

### Starting a business

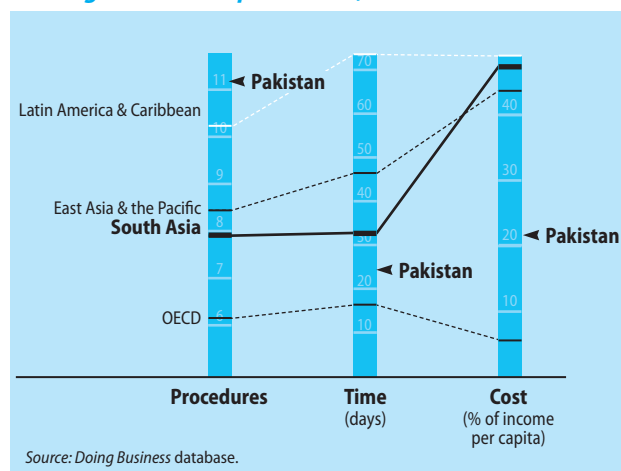
Pakistan ranks relatively well in starting a business—both globally and regionally. Reforms in the early part of the decade cut start-up time by half. Start-up now takes 24 days, 8 days less than the South Asian average (32 days) and less than Bhutan (62 days), Sri Lanka (50 days), Bangladesh (37 days) and India (35 days). The cost is 21% of income per capita, well below the South Asian average of 47%, and compares favorably to all regional averages apart from those of the OECD (5%) and Europe and Central Asia (14%). Like all South Asian countries except for the Maldives, Pakistan does not impose a minimum capital requirement.

Start-up in Pakistan still requires a high number of procedures (11)—more than in 116 other countries, including Bangladesh (8), Nepal (7) and Sri Lanka (8) (figure 2.14). In the region, only India requires an

equally high number (11). Pakistan’s procedures are cumbersome, require considerable documentation and involve 6 different agencies—the registrar of companies at the Securities and Exchange Commission, the Central Board of Revenue, the local tax authority, the Employees Social Security Institution, the Employees Old Age Benefits Institution, and the Inspector in the Department of Labor of the provincial government—and a visit to a specifically designated bank.

Costs are 25% higher in Karachi than in other cities. By removing the stamp duty requirement in 2004, Faisalabad, Lahore, Sialkot and Peshawar all eliminated 1 procedure, 1 day and considerable cost—16% of income per capita—from the start-up process. Start-up time does not vary significantly across cities, with 2 more days required to register with the Registrar of Companies in Quetta than in Faisalabad, Lahore, Sialkot and Peshawar.

FIGURE 2.14  
**Starting a business—procedures, time and cost**



### What to reform

Over the last decade Pakistan has undeniably made considerable progress—by reducing the number of steps and the cost of starting a business and by increasing access to registration offices. But limited gains have been recorded in recent years. Although Faisalabad, Lahore, Sialkot and

TABLE 2.7  
**Subnational rankings on the ease of doing business in Pakistan**

- |              |            |
|--------------|------------|
| 1 Karachi    | 4 Lahore   |
| 2 Faisalabad | 5 Peshawar |
| 3 Sialkot    | 6 Quetta   |

Note: The rankings for all cities are benchmarked to April 2006 and reported in Appendix III. The ease of doing business averages rankings across the 10 topics covered in *Doing Business*. This excludes variables such as macroeconomic policy, quality of infrastructure, currency volatility, investor perceptions, or crime rates.

Source: Doing Business database.

Peshawar lowered costs by eliminating the stamp duty, the number of procedures and days has remained the same over the past years. A large number of federal and provincial institutions are still involved in start-up, and documentation requirements are heavy.

As a first step, Karachi and Quetta can follow their neighbors' example and eliminate the stamp duty for registration. Then the system for the different tax and social security registrations can be simplified. Entrepreneurs must visit various federal and provincial departments to register for sales tax (6 days), professional taxes (7 days), social security (11 days) and old age benefits (11 days) and to register with the Department of Labor and Industries (7 days). A one-stop portal and unique company identification number can be introduced to further reduce the time and cost of setting up a business. As an intermediate solution, representatives from different agencies can be located in the same building to create a single access point for entrepreneurs. Over time, the government can approach international best practices by introducing online registration. This will require implementing the Electronic Signatures Ordinance. But even without online registration, time can be cut by simplifying internal procedures.

