to establishing an independent revenue administration agency that would increase efficiency, transparency, and accountability. Moving to such an agency would enable customs to play a stronger role in facilitating trade.

In Nepal, there is a need to make the duty draw-back and VAT refund system much more efficient. The refund of VAT and duty should not be delayed to make up for government revenue shortfalls. The procedures must be streamlined so that a firm can meet the procedural requirements with minimal effort.

Complementary to custom administration improvements, there is a need to improve customs infrastructure in order to handle the volume of traffic and secure shipments. In Sri Lanka, one important measure for increasing competition and efficiency is to restructure the Sri Lanka Ports Authority along the landlord port model, sharpening the distinction between the management of ports and the operation of terminals.

consultation. Business activities in a country such as Nepal are already risky and uncertain, and there is no reason that government actions should add to the level of uncertainty.

Judicial Reforms

All South Asian countries need to strengthen their judicial system. The Bangladesh ICA, for example, recommended the forceful pursuit of the Supreme Court's mandate to ensure separation of powers between the executive and the judiciary, arguing that this separation would do much to lessen corruption and delays in the lower courts. It also recommended decentralizing the lower judiciary, simplifying procedures, and introducing effective mechanisms to ensure transparency and accountability. Afghanistan needs to develop an effective judicial system that enforces decisions and helps resolve disputes so that recourse to informal means of dispute resolution is reduced, which is particularly important in the current context where investors often fall back on the informal connections and relationships to help settle disputes. In Bhutan, improving and streamlining the legal system would help improve access to capital and probably also

lower its cost. For Nepal, the ICA argued for strengthening the court and legal system so that contracts can be adequately enforced at a reasonable cost. In India, the company law is being amended to establish a bankruptcy tribunal. Reforms undertaken in Maldives and Sri Lanka provide additional examples of what can be done (see box below).

Judicial reforms in Sri Lanka and Maldives

In Sri Lanka, the government has initiated reforms of the legal and regulatory framework to support private sector development. Comprehensive training is provided for the judiciary and the legal community to enhance their knowledge of modern concepts of commercial law. In addition, modern, computerized systems will be introduced in a group of courts countrywide, to minimize delays in the legal process and reduce associated corruption and costs.

In Maldives, the government has introduced a number of reforms targeted at improving the courts, such as setting up a separate body for monitoring compliance of enforcement of court decisions in the attorney generals' department. The government also announced that it would introduce an examination for practicing lawyers and plans to establish a bar association and draft a code of ethics for judges. Further reforms are required in the following areas: human resource development for legal and judicial services; drafting of new commercial laws; provision of legal aid; introduction of alternate dispute resolution mechanisms; court automation, including court management and case management; set up of a high-level steering committee with all stakeholders.

Security

In Pakistan, tackling the law-and-order problem quickly and decisively is essential for boosting investor confidence. Doing so

requires reforming enforcement institutions. The government has already initiated some measures, such as the Police Act of 2002. The act provides for more democratic control over the police and their insulation from political interference. The government has also initiated grassroots reforms in the judicial system, with the aim of improving the

administration of the courts by streamlining recordkeeping, training judges, and disseminating information. However, progress in implementing both police and judicial reforms remains slow. Urgent and aggressive action is required to persuade investors that enough is being done to restore law and order.

ANNEX: COUNTRY PROFILES

(South Asia)

AFGHANISTAN

Summary of Enterprise Survey Indicators						
	Afghanistan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	28.6	30.6	25.6	28.6	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	64.6	60.8	71.7	57.1	38.3	34.8
Days/Year of Insufficient Water Supply	30.6	35.4	28.4	13.3	8.0	23.9
Delays in Obtaining Electricity Connections (Days/Year)	43.9	39.2	50.6	38.2	55.2	39.7
Delays in Obtaining Telephone Connections (Days/Year)	30.5	35.9	28.2	21.0	65.0	54.8
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	56.2	56.8	56.7	50.0	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	56.8	55.6	61.1	44.4	34.6	44.1
% of Investments Financed by Internal Funds	78.6	66.7	61.5	68.8	53.1	63.9
% of Investments Financed by Banks	0.2	24.0	0.0	0.0	18.0	16.5
% of Investments Financed by Leasing	0.1	21.0	3.1	1.2	2.9	1.1
% of Investments Financed by Informal Sources	19.9	40.7	50.0	38.5	5.2	4.7
% of Investments Financed by Trade Credits	0.9	NA	NA	NA	1.9	1.6
% of Investments Financed by Other Sources	0.2	6.0	44.6	0.0	18.8	12.3
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	22.8	28.4	17.3	10.7	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	12.8	15.3	11.2	3.6	16.5	20.3
% of Firms Offering Formal Training	1.9	2.0	1.9	1.9	26.9	40.1
Managers/Professionals (as % of Total Workforce)	65.5	126.9	63.3	62.2	31.7	38.7
% of Firms Identifying Corruption as Major Constraint	57.3	58.6	55.9	55.6	30.5	37.1
Unofficial Payments to Get Things Done (% of Sales)	8.1	68.3	7.4	6.6	1.3	1.5
Unofficial Payments to Secure Government Procurement (% of Contract)	64.0	58.6	59.5	55.6	2.0	3.0
% of Firms Expected to Give Gifts to Obtain Import Licenses	41.7	45.2	33.3	50.0	9.4	16.9
% Senior Management Time Dealing with Government Regulations	19.6	17.9	19.7	28.3	7.2	8.2

	Afghanistan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	31.5	33.9	30.7	19.2	na	19.5
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	20.8	23.9	18.4	11.1	22.6	25.9
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	93.2	92.8	94.1	90.9	16.2	57.1
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	44.4	46.1	42.4	42.9	48.5	52.8
Length of Time to Resolve an Overdue Payment (Weeks)	8.3	8.5	8.6	4.5	9.2	7.4
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	48.3	46.3	50.5	50.0	79.3	72.6
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	14.7	11.7	17.6	21.4	62.1	49.9
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	8.7	6.1	12.8	7.1	26.7	26.1
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	38.9	57.7	37.5	33.3	28.3	28.9
Days on Average to Claim Imports From Customs	11.3	5.7	10.9	18.0	8.5	8.0
% of Inputs Which Firms Import Directly	50.9	80.6	48.5	39.6	35.4	25.2
<p><i>Note:</i> Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.</p>						

BANGLADESH

Summary of Enterprise Survey Indicators						
	Bangladesh	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	24.2	18.6	27.4	23.2	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	73.2	70.1	77.0	71.9	38.3	34.8
Days/Year of Power Outages	249.0	272.2	268.6	239.0	75.1	47.5
% of Sales Lost to Power Outages	3.0	2.4	3.8	2.7	5.7	4.6
Days/Year of Insufficient Water Supply	17.6	10.7	26.6	15.3	8.0	23.9
Delays in Obtaining Electricity Connections (Days/Year)	66.3	46.1	74.8	65.6	55.2	39.7
Delays in Obtaining Telephone Connections (Days/Year)	126.0	116.4	135.5	123.0	65.0	54.8
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	41.5	41.5	47.4	38.6	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	49.8	38.0	54.3	48.9	34.6	44.1
% of Investments Financed by Internal Funds	59.9	75.6	62.4	56.9	53.1	63.9
% of Investments Financed by Banks	29.7	11.2	27.5	32.8	18.0	16.5
% of Investments Financed by Leasing	1.9	0.0	1.1	2.4	2.9	1.1
% of Investments Financed by Informal Sources	4.6	10.1	4.8	3.9	5.2	4.7
% of Investments Financed by Trade Credits	2.6	2.3	2.9	2.5	1.9	1.6
% of Investments Financed by Other Sources	1.3	0.7	1.2	1.4	18.8	12.3
% of Firms with Bank Loans/Overdraft Accounts	64.4	35.1	58.5	71.5	48.7	33.7
Value of Collateral (% of Loan Value)	92.5	77.1	84.2	95.8	108.9	139.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	8.3	1.4	7.3	9.6	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	19.3	6.6	21.0	19.5	16.5	20.3
% of Firms Offering Formal Training	27.2	6.6	23.0	31.3	26.9	40.1
% of Skilled Workers Offered Formal Training	32.6	NA	NA	32.6	33.2	25.6
Managers/Professionals (as % of Total)	10.1	19.6	13.8	7.5	13.5	23.7
of which: % Female	0.5	0.6	0.4	0.6	2.5	4.1
Non-production Workers (as % of Total)	6.7	6.0	8.3	6.1	15.7	12.8
of which: % Female	14.4	4.3	8.0	19.1	13.6	18.9
Skilled Production Workers (as % of Total Work-force)	62.3	59.8	58.8	64.1	31.5	34.1
of which: % Female	31.5	7.3	6.7	43.4	25.4	14.0
Unskilled Production Workers (as % of Total Work-force)	21.2	14.6	19.1	22.8	28.7	26.3
of which: % Female	33.7	7.3	12.3	42.9	26.0	20.6

