

A woman with dark hair, wearing a pink patterned shirt, is smiling and sorting through green peas in a market stall. She is surrounded by large white sacks filled with produce, including green peas and cabbages. The background shows more sacks and a red chair.

Doing Business in Nepal

Ground Realities

Dr. Dileep K. Adhikary, Anita Krishnan & Surath Giri

Published by
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Acknowledgement

This research paper “Doing Business in Nepal: Ground Realities” covers one of the six cross-cutting issues identified as important across the five sectors of growth in Nepalese economy, namely agriculture, education, infrastructure, hydropower and tourism. We would like to thank everyone who directly or indirectly contributed in the preparation of this paper. We are highly appreciative of Dr. Dileep Adhikary whose inputs and direction were instrumental in giving a definitive framework to the paper. His mentorship as well as his immense knowledge was very helpful to the research assistants to comprehend and analyze the subject matter. We would also like to thank Anita Krishnan & Surath Giri for working so arduously to prepare the paper.

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Preface

As part of its efforts to bring economic issues into public discourse of Nepal, Samriddhi, The Prosperity Foundation is committed to an annual analysis of constraints of economic growth of Nepal along with exploring policy options. This process termed as the “Nepal Economic Growth Agenda (NEGA)”, is an annual effort to identify short term as well as long-term policy bottlenecks that hinder Nepal’s economic growth. NEGA 2012 identified and discussed policy constraints in five growth sectors of Nepal viz. Agriculture, Education, Hydropower, (Transport) Infrastructure and Tourism.

Building on this research, NEGA 2013 focuses on identifying and discussing cross-cutting issues affecting the growth of all five sectors and also makes recommendations to address those issues. The six different issues studied under NEGA 2013 are industrial relations, contract enforcement, anti-competitive practices, foreign direct investment, state-owned enterprises and regulatory environment for businesses. The studies of the six issues have been published as six different research papers representing each issue. The papers have been prepared in consultation with individuals and groups who are experts of or directly involved in the field.

“Doing Business in Nepal: Ground Realities” was prepared by the team of Dr. Dileep K. Adhikary, Mr. Surath Giri and Ms. Anita Krishnan. This research paper studies business regulations and arbitrary bureaucratic decisions, one of the major cross-cutting issues affecting different sectors of Nepalese economy.

With the economic reforms of early 1990s, Nepal has adopted a policy of market economy. One of the major characteristics of a market economy is the freedom to enterprise which requires that there are no excessive regulations from the government. Studies have found that poor countries regulate their business the most and heavier regulations usually result in more inefficiency in public institutions

with longer delays and higher costs along with higher unemployment, higher rates of corruption and less investment and productivity (World Bank, 2004).

In the context of Nepal, one of the major hurdles to doing business cited by many national and international entrepreneurs is the bureaucratic delays. Bureaucratic delays are usually results of loopholes in the law and discretionary authority handed over to the bureaucracy by the law. Frequent changes in regulations or lack of clarity of regulations and discretionary provisions for bureaucrats create uncertainty and avenues for corruption which ultimately discourages entrepreneurship.

In this context, the paper analyzes the existing bureaucratic hurdles of doing business in five sectors of the Nepalese economy through a study of a particular product or service viz: agriculture (a review of seed enterprises), education (a review of schools excluding 10 plus 2), energy (a review of licensing process for hydropower), infrastructure (a review of Construction Company) and tourism (a review of travel and tour agencies).

The paper identifies the various problems faced by enterprises related to above products or services, analyzes the cause of these problems and makes the necessary recommendations that can help alleviate the problems and drive entrepreneurial growth in the country.

Abbreviations and Acronyms

AOA	Articles of Association
CAAN	Civil Aviation Authority of Nepal
CEO	Chief Executive Officer
DOED	Department of Energy Development
EIA	Environmental Impact Assessment
GDP	Gross Domestic Product
IMF	International Monetary Fund
MOA	Memorandum of Association
MoSTE	Ministry of Science, Technology and Environment
MoWR	Ministry of Water Resources
MW	Megawatt
NARC	Nepal Agricultural Research Council
NEA	Nepal Electricity Authority
NSP	National Seed Policy
SRR	Seed Replacement Rate
VAT	Value Added Tax
WTO	World Trade Organization

The Nepali year is based on the Bikram Sambat Calendar and is approximately 57 years ahead of the Gregogrian calendar (2062/1/1=2005/4/14)

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1. Introduction

Since the economic reforms started in 1980s under the Structural Adjustment Program of IMF and World Bank, Nepal has endeavored to follow an open and export-oriented economic model. Many restrictions on imports have been removed and custom duties have been reduced, the controls on foreign exchange also have been relaxed. Industrial licensing system has been reformed and foreign investment has been allowed in the country. Private sector has been recognized as one of the major pillars of the Nepalese economy. In 2004, Nepal acceded to the World Trade Organization as 147th member of the multilateral trade body and as the first least-developed country to have joined the institution through the process of accession.

One of the major characteristics of a market economy is the freedom to enterprise which requires that there are no excessive regulations from the government. Studies have found that poor countries regulate their business the most and heavier regulations usually result in more inefficiency in public institutions with longer delays and higher costs along with higher unemployment, higher rates of corruption and less investment and productivity (World Bank, 2004). Nepal is not an exception despite adopting market friendly economic regime in the framework of economic liberalization with the objective of improving the competition and doing business scenario.

World Bank's Doing Business Report is one of the most influential studies on the regulations and business environment of the developing countries. The report measures and tracks changes in 11 areas of business, namely: starting a business, dealing with construction permits, getting

electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency and employing workers. Currently, Nepal ranks 108th on ease of doing business out of 185 economies studied (World Bank, 2013).

