Policy Options for Public Enterprises Reform in Nepal: A look at two public enterprises

Bimal Wagle, Akash Shrestha & Koshish Acharya

Edited by Arpita Nepal

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Contents

About the Authors iv
Acknowledgement vii
Preface ix
Abbreviations & Acronyms xi

1. Introduction and Study Approach 1
2. Current Status of Selected Public Enterprises 5
3. Policy Options for Reform 15
4. Recommendations 29

References 35
Annexes 39

Samriddhi, The Prosperity Foundation: an introduction
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Mr. Wagle has spent most of his career working for the Government of Nepal (GoN) in various capacities. Besides serving as a director to a number of government agencies, he has been the Joint Secretary at Economic Analysis and Policy Affairs Division under the Ministry of Finance and Ministry of Industry, Commerce & Supplies. In 2011, he retired as the Secretary to the Government of Nepal. Currently, he is the Chairman of the Public Enterprises Directorate Board that recommends competent candidates for the position of Chief Executive Officers at different Public Enterprises and gives policy advice to the Government of Nepal for the overall improvement of the performance of public enterprises.

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Mr. Shrestha is a Research Officer at Samriddhi, The Prosperity Foundation and has previously co-authored a policy analysis paper ‘Foreign Direct Investment in Nepal: Towards Second Generation of Reforms’ for The Foundation. He was also one of the founding members of the Nepal chapter of Youth for Nepal (YFN) - a New-York based non-profit working to create social entrepreneurs out of the Nepali youth in the fields of health, education and environment. Prior to joining Samriddhi, he was involved with the Himalayan Bank Ltd. He is a student of Business Administration and has written numerous newspaper articles, blog posts and radio capsules from a free market perspective.
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Mr. Acharya is a Research Officer at Samriddhi, The Prosperity Foundation and has previously co-authored a number of research papers for The Foundation viz. ‘Industrial Relations: An Institutional Analysis’, ‘Analysis of the Performance of Public Enterprises’, and ‘Review and Overview of Economic Contribution of Education in Nepal’. He is a student of Social Work and has published several articles in Nepali national dailies.
Acknowledgements

Samriddhi, The Prosperity Foundation wishes to thank the authors Mr. Bimal Wagle, Mr. Akash Shrestha and Mr. Koshish Acharya for preparing this policy analysis paper which outlines reform options for selected public enterprises in Nepal. We are especially thankful to Mr. Brihat Man Tuladhar of Nepal Airlines Corporation and Mr. Rishi Raj Koirala of Hetauda Cement Industry for their cooperation. We are indebted to Mr. Pramod Nepal of Ministry of Culture, Tourism and Civil Aviation and Mr. Bashudev Sharma of Ministry of Finance (Privatization Cell) for sharing their expertise and providing valuable input. Our appreciation also goes to all the experts, entrepreneurs, bureaucrats, officials and scholars for providing their valuable feedback during individual and group consultations.

Finally, we would like to thank Ms. Pranati Koirala for editorial support and hope that this policy analysis will be helpful in guiding the implementation of practical reform measures for public enterprises in Nepal so as to ensure a more efficient spending of taxpayers’ money.

Samriddhi, The Prosperity Foundation
July 2014
Preface

The Nepal Economic Growth Agenda (NEGA), first released in 2012, is an annual effort of Samriddhi Foundation to identify key constraints to Nepal’s economic growth and policy options for reform. This policy analysis paper titled “Policy Options for Public Enterprises Reform in Nepal: A look at two public enterprises” is prepared under the banner of NEGA 2014, which is preceded by NEGA 2012 and NEGA 2013. NEGA 2012 identified and discussed policy constraints in five growth sectors of Nepal viz. Agriculture, Education, Hydro power, Transport infrastructure and Tourism. NEGA 2013 focused on six cross-cutting issues viz. Industrial Relations, Contract Enforcement, Anti-Competitive Practices, Foreign Direct Investment, Public Enterprises, and Regulatory Environment for Doing Business. NEGA 2014 builds on The Foundation’s previous studies on hydro power, industrial relations and public enterprises. Of the three study reports produced under NEGA 2014, this study on public enterprises proposes policy options for reform of public enterprises through two case studies of Nepal Airlines Corporation (NAC) and Hetauda Cement Industry Limited (HICL). This policy analysis paper has been prepared in consultation with individuals and groups who are experts in the area or are involved in the mentioned organizations.

Based on the Annual Performance Review of Public Enterprises report (2013-14) published by the Ministry of Finance, out of the existing 33 public enterprises, 21 enterprises have been facing cumulative losses. The losses incurred by these enterprises are a huge burden on the taxpayers. Managing both commercial and non-commercial goals i.e. making profit for sustainability and fulfillment of social objectives, has created enormous pressure in the management of Public Enterprises (PEs). This pressure combined with ineffective organizational structure has led to the downfall of PEs in many cases. The Foundation’s first study on public enterprises published under NEGA 2013 titled “Analysis of the Performance of Public
Enterprises’ jointly authored by Bimal Wagle, Koshish Acharya & Sarita Sapkota attempted to streamline overall challenges faced by all the PEs and outline recommendations to revise the incentive system, conduct structural reform for autonomous functioning, and a serious re-evaluation of the significance of some PEs. This policy analysis paper takes a step further by taking a deeper look at two of the thirty six existing public enterprises in Nepal to propose concrete policy options for reform. Both NAC and HICL have been facing high cumulative losses and presence of unfunded liabilities due to operational inefficiencies and other problems. This paper analyses the poor performance of public enterprises from a policy perspective with an aim of identifying practical reform options and these reform options are mainly focused on improving the organizational efficiency either by bringing changes in the current working modality or by introducing a new modality based on a cost benefit analysis. The larger objective of conducting such analysis on two loss making PEs is to pave way for similar analysis of other public enterprises which are increasingly becoming a burden on taxpayers and consumers.
### Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>CAAN</td>
<td>Civil Aviation Authority of Nepal</td>
</tr>
<tr>
<td>CBA</td>
<td>Cost-Benefit Analysis</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal Year</td>
</tr>
<tr>
<td>GHS</td>
<td>Ground Handling Service</td>
</tr>
<tr>
<td>GoN</td>
<td>Government of Nepal</td>
</tr>
<tr>
<td>HCIL</td>
<td>Hetauda Cement Industry Ltd.</td>
</tr>
<tr>
<td>IC</td>
<td>Installed Capacity</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labor Organization</td>
</tr>
<tr>
<td>MoCTCA</td>
<td>Ministry of Culture, Tourism and Civil Aviation</td>
</tr>
<tr>
<td>MoF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MoI</td>
<td>Ministry of Industry</td>
</tr>
<tr>
<td>NAC</td>
<td>Nepal Airlines Corporation</td>
</tr>
<tr>
<td>NRs.</td>
<td>Nepalese Rupees</td>
</tr>
<tr>
<td>OPC</td>
<td>Ordinary Portland Cement</td>
</tr>
<tr>
<td>PEs</td>
<td>Public Enterprises</td>
</tr>
<tr>
<td>PPA</td>
<td>Public Procurement Act</td>
</tr>
<tr>
<td>PPC</td>
<td>Portland Pozzolana Cement</td>
</tr>
<tr>
<td>PPMO</td>
<td>Public Procurement Monitoring Office</td>
</tr>
<tr>
<td>PSC</td>
<td>Portland Slag Cement</td>
</tr>
<tr>
<td>ROI</td>
<td>Returns on Investment</td>
</tr>
</tbody>
</table>