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### Dealing with licenses

Pakistan ranks 89th in the world on the ease of dealing with licenses. Obtaining the necessary construction permits, licenses and inspections and securing utility connections for building a warehouse involves only 12 procedures, the fewest in the region after the Maldives. The process takes 218 days, fewer than only Nepal (424 days) and India (270 days) among the South Asian countries. More strikingly, the official cost is almost 10 times income per capita (973%), more than double the South Asia average of 375% of income per capita.

Site development regulations are governed mainly by provincial and local authorities. As such, the process for dealing with licenses significantly varies from city to city. In some cases, procedures are different—for example, Karachi does not require an environmental protection approval and Quetta requires a higher than average number of inspections. In other cases, procedures vary in length. For example, among the cities with environmental approval requirements, the time it takes to fulfill them ranges from 35 days in Lahore to 75 in Quetta. The number of procedures and time needed to obtain construction licenses have increased in cities outside of Karachi—particularly in Faisalabad, Lahore, Sialkot and

Peshawar—in part due to earthquake-related requirements and added environmental protections.

Karachi, Sialkot and Faisalabad remain the more expensive cities in which to build a warehouse, but for different reasons. Obtaining a building permit in Sialkot costs considerably more than in other cities and accounts for more than half of total licensing costs. In Faisalabad and Karachi, utility connections are the culprit. High costs for electrical connections in both cities—made worse in Karachi by the high costs of water and sewage connections—account for almost a fifth of total costs and are estimated at almost 10 times the costs in other cities. Quetta's relatively high costs derive from the high cost of the building permits coupled with the higher than average costs of obtaining connections to electricity and water.

### What to reform

Reducing the steps, time and cost necessary to develop a site is a priority for improving the business environment in Pakistan. A builder can interface with 15 to 20 authorities—most of which are provincial or local—to obtain all necessary development permits and site inspections. Reforms should focus on reducing the costs of building permits and utility connections and on minimizing the time needed for inspections.

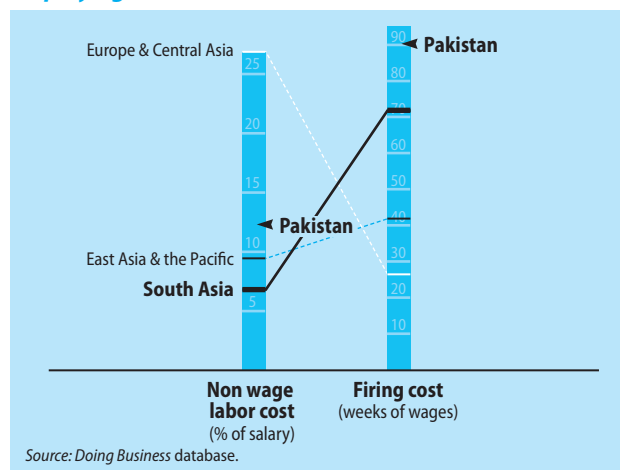
Pakistan can start by modernizing outdated municipal bylaws and the process for issuing permits—particularly in the large industrial areas. Road maps of the process can also assist investors, as can creating single windows for submitting applications and documents. This would require, first, clarifying the roles of national, provincial and local authorities, followed by a coordinated effort to modernize and harmonize zoning and land development laws and regulations. Mechanisms to assist with implementing reforms, such as introducing performance standards and service/complaint centers, could also reduce the licensing burden.

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### Employing workers

As in other South Asian countries, labor regulations are relatively rigid in Pakistan. Pakistan scores 43 on the rigidity of employment index, slightly higher than the South Asian average of 35. Unlike most countries in the region, however, Pakistan's labor code imposes rigid conditions on hiring while officially allowing flexibility in firing. Pakistan scores 78 out of 100—higher than any other South Asian country—on the difficulty of hiring

FIGURE 2.15

**Employing workers—cost to hire and fire**

index, which takes into account rules governing temporary contracts and minimum wage.