	Bangladesh	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	57.8	32.4	60.6	58.7	30.5	37.1
Unofficial Payments to Get Things Done (% of Sales)	2.1	2.3	2.1	2.1	1.3	1.5
Unofficial Payments to Secure Government Procurement (% of Contract)	4.0	4.2	4.2	4.0	2.0	3.0
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	85.8	79.4	81.9	87.7	44.3	28.8
% Firms asked to give a gift to the labor	77.2	58.3	70.9	79.7	58.6	52.7
% Firms asked to give a gift to the fire inspector	68.8	50.0	55.4	74.4	15.1	10.4
% Senior Management Time Dealing with Government Regulations	3.7	2.1	3.7	3.9	7.2	8.2
Time Spent in Tax Inspection Meetings	2.8	2.3	2.8	2.9	3.8	4.7
Courts and Crime Indicators						
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	39.2	19.4	47.0	37.8	22.6	25.9
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	5.7	10.2	8.6	3.9	16.2	57.1
% of Firms Resolving Disputes through Court Action	7.8	7.9	1.9	12.2	3.0	9.2
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	17.0	11.7	17.1	17.0	48.5	52.8
Costs of Security (% of Sales)	0.5	0.7	0.6	0.5	0.5	1.7
Losses due to Crime (% of Sales)	0.4	0.4	0.5	0.4	0.3	1.3
Innovation and Technology Indicators						
R&D Expenditures (% of Sales)	0.2	0.0	0.3	0.2	0.5	0.7
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or Equipment	42.6	28.2	32.1	48.5	34.9	53.1
% of Firms Acquiring Technological Innovations by Hiring Key Personnel	19.1	23.9	21.4	17.9	13.4	9.5
% of Firms Acquiring Technological Innovations by Licensing	1.9	0.0	2.9	1.8	5.0	3.7
% of Firms Acquiring Technological Innovations by Developing Internal or with Others	26.5	39.4	32.1	22.6	30.4	22.5
% of Firms Acquiring Technological Innovations by Other Ways	9.9	8.5	11.5	9.3	16.4	11.2
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	70.3	13.0	48.5	85.6	62.1	49.9
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	31.1	2.6	18.7	39.4	26.7	26.1
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	43.3	23.5	40.6	44.6	28.3	28.9
Days on Average to Claim Imports From Customs	10.6	10.3	9.4	10.8	8.5	8.0
Days on Average to Clear Customs for Exports	8.3	15.5	9.4	8.1	6.3	4.6
% of Firms That Import Directly	53.7	17.3	27.7	68.3	39.2	43.8
<i>Note:</i> Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

BHUTAN

Summary of Enterprise Survey Indicators						
	Bhutan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employee)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	10.9	12.9	14.3	10.5	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	5.4	5.3	6.5	5.0	38.3	34.8
Days/Year of Power Outages	20.9	19.8	18.4	27.7	75.1	47.5
Days/Year of Insufficient Water Supply	5.5	5.2	6.2	5.3	8.0	23.9
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	14.3	17.1	15.2	9.1	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	12.2	7.3	24.2	4.5	34.6	44.1
% of Investments Financed by Internal Funds	66.0	37.0	33.5	67.5	53.1	63.9
% of Investments Financed by Banks	18.1	13.9	21.4	12.5	18.0	16.5
% of Investments Financed by Informal Sources	3.8	8.3	0.0	4.8	5.2	4.7
% of Investments Financed by Trade Credits	2.0	0.0	4.0	0.0	1.9	1.6
% of Investments Financed by Other Sources	10.2	15.9	10.8	4.8	18.8	12.3
% of Firms with Bank Loans/Overdraft Accounts	41.8	29.3	39.4	68.2	48.7	33.7
Value of Collateral (% of Loan Value)	156.3	147.9	119.6	205.8	108.9	139.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	30.6	36.6	27.3	27.3	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	49.0	46.3	45.5	49.2	16.5	20.3
% of Firms Offering Formal Training	1.6	1.7	1.6	1.5	26.9	40.1
% of Skilled Workers Offered Formal Training	27.5	22.7	31.9	26.8	33.2	25.6
Managers/Professionals (as % of Total Workforce)	14.0	18.7	11.3	10.1	13.5	23.7
of which: % Female	2.1	2.8	1.9	0.4	2.5	4.1
Non-production Workers (as % of Total)	31.5	25.3	35.5	36.1	15.7	12.8
of which: % Female	17.6	25.0	14.2	14.0	13.6	18.9
Skilled Production Workers (as % of Total)	21.7	26.8	16.3	21.0	31.5	34.1
of which: % Female	6.6	9.0	6.7	2.0	25.4	14.0
Unskilled Production Workers (as % of Total)	32.8	29.3	36.9	32.8	28.7	26.3
of which: % Female	19.0	13.5	26.1	16.0	26.0	20.6

	Bhutan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employee)	South Asia	Low Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	5.1	4.9	3.0	9.1	30.5	37.1
Courts and Crime Indicators						
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	32.2	21.1	40.0	38.0	16.2	57.1
% of Firms Resolving Disputes through Court Action	21.4	12.5	8.3	50.0	3.0	9.2
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	58.5	43.6	68.8	68.2	79.3	72.6
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or	100.0	100.0	100.0	100.0	34.9	53.1
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	76.3	70.6	68.0	95.2	62.1	49.9
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	18.8	23.5	12.0	19.1	26.7	26.1
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	8.3	5.0	5.3	11.1	28.3	28.9
Days on Average to Claim Imports From Customs	4.7	4.5	0.0	4.3	8.5	8.0

INDIA

Summary of Enterprise Survey Indicators						
	India	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	12.4	11.8	13.3	15.2	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	28.9	28.1	31.0	29.0	38.3	34.8
Days/Year of Power Outages	154.1	159.5	157.6	111.8	90.9	52.6
% of Sales Lost to Power Outages	8.2	8.6	8.4	4.7	5.4	4.6
Days/Year of Insufficient Water Supply	24.7	26.7	25.8	9.1	10.8	24.0
Delays in Obtaining Electricity Connections (Days/Year)	67.7	65.3	73.4	72.5	55.2	39.7
Delays in Obtaining Telephone Connections (Days/Year)	63.3	70.1	51.8	49.9	65.0	54.8
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	18.2	17.8	20.6	14.3	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	20.0	19.7	21.5	17.6	34.6	44.1
% Financing by Banks, Working Capital	42.1	65.4	76.9	83.4	NA	NA
% Financing by Banks & DFIs, Term Loans	56.4	11.4	20.2	13.6	NA	NA
% Financing by Venture Capital	0.1	0.6	0.2	0.2	NA	NA
% Financing by Private equity/Private placements	1.4	21.9	2.7	2.7	NA	NA
% Financing by Public offer of equity	0.0	0.7	0.0	0.1	NA	NA
% of Investments Financed by Other Sources	1.1	14.9	3.0	2.9	NA	NA
% of Firms with Bank Loans/Overdraft Accounts	57.2	50.1	68.7	81.7	48.7	33.7
Value of Collateral (% of Loan Value)	94.0	91.1	94.2	107.6	108.9	139.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	16.6	15.6	18.7	17.5	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	12.5	12.3	12.4	14.4	16.5	20.3
% of Firms Offering Formal Training	17.8	12.6	22.9	46.3	26.9	40.1
Managers/Professionals (as % of Total Workforce)	17.7	18.4	16.4	14.7	13.5	23.7
of which: % Female	1.3	1.2	1.5	1.5	2.5	4.1
Non-production Workers (as % of Total Workforce)	18.8	18.0	21.0	16.3	15.7	12.8
of which: % Female	8.8	8.3	7.4	20.3	13.6	18.9
Skilled & Unskilled Production Workers (as % of Total Work-force)	63.5	63.5	62.6	69.1	73.7	63.2
of which: % Female	7.0	5.8	8.8	12.8	15.1	10.4