Table 1: Doing Business in Nepal

Starting a business (rank)	105
Procedures (number)	7
Time (days)	29
Cost (% of income per capita)	33.0
Minimum capital (percentage of income per capita)	0.0
Dealing with construction permits (rank)	97
Procedures (number)	13
Time (days)	115
Cost (percent of income per capita)	654.6
Getting electricity (rank)	96
Procedures (numbers)	5
Time (days)	70
Cost (% of income per capita)	1,762.8
Registering property (rank)	21
Procedures (number)	3
Time (days)	5
Cost (% of income per capita)	4.9
Getting credit (rank)	70
Strength of legal rights index (0-10)	7
Depth of credit information index (0-6)	3
Public registry coverage (% of adults)	0.0

Private bureau coverage (% of adults)	0.5
Protecting investors (rank)	82
Extent of disclosure index (0-10)	6
Extent of director liability index (0-10)	1
Ease of shareholder suits index (0-10)	9
Strength of investor protection index (0-10)	5.3
Paying taxes (rank)	114
Payments (number of year)	34
Time (hours per year)	326
Total tax rate (% of profit)	31.5
Trading across borders (rank)	171
Documents to export (number)	11
Time to export (days)	41
Cost of export (US\$ per container)	1,975
Documents to import (number)	11
Time to import (days)	38
Cost of import (US\$ per container)	2,095
Enforcing contracts (rank)	137
Procedures (number)	39
Time (days)	910
Cost (% of claim)	26.8
Resolving insolvency (rank)	121
Time (years)	5.0
Cost (%of estate)	9
Recovery rate (cents on the dollar)	24.5

Source: *Doing Business 2013, World Bank*

Doing Business report has been an effective tool to evaluate the business environment of countries around the world, particularly developing countries, and has become a guide for directing reform initiatives for some countries like Rwanda. The quantitative approach taken by the report, however, misses out the different practical aspects of doing business as well as the practical aspects of business regulations that severely constrain the business environment. Some academics have raised concern over the ranking technique used by the report especially because it does not focus on small and medium enterprises and the techniques' inability to accommodate the effects of transaction costs in doing business (Kaplan, 2013).

In the context of Nepal, one of the major hurdles to doing business cited by many national and international entrepreneurs is bureaucratic delays. Bureaucratic delays are usually results of loopholes in the law and discretionary authority handed over to the bureaucracy by the law. These provisions also expand avenues for corruption.

In this paper, we analyze the existing bureaucratic hurdles of doing business in five sectors of the Nepalese economy. In order to avoid generalization and shed light on the nature of specific problems, we have chosen one particular product type offered within these sectors viz: agriculture (a review of seed enterprises), education (a review of schools excluding 10 plus 2), energy (a review of licensing process for hydropower), infrastructure (a review of Construction Company) and tourism (a review of travel and tour agencies). Although the regulatory problems faced by enterprises during registration and operation are different and sector specific, problems with regards to exit are similar. Tax implications, labor issues, expensive and time-consuming liquidation process are common problems faced by enterprises across sectors.

2. Sector-Specific Regulations

Agriculture (Seed)

Agriculture is the most dominant sector of Nepalese economy contributing around 35% of the total Gross Domestic Product of Nepal. The average growth of the sector for the recent years has hovered around 3% (The World Bank, 2011). Agriculture sector of Nepal is largely informal and employs around 66% of the workforce. Broadly, agriculture can be categorized into livestock production and crops farming. Agro-enterprises in formal sector of Nepal are focused on animal products such as milk, cheese and meat products, confectionary items such as sugar, candies, and biscuits. Hence, while livestock production is being adopted by the formal sector, crop farming remains largely in the domain of informal economy. However, there is a strong presence of formal enterprises in some cash crops like tea and coffee and these crops have become one of the major exports of Nepal. Major constraints being faced by agro-enterprises in Nepal are lack of access to suitable land, lack of access to credit for business expansion, lack of spare parts for machinery along with lack of human capital to maintain the equipments and lack of necessary infrastructure such as power (NEGA, 2012).

Hence, the return from agriculture sector especially farming has remained very low though as most of the farming activities lack commercial orientation. The per capita GDP of agriculture worker is only US\$ 140 (Ministry of Finance, 2008). Due to rapid population growth land fragmentation has increased. The average land holding size in Nepal is around 0.8 hectares per household (Central Bureau of Statistics, 2002) which is one of the major reasons for low productivity. However, there

is a huge potential of increasing productivity through use of modern technologies such as irrigation, agricultural roads, land improvement, agricultural mechanization, equipment, and the use of purchased inputs such as improved seeds and fertilizers (Joshi, Conroy & Witcombe, 2012).

Seed production plays a major role in the development of agriculture in Nepal. Around 2-5 percent of the annual seed requirement of Nepal is fulfilled through formal trading of domestically farm produced seeds or imported seeds. Rest of the demand is fulfilled informally by farmers trading with each other (Gautam, 2008). Due to dominance of informal trading, the Seed Replacement Rate (SRR) of Nepal is very low. For instance, seed replacement rate for rice, one of the major crops of Nepal is just 8.7% (Sapkota, Regmi, Pandey & Tripathi, 2011).

The regulatory framework of seed farming and seed trading consists of Seed Act 2045 (Amended in 2064), Seed Regulation 2054 and National Seed Policy 2056. Similarly, National Seed Vision 2013-2025 has been prepared by the Government of Nepal in April 2013 with the objective of contributing towards development of sustainable seed system in Nepal. National Seed Board, which was established as per the provision of the Act, regulates quality, approves and registers new seeds, determines seed standards and issues seed certificates.

Table 2: Registration Requirements for Seed Enterprises

Type of Enterprise	Licensing body	Requirements
Seed Production	Seed Quality Control Center	<ul style="list-style-type: none"> • Citizenship Certificate • Passport size photographs (2) • Receipt of fees payment • Company or Firm Registration Certificate • Tax Registration Certificate • Recommendation from District Agriculture Office

Source: *Nepal Business License e-Portal*

Until 1998, there was no provision for private sector's involvement in seed production and trade as the industry was entirely dominated by Nepal Agricultural Research Center (NARC). Private sectors involvement was initiated by the National Seed Policy (NSP) of 1999 which made provisions for private sector's involvement in crop-variety development as well as seed trade. As per the policy, storage facilities and refinery for seed production were to be transferred to private bodies; the pledging mechanism, whereby the pledger had to pay high interest rates was to be reformed to offset the high interest expenses with the government subsidizing the interest expenses; and custom and tax subsidies were to be provided to seed enterprises along with training facilities for businessmen. According to the entrepreneurs (consulted for the purpose of this paper), these provisions have been implemented albeit not consistently across the nation. The storage facilities and refinery usually operate under cooperatives which receive certain subsidies from the government. Similarly, agro-products are provided exemption from customs tax. However, value added tax is still applicable to these products.

