Regulatory Pot-holes

[Impediments to a Digital India]

Abstract

Despite the innumerable benefits brought forth by innovative use of digital technologies, there exist various generic and new age challenges for businesses and consumers alike, which are impeding its growth. Therefore, the role of the government in devising optimal regulatory and policy frameworks, which enable the growth of such businesses, along with balancing consumer welfare, becomes crucial. Catering to this need, this Briefing Paper aims to map the various challenges faced by disruptive digital technology-driven business models as well as consumers, followed by a way forward to strengthen the growth of Digital Economy in India.

Background

India has grown to become the world’s second-largest telecommunications market, having crossed the 1.21 billion subscribers mark in July 2017 (year on year growth of telecom subscribers has been depicted in Figure 1). The rising teledensity, along with a rise in disposable incomes of the middle-class has triggered the demand for smart phones and internet connections, making India the world’s third largest country in terms of Internet subscribers as well.\(^1\)

This has contributed to India’s dream of transforming itself to a Digital Economy (DE). DE may be referred to the enhanced assimilation of digitalisation in social and economic activities, which promotes technological advancement, economic growth and social development. DE has also facilitated the rise of a new era of business, the models of which have massively altered the traditional way of conducting business, and therefore, they are referred to as ‘disruptive businesses’. The examples of disruptive businesses can be drawn from sectors, such as online retail, urban taxi services, holiday planning, flight bookings and digital payment, among many others.

\[\text{Figure 1: Growth in Total Subscribers}\]

The efficiency and effectiveness of these disruptive businesses, largely innovated by start-ups and young entrepreneurs, have enabled them to successfully challenge the established incumbents for market share.\(^2\) The enhanced outreach avenues, associated with such technology-driven businesses, to the underserved population in remote areas, suggests their potential in bolstering a more inclusive and sustainable growth. The same is visible from the box story below.

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\(^1\) **Source:** [https://www.ibef.org/industry/indian-telecommunications-industry-analysis-](https://www.ibef.org/industry/indian-telecommunications-industry-analysis-)

\(^2\) **Source:** [https://www.ibef.org/industry/indian-telecommunications-industry-analysis-](https://www.ibef.org/industry/indian-telecommunications-industry-analysis-)
Digital Footprints in India – Current Scenario

The Government of India (GoI) has showcased a clear intent of transforming India digitally, through its initiatives like Digital India (DI), Smart Cities, Make in India, Start-up India, etc. The impact of digitalisation, on specific groups of stakeholders, has been discussed below.

Consumers
It has been suggested, that digitalisation has deeply influenced the economy and the society at large.\(^3\) It has contributed in creating entrepreneurs, enhancing in quality of life of citizens, facilitating access to knowledge, enhancing efficiency in urban mobility, transport and even dispensing of public services, to name a few.

Businesses, MSMEs and Start-ups
Low cost of operations and outreach, create a level playing field between Medium Small and Micro Enterprises (MSMEs) and their established local and global counterparts. Further, ICT is also known to have various other benefits for MSMEs, such as enhanced productivity, knowledge management, business intelligence et al.\(^4\) Besides, the rapid evolution of new digital technologies is fostering the startup ecosystem, which is attracting young entrepreneurs of the country.

Sustainable Development Goals\(^5\)
The potential and support of Information and Communication Technology (ICT) may be leveraged in achieving a few of the Sustainable Development Goals (SDGs) like removing poverty and hunger (Goals 1 and 2), ensuring universal access to basic services (Goals 3, 4, 6, 8), and making the transition to a low-carbon economy (Goal 13).\(^6\)

Governance and Economy
The modernisation of public administration and improving governance has been one of the pivotal focus areas for the GoI, with the Unique Identification Number or Aadhaar for citizens being its flagship programme. The MyGov.in\(^7\) initiative, which has seen active citizen engagement, has resulted in a more participative and democratic form of delivering governance. Such convenient citizen engagement platforms also enable citizens to voice their complaints and concerns related to various government functions like Meri Sadak Application for consumers to provide feedback on quality of roads and work under the Pradhan Mantri Gram Sadak Yojana (PMGSY).

However, the growth of many of these innovative disruptions, are being marred by various regulatory challenges, which might further impede the proliferation of DE. Thus, it is imperative to understand these challenges and the perspective of key stakeholders.