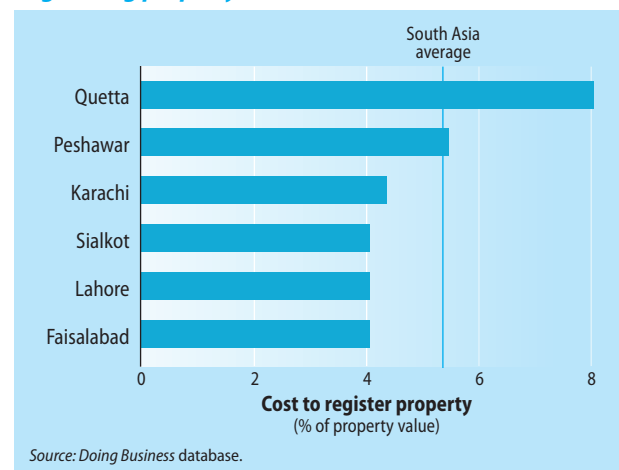
Other labor regulation indicators present a mixed picture. The cost of hiring a worker is 12% of salary, compared to 10% in Nepal, 15% in Sri Lanka and 17% in India. Pakistan's procedures for firing are moderately onerous, with a global ranking of 77th on the difficulty of firing index. But an employer must pay the equivalent of 90 weeks of salary in severance, penalties and notice to dismiss a worker (figure 2.15). Only Bhutan and Sri Lanka have higher dismissal costs, with 95 weeks and 178 weeks, respectively.

**What to reform**

Facing competitive pressure and high amounts of informality, all levels of Pakistan's government recognize the importance of modernizing the labor market. At the federal level, the government is undertaking an extensive reform of the labor code to (i) increase flexibility in the labor market, particularly in hiring, and (ii) lower the cost of complying with all labor regulations.

Reforms at the federal level seek to increase flexibility in hiring by eliminating restrictions on temporary contracts and by streamlining procedures for resolving labor disputes. At the provincial level, enforcement of the new legislation will be enhanced through more professional inspections. Future changes planned at the federal level include modernizing the provisions on health and safety protections and reforming labor welfare. To further improve labor market flexibility, Pakistan could also reduce the mandatory severance pay (of 20 months of wages for an employee with 20 years of seniority) and ease the requirements for redundancy.

FIGURE 2.16

**Registering property in Pakistan****Registering property**

Pakistan ranks 68th on the ease of registering property—the top performing South Asian country after Nepal (25). Registering property is a relatively simple process requiring 6 procedures. Costs are 4% of the property value, higher than Bhutan (0%) but below all other countries in the region. The time to register is also slightly lower in Pakistan (50 days) than in most South Asian countries, including India (62 days) and Sri Lanka (63 days), and much lower than in Bangladesh (425 days). Only in Nepal (5 days) does property registration take less time than in Pakistan.

Land registration is governed by provincial and local authorities. The number of steps to register property therefore differs significantly across provinces—ranging from 6 in Sindh (Karachi) to 12 in Baluchistan (Quetta) with Punjab (Faisalabad, Lahore, Sialkot) and NWFP (Peshawar) falling in the middle. The cost to register property consists of the stamp duty, registration fees and transfer taxes. In addition to taking less time, registering property in Faisalabad, Lahore, Sialkot, Karachi and Peshawar is less costly (averaging around 4.5% of total property value) than in Quetta, where the cost is 8% of the property value (figure 2.16).

**What to reform**

Although the time and cost of registering property are moderate in Pakistan by global and regional standards, in some parts of the country—principally Quetta—the time and cost remain high. Learning from better practices in other countries may provide simple ways to cut procedures, time and costs. For example, most countries have eliminated the requirement to publish a public

notice of property transfers. Instead the registry can make its records accessible to the public. This serves the same purpose as publication, without the delays and cost. Expanding the e-government registration pilot program—currently in Punjab, where Faisalabad, Lahore and Sialkot are located—to other parts of the country can also simplify the registration process and cut costs.

Beyond property registration, problems with land titling and land availability are limiting entry, preventing financing and clogging the courts with land disputes. All levels of government need to work to expand access to clearly titled land. A significant effort is also needed to clarify rights of landowners for whom title is unclear—which is a majority of them. This will require a large-scale land registration reform that will include verifying borders and ownership. After establishing clear property rights, property markets can be further boosted by streamlining local zoning, rental and building regulations.

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### Getting credit

Pakistan is one of relatively few countries around the world with both public and private credit registries. Only 65 countries have public credit registries with greater coverage than Pakistan's. The only other country in South Asia with one is Bangladesh. Four other countries in the region have private credit bureaus. On the credit information index, which measures the depth of available credit information, Pakistan scores 4 out of 6—the highest in South Asia. Only 52 countries in the world score higher. By comparison India and Sri Lanka score 3, while Bangladesh and Nepal score 2 out of 6.

Although the credit information system is relatively well structured, the coverage is low. The public registry contains credit information on only 0.3% of adults. The private bureau covers only 1.1%. This is in contrast to the 0.6% of adults covered by the public registry in Bangladesh and the 6.1% and 3.1% coverage of adults by the private bureaus in India and Sri Lanka, respectively.

