

Formal Contract Enforcement and Entrepreneurial Success of the Marginalized

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Introduction

- From an economic perspective a business is a set of contracts.
- Efficient institutions of contract enforcement, therefore, are critical for proliferation of business.
- Cross country studies do not find any effect contract enforcement institutions on country's growth (Acemoglu and Robinson, 2003).
- This could be because of the use of informal mechanisms to enforce contracts.
 - Our interviews with the entrepreneurs in India also reveal that entrepreneurs often depend on relational (rather than formal) contract to do business.

Scope of Our Work

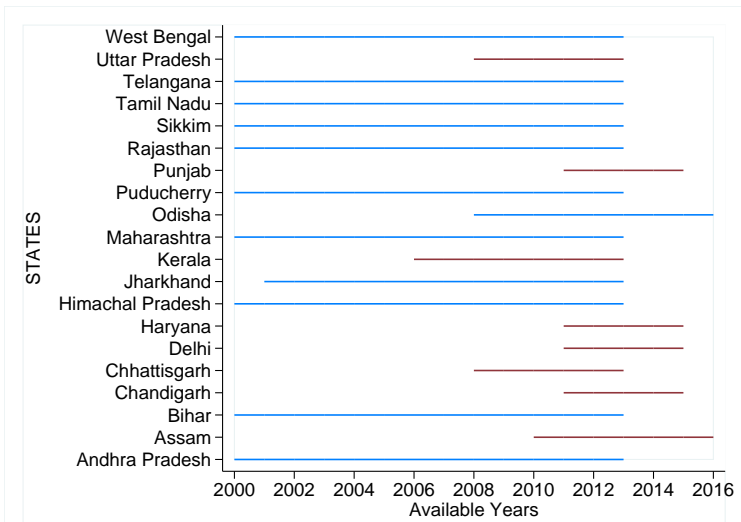
- The main objectives of this paper are three fold:
 - 1 Collect and create Indian judicial data in district level panel
 - 2 Investigate whether judicial efficiency affects business performance - Trivial?
 - Entrepreneurs are averse to going to the courts in the event of a breach of contract
 - The *shadow of the court* may still matter even if no one goes to the court in equilibrium.
 - 3 Does judicial efficiency matter more for the socially disadvantaged groups ?

Existing Evidence & Our Contribution

- Chemin (2011) looked at the effect of Civil Procedure Amendment Act – a judicial reform in India that facilitated speedy disposal of civil lawsuits – on business practices.
 - Found that this reform led to fewer breaches, encouraged investment and facilitated access to finance.
- Ahsan (2013) looked at the complementarity between trade liberalization and judicial efficiency.
 - Found that enterprises situated in states with better judicial efficiency gain more from trade liberalization.
- Amirapu (2015), builds on Nunn (2007), studies how judicial efficiency affects industries differentially depending on the contract intensity of the industry.
 - Found that faster courts have a strong effect on firms in more contract intensive industries.
- Our Contribution:
 - District level panel over a period of 10-15 years, for civil cases
 - New Measure

Court Data Coverage

Figure: State wise availability of Judicial data



Court Data: Variables

- Cases pending at the beginning of the year,
- Cases pending at the end of the year
- Cases instituted during the year,
- Cases disposed during the year.
- Age break-up of pending cases: 0-1, 1-5, 5-10, γ 10.

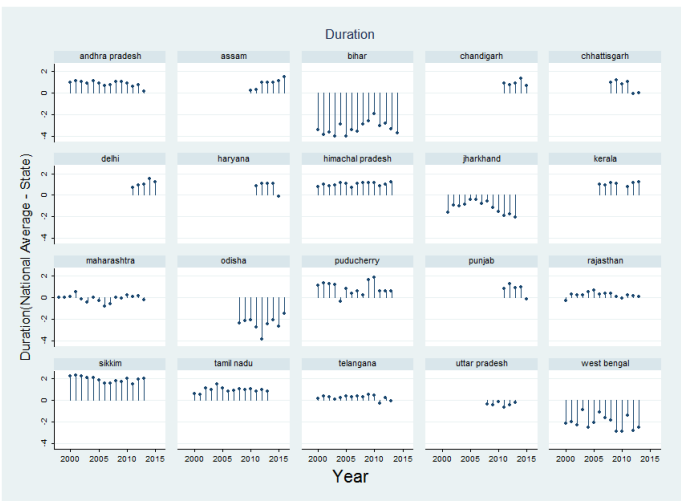
Measure of Court (In)Efficiency

- **Duration/congestion rate:** Chemin(2009)