Regulatory Challenges for Sustained Growth

Growth of new age digital technology driven businesses (private sector) is being hindered due to various factors, such as: weak technological infrastructure in the country, fragmented and unorganised market structures, cyber security concerns,\(^8\) lack of digital literacy, along with low internet penetration among
consumers et al. Apart from these challenges, existing regulations and policies are also acting as impediments to the growth of disruptive businesses.

The primary reason for regulatory challenges may be attributed to incompatibility of existing regulations with the new age businesses. This is further exacerbated due to constant evolution of technology, which creates a constraint for the policy makers to understand the scenario holistically, in order to frame optimal regulation. Tussles between disruptive and traditional businesses are widespread, where accusations of government protectionism, capital dumping, cross-subsidies and differences in regulatory burdens have been regularly brought into limelight. While digitalisation has favoured new age businesses, the political scenario has often backed the incumbents. This hinders the markets to operate freely by posing hurdles to the growth of digital businesses, while also protecting the traditional businesses from natural extinction.

**Regulatory Challenges faced by new age digital technology driven disruptive businesses**

The challenge for the policymakers is to frame the right policy mix, which enables maximisation of benefits emanating from digitalisation, while safeguarding the interests of all stakeholders. Even in the best of circumstances, regulators face many challenges in regulating the new-age disruptive businesses. These have been mentioned in the box story below.

<table>
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<tr>
<th>Challenges faced by Regulators</th>
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<td>• Imperfect information about the complex nature of the digital markets sometimes result in regulations having unintended consequences, such as restricting competition and harming consumers.</td>
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<tr>
<td>• Even after accurate diagnosis of a market failure; the dynamic nature of the market conditions, and constantly evolving technologies, makes regulations obsolete faster, resulting in regulatory structures and policies that are mismatched to market realities.</td>
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<td>• The increased regulatory uncertainty of disruptive business practices makes it difficult for regulators to assess market performance and come up with solutions; sometimes leading to over-regulation, or regulations which are often complex and ambiguous, thereby substantially adding to the compliance burdens of the regulated industries.</td>
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These challenges to effective regulation are a manifestation of the regulators not having transitioned quickly enough and from coming up with prescriptive ex-ante rules, to adopting a more dynamic ex post approach. Therefore, the archaic regulations are often too static and inflexible for effectively regulating the rapidly evolving digital ecosystems. Also, regulations differentiating between market players based on the type of technology/business model sometimes create regulatory arbitrages and uneven playing field.

These factors have created regulatory and policy roadblocks for proliferation of DE. Few examples of such roadblocks faced by taxi aggregators in the urban mobility sector, and E-commerce, have been discussed below.

**Sub-optimal Regulations Impeding Growth**

**The Case of Taxi aggregators**

The disruptions occurring in the urban mobility sector with the entry of taxi aggregators needs to be adequately accounted for. Since the issue falls in the concurrent list, the Centre needs to work with the state
governments to formulate optimal regulations.11 Though the Taxi Policy Guidelines issued by the Ministry of Road Transport and Highway (MoRTH) in December 201612 are appreciable, however, there still exist some gaps which need to be addressed. Some of such gaps have been listed below:

- **Unnecessary Infrastructure Requirement:** The Aggregators should have a physical presence/premise in the respective State of operations.13 In a vast country like India, where taxi aggregators are providing services in numerous cities, this requirement may not be economically feasible for companies. Thus, the possibility of having a centralized office in the country in light of the advent of digital technologies should not be left unexplored.

- **Pricing Regulations:** State Transport Departments may regulate the fares of the taxis in economy segment with the overall objective of facilitating the citizens with adequate supply at reasonable prices.14 However, pricing decisions are best left onto market forces, and government intervention might only be required in cases of market failure. This highlights the need for light touch regulations in the urban mobility sector.

- **High permit fees:** The guidelines have not touched upon the need for reducing the permit fees, which in some States is too steep. Though such permit fees may prove to be a source of revenue for State governments, it may simultaneously also raise the entry barriers for small operators / car-owners / drivers.15 Thus, there is a need for optimal regulations to achieve a win-win situation for both the government and other stakeholders.