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

Table 1: Financial indicators of NAC
Table 2: Production of HCIL
Table 3: Capacity Utilization comparison between HCIL and Cement Industry in Nepal
Table 4: Financial Indicators of Hetauda Cement Industry Ltd.
Table 5: Profit/Loss Situation: Before and After Privatisation
1. Introduction and Study Approach

The concept of Public Enterprises (PEs) entered the Nepalese economic realm after the promulgation of the first industrial policy in 1957 (Paudel, 2006). The Economic Survey of the Fiscal Year 2010/2011 reiterates the initial commitment and objectives behind the establishment of PEs: that of a) boosting the national economy, b) creating employment opportunities, c) mobilizing public savings, d) eliminating discriminatory practices in the society, and e) delivering quality goods and services to the society at reasonable prices. However, failure to strike a right balance between profit and non-profit motives, autonomy and accountability, and commercial and bureaucratic orientation supplemented by the lack of a clear incentive mechanism and several institutional challenges have rendered many PEs of Nepal ineffective and in need of a serious strategic rethinking (Wagle, Acharya & Sapkota, 2013).

This paper takes under consideration two of the thirty six existing PEs of Nepal. Nepal Airlines Corporation (NAC) which is one of the two institution under study in this paper is facing problems of corruption (Ghimire, 2013), political intervention, nepotism, impunity (Adhikari, 2013), labor issue and operational inefficiency (Nepal Airlines Corporation, 2013). Hetauda Cement Industry (HCI) which is the other institution being studied by this paper is also facing problems of operational inefficiency, heavy competition, lack of technical manpower, labor issues, and lack of clear action plan (Hetauda Cement Industry Ltd., 2012). Both of these public enterprises are facing high cumulative losses and have unfunded liabilities (Ministry of Finance, 2013).

Since the operational inefficiency and loss incurred by PEs presents a direct challenge of additional burden to taxpayers, we examine two policy
options to address this challenge: the first being institutional reforms (improving governance) and the other being institutional restructuring (bringing changes in ownership structure through privatization, public-private partnership, strategic partnership etc.) (Fudda, 2013).

Against this background, this paper attempts to analyze the costs of failure in managing PEs efficiently and also makes recommendations on suitable structural reform measures based on the costs and benefits of the proposed reforms.

1.1 Statement of the policy problem

PEs in Nepal played a vital role in the initial stages of economic development. They were established during the era when private sector was hardly contributing much to the economy. These enterprises were justified as contributors in creating employment, providing affordable goods and services, enhancing national economy, and controlling private sector’s monopoly (Ministry of Finance, 2011).

The contribution of PEs in the national economy cannot be undermined; however, review study of those enterprises carried out during the Fifth Five Year Plan period (1975–80) indicated poor performance, poor service, and poor contribution of PEs (CCC, 1977 as cited in Manandhar & Bajracharya, 1999).

Some of the major problems faced by PEs are operational inefficiency, objective dilemma, procurement, political interference, corruption, lack of autonomy, and lack of proper incentive structure. The root of all problems lie in the structure of the enterprises. With both commercial and non-commercial goals assigned to PEs which entails both making profit for sustainability and fulfillment of social objectives creates enormous pressure in the management of PEs. In most of the cases, this pressure combined with ineffective organizational structure leads to the downfall of PEs.

PEs being government entities are funded through taxpayers’ money and were formed in order to provide goods and services to the public. The
success and failure of these enterprises either directly or indirectly affect the public. Bailing out these enterprises and keeping it functional imposes a hefty burden on the taxpayers. The government, board of directors, employees, and the general public are the major stakeholders concerned with public enterprises. Indirectly, political parties are also stakeholders in these enterprises. Since PEs are important entities whose success and failure is equally important to the taxpayers, it becomes necessary to seek alternatives for better performance of the enterprises.

1.2 Statement of Intent

As mentioned above the major problem in both the enterprises is ineffective organizational structure which has led to several other problems that directly or indirectly affects the performance of these enterprises. The repercussion of this has been excessive burden on taxpayers and resources being directed towards unproductive sectors. This paper seeks alternative reform initiatives for the PEs with poor performance. The reform initiatives will be mainly focused on improving the organizational efficiency either by bringing changes in the current working modality or by introducing a new modality that could work better for the enterprises based on the cost-benefit analysis of each studied modality.

1.3 Cost-Benefit Analysis

Put succinctly, the idea behind a cost-benefit analysis is to analyze if the benefits that are expected to be brought about by the implementation of a given policy under consideration exceed the costs – to whomsoever the costs and benefits may accrue (Fuguitt & Wilcox, 1999).

In this paper, the policy under consideration is the implementation of structural reform at HCI and NAC.