	India	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	37.3	37.4	37.1	41.2	30.5	37.1
% Senior Management Time Dealing with Government Regulations	12.9	12.1	14.3	14.1	7.2	8.2
Time Spent in Tax Inspection Meetings (Days/Year)	4.9	4.2	5.0	10.8	3.8	4.7
Courts and Crime Indicators						
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	15.6	15.5	14.9	15.3	22.6	25.9
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	9.8	9.0	11.0	12.8	16.2	57.1
% of Firms Resolving Disputes through Court Action	18.1	15.2	20.8	35.3	3.0	9.2
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	70.6	70.3	69.9	76.8	48.5	52.8
% Firms Satisfied with Law & Order Situation	15.3	15.5	15.8	10.9	NA	NA
% Firms Victimized by Crime in Past Year	14.7	13.0	16.5	24.2	NA	NA
% Firms Paying For Security Personnel or Devices	81.1	81.6	79.2	91.7	NA	NA
Innovation and Technology Indicators						
R&D Expenditures (% of Sales)	0.5	0.4	0.6	0.6	0.5	0.7
% Capacity Utilization Over the Last Year	78.3	78.3	77.6	78.1	70.0	66.5
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	62.1	54.4	73.6	86.5	62.1	49.9
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	35.9	28.5	47.3	62.6	26.7	26.1
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	17.2	15.9	20.1	16.9	28.3	28.9
Days on Average to Claim Imports From Customs	6.6	5.1	7.7	8.0	8.5	8.0
Days on Average to Clear Customs for Exports	4.7	4.0	5.8	4.8	6.3	4.6
% of Firms That Import Directly	21.2	14.8	29.4	46.4	39.2	43.8
Note: Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

MALDIVES

Summary of Enterprise Survey Indicators						
	Maldives	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Lower Middle
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	26.2	27.3	20.8	33.3	15.8	9.9
% of Firms Identifying Electricity as a Major Constraint	21.4	22.2	25.0	12.0	38.3	19.6
Days/Year of Power Outages	1.8	0.8	2.8	2.4	75.1	73.3
Days/Year of Insufficient Water Supply	3.4	3.8	2.9	0.0	8.0	89.4
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	69.3	66.7	69.8	72.2	28.1	26.4
% of Firms Identifying Cost of Finance as a Major Constraint	66.7	58.0	72.5	70.3	34.6	33.2
% of Investments Financed by Internal Funds	64.3	65.2	72.2	52.3	53.1	63.9
% of Investments Financed by Banks	22.7	13.9	19.5	37.0	18.0	16.5
% of Investments Financed by Leasing	4.3	3.9	7.7	0.0	2.9	1.1
% of Investments Financed by Informal Sources	1.0	2.4	0.0	0.7	5.2	4.7
% of Investments Financed by Trade Credits	2.2	5.0	0.6	1.4	1.9	1.6
% of Investments Financed by Other Sources	5.5	9.7	0.0	8.6	18.8	12.3
% of Firms with Bank Loans/Overdraft Accounts	43.2	38.2	33.3	64.1	48.7	22.5
Value of Collateral (% of Loan Value)	128.6	88.8	117.7	81.3	108.9	143.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	25.9	20.8	30.8	26.3	16.4	14.6
% of Firms Identifying Labor Skill Level as a Major Constraint	43.5	30.9	50.0	52.6	16.5	17.4
% of Firms Offering Formal Training	66.3	48.6	78.0	76.5	26.9	55.9
% of Skilled Workers Offered Formal Training	62.5	79.0	58.9	52.1	33.2	26.0
Managers/Professionals (as % of Total Workforce)	20.2	27.9	13.3	19.1	13.5	26.1
of which: % Female	10.4	3.7	9.9	26.7	2.5	1.7
Skilled Production Workers (as % of Total Workforce)	46.3	43.8	47.2	48.8	31.5	40.6
of which: % Female	16.2	11.4	19.8	17.8	25.4	12.5
Unskilled Production Workers (as % of Total Workforce)	35.7	29.3	40.8	37.7	28.7	22.7
of which: % Female	12.0	17.7	9.4	9.4	26.0	19.1

THE INVESTMENT CLIMATE IN SOUTH ASIA

	Maldives	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Lower Middle
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major	42.9	41.8	48.1	36.8	30.5	34.9
% of Firms Expected to Give Gifts to Obtain Operating Licenses	2.9	0.1	0.0	0.0	17.8	23.2
% of Firms Expected to Give Gifts to Obtain Import Licenses	0.0	0.0	0.0	0.0	9.4	16.0
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	38.6	34.0	45.3	35.9	.	19.7
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	26.1	20.8	40.4	13.5	22.6	24.1
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	9.7	8.4	1.6	19.8	16.2	58.4
% of Firms Resolving Disputes through Court Action	26.8	27.0	33.3	20.0	3.0	20.1
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	58.8	49.1	70.4	56.4	79.3	70.1
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	42.9	25.0	57.1	50.0	.	35.8
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	79.0	67.6	85.7	83.9	.	63.3
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or Equipment	90.9	66.7	100.0	few obs	34.9	63.7
% of Firms Acquiring Technological Innovations by Hiring Key Personnel	16.0	13.3	19.2	11.1	13.4	8.8
% of Firms Acquiring Technological Innovations by Licensing	4.0	6.7	3.8	0.0	5.0	2.4
% of Firms Acquiring Technological Innovations by Developing Internal or with Others	18.0	20.0	11.5	33.3	30.4	17.6
% of Firms Acquiring Technological Innovations by Other Ways	22.0	20.0	19.2	33.3	16.4	7.6
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	97.1	94.3	97.3	100.0	62.1	58.2
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	68.9	51.4	73.0	83.9	26.7	44.4
Trade Indicators						
Days on Average to Claim Imports From Customs	0.0	0.0	0.0	0.0	0.0	0.0
% of Firms That Import Directly	0.0	0.0	0.0	0.0	0.0	0.0
% of Inputs Which Firms Import Directly	42.9	25.0	57.1	50.0	.	35.8
% of Firms Expected to Give Gifts to Obtain Import Licenses	0.0	0.0	0.0	0.0	0.0	0.0