Despite the opening of seeds business for the private sector, as of December 2012, there are only 16 registered private seed companies in Nepal (Joshi, Conroy & Witcombe, 2012). These companies mainly deal with seeds of rice, wheat, maize and vegetables. Majority of seed enterprises in Nepal are involved in both the production and trading of seeds.

Some of the regulatory hurdles faced by private seed entrepreneurs in Nepal are as follows:

- Currently, the Nepal Agricultural Research Council (NARC) is responsible for generating data on distinctness, uniformity, and stability of seeds while it is also the major crop-breeding and variety-releasing institution. This has resulted in conflict of interest (Joshi, Conroy & Witcombe, 2012). Entrepreneurs consulted during the preparation of this paper also complained

of the delay in approval of new varieties of seed by NARC. According to them, it takes around 2-3 years for approval of a new seed. The time frame is not feasible for small scale seed enterprises.

- National Seed Policy has the provision of “truthful labeling” as one of the options for seed certification. This provision, if implemented would provide a greater flexibility to the seed enterprises. However, there has been a lack in the popularization and implementation of the provision and has prevented further deregulation of the market.
- Seeds from Uttar Pradesh, Bihar and West Bengal are informally imported to Nepal. Lack of market monitoring has resulted in spurious seeds (often branded under reputable names) being used by farmers. Since, the trade is done through informal and illegal channels, no party can be held responsible for any damages incurred by the use of these seeds.

Education (Schools)

Education is considered one of the prerequisites for economic growth. Educated and skilled human resource is a vital resource for every economy in the world. Nepal has also given a high priority to its educational sector. With the advent of democracy in 1951, reach of education extended beyond the royal and Rana families. People and communities started building schools on their own which led to a mushrooming of private schools, although there were known as non-governmental schools rather than private schools. The trend however came to a halt in 1971 as the government nationalized all existing schools with the implementation of Education Act 1971. But as demand for education outstripped the supply, the government came to the realization that government efforts and initiatives were inadequate meet the demand for education which led to the

amendment of the Education Act in 1980 and paved way for private schools in Nepal once again (NEGA, 2012).

Since the restoration of democracy in 1990, Nepal has seen a rapid proliferation of private schools. According to Ministry of Education there are currently 10,478 private schools out of which 2306 schools provide secondary level education (Ministry of Education and Sports, 2011). The poor performance of public schools has resulted in more and more parents opting for private educational institutions. Some 15 per cent of the educational institutions in Nepal are run by the private sector. However, more than a quarter of the total students of Nepal attend these institutions.

District Education Office, Regional Education Directorate and Department of Education are the responsible agencies for registering and monitoring private educational institutions in Nepal. Registration of educational institutions running classes up to grade 10 are regulated by Education Act, 2028 (1971) Section 3; Education Rules, 2059 (2002), Rule 3. Schools providing primary education need to be registered with the District Education Office only and pay NRs. 50,000 for the license whereas

Table 3: Registration Requirements for Private Schools

Type of School	Licensing Body	Requirements
Primary Level School	District Education Office	<ul style="list-style-type: none"> • Application • Inspection Report • Copy of the statue of the Educational Trust or the Memorandum and Articles of Associations of the Company • In case of rented land and building, contract paper of rent with the owner for at least 5 years • Educational map of the proposed school area • Company or Educational Trust Registration Certificate • Tax Registration Certificate • License Fee of NRs. 50,000

Type of School	Licensing Body	Requirements
Secondary Level School	- District Education Office	<ul style="list-style-type: none"> • Application • Inspection Report • In case of rented land and building, contract paper of rent with the owner for at least 5 years • Educational map of the proposed school area • Company or Educational Trust Registration Certificate • Recommendation from respective District Education Committee/ Municipality • Recommendation from 2 nearby schools • PAN Registration • License Fee of NRs. 1,50,000 (Lower Secondary) NRs. 2,00,000 (Secondary)

Source: Nepal Business License e-Portal

schools providing secondary education need to be registered with Regional Education Directorate and Department of Education and pay NRs. 1,50,000 and NRs. 2,00,000 as license fees for lower secondary level and secondary level respectively.

Some of the regulatory hurdles faced by private education entrepreneurs in Nepal are as follows:

- While acquiring permission to open Secondary Level School (Grade 6 to 10), an entrepreneurs needs to get recommendations from 2 nearby schools if there are already other schools in the ward. In case there are no older schools in the ward, the promoter is exempt from this requirement. The provision creates a conflict of interest for the recommending schools and encourages anti-competitive behavior.
- Educational institutions are levied 25% income tax like other

private companies. Additionally, the government has also introduced Education Service Tax of 1% which has added to the operation cost of the private educational institutions.

- The fees charged by private schools have time and again been controlled by the government and in some cases the Supreme Court decides whether or not to allow private educational institutions to hike fees (Adhikari, 2013).
- Fearing competition from the private educational institutions for community schools, Government agencies have halted the registration of new private schools (Republica, 2013). The move has not only denied new entrepreneurs from entering the education sector but also resulted in people holding licenses of educational institutions to sell them at premium rates.
- Private and Boarding Schools Directive, 2013 has stipulated that all private schools should have a minimum of 22 students in a single grade, and a minimum of 115 students for a primary school, 165 for a lower secondary and 220 for secondary schools. There might be cases where a particular classroom might run short of a couple of students and shutting down the school for that reason alone doesn't appear to be a viable option. The provision is likely to make it difficult to open up new private school and hence stifle competition as an increasing number of schools might not necessarily be able to have at least 22 students in all the grades or even meet the other infrastructural requirements. Schools will have to increase their fees exponentially to ensure that all the standards are met hence raising the prices for consumers. Even some top notch schools of Nepal today would not have met these requirements in their initial years (Jha, 2013).
- Extortion by political parties and their affiliated organizations,

use of violence when their demands are not met are some other hurdles faced by educational enterprises (Pokharel, 2012) (Himalayan News Service, 2012).