$$Inefficiency_t = \frac{Pending_t + Filed_t}{Disposed_t}$$

- $Pending_t$: number of cases pending at the beginning of the year t
 - $Filed_t$ is the number of cases filed in year t
 - $Disposed_t$ is the number of cases disposed in year t
- Measures the time a district court takes to dispose off all its pending cases
 - Longer it takes, the more congested the court is and hence more inefficient

Figure: Variation in *Duration* across States

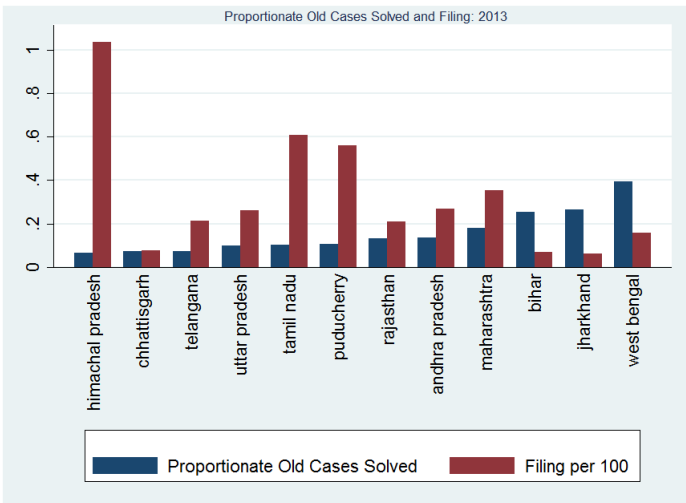


Source: Data collected from High Courts, own calculations.

Alternate Measure of Court (In)Efficiency

- Assumptions of Duration Index:
 - No more new cases
 - All cases, old and new, are disposed off at the same rate
- The decision to start a business likely depends on the pace of solving new cases, not the backlogs
- We distinguish between courts that focus more on solving new cases vis-a-vis old cases
- Fraction of cases solved by a court that are 1-5 years old as opposed to more than 5 years old.

Figure: Proportion old cases solved – Filed



Source: Data collected from High Courts, own calculations.

Industry Data

- We combine Judicial data with firm level data on Micro Small and Medium Enterprises (MSME)
- Fourth All India Census for Registered Enterprises, 2006-07.
- Business Indicators: Delay in Registration, Total Employees.

Empirical Approach

- Around 158525 enterprises in MSME, whose Year of Establishment ranges from 2000-2007.
- We match the district of operation and year of establishment for a firm from MSME Database to court efficiency measures in that district and year, from Court Database, to create a panel data.
- Confounding Effects: Other institutional settings correlated with both court inefficiency and business performance.
- Panel data allows us to address these concerns to a great extent.

Results

- We find that firms are **10%** more likely to experience a **delay in registration** if the average **duration** to solve civil cases **goes up by a year**
- Our econometric approach means that this is true for otherwise comparable districts
- This relationship is robust to the inclusion of various socio-demographic characteristics of the firms
- **The delay in registration is much higher when we measure (in)efficiency by the fraction of old cases solved.**
- Other Findings
 - Firms are more likely to register in the same year that they become operational, more efficient the judiciary
 - Employment, and hence size of the firm, goes up with more efficient courts

Who benefits more from Efficient Judiciary?

- In our sample, women and socially disadvantaged groups benefit more from an efficient court
- Experience a lower delay in registration, compared to men and General groups when courts are more efficient
- The benefits are particularly high for SC-ST entrepreneurs in regions with low population share of SC-ST
 - Informal Networks at play?

Conclusion

- Shadow effect of the courts work even though general perception is that entrepreneurs do not approach the court
- We care about Ease of Doing Business in India
- Much discussion about capacity constraint of judiciary - vacancy, infrastructure etc.
- Consider alternate approaches?
 - First in first out principle
 - Spend relatively more time on new cases?
- **Hope** to complete the study including all states of India