ES Country Profile: MALDIVES 2005

NEPAL

	Nepal	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	15.2	14.6	17.5	13.7	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	41.5	28.4	37.3	47.9	38.3	34.8
Days/Year of Power Outages	18.9	17.2	16.9	20.8	75.1	47.5
Days/Year of Insufficient Water Supply	5.6	3.2	6.3	5.5	8.0	23.9
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	11.2	3.6	10.7	13.5	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	17.5	7.1	21.4	17.1	34.6	44.1
% of Investments Financed by Internal Funds	68.3	41.5	48.8	58.3	53.1	63.9
% of Investments Financed by Banks	23.5	33.7	20.6	20.5	18.0	16.5
% of Investments Financed by Leasing	0.0	0.0	0.0	0.0	2.9	1.1
% of Investments Financed by Informal Sources	2.2	1.1	3.0	1.3	5.2	4.7
% of Investments Financed by Trade Credits	2.3	1.4	1.9	2.2	1.9	1.6
% of Investments Financed by Other Sources	3.7	5.4	5.4	2.7	18.8	12.3
% of Firms with Bank Loans/Overdraft Accounts	49.8	53.6	53.6	45.9	48.7	33.7
Value of Collateral (% of Loan Value)	136.6	151.2	137.0	131.3	108.9	139.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	11.6	17.9	14.3	8.1	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	15.2	21.4	11.9	16.2	16.5	20.3
% of Firms Offering Formal Training	45.7	59.3	46.4	41.8	26.9	40.1
Managers/Professionals (as % of Total Workforce)	6.8	18.4	7.3	4.0	13.5	23.7
of which: % Female	0.2	0.0	0.2	0.4	2.5	4.1
Non-production Workers (as % of Total Workforce)	17.7	12.8	20.2	16.5	15.7	12.8
of which: % Female	5.9	0.0	5.1	7.7	13.6	18.9
Skilled Production Workers (as % of Total Workforce)	8.1	9.1	7.8	8.1	31.5	34.1
of which: % Female	2.0	0.0	1.5	2.9	25.4	14.0
Unskilled Production Workers (as % of Total Workforce)	67.4	59.7	64.7	71.5	28.7	26.3
of which: % Female	18.8	26.1	10.6	24.1	26.0	20.6

	Nepal	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	10.7	10.7	13.1	9.0	30.5	37.1
Courts and Crime Indicators						
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	50.0	65.6	65.7	59.3	16.2	57.1
% of Firms Resolving Disputes through Court Action	8.3	8.7	8.7	17.9	3.0	9.2
Costs of Security (% of Sales)	6.4	1.9	7.0	7.0	0.5	1.7
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	100.0	0.0	100.0	100.0	79.3	72.6
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or Equipment	28.1	35.7	22.6	28.8	34.9	53.1
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	0.0	0.0	0.0	0.0	62.1	49.9
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	54.8	57.9	63.2	45.1	28.3	28.9
Note: Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

PAKISTAN

Summary of Enterprise Survey Indicators						
	Pakistan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	9.9	11.7	8.4	11.3	15.8	16.6
% of Firms Identifying Electricity as a Major Constraint	39.2	39.8	39.7	34.6	38.3	34.8
Days/Year of Power Outages	11.5	11.5	11.0	13.5	75.1	47.5
% of Sales Lost to Power Outages	5.1	5.5	4.9	4.5	5.7	4.6
Days/Year of Insufficient Water Supply	4.2	3.9	4.0	6.3	8.0	23.9
Delays in Obtaining Electricity Connections (Days/Year)	32.9	35.9	31.2	31.4	55.2	39.7
Delays in Obtaining Telephone Connections (Days/Year)	22.3	33.7	19.2	16.6	65.0	54.8
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	37.5	34.3	41.2	30.8	28.1	35.5
% of Firms Identifying Cost of Finance as a Major Constraint	42.6	39.1	45.0	42.9	34.6	44.1
% of Investments Financed by Internal Funds	58.1	60.7	60.2	48.2	53.1	63.9
% of Investments Financed by Banks	6.5	0.7	5.7	17.7	18.0	16.5
% of Investments Financed by Leasing	2.5	0.4	3.1	3.8	2.9	1.1
% of Investments Financed by Informal Sources	13.6	12.6	14.5	12.8	5.2	4.7
% of Investments Financed by Trade Credits	1.8	0.9	1.9	3.1	1.9	1.6
% of Investments Financed by Other Sources	17.5	24.7	14.6	14.3	18.8	12.3
% of Firms with Bank Loans/Overdraft Accounts	22.8	10.0	26.7	47.7	48.7	33.7
Value of Collateral (% of Loan Value)	69.5	72.2	71.2	63.9	108.9	139.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	15.0	10.0	17.4	20.6	16.4	11.0
% of Firms Identifying Labor Skill Level as a Major Constraint	12.7	9.2	15.2	13.1	16.5	20.3
% of Firms Offering Formal Training	11.1	7.2	9.4	31.8	26.9	40.1
% of Skilled Workers Offered Formal Training	36.0	31.7	40.1	33.4	33.2	25.6
Managers/Professionals (as % of Total Workforce)	24.3	25.1	24.7	19.3	13.5	23.7
of which: % Female	2.2	1.6	2.4	3.5	2.5	4.1
Non-production Workers (as % of Total Workforce)	9.3	8.6	9.8	9.3	15.7	12.8
of which: % Female	1.9	0.7	1.9	6.0	13.6	18.9
Skilled Production Workers (as % of Total Workforce)	50.9	52.5	49.3	52.8	31.5	34.1
of which: % Female	3.5	1.4	4.2	7.3	25.4	14.0
Unskilled Production Workers (as % of Total Workforce)	15.5	13.8	16.1	18.6	28.7	26.3
of which: % Female	4.0	2.0	3.5	11.3	26.0	20.6

	Pakistan	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Low Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	40.3	37.3	41.0	47.1	30.5	37.1
Unofficial Payments to Get Things Done (% of Sales)	1.6	1.6	1.5	1.9	1.3	1.5
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	1.4	0.3	2.0	2.0	44.3	28.8
% of Firms Expected to Give Gifts to Obtain Operating Licenses	17.7	0.0	25.0	0.0	17.8	18.2
% of Firms Expected to Give Gifts to Obtain Import Licenses	NA	NA	NA	NA	9.4	16.9
% Senior Management Time Dealing with Government Regulations	8.7	7.9	8.7	11.4	7.2	8.2
Time Spent in Tax Inspection Meetings (Days/Year)	3.1	1.1	4.3	4.5	3.8	4.7
Courts and Crime Indicators						
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	21.5	19.5	19.6	36.8	22.6	25.9
% of Firms Resolving Disputes through Court Action	NA	NA	NA	NA	3.0	9.2
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	37.4	37.9	37.1	37.4	48.5	52.8
Costs of Security (% of Sales)	1.1	1.0	1.1	1.2	0.5	1.7
Losses due to Crime (% of Sales)	0.1	0.1	0.1	0.1	0.3	1.3
Innovation and Technology Indicators						
R&D Expenditures (% of Sales)	1.1	0.4	1.7	0.6	0.5	0.7
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or Equipment	8.0	6.3	7.9	14.3	34.9	53.1
% of Firms Acquiring Technological Innovations by Hiring Key Personnel	13.8	10.8	16.4	11.4	13.4	9.5
% of Firms Acquiring Technological Innovations by Licensing	9.2	9.1	8.7	11.4	5.0	3.7
% of Firms Acquiring Technological Innovations by Developing Internal or with Others	46.0	49.9	43.2	46.7	30.4	22.5
% of Firms Acquiring Technological Innovations by Other Ways	23.0	23.9	23.7	16.2	16.4	11.2
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	33.6	21.4	33.7	73.8	62.1	49.9
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	18.3	10.6	17.2	49.5	26.7	26.1
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	29.7	14.6	32.4	42.9	28.3	28.9
Days on Average to Claim Imports From Customs	17.1	11.3	21.3	12.1	8.5	8.0
Days on Average to Clear Customs for Exports	8.9	3.7	9.6	11.9	6.3	4.6
% of Firms That Import	24.8	12.8	29.1	44.9	44.1	45.3
% of Firms Expected to Give Gifts to Obtain Import Licenses	NA	NA	NA	NA	9.4	16.9
<i>Note: Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.</i>						