Public ownership is the status quo. This form of ownership will be tested against other forms of ownership, namely, private ownership, and public-private ownership. The analysis will be done on the basis of
the consequences that the status quo has yielded thus far and expected consequences of the implementation of the alternatives. There will, however, be certain limitations of the study and the resulting conclusion and recommendation might not be as comprehensive as the research team would have otherwise preferred.

1.4 Limitations

Data on the several measures required for efficiency measurement of PEs involved were not available in the public domain during the course of this research. Therefore, due to limitations of data, adequate evidence to back up arguments presented in this paper may be lacking. Similarly, policy interventions yield several consequences – both implicit and explicit. This paper may not have addressed all these consequences. Due to limited availability of quantitative data, the researchers had to rely on consultation inputs provided by various stakeholders. Therefore, the findings of this paper includes value judgments made by the stakeholders.

Despite these limitations, this paper has attempted to list the various costs and benefits associated with the policy proposals. The actual valuation of these costs and benefits have been left as an area of inquiry for further research. The costs and benefits of all forms of structural set-ups are derived from primary sources (individual and group consultations with experts) and secondary sources (newspaper articles and available publications from the respective PEs.)
2. Current Status of Selected Public Enterprises

2.1 Nepal Airlines Corporation

2.1.1 History

NAC was established in the year 1958 during the First Five Year Plan (1956-61). It is governed by the Nepal Airlines Corporation Act, 2014 and is under the Ministry of Culture, Tourism and Civil Aviation. NAC began its operations with a single Douglas DC-3 Dakota aircraft in different locations throughout the country with a total of 97 staff members. In the mid-80s, NAC covered 38 domestic and 10 international destinations and had a fleet of 19 planes (Funding Universe, n.d.).

During 1988-89, NAC’s (then known as Royal Nepal Airlines Corporation) revenue amounted to USD 54.3 million while the same year, the operating profit was USD 17 million. NAC was then the largest employer in the nation and also the largest foreign currency earner (Funding Universe, n.d.).

2.1.2 Current status

2.1.2.1 Financial

Currently, NAC has no operational twin otters; two Boeing 757s (190-seater) are in operation on the international routes (Dhungana, 2014) flying to five destinations (Bangkok, Hong Kong, Kuala Lumpur, Dubai
and Doha). The flights to New Delhi were suspended in December, 2011 (Ekantipur, 2012 a). NAC is often blamed for management failures and excessive flight cancellations (The Kathmandu Post, 2014) besides facing charges of corruption, political intervention, nepotism, impunity, labor issue and operational inefficiency.

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit/Loss (in NRs. ‘000,000)</th>
<th>Cumulative Profit/Loss (in NRs. ‘000,000)</th>
<th>Unfunded Liability (in NRs. ‘000,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011/12</td>
<td>(20.038)</td>
<td>(1541.421)</td>
<td>221.6</td>
</tr>
<tr>
<td>2010/11</td>
<td>20.311</td>
<td>(1921.218)</td>
<td>894.387</td>
</tr>
<tr>
<td>2009/10</td>
<td>126.200</td>
<td>(1557.500)</td>
<td>549.366</td>
</tr>
<tr>
<td>2008/09</td>
<td>30.016</td>
<td>(1666.192)</td>
<td>546.300</td>
</tr>
<tr>
<td>2007/08</td>
<td>(197.059)</td>
<td>(1,763.451)</td>
<td>347.120</td>
</tr>
<tr>
<td>2006/07</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2005/06</td>
<td>11.7</td>
<td>(2320.8)</td>
<td>80.0</td>
</tr>
<tr>
<td>2004/05</td>
<td>(140.8)</td>
<td>(1882.7)</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Annual Performance Review of Public Enterprises of several years, Ministry of Finance (MoF)

The figured provided herein can be debated. For example, if we go from the year 2010/11 to 2011/12, the net profit figure has gone down by Rs. 40 million. In the meantime, unfunded liabilities have come down by Rs. 672 million. These figures do not reflect the financial position of the PE as smoothly as the research team would have liked. Nevertheless, the figures have been extracted straight out of the Yellow Book (the Annual Performance Review of PEs.) The research team has not gone into the financial specifics.

In the year 2011/12, NAC incurred a loss of NRs. 20.038 million furthering the cumulative loss position to NRs. 1,541.421 million. In the same year NAC had unfunded liabilities worth NRs. 221.6 million. As of 2011/12, NAC employs over 1400 employees. Though NAC has made net profits in some previous years, most of its profit comes from a NRs. 2 billion-a-year worth of Ground Handling Services at Tribhuvan International Airport (The Kathmandu Post, 2012). Under the given eight-year review period, NAC suffered an average net loss of Rs. 21.91 million per year. Without any reform measure being undertaken, NAC will never recover its cumulative loss figures, therefore increasing the financial burden to the government.
In the year 2012, NAC accounted for only 3.74% of total flight movements at Tribhuvan International Airport (TIA) while it carried only 2.34% of total domestic passengers (see Annex I). The same year, NAC accounted for only 6% of the total international flight movements in Nepal, catering to a total of 6.8% of total passenger movement at TIA (CAAN, 2013).

2.1.2.2 Non-financial

In addition to the financial plight, there is more to NAC’s misery. The European Union (EU) has banned Nepalese airlines in its skies. NAC being the only flyer in international skies (other than Buddha Air’s flight to Varanasi), has an image of being unsafe under international aviation safety standards. This has had serious negative impacts on the image of the national flag carrier.

NAC has long held its infamy for falling prey to political intervention. In 2050 B.S, an English businessman was nominated as an NAC agent by the then prime-minister using his political power. In the chain of events (which gained popularity as ‘Dhamija case’) that followed after the nomination, NAC suffered a loss amounting to NRs. 395.5 million. In 2055 B.S., a new chairman was nominated at NAC, yet again, through the use of political power. A fake deal to lease an aircraft was then signed with a non-existent company. This deal cost NAC around USD 900,000. Again, in 2055 B.S., another deal was signed with a Chinese company to hire an aircraft without calling for tender. NAC lost another NRs. 220 million during this event. In 2057 B.S., in another infamous ‘Lauda case’, NAC suffered a loss of another NRs. 2 billion (Bohara, 2013).