- While exiting, only schools with less than 220 children can shut down the enterprise.
- Lack of clarity on whether the government wants to treat private educational institutions as profit-making companies or service-oriented organizations have caused confusion and uncertainty among the stakeholders (Pokharel, 2012). As per the existent law, a school can have the status of either a profit-making company or a service-oriented organization and comply with the taxation structures accordingly. However, the government has been issuing directives to control fees and other operations of these enterprises at the same time levying taxes as private companies.

Energy (Hydropower)

Source of energy in Nepal has continued to remain traditional forest and agro-based, on use by most of the households in the rural areas; it is mainly commercial in the urban areas. The commercial supply is overwhelmingly petroleum based fulfilled through imports; Nepal has not moved to nuclear energy front and as such hydropower is the most significant source of energy. However, despite having huge potential, as of 2012 Nepal has been generating only 652 MW of hydropower which is less than 1% of its projected total potential of 83000 MW. Nepal hydropower generation is considerably lower than its South Asian neighbors including Bhutan. Because of the gap between demand and supply of electricity, Nepal has been facing a chronic power shortage in the dry season. As of 2011, there are 11 major hydropower stations, 16 small hydropower stations and 23 isolated (not connected to the national grid) small hydropower stations in Nepal. Additionally, 6 stations are under construction and other 8 stations

have been planned (Nepal Electricity Authority, 2012). Bureaucratic delays and political interference are very common in hydropower sector of Nepal.

The Hydropower Policy of 1992 opened the harnessing of this source of energy for private sector participation. It had made provisions for hydropower license validity for 50 years, tax holiday for 15 years for hydropower projects, income tax (applicable after 15 years) at the rate of 10% below prevailing corporate income tax, 1% customs duty on imported goods for the project, exemption on sales tax among other things. However, the Hydropower Policy of 2001 has reduced the license validity for 35 years, eliminated tax holiday provision and brought hydropower sectors under corporate tax net. This new policy has been considered regressive for hydropower sector in Nepal (Adhikari, 2011). However, the Electricity Draft Act 2065 tabled in the parliament is yet to be passed. Hence, although some provisions mentioned in the new policy are in effect already, others provisions are dictated by the older Act. This has created areas of confusion and led to discretionary decision-making. Although the Policy had made a provision of making hydropower projects exempt from Value-Added Tax (VAT), the government introduced an ordinance in July making VAT applicable to all projects above 3 MW increasing the cost of projects by 13% (Mathema, Guragain, Khadka, Sherpa & Adhikari, 2013). Such inconsistency in policies has huge adverse effects in hydropower sector where investments are made for longer period of time.

Table 4: Registration Requirements for Survey of Hydropower Generation

License for	Licensing Body	Requirements
Survey of Electricity Generation	Department of Electricity Development	<ul style="list-style-type: none"> • Application • Map of the Project Site • Area of water resource to be surveyed & water to be utilized • Estimated Amount of Cost and Time • Total Capacity of the product & estimate of annual production • Company Registration Certificate • Tax Registration Certificate

License for	Licensing Body	Requirements
Electricity Generation	Department of Electricity Development	<ul style="list-style-type: none"> • Application • Source of electricity to be produced • Estimated amount of cost and time • Name of partners and types of their associations • Full name & address of person/ corporate body • Feasibility & environmental study • Company Registration Certificate • Tax Registration Certificate • EIA report
		<p>License Fee:</p> <ol style="list-style-type: none"> 1. From 1MW - 5MW NRs. 100000 per year 2. From 5MW - 100MW NRs. 500000 per year 3. From 100MW - 500MW NRs. 1000000 per year 4. From 500MW - 1000MW NRs. 2500000 per year 5. Above 1000MW - NRs. 5000000

Source: Nepal Business License e-Portal

Some of the regulatory hurdles faced by private hydropower entrepreneurs in Nepal are as follows:

- One of the major issues of contention in this sector for decades has been the licensing provision. In terms of the licensing two distinct set of licenses are needed for those who want to set up their business around hydropower—feasibility license and generation license. As has been a practice for years, investment in the feasibility license does not guarantee that the particular entity would get a generation license. Also, the generation licenses have been bought by individuals who have been pocketing the licenses and selling them at their own convenience and rates. This has resulted in real developers not being able to acquire licenses for their projects and instead have

been forced to buy licenses from the pseudo-entrepreneurs holding the licenses (Dhungel & Rijal, 2012).

- Lack of coordination between ministries is a significant bottleneck for enterprises related to hydropower in Nepal. For instance, in January 2012, a dozen transmission lines were stalled because Ministry of Forest did not give clearance for tree felling. Delay by forest ministry in giving the clearances frequently delays the hydropower project development (Hydro Nepal, 2012). Similarly, Initial Environmental Examination (IEE) and Environmental Impact Assessment (EIA) generally consume 1.5 to 2 years because of involvement of numerous governmental agencies such as Department of Energy Development (DOED), Ministry of Water Resources (MoWR), Ministry of Science, Technology and Environment (MoSTE), Department of Forests, Department of National Parks and Ministry of Forest and Soil Conservation.
- Bureaucratic delays on leasing government land are also cited as major hurdle for hydropower related enterprises in Nepal. Despite provision of making government land available for hydropower projects during the generation period, bureaucracy of Ministry of Forest and Soil Conservation and its related departments are reluctant to provide forest land on lease to developers. Such tendency has been fatal to several hydropower projects (Sherchan, 2008).