SRI LANKA

	Sri Lanka	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Lower Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	22.0	6.7	16.6	27.9	15.5	11.6
% of Firms Identifying Electricity as a Major Constraint	41.3	37.8	43.7	39.8	42.2	20.6
Days/Year of Insufficient Water Supply	7.6	2.4	8.7	7.6	15.5	5.8
Delays in Obtaining Electricity Connections (Days/Year)	54.0	0.0	64.6	46.6	65.8	20.9
Delays in Obtaining Water Connections (Days/Year)	19.4	0.0	18.4	20.3	19.4	14.2
Delays in Obtaining Telephone Connections (Days/Year)	48.4	0.0	75.6	40.4	68.6	20.8
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	15.1	13.3	15.9	13.7	27.8	30.0
% of Firms Identifying Cost of Finance as a Major Constraint	25.8	15.6	27.8	26.1	32.8	36.7
% of Investments Financed by Internal Funds	50.0	75.7	46.3	49.2	57.0	53.7
% of Investments Financed by Banks	15.3	7.1	14.0	16.6	22.6	21.2
% of Investments Financed by Leasing	4.4	0.0	6.2	3.9	2.5	2.9
% of Investments Financed by Informal Sources	1.7	0.0	3.9	0.7	5.5	4.5
% of Investments Financed by Trade Credits	1.9	0.0	1.1	2.7	2.3	3.7
% of Investments Financed by Other Sources	26.6	17.1	28.6	26.8	10.1	14.0
% of Firms with Bank Loans/Overdraft Accounts	56.2	48.9	57.0	62.7	50.8	34.5
Value of Collateral (% of Loan Value)	104.7	106.5	101.1	106.9	93.7	124.7
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	25.6	11.1	21.9	30.5	15.6	20.4
% of Firms Identifying Labor Skill Level as a Major Constraint	21.3	15.6	16.6	24.3	15.1	23.1
% of Firms Offering Formal Training	32.6	2.2	21.2	46.3	20.0	52.1
% of Skilled Workers Offered Formal Training	31.3	0.0	40.9	27.2	32.7	22.8
Managers/Professionals (as % of Total Workforce)	8.6	16.6	10.9	5.6	16.6	28.4
of which: % Female	3.8	1.1	6.9	1.5	1.4	1.4
Non-production Workers (as % of Total Workforce)	10.3	11.6	10.6	9.9	13.2	9.9
of which: % Female	33.8	9.1	30.4	41.6	10.3	20.8
Skilled Production Workers (as % of Total Workforce)	45.8	55.0	41.2	47.1	32.3	32.7
of which: % Female	52.6	33.9	43.5	61.9	22.0	18.8
Unskilled Production Workers (as % of Total Workforce)	35.8	16.8	37.3	38.3	12.7	34.1
of which: % Female	48.3	58.2	43.8	50.3	27.3	24.0

	Sri Lanka	Small (1-19 Employees)	Medium (20-99 Employees)	Large (100+ Employees)	South Asia	Lower Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	16.9	6.7	11.3	21.7	40.1	35.6
Unofficial Payments to Get Things Done (% of Sales)	0.1	0.0	0.1	0.2	1.6	1.2
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	2.7	0.0	2.9	3.4	27.4	16.6
% of Firms Expected to Give Gifts to Obtain Operating Licenses	18.0	0.0	22.7	18.2	17.9	14.0
% of Firms Expected to Give Gifts to Obtain Import Licenses	18.8	0.0	23.1	11.8	16.7	12.5
% Senior Management Time Dealing with Government Regulations	3.5	2.4	3.5	3.7	8.6	8.9
Time Spent in Tax Inspection Meetings (Days/Year)	4.2	1.4	3.5	5.2	3.9	5.1
Courts and Crime Indicators						
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	14.0	6.7	8.6	18.6	22.3	25.4
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	33.0	40.0	39.5	27.4	11.7	62.7
% of Firms Resolving Disputes through Court Action	8.8	0.0	3.9	16.0	13.5	24.5
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	68.8	82.2	64.9	68.0	50.2	62.6
Costs of Security (% of Sales)	0.8	0.4	0.9	0.9	0.8	1.5
Losses due to Crime (% of Sales)	0.5	0.5	0.5	0.6	0.3	0.4
Innovation and Technology Indicators						
R&D Expenditures (% of Sales)	0.0	0.1	0.0	0.0	0.5	1.1
% of Firms Acquiring Technological Innovations by Purchasing New Machinery or Equipment	54.2	46.9	48.2	56.9	30.5	51.0
% of Firms Acquiring Technological Innovations by Hiring Key Personnel	7.2	9.4	6.4	7.8	14.8	9.7
% of Firms Acquiring Technological Innovations by Licensing	3.8	9.4	5.7	2.3	5.2	2.6
% of Firms Acquiring Technological Innovations by Developing Internal or with Others	18.6	25.0	21.3	16.1	33.1	24.6
% of Firms Acquiring Technological Innovations by Other Ways	16.2	9.4	18.4	17.0	16.4	12.1
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	68.2	17.8	55.6	84.5	58.4	61.3
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	29.3	11.1	14.6	41.2	29.7	43.3
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	16.5	15.4	15.3	17.8	28.0	25.4
Days on Average to Claim Imports From Customs	3.6	0.0	4.1	3.4	8.7	6.9
Days on Average to Clear Customs for Exports	3.1	2.8	2.3	3.6	6.2	4.1
% of Firms That Import Directly	42.6	4.4	25.8	59.4	34.1	35.5
% of Firms Expected to Give Gifts to Obtain Import Licenses	18.8	0.0	23.1	11.8	16.7	12.5
Note: Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

COUNTRY PROFILES

(Comparator Countries)

BRAZIL

Summary of Investment Climate Indicators						
	Brazil	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Latin America	Lower Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	19.3	18.6	18.3	26.5	11.5	9.9
% of Firms Identifying Electricity as a Major Constraint	20.3	20.5	19.1	23.5	25.6	19.6
Days/Year of Power Outages	3.5	3.4	3.7	3.7	11.7	16.9
% of Sales Lost to Power Outages	2.5	2.7	2.3	2.1	3.9	4.5
Days/Year of Insufficient Water Supply	0.7	0.7	0.7	0.2	13.4	13.9
Delays in Obtaining Electricity Connections (Days/Year)	20.6	20.0	20.6	22.4	25.6	25.0
Delays in Obtaining Water Connections (Days/Year)	10.7	9.8	10.6	16.8	39.8	30.2
Delays in Obtaining Telephone Connections (Days/Year)	12.6	12.8	13.3	8.3	64.5	37.5
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	59.5	61.0	59.7	51.1	43.9	26.4
% of Firms Identifying Cost of Finance as a Major Constraint	82.3	82.9	82.3	79.4	53.6	33.2
% of Investments Financed by Internal Funds	56.3	59.0	54.7	49.6	54.5	64.0
% of Investments Financed by Banks	14.3	14.0	14.2	15.2	22.9	15.6
% of Investments Financed by Leasing	3.1	2.0	4.3	4.4	1.7	1.7
% of Investments Financed by Informal Sources	2.3	3.2	1.5	0.5	5.1	5.7
% of Investments Financed by Trade Credits	8.7	10.7	6.7	6.9	8.2	3.7
% of Investments Financed by Other Sources	15.3	11.1	18.7	23.4	7.7	8.7
% of Firms with Bank Loans/Overdraft Accounts	74.1	66.8	81.9	82.7	45.3	22.5
Value of Collateral (% of Loan Value)	119.9	118.9	120.4	119.2	132.2	143.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	56.7	55.3	59.0	55.4	18.8	14.6
% of Firms Identifying Labor Skill Level as a Major Constraint	39.6	41.0	40.1	29.0	24.2	17.4
% of Firms Offering Formal Training	67.1	52.9	80.7	91.3	55.7	55.9
Managers/Professionals (as % of Total Workforce)	10.8	12.9	8.4	8.4	18.1	26.1
of which: % Female	3.7	4.1	2.8	3.1	6.3	1.7
Non-production Workers (as % of Total Workforce)	11.4	10.6	12.7	10.9	11.4	10.7
of which: % Female	44.8	50.5	42.5	25.6	38.2	12.8
Skilled Production Workers (as % of Total Workforce)	30.9	33.6	28.7	24.3	33.8	40.6
of which: % Female	39.2	40.8	39.4	25.8	25.5	12.5
Unskilled Production Workers (as % of Total Workforce)	47.0	42.9	50.2	56.5	36.8	22.7
of which: % Female	37.6	38.0	37.9	34.7	29.1	19.1