**The Case of E-commerce**

Few of the regulatory and legal compliance challenges faced by the E-commerce industry have been discussed below:

- **GST registration compulsion:** The government has prescribed a threshold limit with respect to the turnover of all businesses; crossing which will force a business to get itself registered under recent Goods and Services Tax (GST) regime. However, such a threshold is not applicable for online sellers, and all are mandatorily required to get themselves registered (irrespective of their turnover) under the new tax regime. Further, E-commerce service providers have now been mandated to deduct the GST liability of the online seller, and deposit it with government as Tax Collected at Source (TCS). This will further require online sellers to file a monthly return under GST, in order to claim the credit of such TCS deducted by the E-commerce platform, which would resultantly impact their liquidity and cash flow, apart from increasing their regulatory compliance burden.16

- **Implication of Section 79 of the Income Tax Act:** Section 7917 of the Income Tax Act provides that, if a company has more than 50 percent of its shareholding changing hands, then the accumulated losses cannot be carried forward next year. Most consumer internet companies make heavy investments in team, promotion and technology, without much income in its early years. Also, multiple investors keep changing in the funding life cycle. Owing to this provision of the Act, these companies have to be very careful while raising capital to ensure the capital structure does not change by more than 50 percent.

- **Regulations relating to discounts:** Online marketplaces are now prohibited from funding discounts through bonus schemes, marketing cost reimbursement, etc. However, an online seller may
continue to sell goods at a discount. Accordingly, this could make online marketplaces less attractive to shoppers and investors.\(^{19}\)

- **FDI in E-commerce:** Though the Department of Industrial Planning and Promotion (DIPP) has permitted 100% Foreign Direct Investment (FDI) in online retail of goods and services under the marketplace model through the automatic route, the same is prohibited for companies that own inventories of goods and services, and sell directly to consumers using online platforms.\(^{20}\)

### Challenges in Digital Economy for Consumers

While there are a number of challenges on the supply side, there exist equal numbers at the demand side as well. Consumers have benefited immensely from DE, in terms of both, accessibility and affordability of goods and services. However, their experience has not been bereft of challenges, some of which have been categorised below:

#### Generic Challenges

- **Lack of adequate technical infrastructure:** With over 90 percent of Indian consumers, dependent on wireless medium for internet access\(^{21}\), the current mobile tower network is insufficient to cater to the demand. Quality of Internet services is also a major challenge.

- **Deferred policy implementation:** The government is making efforts to connect all village councils to broadband services, through optic fibre connectivity as a part of Bharat Net programme; its completion is still awaited. Approved by Cabinet in 2011, the project has deferred its deadlines from December 2013 to September 2015 to March 2017 to March 2019. Such delays in a fast-moving digital world, amount to a substantial loss of opportunity cost.

- **Limited supply of Electricity:** Electricity supply is limited and prone to loss at many remote locations, not to mention, we still have habitations in India, which are yet to see electricity, even after seven decades of gaining independence.

- **Other hindrances:** Most of the content and platforms are available only in English. In India, English proficiency is not high, especially outside the urban areas, which create another barrier in utilising the benefits of ICT. Apart from this, high cost of communication equipment, lack of trust in the ICT technologies and poor digital literacy adds up to the challenges of enabling DE.

#### New Age Challenges

- **Data Protection Law:** The country does not have any exclusive data protection law as yet, although a Committee headed by Retired Justice B N Srikrishna, has been established to recommend data protection framework for the country. Subsequently, the Committee had released a whitepaper to seek comments from stakeholders on this issue.\(^{22}\)

- **Cyber Crime:** India has witnessed increase in cases related to cyber terrorism, hacking, phishing, fraudulent online banking transactions etc. Added to these, the recent malware attacks in India, such as Wannacry and Petya\(^{23}\), along with information /data leaks even from government websites\(^{24}\) have also dented consumer
confidence on uptake of digital platforms. Insufficient policies related to countering job loss due to automation have also impeded the growth of DE among consumers.

**Rise of multi-sided platforms:** Lack of clarity on the aspect of liability binding or accountability for service where suppliers and buyers both act as consumers to the platform, is a major cause of concern for consumers. Moreover, information asymmetry on these platforms between the two set of consumers (suppliers and buyers) result in consumer or producer surplus, which is not optimal for the economy.

Apart of these, exclusive contracts (as on e-commerce platforms), rising monopolies, through the issues of capital dumping, hostile takeovers, etc., limit options for consumers in the market. The issue of price holding through use of algorithms and geo-blocking also add to competition/consumer welfare concerns, which resists consumers in imbibing confidence towards enhanced use of digital technology platforms.