Pakistan's score of 4 out of 10 on the legal rights index indicates weaknesses in collateral and bankruptcy laws. Pakistan currently ranks 93rd on the index along with 32 other similarly rated countries—on par with the South Asian average, but lower than Bangladesh (7) and India (5).

### What to reform

Coverage by private bureaus is increasing, although slowly, along with Pakistan's developing corporate sector. The public registry—currently run by the State Bank but which may be privatized in the future—recently expanded its database to include borrowers of smaller loan sizes. Both public and private credit bureaus can expand their coverage to include information from creditors other than financial institutions, such as retailers and utilities. Guaranteeing the legal rights of borrowers to inspect their credit data can improve the quality of the data. This in turn can help improve access to credit.

The relatively low degree of legal rights for borrowers and lenders also constrains access to credit. Although specialized legislation gives banks strong powers to seize collateral, further measures are needed. Reforms to the Company Law are currently being pursued. An opportunity exists to further strengthen creditor rights by (i) creating a unified registry for all security rights in moveable property, (ii) clearly specifying the priority for secured creditors to recover their security upon default and in bankruptcy and (iii) permitting out-of-court enforcement.

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### Protecting investors

Pakistan provides relatively strong protections for minority shareholders against the misuse of corporate assets. It ranks 19th worldwide on protecting investors. In South Asia only Bangladesh ranks higher, at 15th. Pakistan earns consistently high scores for each of the three components of the protecting investors indicator: (i) disclosure, (ii) director's liability and (iii) ease of shareholder suits.

This favorable ranking is a result of recent reforms that (i) introduce a code of corporate governance, (ii) require insider transactions be approved by the board of directors and (iii) require a range of disclosures be reported both to the board and in periodic public filings. Directors are held accountable with strict penalties if negligence can be shown. Finally, minority shareholders can obtain documents and directly question defendants during lawsuits.

### What to reform

More effective enforcement has helped improve compliance. But the Securities and Exchange Commission of Pakistan still needs to do more to increase compliance with respect to immediate disclosure of large party-

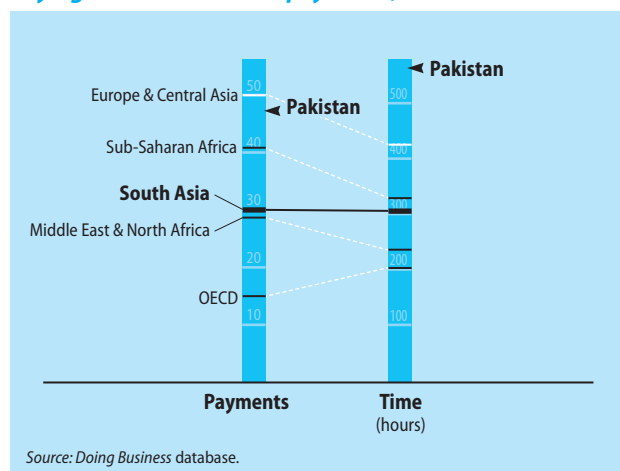
related transactions, beneficial ownership and control by shareholders and companies. Access to information about specific transactions by minority shareholders prior to filing a lawsuit can also be strengthened. The burden of proof for holding directors liable is generally high. Finally, Pakistan needs to strengthen compliance with its rules governing annual general shareholder meetings. Some companies still do not hold them, or hold them in difficult to reach or obscure locations. This is particularly important because the law does not allow voting by mail or electronically.

## Paying taxes

Pakistan ranks 140th on the ease of paying taxes—up from 143rd last year. Pakistan’s tax rate of 43.4% of commercial profit is moderate compared with other countries in the world and well below India’s (81.1%) and Sri Lanka’s (74.9%). But the administration of taxes continues to be a principal obstacle to doing business in Pakistan. The current tax code is cumbersome, requiring a standard business to make 47 tax payments per year to various levels of government. Complying with all statutory tax requirements takes an estimated 560 hours per year, placing Pakistan 150th in the world on time to comply with taxes (figure 2.17). These numbers are well above the regional average of 30 payments and 304 hours per year. Paying taxes in Pakistan is by far more time consuming than anywhere else in the South Asia region—requiring about 150 more hours to file taxes than Bangladesh (400 hours) and Nepal (408 hours), the two South Asian countries that come closest.