	Brazil	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Latin America	Lower Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	66.9	71.6	65.6	47.9	59.8	34.9
Unofficial Payments to Secure Government Procurement (% of Contract)	12.2	13.2	12.1	6.5	7.2	3.2
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	9.9	10.4	10.7	5.6	11.7	23.1
% of Firms Expected to Give Gifts to Obtain Operating Licenses	5.4	7.0	4.8	2.9	13.3	22.3
% of Firms Expected to Give Gifts to Obtain Import Licenses	5.0	3.7	6.8	2.6	7.7	16.0
% Senior Management Time Dealing with Government Regulations	7.8	6.8	8.7	9.8	12.5	8.3
Time Spent in Tax Inspection Meetings (Days/Year)	1.3	0.8	1.4	2.5	3.5	3.8
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	32.5	32.4	32.3	34.3	28.1	19.7
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	52.0	55.8	50.5	38.7	51.5	24.1
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	79.0	76.5	81.0	84.0	83.4	58.4
% of Firms Resolving Disputes through Court Action	17.9	11.2	22.3	35.5	15.0	21.3
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	60.4	57.2	61.5	73.5	45.8	55.6
Costs of Security (% of Sales)	1.4	1.5	1.3	1.1	4.8	1.6
Losses due to Crime (% of Sales)	0.4	0.4	0.4	0.1	3.7	1.1
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	96.8	95.7	98.4	96.9	85.3	70.1
R&D Expenditures (% of Sales)	0.9	1.0	1.0	0.6	1.1	0.9
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	17.2	12.9	19.5	31.5	26.6	35.8
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	57.9	59.0	58.6	50.6	46.7	63.3
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	92.0	86.0	98.5	100.0	63.3	58.2
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	73.1	61.1	85.0	91.4	37.7	44.4
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	45.2	41.2	49.3	41.8	25.2	22.7
Days on Average to Claim Imports From Customs	12.4	12.3	12.2	12.8	8.3	6.4
Days on Average to Clear Customs for Exports	7.8	7.9	8.3	6.9	3.4	3.7
% of Firms That Import Directly	15.7	6.0	21.6	44.4	37.1	37.4
% of Firms Expected to Give Gifts to Obtain Import Licenses	5.0	3.7	6.8	2.6	7.7	16.0
<i>Note:</i> Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

CHINA

Summary of Investment Climate Indicators						
	China	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	East Asia & Pacific	Lower Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	19.1	15.0	15.6	25.8	15.4	9.9
% of Firms Identifying Electricity as a Major Constraint	29.7	26.2	29.3	32.5	24.5	19.6
Days/Year of Power Outages	4.9	4.3	5.6	4.8	4.5	16.9
% of Sales Lost to Power Outages	1.9	2.1	2.1	1.5	4.0	4.5
Delays in Obtaining Electricity Connections (Days/Year)	10.4	7.4	7.3	14.8	9.0	25.0
Delays in Obtaining Telephone Connections (Days/Year)	6.0	6.0	6.2	5.9	9.4	37.5
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	22.8	17.6	20.5	29.0	15.3	26.4
% of Firms Identifying Cost of Finance as a Major Constraint	21.8	18.1	17.7	28.8	20.5	33.2
% of Investments Financed by Internal Funds	15.2	14.4	16.4	15.2	33.8	64.0
% of Investments Financed by Banks	20.4	12.4	19.3	31.1	13.2	15.6
% of Investments Financed by Leasing	n.a	n.a	n.a	n.a	1.3	1.7
% of Investments Financed by Informal Sources	7.7	10.8	8.2	3.5	17.4	5.7
% of Investments Financed by Trade Credits	1.0	1.0	0.7	1.5	3.3	3.7
% of Investments Financed by Other Sources	55.6	61.4	55.4	48.7	31.2	9.3
% of Firms with Bank Loans/Overdraft Accounts	23.3	10.1	23.3	39.4	19.6	22.5
Value of Collateral (% of Loan Value)	80.8	83.8	81.6	78.9	76.3	143.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	20.7	15.5	20.1	25.1	19.3	14.6
% of Firms Identifying Labor Skill Level as a Major Constraint	30.7	28.8	31.4	31.4	17.0	17.4
% of Firms Offering Formal Training	84.8	82.0	85.1	87.5	38.2	55.9
% of Skilled Workers Offered Formal Training	47.7	47.0	48.6	47.2	46.2	25.5
Managers/Professionals (as % of Total Workforce)	59.2	59.8	58.0	60.1	33.4	26.1
Non-production Workers (as % of Total Workforce)	9.2	11.9	7.5	7.9	9.4	10.7
Skilled Production Workers (as % of Total Workforce)	3.9	3.0	4.1	4.8	34.0	40.6
Unskilled Production Workers (as % of Total Workforce)	27.7	25.3	30.4	27.2	23.2	22.7

	China	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	East Asia & Pacific	Lower Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	27.3	30.8	25.5	26.8	39.8	34.9
Unofficial Payments to Get Things Done (% of Sales)	1.9	2.5	1.6	1.7	2.7	2.5
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	38.7	41.9	37.0	38.0	29.9	23.1
% of Firms Expected to Give Gifts to Register Their Business	7.6	6.7	8.3	8.0	7.6	7.6
% of Firms Expected to Give Gifts to Obtain Import Licenses	16.9	17.9	20.6	14.3	13.8	16.0
% Senior Management Time Dealing with Government Regulations	19.6	20.7	19.3	18.5	11.2	8.3
Time Spent in Tax Inspection Meetings (Days/Year)	12.0	10.7	12.3	13.4	5.8	3.8
Courts and Crime Indicators						
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	20.0	24.4	19.4	17.5	27.4	24.1
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	73.4	71.9	75.3	72.5	66.5	58.4
% of Firms Resolving Disputes through Court Action	21.7	11.8	22.0	34.6	11.0	21.3
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	82.5	82.3	83.3	81.6	61.7	55.6
Costs of Security (% of Sales)	0.5	0.6	0.5	0.5	4.5	1.6
Losses due to Crime (% of Sales)	0.1	0.1	0.1	0.1	0.7	1.1
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	47.7	33.2	50.2	62.4	73.1	70.1
R&D Expenditures (% of Sales)	2.5	2.0	2.8	2.6	3.0	0.9
% of Firms Acquiring Some Technological Innovations by Purchasing New Machinery or Equipment	43.0	26.3	37.3	53.7	65.4	70.7
% of Firms Acquiring Some Technological Innovations by Hiring Key Personnel	15.1	7.0	17.8	15.6	43.9	21.0
% of Firms Acquiring Some Technological Innovations by Developing Internally or with Others	67.0	56.1	64.9	72.7	72.1	37.5
% of Firms Using Internet to Communicate for Business Purposes	47.7	37.2	50.1	57.5	47.0	62.9
% of Firms Whose Employees Use a PC Regularly	38.0	46.2	36.4	30.0	25.1	22.3
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	29.7	25.0	25.0	34.2	27.7	22.7
Days on Average to Claim Imports From Customs	7.6	9.0	8.0	6.5	6.5	6.4
Days on Average to Clear Customs for Exports	6.2	7.4	6.7	4.9	5.0	3.7
% of Firms That Import	21.7	9.2	21.9	37.2	35.0	54.7
% of Firms Expected to Give Gifts to Obtain Import Licenses	16.9	17.9	20.6	14.3	13.8	16.0
<i>Note:</i> Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