NAC also has a history of thefts such as the ‘300-kg-Fly Away Kit’ and spare tires of the Boeing 757 and landing gear of a Twin Otter were also stolen. Some NAC officials were found guilty in the landing gear theft while other cases still remain a mystery (Ekantipur, 2012 b).

There is therefore enough room for upgrading the management of NAC. While the PE is mired with managerial failures, operational
inefficiency, corruption and political intervention, even private domestic airlines have been showing mixed results. The most successful domestic airline (Buddha Air) catered to more than 50% of total domestic passengers and also netted over 50% of total profits made in the domestic sector in the year 2012 (Triparthi, 2013). In the meantime, a number of private airlines have been closed down and more than fifty airliners haven’t come to operation despite having been granted the Airline Operator’s Certificate.

More recently, NAC is looking at fleet expansion as an alternative solution to its problems. However, NAC’s structural problems and consistent managerial inefficiencies in handling its current fleet, clearly demonstrates that a fleet expansion will not resolve NAC’s problems. To the contrary, it may exacerbate the problem further.

NAC, as a public enterprise is expected to deliver social welfare via job creation, eliminate of social discrimination and utilize and safeguard national resources. The fact that it is running on cumulative loss and depends on taxpayers’ money to fulfill its liabilities beats these fundamentals. What NAC requires at the moment is transparency, efficiency and accountability in management, company downsizing, qualified employees, product innovation, and branding-based marketing.

With eight new airplanes arriving within 2015, NAC needs to focus on efficient operation and be commercially oriented. With the right kind of branding coupled with quality services, there are opportunities of penetrating markets beyond the existing scheduled flights and enhancing the current market share status. When business booms, NAC can also serve as an enterprise that can fulfill its social obligations. However, the current modality of government ownership, management and operation has not been able to tap these opportunities (P. Nepal, personal communication, December 19, 2013).

Therefore, there is a need to strategically rethink the structure of NAC. It is so far the only national flag carrier in the international skies (other than Buddha Air that flies to Varanasi) and also plays a direct role in
other economic sectors like tourism. The aviation sector also holds strategic importance. As evinced by the case of domestic private airliners, there is profit to be made in the business. There are challenges in terms of aviation expertise, financial risk management, and marketing. On the other hand, NAC’s past performance has shown that it cannot come out of its existing financial plight. Therefore, a viable structural alternative for NAC lies in introducing an international strategic partner with specialization in civil aviation.

### 2.2 Hetauda Cement Industry

#### 2.2.1 History

Hetauda Cement Industry Limited (HCIL) established during the Fifth Five Year Plan (1975-1980) in the year 1976 is currently under the Ministry of Industry. HCIL was established under Company Act, 2021 with a loan of NRs. 1,044,823,000 from Asian Development Bank, NRs. 330,000,000 from Nepal Bank and a share of Government of Nepal of NRs. 206,395,000 (Pandey, n.d.).

#### 2.2.2 Current Status

HCIL has the capacity to produce 260,000 metric tonnes of cement annually which is equivalent to 5.2 million sacks of cement. The targeted production for the year 2011/12 was 156,000 metric tonnes, however, the industry only produced 98575 metric tonnes of Ordinary Portland cement i.e. 37.91% of the total production capacity in the same year. In the last eight years, the maximum production forecast has been 69.23% of the installed capacity while maximum realized production has been 52.93% of the installed capacity. The report of the eighth annual general meeting of HCIL puts forward reasons like labour issues, lack of technical expertise, and power crisis for their dismal performance as opposed to its production capacity.
## Table 2: Production of HCIL

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Production Capacity (in metric tonnes)</th>
<th>Targeted Production</th>
<th>Target as % of Installed Capacity (IC)</th>
<th>Actual Production</th>
<th>Actual production as % of IC</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011/12</td>
<td>260,000</td>
<td>156,000</td>
<td>60.00</td>
<td>98,575</td>
<td>37.91</td>
</tr>
<tr>
<td>2010/11</td>
<td>260,000</td>
<td>156,000</td>
<td>60.00</td>
<td>70,198</td>
<td>26.99</td>
</tr>
<tr>
<td>2009/10</td>
<td>260,000</td>
<td>156,000</td>
<td>60.00</td>
<td>100,371</td>
<td>38.60</td>
</tr>
<tr>
<td>2008/09</td>
<td>260,000</td>
<td>180,000</td>
<td>69.23</td>
<td>91,350</td>
<td>35.13</td>
</tr>
<tr>
<td>2007/08</td>
<td>260,000</td>
<td>180,000</td>
<td>69.23</td>
<td>137,623</td>
<td>52.93</td>
</tr>
<tr>
<td>2006/07</td>
<td>260,000</td>
<td>156,000</td>
<td>60.00</td>
<td>104,287</td>
<td>40.11</td>
</tr>
<tr>
<td>2005/06</td>
<td>260,000</td>
<td>156,000</td>
<td>60.00</td>
<td>102,108</td>
<td>39.27</td>
</tr>
<tr>
<td>2004/05</td>
<td>260,000</td>
<td>143000</td>
<td>55.00</td>
<td>111,518</td>
<td>42.89</td>
</tr>
</tbody>
</table>

Source: Annual Performance Review of Public Enterprises of several years, Ministry of Finance (MoF)

Similarly, compared to the industry average of the last eight years, HCL's performance is below industry average in terms of capacity utilization. While the industry average stands at 47.5 percentage, HCL's capacity utilization is around 40% only.
Table 3: Capacity Utilization comparison between HCIL and Cement Industry in Nepal

<table>
<thead>
<tr>
<th>Year</th>
<th>Capacity Utilization of HCI (%)*</th>
<th>Capacity Utilization of Industry (%)**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004/05</td>
<td>42.89</td>
<td>49</td>
</tr>
<tr>
<td>2005/06</td>
<td>39.27</td>
<td>39</td>
</tr>
<tr>
<td>2006/07</td>
<td>40.11</td>
<td>42</td>
</tr>
<tr>
<td>2007/08</td>
<td>52.93</td>
<td>41</td>
</tr>
<tr>
<td>2008/09</td>
<td>35.13</td>
<td>45</td>
</tr>
<tr>
<td>2009/10</td>
<td>38.6</td>
<td>50</td>
</tr>
<tr>
<td>2010/11</td>
<td>26.99</td>
<td>56</td>
</tr>
<tr>
<td>2011/12</td>
<td>37.91</td>
<td>57.7</td>
</tr>
<tr>
<td>Average</td>
<td>39.22875</td>
<td>47.4625</td>
</tr>
</tbody>
</table>

Author’s calculation based on:
*Source: Annual Performance Review of Public Enterprises, Ministry of Finance (MoF)
**Source: Economic Survey, 2012/13
**Including two Public Enterprises (PEs), Hetauda Cement Industry Ltd (HCIL), and Udayapur Cement Industry Ltd.