FIGURE 2.17

### Paying taxes—number of payments, time



## What to reform

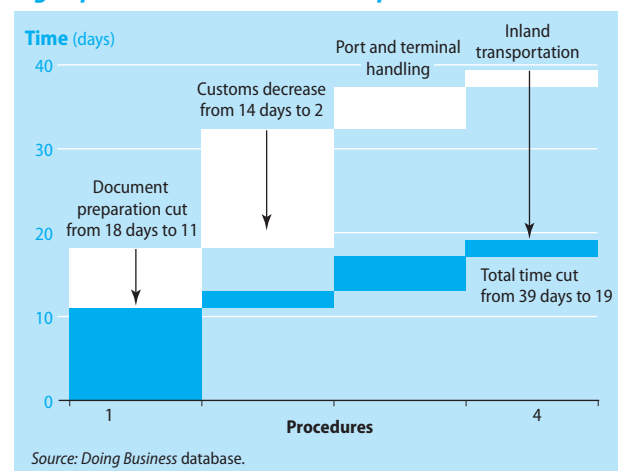
There is an urgent need to further reform tax policy in Pakistan to widen the tax base and reduce the average tax rate. Easing tax administration by lowering the number of taxes and reducing the time to comply is also a priority. The government is taking on both challenges. A recently launched comprehensive analysis of tax policy will complement an already strong effort to improve tax administration. Legislative efforts are being driven by the federal government. A number of tax agencies are modernizing, building capacity and improving the interface between government and business. Archaic complexities in the tax code are being eliminated. Efforts to enable taxpayers to file returns and statements electronically are underway. Taxpayers Units and Medium Taxpayers Units have been established in large cities and so have Regional Tax Offices and Taxpayer Facilitation Centers. The effects of the tax reforms have started to show results. Pakistan jumped 3 spots in the rankings from last year—from 143rd to 140th. But further implementation of reforms is needed to continue this rise.

## Trading across borders

Pakistan now ranks 98th on the ease of trading across borders—above the South Asian average but some distance from best practices. Last year Pakistan ranked 117th. Recent reforms have reduced the time to export (from 33 to 24 days) and import (from 39 to 19 days), rivaling or bettering the clearance time recorded in most other countries in the region (figure 2.18). Pakistan now ranks 91st in the world in time to export and 51st in the world in time to import based on a concerted effort to complement trade liberalization with improved trade

FIGURE 2.18

### Big improvement in the time to import in Pakistan



logistics. A similar improvement has been achieved in the costs of trade. Sri Lanka (\$797 per container), India (\$864) and Bangladesh (\$902) all have lower export costs than Pakistan (\$996).

Despite these improvements, the number of documents required to import and export remains high by global standards. Eight documents are needed to export from Pakistan, which places the country at 107th in the world, while 12 documents are needed for import in Pakistan, putting the country at 120th.

Within Pakistan, Karachi is the cheapest and quickest city from which to export and import—because of the city's proximity to the port and the scale economies from the large volume of trade taking place there. The slowest and most costly place from which to trade is Peshawar, followed by Sialkot and Quetta. Indeed the range of export times (from 24 days in Karachi to 41 days in Peshawar) and import times (from 19 days in Karachi to 42 days in Peshawar and Quetta) across the country is large, reflecting differences in time spent in internal transport. The same is true of import costs (from \$1,005 in Karachi to \$1,786 in Peshawar) and export costs (from \$996 in Karachi to \$1,872 in Peshawar).

### What to reform

Pakistan has focused intensively on reducing the level of trade taxes and administrative burden in recent years. Quotas have been converted to tariffs, followed by a reduction in the level and number of tariff bands, lowering average nominal protection levels from 67% to 10% over the past decade. Significant gains have been made in reducing the cumbersome procedures for export and import clearance. In the past the process involved 34 verifications and 62 steps—with an average time of over eight days per step and in some cases repeated interventions from various public officials. Now, under the pilot project to computerize customs, the clearance process involves only 2 or 3 documents and 2 signatures.

Continued tariff reforms and reforms to trade facilitation are needed to strengthen predictability and stability of trade policy. In particular, a review of documentary requirements is needed to build on the gains already made. Further improvements in the time to export and import are expected to result from the full implementation of tax and customs reforms currently underway. In addition, modernization of harbors, internal transportation corridors and the air transportation system—such as those changes being initiated under the National Trade Corridor Project—complement ongoing efforts at the border.