INDONESIA

Summary of Investment Climate Indicators						
	Indonesia	Small (1-49 employees)	Medium (50-249 employees)	Large (250+ employees)	East Asia & Pacific	Lower Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	16.4	15.2	15.6	18.3	15.4	10.8
% of Firms Identifying Electricity as a Major Constraint	22.3	11.5	25.4	29.8	24.5	19.5
% of Firms Identifying Telecommunications as a Major Constraint	9.1	4.5	12.7	10.3	11.8	9.4
Days of Power Outages	3.5	3.7	3.4	3.4	4.3	9.9
% of Sales Lost to Power Outages	3.3	3.4	3.7	2.8	3.1	3.3
Delays in Obtaining Electricity Connections (Days)	12.2	11.7	11.4	13.5	9.0	19.0
Delays in Obtaining Water Connections (Days)	11.4	8.5	14.7	11.4	7.9	25.3
Delays in Obtaining Telephone Connections (Days)	19.2	17.7	10.8	21.0	9.3	31.9
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	17.5	16.0	16.6	19.5	15.3	28.1
% of Investments Financed by Internal Funds	41.9	38.4	36.7	49.4	33.9	66.1
% of Investments Financed by Informal Sources	24.5	43.3	22.5	10.1	23.0	4.9
% of Investments Financed by Trade Credit	2.8	3.1	1.9	3.2	3.1	4.7
% of Investments Financed by Commercial Banks	16.3	8.0	9.8	29.1	8.9	12.4
% of Investments Financed by Leasing	2.4	1.1	2.9	3.1	1.2	2.7
% of Investments Financed by Other Sources	12.1	6.1	26.1	5.1	29.9	9.3
% of Firms with Bank Loans/Overdraft Accounts	19.2	6.6	26.3	25.6	20.2	22.9
Value of Collateral (% of Loan Value)	116.3	92.9	142.5	107.5	77.4	123.6
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	25.9	11.9	29.8	35.5	19.3	16.0
% of Firms Offering Formal Training	23.8	5.2	27.9	38.5	46.5	48.0
Managers/Professionals (as % of Total Workforce)	5.1	9.4	8.4	4.8	12.3	18.3
of which: % Female	15.0	14.7	16.4	14.0	21.3	10.0
Non-production Workers (as % of Total Workforce)	11.6	11.5	10.3	11.7	9.0	10.5
of which: % Female	22.1	22.2	24.6	20.3	25.6	40.1
Skilled Production Workers (as % of Total Workforce)	43.5	39.3	44.7	43.5	48.8	44.2
of which: % Female	26.8	25.9	26.7	27.5	31.6	30.4
Unskilled Production Workers (as % of Total Workforce)	39.7	39.9	36.6	39.9	29.8	26.9
of which: % Female	34.1	35.1	36.4	31.1	31.1	33.0

ICS Country Profile: INDONESIA 2003

	Indonesia	Small (1-49 employees)	Medium (50-249 employees)	Large (250+ employees)	East Asia & Pacific	Lower Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	41.5	34.8	36.6	51.9	40.0	35.5
Unofficial Payments to Get Thing Done (% of Sales)	1.1	1.1	1.2	1.1	2.1	2.4
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	11.2	7.4	11.7	14.5	40.7	22.8
% of Firms Expected to Give Gifts to Obtain Operating Licenses	8.4	7.9	7.8	9.3	55.8	27.7
% of Firms Expected to Give Gifts to Obtain Import Licenses	4.7	1.7	5.4	6.9	33.4	20.0
% Senior Management Time Dealing with Government Regulations	4.0	3.9	2.9	4.9	10.7	9.2
Time Spent in Tax Inspection Meetings (Days)	1.1	0.7	1.0	1.5	6.7	4.3
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	24.7	16.4	22.9	33.6	26.8	21.4
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	22.0	14.3	22.0	29.0	27.4	27.4
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	50.4	48.8	59.5	44.7	69.2	69.6
% of Firms Resolving Disputes through Court Action	10.1	9.2	10.7	10.3	14.9	22.1
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	59.2	55.7	58.0	63.0	61.7	57.0
Costs of Security (% of Sales)	0.8	0.6	1.0	0.8	4.5	2.3
Losses due to Crime (% of Sales)	0.2	0.2	0.3	0.2	0.7	1.2
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	73.9	61.9	75.6	83.4	67.6	66.5
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	25.8	11.3	26.1	39.5	18.7	22.9
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	47.3	54.6	54.8	35.2	52.8	50.9
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	49.9	18.5	47.1	80.9	46.5	55.8
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	24.3	6.6	17.6	45.8	23.9	41.6
<i>Note:</i> Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

SOUTH AFRICA

Summary of Investment Climate Indicators						
	South Africa	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Africa	Upper Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	10.1	9.0	10.4	11.3	22.1	5.4
% of Firms Identifying Electricity as a Major Constraint	9.0	6.0	8.3	13.2	44.5	6.0
Days/Year of Power Outages	5.5	4.9	5.9	5.1	53.5	2.0
% of Sales Lost to Power Outages	0.9	0.4	1.2	0.8	5.3	2.3
Days/Year of Insufficient Water Supply	4.8	4.9	5.1	4.1	37.0	2.6
Delays in Obtaining Electricity Connections (Days/Year)	5.3	4.7	4.8	6.3	49.9	11.9
Delays in Obtaining Water Connections (Days/Year)	3.6	3.7	3.9	2.7	18.6	5.7
Delays in Obtaining Telephone Connections (Days/Year)	6.6	7.1	5.8	6.9	64.0	8.0
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	12.6	18.6	11.9	7.3	44.5	14.6
% of Firms Identifying Cost of Finance as a Major Constraint	16.4	18.6	15.1	16.6	55.7	18.2
% of Investments Financed by Internal Funds	58.4	51.0	61.9	60.2	66.0	60.2
% of Investments Financed by Banks	16.5	19.3	15.2	15.6	18.8	12.3
% of Investments Financed by Leasing	15.6	20.5	15.3	11.7	2.6	8.4
% of Investments Financed by Informal Sources	1.1	0.7	1.7	0.2	2.3	3.0
% of Investments Financed by Trade Credits	0.6	0.9	0.8	0.0	1.3	2.5
% of Investments Financed by Other Sources	7.7	7.6	5.1	12.3	9.0	13.6
% of Firms with Bank Loans/Overdraft Accounts	68.0	70.1	66.9	68.2	44.0	10.2
Value of Collateral (% of Loan Value)	123.8	124.9	132.1	111.7	145.8	133.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	32.8	38.3	25.2	41.7	15.9	13.7
% of Firms Identifying Labor Skill Level as a Major Constraint	35.5	32.3	36.3	39.1	28.6	15.7
% of Firms Offering Formal Training	64.0	37.1	66.2	88.7	41.0	77.0
% of Skilled Workers Offered Formal Training	45.2	43.0	46.8	44.6	25.0	36.2
Managers/Professionals (as % of Total Workforce)	13.8	18.1	12.9	10.5	22.7	30.7
of which: % Female	2.8	5.2	1.4	1.2	2.7	0.3
Non-production Workers (as % of Total Workforce)	6.4	5.0	7.2	6.5	13.4	8.2
of which: % Female	52.9	81.3	50.1	33.7	24.8	4.1
Skilled Production Workers (as % of Total Workforce)	35.3	33.4	34.8	38.7	30.1	47.3
of which: % Female	24.1	21.5	23.7	27.5	14.3	1.9
Unskilled Production Workers (as % of Total Workforce)	44.5	43.5	45.1	44.3	33.9	13.8
of which: % Female	25.6	28.1	23.3	27.3	21.5	7.1