Cement produced by HCIL is distributed through a network of 415 authorized dealers some of which are National Trading Limited, Sajha Bhandar Limited, Salt Trading Corporation Limited, Rastriya Sahakari Sangh and Sajha Pasal. Although the number of authorized dealers reached up to 700 in the year 2009 most of the dealers cancelled their registration and took their collateral back.
Table 4: Financial Indicators of Hetauda Cement Industry Ltd.

<table>
<thead>
<tr>
<th>Year (in NRs. ‘00,000)</th>
<th>Net Profit/Loss (in NRs. ‘00,000)</th>
<th>Cumulative Profit/Loss (in NRs. ‘00,000)</th>
<th>Unfunded Liability (in NRs. ‘00,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011/12</td>
<td>(722.45)</td>
<td>(6,419.82)</td>
<td>2,084.06</td>
</tr>
<tr>
<td>2010/11</td>
<td>388.98</td>
<td>(5,807.77)</td>
<td>662.15</td>
</tr>
<tr>
<td>2009/10</td>
<td>1170.17</td>
<td>(6,198.30)</td>
<td>1,196.41</td>
</tr>
<tr>
<td>2008/09</td>
<td>(380.74)</td>
<td>(7,368.47)</td>
<td>1321.00</td>
</tr>
<tr>
<td>2007/08</td>
<td>1103</td>
<td>(6856.00)</td>
<td>3329.38</td>
</tr>
<tr>
<td>2006/07</td>
<td>717</td>
<td>(7944)</td>
<td>151</td>
</tr>
<tr>
<td>2005/06</td>
<td>397</td>
<td>(8681)</td>
<td>738</td>
</tr>
<tr>
<td>2004/05</td>
<td>657</td>
<td>(9114)</td>
<td>514</td>
</tr>
</tbody>
</table>

Source: Annual Performance Review of Public Enterprises of several years, Ministry of Finance (MoF)

Although the financial position (profit/loss) of HCIL for the last 7 years have shown mixed results with most of the years ending in profit, it still has a large amount of cumulative loss. HCIL made a loss of NRs. 722.45 lakhs in the year 2011/12 while the cumulative loss amounted to NRs. 6,419.82 lakhs up to 2011/12. In the year 2011/12, it had due amount of NRs. 2,084.06 lakhs as unfunded liabilities. Within the aforementioned review-period HCIL made an average net profit of Rs. 416.28 lakhs. At this rate it would take HCIL another 15.4 years, only to write off the cumulative losses, under the current operational model.

The industry currently has 400 technical and 148 non-technical staff members. The objective of HCIL as mentioned in the Annual Report of Public Enterprises prepared by MoF is to produce and sell ordinary portland and ordinary slag cement and to create direct and indirect employment.

2.2.3 Private Cement Industries in Nepal

The cement industry in Nepal has been growing at around 10% per annum. Of the total 33 lakh metric tonnes consumed cement in the country, 60-70% is produced within the country while the remaining is
imported from India (Kumar, 2012). Cement industries in Nepal mainly produce three types of cement: Ordinary Portland Cement (OPC), Portland Pozzolana Cement (PPC) and Portland Slag Cement (PSC). Although Nepalese industries produce 60-70% of the consumed cement, 75% of the raw materials are imported from India while only 25% is found in the country itself (Kumar, 2012).

According to the Industrial Statistics from the year 2061/62 to 2069/2070 there are a total of 46 private cement industries in Nepal with a total annual capacity of 6,483,915 metric tonnes (Annex IV). The two state owned cement factories: Hetuada cement and Udayapur cement have an annual capacity of 260,000 and 277,200 metric tonnes respectively.

A total of about 1.07 billion tons of limestone deposits have been discovered in various parts of the country including Udayapur, Dhankuta, Makwanpur, Lalitpur, Dhading, Shyangja, Arghakhachi, Surkhet, Dang, Salyan, Baitadi and Palpa. Of this total volume of limestone deposit discovered, about 540 million tons are proven, 110 million tons are semi-proven, and 420 million tons are feasible (MoF, 2013). This clearly indicates the huge potential of growth for the cement industries in Nepal. Cement industries in Nepal pay revenue worth NRs.10 billion to the government annually (Kumar, 2012).

Jagadamba Cement a private player in the cement industry occupies the largest market share of 12 percent followed by Vishwakarma Cement which has market share of 10% while Hetuada Cement occupies four percent of the market share (Annex-III). In terms of employment, the private cement industries employ around 10963 people (Annex IV) which is 91.26% of the total employment in the cement market while Hetauda employs 548 people which is 4.6% of the total employed.

The comparisons of private cement industries and state owned cement industries clearly indicates that the former has been performing much better in terms of finance and employment generation and has a higher market share. The overall capacities of the private industries are
much higher than that of Hetauda cement. Private cement industries are running on substantial profit and every year new industries are emerging in the market and foreign investors from Nigeria, India and China are investing in cement industries. However, state owned cement industries are adding up taxpayers’ burden with high unfunded liabilities and loan while incurring losses resulting in high cumulative losses.

Furthermore, cement is not an essential commodity which the government has to look after. In this given scenario where private cement industries are booming and are expected to grow at 10% per annum it does not make sense for the government to run Hetauda cement. Although Hetauda Cement is in a sorry state, it is one of the most important industries which can make a greater impact on the economy. Given its capacity, better managed Hetauda Cement could bring better results.