Infrastructure (Construction)

For a developing country like Nepal, infrastructure (transport, water supplies, telecommunication, etc.) is among the most important prerequisite for economic growth and development as extensive and effective infrastructure is one of the key components of an economy's competitiveness as well as growth. Access to quality and affordable infrastructure is essential for including people from across the country in

economic activities thereby reducing poverty, encouraging inclusiveness and raising standard of living. The state of infrastructure, especially infrastructure related to land transport is very poor in Nepal. 2 of the 75 districts of Nepal are yet to be connected by motorable roads and 17 district headquarters have only seasonal road connections. More than half of the population does not have year-round ready access to roads (Afran & Pero, 2013). Similarly, there is also a significant need to build other infrastructures like irrigation canals, drinking water supplies and power projects.

Nepalese Construction Industry contributes around 10 to 11 percentage of GDP and employs an estimated one million people (Federations of Contractors' Association of Nepal, n.d.). Construction industry is emerging as a major sector for employment both domestically and abroad. Nepalese construction industry can be broadly categorized into two: on one hand, Nepalese construction companies are involved in developing infrastructures such as real estate, housing and commercial complexes and selling them as products whereas on the other hand they also provide construction as a service through construction contracts with the government agencies. In the latter category, construction industry uses around 35 percent of the government's total budget and 60 percent of the development budget. Construction business in Nepal is governed by the Construction Business Act 2055. Similarly, The Public Procurement Act 2007 and The Public Procurement Rules 2007 also affect the operation of these enterprises. The registration process of a construction company is guided by Company Registration Act itself.

Major regulatory problems in the sector can be briefly discussed as follows:

- Some of the provisions made in the regulations with good intentions have resulted in unintended consequences. Article 97 of the Public Procurement Rules 2007 stipulates that construction projects costing under NRs. 6 million may be done through or obtained from a user committee or beneficiary community. According to entrepreneurs consulted, this has,

however, resulted in corruption by local representatives of political parties who undertake the project and outsource it to contractors that are willing to provide them with some commission.

- Delays in payment are another hurdle faced by enterprises in this sector. As bureaucrats have the discretionary power regarding budget disbursement, the time taken to sanction a budget depends on the whim of the concerned bureaucrat and contractors are at the mercy of the project manager for payments. After the sanction too, it generally takes more than 3 months for the budget to reach the project level (Federations of Contractors' Association of Nepal, n.d.).
- There are certain inconsistencies between the Public Procurement Act 2007 and actual practice. The act has made a provision that presentation of certificate of registration or permanent account number is not necessary to participate in the bid. The prevailing practice, however, has been such that presentation of these documents is compulsory (Nepal Constitution Foundation, n.d.).
- Frequent change of government officials or project personnel is another hurdle faced by the construction industry in Nepal (Federations of Contractors' Association of Nepal, n.d.). Replacement of official/personnel by a new person usually results in delayed projects as the new person needs time to get acquainted with the project and the project environment.

The other category of construction industry is housing and real estate sector where construction companies construct infrastructures and sell them as products. There are over 400 institutional real estate entrepreneurs in Nepal out of which 147 are registered at Nepal Land and Housing Development Association. Housing sector in Nepal took its first steps as the Collective Housing Act, 1995 and opened doors for private ownership of apartment units in Nepal.

In this category, following hurdles are being faced by the sector:

- Until 2010, Nepal's real estate sector had been growing at an exponential rate when Nepal Rastra Bank, the regulatory agency of financial sector of Nepal, suddenly restricted banking and financial institution's lending to the real estate sector and put a ceiling on loans to the sector. The move was prompted by the increasing exposure of banking and financial institutions to the sector. The move resulted in making access to loans extremely difficult for real estate developers and the sector has gone into a slump. According to the real estate developers and bankers, the move was too sudden and tantamount to trying to abruptly stop a vehicle going at a very high speed (New Business Age, March 2013).
- Additionally, capital gain tax imposed on real estate transactions and land ceiling has also adversely affected the sector (The Kathmandu Post, May 2010).

Tourism (Travel Agencies)

Tourism is widely recognized as one of the sectors with high growth potential and comparative advantage for Nepal. It is one of the highest contributors of foreign currency earnings to Nepal second to remittance. Presently, tourism sector contributes around 4.3 percent of the Gross Domestic Product of Nepal and has been providing around half a million direct employment opportunities (World Travel & Tourism Council, 2013). The highest number of visitors Nepal received was in 2011 when Nepal Tourism Year was celebrated. 7,36,215 international tourists visited Nepal in the year. However, the number of visitors was below the initial target of receiving 1 million visitors. The number of Indian and Chinese tourists has been growing rapidly in recent years. A total of 149,504 Indian tourists and 61,917 Chinese tourists visited Nepal in 2011. However, these figures represent less than 6 percent and 2 percent of the total outbound tourists of these nationalities in the same year respectively (Ministry of Culture, Tourism and Civil Aviation, 2011).

The growth of tourism sector so far in Nepal owes its success to largely private sector participation. Since the opening up of Nepalese economy in 1990s, there has been a proliferation of tourist enterprises providing services such as travel, accommodation and adventure activities. The sector is guided by Tourism Policy 2009, Tourism Act 1978, Travel and Trekking Agency Regulations 2005, Immigration Act 1992, Mountaineering Regulation 2002, Hotel, Lodge, Restaurant, Bar and Tourist Guide Regulation 1981, Immigration Regulations 1994, Home stay Operation Procedures 2010. Tourism policies of Nepal have given high priority to private sector's participation while assigning government the role of facilitator.

Table 5: Registration requirements for Travel Agencies

License for	Licensing Body	Requirements
Travel Agency	Tourism Industry Division	<ul style="list-style-type: none"> • Application with MOA and AOA of company • Copy of citizenship certificate of Director along with 2 pp photographs • Bank Guarantee in the name of Ministry worth Rs 3lakhs for 5 years • Company Registration Certificate • Agreement letter from the ministry • Tax Registration Certificate

Source: Nepal Business License e-Portal

There are about 1900 registered travel agencies in Nepal. Travel agencies in Nepal provide services like pre-hand information on the destination, ticketing, accommodation, local transportation, communication among other things. They are also involved in international promotion of Nepal.