	South Africa	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Africa	Upper Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	16.1	14.4	16.2	17.9	41.6	13.3
Unofficial Payments to Get Things Done (% of Sales)	0.3	0.8	0.1	0.1	2.6	0.8
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	0.6	1.4	0.0	1.1	17.2	16.2
% of Firms Expected to Give Gifts to Obtain Operating Licenses	0.6	3.8	0.0	0.0	9.1	8.5
% of Firms Expected to Give Gifts to Obtain Import Licenses	0.6	0.0	1.1	0.0	7.4	5.4
% Senior Management Time Dealing with Government Regulations	10.1	9.9	9.0	12.3	10.8	5.7
Time Spent in Tax Inspection Meetings (Days/Year)	2.9	1.7	3.4	3.4	5.4	2.4
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	8.8	13.2	7.2	7.3	21.8	13.3
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	29.0	29.3	28.1	31.1	31.1	9.9
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	68.7	68.5	67.0	71.8	71.9	62.9
% of Firms Resolving Disputes through Court Action	27.2	20.9	29.9	30.3	4.9	40.6
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	79.2	74.7	79.0	84.1	61.0	60.2
Costs of Security (% of Sales)	0.6	0.5	0.5	0.8	1.2	0.5
Losses due to Crime (% of Sales)	0.4	0.5	0.4	0.5	1.3	0.3
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	91.0	81.4	94.9	94.7	72.1	66.7
R&D Expenditures (% of Sales)	1.0	1.2	0.9	1.0	0.5	0.3
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	15.3	11.6	10.9	27.7	13.4	38.8
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	45.7	49.4	46.5	41.2	45.1	75.2
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	98.3	95.8	99.3	100.0	55.9	79.8
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	70.8	50.3	73.4	88.7	27.8	75.5
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	19.5	14.4	14.8	30.8	34.9	11.8
Days on Average to Claim Imports From Customs	6.2	5.5	6.7	5.9	9.0	4.5
Days on Average to Clear Customs for Exports	4.3	4.0	4.3	4.3	4.5	3.5
% of Firms That Import Directly	60.0	39.3	61.4	81.5	56.7	33.1
% of Firms Expected to Give Gifts to Obtain Import Licenses	0.6	0.0	1.1	0.0	7.4	5.4
Note: Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

TURKEY

Summary of Investment Climate Indicators						
	Turkey	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Europe and Central Asia	Upper Middle Income
Infrastructure Indicators						
% of Firms Identifying Transportation as a Major Constraint	6.7	6.1	9.4	5.7	4.9	5.4
% of Firms Identifying Electricity as a Major Constraint	9.2	8.6	10.3	11.7	7.5	6.0
Days/Year of Power Outages	3.1	3.4	2.7	1.7	12.3	2.0
% of Sales Lost to Power Outages	2.3	2.2	2.9	1.6	3.4	2.3
Days/Year of Insufficient Water Supply	0.3	0.3	0.3	0.2	4.4	2.6
Delays in Obtaining Electricity Connections (Days/Year)	5.7	5.3	7.6	5.6	12.3	11.9
Delays in Obtaining Telephone Connections (Days/Year)	7.5	7.5	7.4	7.5	13.8	8.0
Finance Indicators						
% of Firms Identifying Access to Finance as a Major Constraint	14.1	13.9	16.0	11.5	16.0	14.6
% of Firms Identifying Cost of Finance as a Major Constraint	20.9	20.2	28.0	11.5	21.6	18.2
% of Investments Financed by Internal Funds	55.1	55.9	51.2	57.5	69.8	60.2
% of Investments Financed by Banks	5.8	5.2	8.7	3.8	11.9	12.3
% of Investments Financed by Leasing	0.8	0.7	1.5	0.0	3.7	8.4
% of Investments Financed by Informal Sources	3.9	4.8	1.4	1.7	3.6	3.0
% of Investments Financed by Trade Credits	1.6	1.4	0.8	6.3	2.0	2.5
% of Investments Financed by Other Sources	32.7	32.0	36.4	30.8	9.1	13.6
Value of Collateral (% of Loan Value)	100.5	100.7	97.8	107.2	153.7	133.4
Labor Market Indicators						
% of Firms Identifying Labor Regulations as a Major Constraint	12.1	11.3	16.9	7.7	7.1	13.7
% of Firms Identifying Labor Skill Level as a Major Constraint	9.7	8.3	15.2	9.7	10.0	15.7
% of Firms Offering Formal Training	52.8	42.6	59.7	77.5	75.0	77.0
% of Skilled Workers Offered Formal Training	18.0	11.6	28.0	41.3	25.7	36.2
Managers/Professionals (as % of Total Workforce)	24.2	25.0	20.6	26.5	32.0	30.7
Non-production Workers (as % of Total Workforce)	11.3	12.6	8.0	9.3	9.7	8.2
Skilled Production Workers (as % of Total Workforce)	49.5	49.3	51.2	47.3	47.5	47.3
Unskilled Production Workers (as % of Total Workforce)	14.9	13.2	20.2	16.9	10.8	13.8

	Turkey	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Europe and Central Asia	Upper Middle Income
Regulatory Burden and Corruption Indicators						
% of Firms Identifying Corruption as Major Constraint	16.8	17.7	15.6	11.8	17.1	13.3
Unofficial Payments to Get Things Done (% of Sales)	1.1	1.4	0.9	0.3	1.0	0.8
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	12.4	11.5	16.3	10.4	22.0	16.2
% of Firms Expected to Give Gifts to Obtain Operating Licenses	8.9	8.5	13.5	2.1	13.6	8.5
% of Firms Expected to Give Gifts to Obtain Import Licenses	7.2	5.9	13.7	4.2	11.5	5.4
% Senior Management Time Dealing with Government Regulations	11.7	10.9	12.4	14.1	5.6	5.7
Time Spent in Tax Inspection Meetings (Days/Year)	2.0	2.0	2.3	1.8	2.8	2.4
Courts and Crime Indicators						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	12.1	12.7	10.2	11.4	14.0	13.3
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	14.6	15.2	13.0	13.6	9.2	9.9
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	23.2	24.2	23.4	15.1	52.4	62.9
% of Firms Resolving Disputes through Court Action	50.4	49.0	60.0	37.5	37.0	40.6
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	71.5	69.4	71.7	88.0	56.0	60.2
Costs of Security (% of Sales)	0.3	0.2	0.4	0.5	0.8	0.5
Losses due to Crime (% of Sales)	0.2	0.2	0.1	0.1	0.3	0.3
Innovation and Technology Indicators						
% of Firms Undertaking Innovation	52.1	48.1	61.7	62.3	65.1	66.7
R&D Expenditures (% of Sales)	0.3	0.2	0.5	1.4	0.3	0.3
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	33.5	27.2	47.1	53.8	40.3	38.8
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	69.9	69.3	74.3	65.4	73.2	75.2
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	65.2	55.7	87.9	90.6	64.8	79.8
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	65.2	55.7	88.8	88.7	62.5	75.5
Trade Indicators						
% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	14.3	13.7	13.8	19.4	13.8	11.8
Days on Average to Claim Imports From Customs	5.6	5.8	4.5	6.2	3.8	4.5
Days on Average to Clear Customs for Exports	4.2	3.9	4.8	4.9	3.3	3.5
% of Inputs Which Firms Import Directly	5.8	5.7	3.2	12.1	17.2	15.4
% of Firms Expected to Give Gifts to Obtain Import Licenses	7.2	5.9	13.7	4.2	11.5	5.4
<i>Note</i> : Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.						

The investment climate of a country, province, or region describes the policy, regulatory, institutional and governance environment, both present and expected, that influences entrepreneurship, supports well-functioning markets, and affects the returns and risks associated with investment. The World Bank has carried out investment climate assessments for all countries in the South Asia region.

This report summarizes the findings of these assessments. It compares South Asian countries to a number of countries in other regions, analyzes similarities and differences within the region, assesses the costs of a deficient investment climate, and identifies the way forward in improving the investment climate.



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