**The Way Forward**

The digitalisation of economies and societies is only going to expand and deepen with time. Therefore, the challenges listed above, need to be effectively addressed in order to enable consumers to gain confidence in digital technologies, which will ultimately result in inclusive participation and contribution to DE. Also, it is essential to assess the need for light touch regulations with regard to technologies of the future, since it has often been advocated that markets perform best when left to operate freely. Regulations might only be introduced in case of market failure, and over-regulation should be avoided as to avoid crippling the market through inefficiencies.

The government needs to clarify the accountability aspects for the rising multi-sided markets. Moreover, there is also a need to safeguard consumers on privacy and online safety. For this, there is a need for well-drafted and optimised policy on privacy, management of consumer data and consumer safety. Optimal regulations will incubate new age business, which may further facilitate inclusiveness, innovation and overall consumer well-being. Resolution of policy impediments is also imperative in order to effectively steer the growth of the India’s DE aspirations in the right direction.

The following suggestions may be implemented for framing enabling regulatory and policy frameworks:

- **Undertaking comprehensive analysis of the compliance cost burden of implemented regulations**
  This might be done by assessing the extent and feasibility of implementation of the respective regulations, to identify the shortcomings in them. Recommendations of all relevant stakeholders might be taken on them and a dedicated single repository may be created for its access.

- **Data sharing between various government and non-government entities**
  This will enable future regulations and policies to be guided by better information and knowledge base, and will also help in identifying and focussing on gaps and emerging areas of concern.

- **Conducting RIA’s (Cost-Benefit Analysis) while designing new regulations/policies**
  This will guide the policymakers in framing optimal regulations. Further, adopting a regulatory sandbox approach before implementing a policy on a nation-wide scale will also provide adequate course correction opportunities to the government in an enclosed environment.
• Encouraging investments in R&D
For technology advancement through public-private partnerships (PPPs), facilitating further participation of Small and Medium-sized Enterprises (SMEs) and MSMEs, and promoting entrepreneurship in digital technologies to build a strong ecosystem for nurturing innovation and a start-up culture under the ‘Start-up India’ and ‘Make in India’ initiatives.

• Digitally Empowering India
Concrete steps must be undertaken to ensure wider digital payment methods, strengthening cyber security and improving digital infrastructure thereby digitally empowering India under the ‘Digital India’ programme and accomplishing the Cashless India mission.

• Building required digital skills
Efforts must be made towards developing digital skills, especially in rural areas to develop a digitally sound workforce under the Skill India mission. This would enable inclusive growth, by ensuring the participation of the rural populations in the DE.

• Spread awareness amongst consumers
Various activities, such as Massive Open Online Courses (MOOCs) must be undertaken by the government, to not only spread the benefits of ICT, but also to enhance digital literacy and allay consumer concerns.

It is needless to say, that the future will be even more digitised than today. Thus, it is essential to take into consideration the future challenges and devise appropriate solutions at the earliest. The solutions should be inclusive as well as cater to the interests of all stakeholder groups, while retaining the focus on the socio-economic growth of the country.

The key is to adopt an optimal regulatory framework, which originates from inclusiveness, long term vision, careful mapping for stakeholders and associated benefits and capacity building of stakeholders for maximum efficiency.

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End Notes

1 India and Indian Analysis, ‘Indian Telecom Industry Analysis, Telecommunications Sector Reports’ (Ibef.org) <http://www.ibef.org/industry/indian-telecommunications-industry-analysis-presentation> accessed 7.03.2017


4 SDGs are a universal set of goals, targets and indicators, established by the United Nations (UN), create a common set of development goals for all communities in every country, which may be used to frame policies and agendas for next 15 years. Consisting of 17 global goals and 169 targets, they envision the role of governments, foundations, etc. devising solutions of the most urgent global issues.

5 https://www.slideshare.net/Ericsson/ict-sdgs

6 https://www.mygov.in/ accessed on 22.11.17

7 https://www.pwc.in/assets/pdfs/publications-2011/innovation-msme-2011.pdf accessed on 22.11.17

8 http://www.grant Thornton.in/globalassets/1.-member-firms/india/assets/pdfs/grant Thornton-startups_report.pdf accessed on 22.11.17


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17 https://www.medianama.com/2015/07/223-ashish-chandra-snapdeal-ecommerce/ accessed on 22.11.17