Tourism sector has been heavily impacted by indirect regulations rather than by direct regulations. Some of such regulatory hurdles are:

- One of the major hurdles cited by many tourism entrepreneurs is the weak performance of air transporters to connect Nepal right from the heart of tourist source centers from the origin countries on the one hand and hub connectors in south, south-

east and middle-east countries. The limited networking to these centers by tourism promoters like Nepal Tourism Board, air transporters like Nepal Airlines, and business associations of tourism sector services is largely responsible.

- International promotion of Nepal as a tourist destination is a must in today's highly competitive international tourism market. Nepal's promotional activities, however, have been limited. One of the reasons for this is lack of capital account convertibility which prevents foreign investment required for large scale promotional activities (Chitrakar, 2009). Similarly, lack of appointment of CEO of Nepal Tourism Board, the public-private agency responsible for tourism related promotions and marketing, for almost 2 years by now, has hampered the operation of the agency. Conflict of interest among private sector groups and government's apathy are the primary reasons behind these state of affairs.
- Regarding Nepal Airlines, its poor performance has resulted in making air travel to Nepal difficult in terms of access from European and American countries (Himalayan News Service, n.d.). Tourism Policy 2009 has recognized this as one of the major problems for the sector and had suggested organizational restructuring of Nepal Airlines. However, no action in this regard has been taken yet.
- From the perspective of providing travel services, travel agencies operating in Nepal are mainly local and serving domestic travel services to tourists and facilitating outbound Nepali nationals while they operate as agents to foreign travel service providers in bringing tourist traffic into the country. Travel agencies do not have outlets of their own outside Nepal. During consultations, getting permission from Nepal Rastra Bank for operating a dollar account was also highlighted as time-consuming and taking too many procedural requirements and cited as one of the hurdles in expanding agency operations beyond the frontiers of Nepal.

3. Main Reasons Behind the Hurdles

Starting and operating a business in developing countries is usually difficult as myriads of regulations, weak institutions, inefficient bureaucracy and ineffective justice system hamper smooth operations. The justification for elaborate regulations is cited as prevention of market failures and protect the public (Pigou, 1932). However, the public choice theory holds that regulations are created more for the benefit of the regulators than the general public. “An important reason why many of these permits and regulations exist is probably to give officials the power to deny them and to collect bribes in return for providing the permits” (Shleifer and Vishny, 1993, as cited in Djankov, Porta, Lopez-De-Silanes & Shleifer, 2002). Starting with DeSoto (1990), many researchers around the world have studied the effect of regulatory constraints on entrepreneurial activities. The latter view is generally found to be true in developing economies. Doing business in developing economies is not only hampered by presence or absence, use or non-use of regulations but also by various other factors that may or may not be directly related with regulations. These constraints on entrepreneurial activities usually result in stifling competition, promoting monopolies and relegating majority of the small scale entrepreneurs and enterprises into informal economy and the economic growth is adversely affected.

Major reasons behind such regulatory and non-regulatory hurdles found during the research on the above discussed sectors can be summarized as below:

Conflict of interest in a governmental agency

In many cases, governmental agencies perform dual roles which generate conflict of interest. For instance, Nepal Agricultural Research Council is not only responsible for generating data on distinctness, uniformity, and stability of seeds; it is also the major crop-breeding and variety-releasing institution. Similarly, Nepal Electricity Authority is not only involved in transmission and distribution of electricity in Nepal but is also directly involved in power generation. In tourism Civil Aviation Authority Nepal (CAAN) has a similar conflict of interest. Such conflicting roles are likely to create incentives for such agencies to discourage private sector as involvement of private sector means competition. When a government agency itself acts as a player in the market, it usually has an unfair advantage over other players in the market which results in increasing difficulty of doing business for other players.

Lack of coordination between government agencies

In some cases, too many government agencies and departments are involved in a sector which makes coordination between them difficult. As different government agencies have different interests, mandates and objectives, involvement of large number of agencies in a single project results in their unwillingness to cooperate. For instance, lack of support from Ministry of Forest and Soil Conservation to hydropower developers as well as the Nepal Electricity Authority itself has been frequently reported as the major cause for delay in hydropower projects development (Hydro Nepal, 2012). Similarly, lack of coordination between the related government agencies resulted in delay in budget release for tourism promotion in foreign countries during the Nepal Tourism Year, 2011.

Lack of clarity in policy orientation

There is a lack of clear vision and orientation regarding some sectors of the economy. For instance, there is a demand that private educational institutions should be service oriented and commercialization

of education has been condemned time and again by political parties as well as civil society. The government has responded by introducing price controls in private educational institutions. Whereas, on the other hand, private educational institutions are being charged tax rates similar to that of corporate entities. Such uncertainties not only hamper the regular operation of enterprises but also adversely affect economic growth as a whole by deterring long term investments.

Lack of regulations and Acts corresponding with Policies

Lack of assisting regulations and Acts to policies adopted by the Government has been creating uncertainty and confusion in some cases. For instance, although the Hydropower Policy 2001 has been adopted with the intention to replace the former policy, related Act required for implementation of the new policy has not been passed yet, creating confusion and arbitrary dealing of issues related to the sector. Political instability and frequent changes in government has resulted in frequent shift in priorities and also introduced political bickering in policy-making. Hence, a change in government results in a changed prioritization of policies.

Weak institutions

Institutions required for the smooth functioning of a market economy, such as rule of law, efficient and effective administration of justice, competition have not been effective in Nepal. Prevalence of syndicates and cartels in transport sector despite being declared illegal by the Supreme Court is one example of how ineffective institutions are in comparison to special interest groups. Judiciary system is over-burdened and under-resourced which has prevented effective implementation of laws. In absence of strong and effective institutions, practices like strikes and extortion significantly increase the cost of doing business in Nepal.