### Enforcing contracts

Contract enforcement remains one of the weakest dimensions of the business environment in Pakistan. Pakistan ranks 163rd globally. It takes 880 days—well over two years—to enforce a commercial contract. The process involves 55 procedures and costs 23% of the claim's value. Pakistan compares favorably with India (1,420 days) and Bangladesh (1,442 days) on the time needed for a commercial dispute to be resolved through the courts. However, South Asia as a region does not perform well on the enforcing contracts indicator. The smaller countries—Sri Lanka, Nepal, Bhutan and the Maldives—require fewer steps and somewhat less time. The cost of enforcing a contract in Pakistan is on the low end for the region—less than in Nepal (24.4%), India (35.7%) and Bangladesh (45.7%).

Because courts are governed by a national code of civil procedure, 55 steps are required to enforce contracts irrespective of the court's location within Pakistan. However, it takes more time and remains costlier to enforce contracts in large centers such as Karachi, Lahore and, increasingly, Faisalabad. Courts in Peshawar and Quetta resolve disputes more quickly because community-based councils of tribal elders settle small claims. As a result, those courts can decide other matters—such as commercial disputes—faster than the courts in Karachi, Lahore and Faisalabad can. Lawyers' fees in Peshawar and Quetta are also lower than in larger cities, which results in a lower overall cost of contract enforcement.

### What to reform

Contract enforcement presents a major challenge to Pakistan's business environment. Courts are subject to cumbersome administrative and regulatory requirements with the outcome being that a dispute is often resolved informally rather than in court. Federal and provincial governments have been struggling in recent years to improve the court system, with the support of large donor projects to support judicial reform. In particular, draft amendments to Pakistan's Code of Civil Procedure aimed at speeding up the litigation process are pending. The amendments seek to (i) make issuing summonses faster by issuing them electronically, (ii) limit the number of court adjournments, (iii) impose fines for bringing frivolous lawsuits and (iv) formalize alternative dispute resolution procedures.

Other more fundamental efforts remain under consideration. Most importantly, the appointment of judges to fill numerous vacancies at all levels of the court system

is outstanding. The judiciary decided that attempts to introduce a federal commercial court were ill-advised, and the initiative stalled. Specialized administrative and judicial tribunals to address specific types of cases (e.g., tax, banking, customs, labor, etc.) at the lower and appellate court levels are being introduced, as are alternative dispute resolution pilot programs for commercial disputes.

These and other initiatives reflect the government's efforts to further its goal of improving market governance. But there is much to do over the medium term. Improved performance by government officials in implementing regulations will lessen the burden on the judiciary. Ensuring adequate capacity at the lower court levels and timely filling of vacancies at the high court—with dedicated commercial judges—would also contribute to more certainty and predictability in the enforcement of contract rights.

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### Closing a business

Because of specialized legislation introduced during the banking reform of the late 1990s, Pakistan, on paper, scores relatively well globally and regionally on the ease of closing a business. Pakistan's 2.8 years to close business, put it at 69th in the world. It ranks 18th in terms of cost, at 4% of the value of the estate. And with a recovery rate of almost 40%, Pakistan ranks relatively high—46th place globally.

Within the South Asia region, the time to close a business in Pakistan is second only to Sri Lanka (2 years) and compares well with India (10 years), Nepal (5 years) and Bangladesh (4 years). Closing a business in Pakistan costs less than anywhere else in the South Asia region—less than half of the cost in Nepal, India and Bangladesh and less than a quarter of the cost in Sri Lanka. The system in Pakistan is also highly effective relative to other South Asia countries with the recovery rate much higher than in India (13%), Nepal (25%) Bangladesh (25%) and even Sri Lanka (36%).

Although time and recovery rates do not differ dramatically across cities, the cost to close a business does. It costs 4% of the value of the estate to close a business in Karachi, almost double the cost in Peshawar and Quetta (7%) and more than double in Faisalabad, Lahore and Sialkot (9%).

### What to reform

The government has embarked on a comprehensive effort to reform corporate legislation by forming the Corporate Law Reform Commission to rewrite the Companies Act, 1984, which governs the insolvency process and reorganization proceedings. Pakistan's approach until now was to give banks special powers in insolvency cases through specialized banking legislation and banking courts, which has created a creditor-friendly regime. Companies entering insolvency have difficulty reorganizing as a going concern.

The "Corporate Rehabilitation Act" has been drafted but it has not yet been presented to parliament. One of the primary purposes of the legislation is to encourage and facilitate the rehabilitation of viable enterprises and avoid corporate closures through prolonged litigation. It is expected that the proposed law will improve corporate governance, achieve a better balance between creditor and debtor rights, and help prevent unnecessary closures. In addition to new legislation, considerable capacity building for supporting professions—including accountants, receivers, bankers, judges and other legal specialists—will be needed to apply the new regime.