One way of achieving efficient management at Hetauda Cement is by privatizing the enterprise. Mere change in management in the already functioning model won’t be able to bring the desired outcomes in the enterprises for various reasons. Cement is a highly competitive market in case of Nepal. There already exist giants like Jagadama which occupy a high market share. It would be a difficult task for the management to compete with these enterprises with the same government placed management. Since Hetauda Cement covers only four percent of the market share and does not have a comparative advantage like the telecom sector, it would not be feasible to run Hetauda Cement through a public management. Similarly, the new management that the government induces will likely still be bureaucratic in nature and subject to high degree of political interference. Hence, the issues which are currently prevailing will still persist. In addition, a public enterprise is constrained by various government regulations such as the Public Procurement Act which delays decision making process and renders PEs incapable of competing with the private sector. On the other hand, privatizing the enterprise would mean no more burden to the government in case the enterprise fails to meet its financial objectives. In this context, it would not be wrong to say that Hetauda Cement would be much more effective if it were privatized.
3. Policy Options for Reform

3.1 Strategic Partnership at Nepal Airlines Corporation

There is huge untapped potential in the Nepalese aviation market. For tourists, getting into Nepal itself is an expensive endeavor. However, the very fact that tourists are pouring into Nepal despite costly air-fares, and Nepal having only two international carriers serving only limited destinations, implies that Nepal is losing out on a lot of revenues from these inbound tourists. Currently, Nepal does not have a big domestic private company that is catering to these tourists either. The capacities of private companies within Nepal also render it unlikely that Nepal will have such an airliner that can compete with the international players in the very near future. It is NAC that has the mandate and also government backing to compete in this market. Since the current status of NAC renders it inefficient to jump into such competitive market, it needs a strategic partner.

Nepal Airlines Corporation Act, 1963, which currently governs NAC states that Government of Nepal (GoN) keeps complete ownership of the corporation. Under such a circumstance, NAC will not be able to bring in any strategic partner. Therefore, converting NAC into a joint venture company will have to be the first priority. NAC has to be relieved of its current legal status.

NAC needs to focus on getting an operating airline to form a partnership with it. This will allow NAC to have a partner that is already in the same line of business and further allow it to reap the benefits of the operating airlines’ business expertise. It will then be able to acquire enhanced skill sets, practice code sharing with the partner airline and
Policy Options for Public Enterprises Reform in Nepal
A look at two public enterprises

contribute to enhancing air traffic in Nepal. The next move could be designing the modality of strategic partnership. Details like what portion of equity ownership to hand-over to the strategic partner and the risk and reward sharing schemes need to be carefully worked out. Management could be completely handed over to the strategic partner while the NAC board plays the role of a monitor, guaranteeing that the new management meets NAC goals and objectives.

In case no operating airlines expresses interests in making strategic partnership with NAC, it will still have to revamp its management. This can be achieved by handing over the management of NAC to a practicing international management firm. Details, as in case of bringing in an operating airline will have to be worked out carefully in a similar manner. This could however compromise additional benefits offered by an operating airlines. Therefore, an operating airlines should be NAC’s first priority.

3.1.1 Benefits of bringing in a strategic partner at NAC

For NAC, a strategic partner would mean foreign investment, efficiency enhancement, skills, technology and entrepreneurship (B. Sharma, personal communication, February 20, 2014). In addition to these benefits, strategic partnership with a foreign aviation company would benefit not just the Nepalese economy but the Nepalese consumers as well. This has been briefly discussed as follows:

3.1.1.1 Reduction of Financial Burden

NAC is completely owned by the government meaning that the government is the only beneficiary of all the profits and losses made by the enterprise. However, NAC has huge cumulative losses and other unfunded liabilities. In time, all these liabilities will be transferred to the taxpayers. NAC is heavily dependent on revenues from Ground Handling Services (GHS). After the existing contract on GHS ends, NAC faces a risk of bankruptcy. Under such a situation, investments drawn from strategic partnership can relieve NAC and most importantly taxpayers of their financial burdens.
3.1.1.2 Easing-up of procurement

Public Procurement Act (PPA), 2007 governs any procurement activity of PEs in Nepal. Over the years, procurement of aircrafts to expand the fleet of NAC has been a big challenge. While there is consensus on one hand that even if all internal reforms were made, NAC would still require aircrafts at the end of the day to do business and make money. PPA on the other hand has played nuisance in the acquisition of aircrafts. Issues like calling international bids, mandatory provisioning for months before making final decisions, complexities arising from variations in terms of proposed costs and actual costs and lack of appropriate mechanism to deal with the issue, capacity-lag of Public Procurement Monitoring Office (PPMO), all add up to delaying the decision making in all PEs and NAC is no exception.

One benefit of bringing in a strategic partner at NAC will be that all future decisions (after the partnership) will be made as per the terms of agreement between the strategic partner and NAC. Negotiations thereafter will primarily be guided by these terms of agreement and not PPA. This can relieve NAC of one of the major challenges it is facing, in terms of procurement, thus hastening the pace of decision-making.

3.1.1.3 Investment diversification (commercial orientation)

Diversification of investment structure is one of the major highlights of bringing in a strategic partner. Strategic partners are allowed to make capital investments in the new company that they partner with. With new business-driven investors, NAC will have commercial orientation and financial goals and the performance can be directed towards a profit-driven modality.

3.1.1.4 Service expansion via code-sharing

NAC currently has flights to only five international destinations (Bangkok, Hong Kong, Kuala Lumpur, Dubai and Doha) and code-sharing can be a pragmatic approach for expanding the international services.
Code-sharing is a major aviation practice among airline alliances where a passenger can book flights with one airline while actual carriage is done by the cooperating airline. This will offer dual benefits to NAC. One, it will boost NAC’s revenue generation and two, this will also act as a marketing tool for NAC. NAC is currently blacklisted by the European Union (EU) and is banned from flying in the European skies. With enhanced skill set and security up-gradation, when NAC expands its fleet size and international destinations, code-sharing holds the capacity to market and brand NAC in the international arena.