Red Tape and Bureaucratic Hassles

Even where laws and regulations are clear and straight forward, bureaucracy, in absence of a strong accountability system, presents hassles for aspiring entrepreneurs. Lawyers and brokers are usually used by aspiring entrepreneurs to navigate the bureaucratic labyrinth while starting a business and complying with regulations during the operation of the business. Such methods imply that the cost of starting and expanding the business increases as the lawyers and brokers have to be paid for their services. Reliance on traditional methods of record-keeping and request processing and lack of use of technology also provides bureaucrats with opportunities for delay and corruption. As per the entrepreneurs consulted, misplacement of files and records in government offices are used as reasons to delay the work and create avenues for corruption.

Discretionary power of the bureaucracy

When laws provide a lot of discretionary power to bureaucracy this creates more room for rent seeking opportunities. In addition, it also provides a leeway into an unstable environment such that with a change in the personnel in bureaucracy (as is often the case in Nepal), there is a change in some minor policy decision based on the bureaucrats discretion.

Private and Boarding Schools Directive, 2013, for example, asks that too many standards be met by private schools; there are prerequisites in terms of infrastructure (a school building, particularly sized playground and others) that are to be met even before a school goes into operation. Such requirements aren't most necessarily met by all the schools. Given the circumstances, most schools choose to bribe the government officials responsible for surveying the school .

4. Conclusion and Recommendations

A good environment for doing business is quintessential for a well-functioning market economy which in turn is necessary to achieve economic growth and development. Most empirical studies have found that business regulations adversely affect the amount of entrepreneurial activities in an economy (Alfaro & Charlton, 2006; Van Stel, Storey & Thurik, 2006). Some researchers have found that amount of entrepreneurial activities also influence the quality and amount of business regulations (Nyström, 2010). Studies have shown that regulatory reforms can have a significant positive impact on the entrepreneurial activities of a nation (Mullainathan & Schnabl, 2010). Nepal still has a long way to go before it has a very favorable business environment. Besides its poor performance in the components of The World Bank's Doing Business Report, there are various other issues not covered by the report which affect the doing business scenario in Nepal. These extra hurdles to doing business are created by various factors such as involvement of too many government agencies and conflict of interest between them, lack of clarity in policy orientation of the government, weak institutions and their poor performance, red tape and misuse of bureaucratic discretions. Addressing these issues could help Nepal move further towards making Nepalese economy vibrant and prosperous.

Poland provides an example of how consistent regulatory reforms can encourage entrepreneurial activities and propel economic growth. As per the World Bank's 'Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises', Poland was the global top improver as it enhanced the ease of doing business through four institutional or regulatory

reforms, by making it easier to (i) register property, (ii) pay taxes, (iii) enforce contracts, and (iv) resolve insolvency. Poland has computerized the processes and consolidated different aspects of regulations into a single agency to achieve better environment for doing business. For instance, in 2010, it simplified business start up by reducing the required amount of minimum capital by ten times and consolidating processes related to registration, tax, social security and statistics in the National Court Register.

Rwanda is another such example. Starting in 2000, Rwanda been consistently designing and implementing business regulation reforms. It has substantially improved access to credit, streamlined procedures for starting a business, reduced the time to register property, simplified cross-border trade and made courts more accessible for resolving commercial disputes (World Bank, 2013). Presently, it ranks 8th in the Doing Business Report and achieved an annual GDP growth rate of 8.11 percent from 2000 until 2013.

Based on our analysis and study of international experience, Nepal can take the following measures to tackle existing hurdles and create a friendlier environment for entrepreneurial activities.

Amendments to eliminate conflicting provisions in different laws

While making a law regarding a sector, it is necessary that any provision made by it does not conflict with provisions of another law. The law making process should be more inclusive and include all the stakeholders (including cross-departmental and cross-sectorial stakeholders) so that different concerns and objectives of the stakeholders are in harmony.

A travel and tours private limited, for example, falls under both the Cottage and Small Scale Industry Act and also Company Act and also the Tourism Act—these acts do not necessarily complement each other and were drafted in different time periods. Also, different departments have to be reached to meet the procedural requirements when doing a business.

This does not fit well with wanting businesses to prosper as the conflict in laws act as hindrance to the prosperity of a given business venture.

Decrease the number of agencies and departments of government involved

There is a large bureaucratic channel that needs to be navigated in terms of starting and running a business in Nepal. For example, registering as a tours and travel operator involves, to the very least, the Registrar's Office, Nepal Tourism Board, Department of Cottage and Small scale industries and the Tax Office. Given that each of these are governed by their own set of laws—tax law, company act, tourism act and many others, the procedural hassles are paramount.

Hence, to deal with this, the number of governmental agencies and departments involved in a specific sector should be minimized by delegating authorities and responsibilities to limited number of agencies and departments. Implementation of one-window policy could help the government achieve this. It is necessary that one-window system be in place to reduce the number of bureaucratic procedures along with bringing together different departments of the government in single process framework. Use of electronic system can also effectively reduce the number of processes along with time and cost for regulatory compliance. Countries like Sri Lanka, Rwanda, and Poland have introduced electronic system to expedite the process of business registration as well as registration of property (World Bank, 2013).

Unbundle agencies with conflicting roles

Whenever a government agency is performing dual roles that causes conflict of interest, it is necessary to sort out the conflicting mandates and assign the agency a straight-forward objective and mandate. Unbundling of Nepal Electricity Authority, which is involved in power generation, transmission and distribution, is being discussed although no concrete

action has been taken yet. It is necessary to review the roles of government agencies in other sectors of the economy as well.

Make the policy orientation clear

In areas like education, the government should make it clear how it wants to treat the sector so that the sector does not suffer from uncertainty and confusion created by ambiguous policies and regulations. It is also necessary to prevent successive governments from making arbitrary rules for the sector. Unpredictability of the policy regime not only hampers regular operation of an enterprise but also hampers long term growth by deterring investment. Frequent changes in policy resulting from frequent changes in government have been found to lower economic growth significantly (Alesina, Ozler, Roubini & Swagel, 1996).