3.1.1.5 Nepalese Consumers’ Benefit

In the 2001 paper titled ‘The Benefits of Airline Global Alliances: An Empirical Assessment of the Perceptions of Business Travelers’, Goh and Uncles have pointed out that consumers get multiple benefits from airlines’ alliances. Greater network access, seamless travel via code-sharing, transferable priority status and enhanced frequent flier benefits for the consumers. All these benefits can be enjoyed by the Nepalese consumers through NAC’s strategic partnership with a foreign aviation company.

3.1.1.6 Increased traffic in Nepal

Strategic alliance creates a possibility for Nepal whereby it can be transformed into a hub rather than mere end-destination. This will have direct impact on the air traffic in Nepalese airport and the number of passengers flying into Nepal. This increased influx will then create job opportunities across aviation sector and tourism sector as a whole. This is perfectly in line with the objectives set by NAC – the same objectives that the current modality has not been able to fulfill. Aiming to reap the very same benefits, Jet Airways and Etihad Airways went in for a strategic alliance (Jet Airways, 2013).

3.1.1.7 Enhanced skill sets

With over 55 years of history, NAC has still not been able to operate smoothly and profitably. While there have been recurring technical issues
with the planes, domestic destinations (until the last operational twin-otter crashed in February 2014) have not yielded positive results for NAC. NAC abides by its principle of social service and flies to rural areas where the presence of private sector is lacking. The problem however, has been the lack of proper infrastructure and planes with the private airlines.

For now, a strategic partnership with a better airline company will bring modern scientific technological and manual skill set to NAC. This will allow NAC to cater to the rural population with higher efficiency and safety.

**3.1.1.8 Competition in domestic sector**

NAC claims to be serving to rural sectors where private sectors are reluctant to fly. NAC also charges relatively lower fare compared to private airliners. However there are airlines like Goma, Sita, Makalu and Air Kasthamandap that not only cater to these remote sectors but are also planning to expand their services in the remote areas by adding more planes to their fleet (Baskota, 2013). This will tighten competition for NAC in the domestic sector. A strategic partner allows NAC to plan its services in terms of financial costs and benefits. A business-oriented strategic partner will be weary of what regions account for the highest costs of operation and which sectors yield the highest Returns on Investment (ROIs). This will foster competition in the domestic sector and make room for innovation, eventually making the domestic sector livelier.

**3.1.2 Costs of bringing in strategic partner at NAC**

Given the current state of NAC, the cost of bringing in strategic partner at NAC can be reflected by possible laying-off of existing staff at NAC. Once a portion of equity is sold to a foreign strategic partner and the management is handed over, it will introduce reform measures to bring NAC back to sound health. In the process, the new NAC will go for operational efficiency, active brand-based marketing and productive innovation. The existing staff that fails to deliver as per the revised goals of NAC could be relieved of their duties via company downsizing.
As aforementioned, after selling equity and handing out management, GoN could also lose the control it enjoys over NAC. Consequently, operation of flights to rural areas of Nepal, which NAC has been making at subsidized prices whenever possible could possibly come to an end.

3.1.3 Challenges to implementing this reform

As in any policy reform scenario, there are political-economic factors that will remove the benefit that some groups of people have been enjoying so far due to the status quo at NAC. Convincing these groups to be on board for the reform is likely to present one of the many challenges in this reform process.

3.1.3.1 Resistance from Labor Unions

Introduction of a strategic partner at NAC is likely to pose a direct threat to many redundant jobs at the NAC. This in turn is likely to bring about a resistance to change from labor unions especially if the strategic partnership results in loss of jobs of members of the various labor unions. Therefore, any reform process that is initiated at NAC will require strong communications and buy in of the labor unions. The Union leaders need to be convinced of a better outcome for all their members. This may manifest in several lucrative severance packages for employees that need to be let go in addition to transitional help and job placements in other companies for redundant employees.

3.1.3.2 Loss of rent seeking avenue for some groups

It is clear from the mismanagement at NAC that there are rent seeking opportunities that have been capitalized by various group of people. One of the outcomes of a strategic partnership is to curb down on these rent seeking avenues for different sets of people to take advantage of. Naturally, the loss of rent seeking opportunities will result in some resistance from several groups that are currently benefiting from this situation. These resistance
will manifest in several different forms and several logical reasons against strategic partnership can be raised by these groups. Handling these groups would also present a core challenge in implementing this kind of reform at NAC.

3.1.3.3 Lack of political will

Many strategic appointments at the Board of Directors level at NAC is currently in the hands of political parties. Moving ahead with the strategic partnership will mean that the political parties will no longer be able to exercise this privilege. Therefore, this kind of reform may not be able to render enough political will. Without the political will to implement these reforms, recommendations such as the one made in this paper will remain only in paper. Therefore, before embarking on this reform, one of the crucial steps will be to garner political support for this reform through some reform champions within the political parties.

3.1.3.4 Selection of the strategic partner

The selection criteria and the selection process of a strategic partner for NAC presents several rent seeking opportunities for many groups of people. Since, NAC is a public enterprise and the government has a mandate to support it through taxpayer’s monies, many parties may be interested in a strategic partnership only to get their hands on taxpayer’s money. Therefore, the selection process and criteria for a strategic partner needs to be thought through in this process.

3.2 Privatization of Hetauda Cement Industry Limited

Privatization is not a new phenomenon for Nepal and was initiated during the Sixth Five Year Plan (1980-85) but a concrete effort towards privatization was made only after the Nepali Congress (NC) government came into power in 1992 (ILO, 2000). The difference in ideologies of the two major parties NC and UML which came to power during that period affected the process which resulted in poor implementation of privatization efforts.
According to the Privatization Act, 1994, “Privatization means involving private sector in the management, or to sell or lease it, or to transfer government ownership into public ownership, or an act to infuse participation by any means, either wholly or partly, of private sector or of the employees or workers, or of all interested groups”. The privatization cell under the MoF has objective of promoting enterprise efficiency through improved corporate governance and promoting and accelerating wider participation of the private sector in the operation of SOEs (Ministry of Finance, 2014).