For instance, in case of schools the government should decide whether it wants to treat schools as profit-making enterprises and want private sector's participation in the education or it wants the education to be provided as a voluntary service through state mechanisms only.

Strengthen the institutions necessary for a well-functioning market

Institutions are considered “the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction” (North, 1990). Sometimes referred to as “soft infrastructures”, institutions play a vital role in economic growth and prosperity of a society. To make sure that markets function smoothly and provide every group of citizen equal access to economic activities, the government should work towards strengthening the institutions such as judiciary, competition law, maintenance of law and order and provision of security of lives and properties of citizens.

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Annexes

Annex 1: List of people consulted for 'Doing Business in Nepal: Ground Realities'

S.N.	Name	Designation/Organization
1.	Dr. Dileep Adhikary	Research Guide
2.	Mr. Nicholas Pandey	Executive Director, Kalika Construction
3.	Mr. Laxman Shrestha	Department of Commerce
4.	Mr. Pushpa Nath Dhakal	Akash Ganga Secondary School
5.	Mr. Keshav Adhikari	Agro-Enterprise Center
6.	Mr. Raju Prasad Ghimire	Senior Engineer, Department of mines and Geology
7.	Mr. Vidhan Rana	Biruwa Ventures
8.	Mr. Sudarshan Basnet	Member, Nepal Young Entrepreneurs Forum
9.	Mr. Manish K. Agrawal	Employer's Council, FNCCI
10.	Mr. Santosh Bhattarai	Lawyer specializing in company registration
11.	Mr. Deep Bikram Bista	Engineer
12.	Mr. Gyanendra Lal Pradhan	Executive Chairman, Hydro Solutions
13.	Mr. Sashi Sagar Rajbhandari	Upper Solu Hydro Electric Company
14.	Mr. Devraj Timalisina	Owner, Hetauda Seeds Repository
15.	Mr. Bhanu Khatiwada	Owner, Puspa Agro-Center
16.	Mr. Ganesh Kumar Baniya	Owner, Kathmandu Agro-Center
17.	Mr. Biswas Dwivedy	Education Entrepreneur

Samriddhi, The Prosperity Foundation an introduction

Samriddhi, The Prosperity Foundation is an independent policy institute based in Kathmandu, Nepal. It works with a vision of creating a free and prosperous Nepal.

Initiated in 2007, it formally started its operations in 2008. The specific areas on which the organization works are:

- i. Entrepreneurship development
- ii. Improving business environment
- iii. Economic policy reform
- iv. Promoting discourse on democratic values

Centered on these four core areas, Samriddhi works with a three-pronged approach—Research and Publication, Education and Training, and Advocacy and Public Outreach.

Samriddhi conducts several educational programs on public policy and entrepreneurship. It is dedicated to researching Nepal's economic realities and publishing alternative ideas to resolve Nepal's economic problems. Samriddhi is also known for creating a discourse on contemporary political economic issues through discussions, interaction programs, and several advocacy and outreach activities. With successful programs like “Last Thursdays with an entrepreneur” and “Policy Talkies”, it also holds regular interaction programs bringing together entrepreneurs, politicians, business people, bureaucrats, experts, journalists, and other groups and individuals making an impact in the policy discourse. It also hosts the secretariat of the ‘Campaign for a Livable Nepal’, popularly known as ‘Gari Khana Deu’.

One of Samriddhi's award winning programs is a five day residential workshop on economics and entrepreneurship named Arthalya, which intends to create a wave of entrepreneurship and greater participation among young people in the current policy regime.

Samriddhi is also committed towards developing a resource center on political economic issues in Nepal called Political Economic Resource Center (PERC) currently housed at Samriddhi office. It also undertakes localization of international publications to enrich the political economy discourse of Nepal. Samriddhi was the recipient of the Dorian & Antony Fisher Venture Grant Award in 2009, the Templeton Freedom Award in 2011 and the CIPE Global Leading Practice Award in 2012.

(For more information on the organization and its programs, please visit www.samriddhi.org)

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 - i. आर्थिक स्वतन्त्रता
 - ii. उद्यमशीलता विकासमा बजारको भूमिका
 - iii. बजारका गुणहरू
 - iv. Role of Rule of Law in Enterprise Building
 - v. Role of Government in Enterprise Building (Vol. I)
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11. Private Sector Participation in Transport Infrastructure Development in Nepal
12. Review & Overview of Economic Contribution of Tourism Sector in Nepal
13. Review of Agriculture Sector & Policy Measures for Economic Development in Nepal
14. Contract Enforcement: The Practicalities of Dealing with Commercial Disputes in Nepal
15. Foreign Direct Investment: Towards Second Generation of Reforms
16. Industrial Relations An Institutional Analysis
17. Competitive Watch in Key Growth Sectors of Nepalese Economy
18. Analysis of the Performance of the Public Enterprises

All the publications are available in Samriddhi, The Prosperity Foundation and major bookstores in the country.

'Doing Business in Nepal: Ground Realities' is one amongst six research paper series prepared for the Nepal Economic Growth Agenda (NEGA), 2013. NEGA is an annual constraints analysis performed by Samriddhi Foundation to identify, deliberate and offer policy alternatives to existing policy bottlenecks that hinder Nepal's economic growth.

After NEGA 2012 identified five growth sectors of the Nepalese economy viz. agriculture, education, tourism, hydropower and infrastructure, NEGA 2013 focuses on researching cross-cutting issues that affect growth in all these sectors and hinders Nepal's economic growth process. The cross-cutting issues covered by NEGA 2013 are industrial relations, contract enforcement, anti-competitive practices, foreign direct investment, public enterprises and regulatory environment for businesses.

This study tries to bring to light the ground realities of doing business in Nepal does so by analyzing the hurdles faced when doing business in regard to one product type offered within the five selected sectors namely agriculture (a review of seeds), education (a review of schools excluding 10 plus 2), energy (a review of licensing process for hydropower), infrastructure (a review of construction company) and tourism (a review of travel and tours agency). The study also makes recommendations based on the analysis through which the environment for doing business in Nepal can be improved.



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