As mentioned in the previous chapter the performance of HCI has been financially unsatisfactory while their private counterparts are growing at the rate of 10 percent per annum. The modality i.e. public ownership of HICL has become burdensome for the government and it is becoming more and more expensive for the taxpayers. Apart from being financially weak, issues of intervention from political forces have emerged time and again. It has been felt that doing business is not the business of the government because it does not have the required skills, capacity and orientation to handle the business as properly as the private sector does (Raut, n.d.).

Under such circumstance, this paper proposes that HCIL be privatized by selling the industry to the private sector. The new privatized HCIL needs to be free of any form of government/political interference and should be allowed to practice complete autonomy. As already established in this paper, cement industry is a competitive industry in Nepal and new private giants are emerging by the year. Cement is not a basic necessity product. The existing demands in the market are being catered to by the private sector. Furthermore, private sector is continuing to grow in the cement industry (see annex II, III and IV). Hetauda Cement covers only four percent of the market share and does not have a comparative advantage like the telecom sector. Privatizing the enterprise means that no more financial burden will have to be borne by the government at the taxpayers’ expense. Under such a situation, it can be safely argued that it is not a pragmatic move when government continues to participate in such
an industry making such losses and accumulating such liabilities as HCIL is. The funds that is being poured into this sick industry will be freed up for the government to put it to better use in other sectors of basic necessities.

3.2.1 What changes would privatization bring in HCIL?

The main reason behind privatization is increasing efficiency in production and sales of goods and services. Studies also has indicated that privatized enterprises grew more rapidly, were better able to contain their costs and their internal efficiency improved because of better utilization of physical and human resources (Malhotra, 1995 as cited in Ghimire, n.d.). As of 2008, 30 public enterprises were disinvested, dissolved and liquidated by the government (Raut, n.d.).

According to Raut (n.d.), “The impacts of privatization are found to be positive so far as its effects in the economic fronts are concerned— it has been able to increase the production with diversification, improve technology, reduce the losses, reduce the fiscal burden of the government, increase private sector investment, increase the quality of goods and services etc.”

A study done by Ram Ghimire (n.d.) titled ‘Privatization of Public Enterprises in Nepal’ studies the performance of State Owned Enterprises (SOEs) after their privatization. The study highlights that profitability wise, 50% of the privatized enterprises earned profits and the other 50% suffered loss. However, a point to be noted is whether or not these enterprises went on loss only after the reform. Privatization of the enterprises means that they were either running on losses prior to the reform or were facing heavy non-financial burdens. Regmi points out that these enterprises were running on high cumulative losses and employee liabilities. Once such enterprises are privatized, the taxpayers and national treasury are relieved of the burden.

Some of the key benefits of privatizing HCIL have been briefly explained as follows:
3.2.1.1 Increased productivity

There are several examples of PEs having achieved increased productivity post privatization. A study on privatization of PEs in Uganda reveals that production capacity of PEs was below 10% before privatization and it increased to ten folds after privatization (Ddumba-Ssentamu & Mugume, 2001). Earlier privatization processes in Nepal show similar results. A study of 10 privatized public enterprises in the report “Impact of Privatization in Nepal” shows that 9 out of the 10 studied enterprises had increased productivity ranging from 508.27% to 4.55% ; the productivity of only one enterprise remained constant (K.C., n.d.).

3.2.1.2 Reduced financial and administrative burden

The amount of loan and subsidies that has been poured into Hetauda Cement and other PEs are extremely high. Hetauda Cement alone had a cumulative loss of NRs. 6,419.82 lakhs up to 2011/12 along with unfunded liabilities worth NRs. 2,084.06 lakhs. On top of that it has an outstanding loan of NRs. 22,68,05,433 payable to government of Nepal. This clearly indicates huge financial burden on the government which could easily be reduced through privatization. Given the current performance of HCIL- the loan, liabilities and loss will only mount up making it difficult for the government and the taxpayers.

3.2.1.3 Better performance

The performance of PEs after privatization has been found to have increased in several countries primarily because of effective management by private firms. In Bangladesh, sales efficiency increased 73% whereas income efficiency increased 78%, both appreciably at one percent level (Syeduzzaman, 2012). Similarly, privatization has had some effect in profitability in privatized public enterprise in Nepal too.
Table 5: Profit/Loss Situation: Before and After Privatization

<table>
<thead>
<tr>
<th>Privatized units</th>
<th>Before privatization</th>
<th>After privatization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nepal Lube</td>
<td>+0.60 (1993/94)</td>
<td>+5.38 (1997/98)</td>
</tr>
<tr>
<td>Nepal Bitumen</td>
<td>+0.68 (1992/93)</td>
<td>+3.07 (1997/98)</td>
</tr>
<tr>
<td>Nepal Foundry</td>
<td>+3.88 (1995/96)</td>
<td>+0.83 (1998/99)</td>
</tr>
<tr>
<td>Nepal Film</td>
<td>-4.81 (1992/93)</td>
<td>+0.25 (1997/98)</td>
</tr>
<tr>
<td>Bhrikuti Paper</td>
<td>+8.70 (1991/92)</td>
<td>-228.00 (1997/98)</td>
</tr>
<tr>
<td>Harishiddhi Bricks</td>
<td>+0.04 (1991/92)</td>
<td>-20.28 (1995/96)</td>
</tr>
<tr>
<td>Raghupati Jute Mills</td>
<td>-75.30 (1991/92)</td>
<td>-3.18 (1997/98)</td>
</tr>
<tr>
<td>Balaju Textile</td>
<td>-1.20 (1991/92)</td>
<td>-0.21 (1997/98)</td>
</tr>
</tbody>
</table>

Note: Rs. in Million (Source: Manandhar and Bajracharya, 2000)

The table indicating the profit/loss situation of PEs before and after privatization shows how profit share increased significantly. Even though a few have incurred losses, the amount of loss was reduced. Only two of the enterprises that were privatized performed worse after privatization but it was the loss of the private sector and was not to be borne by the government.

3.2.1.4 Improved technology

With privatization the enterprises face competition with other and thus to remain profitable in the long run, these enterprises gradually shift towards improved technologies. A study on 10 PEs that were privatized in Nepal indicates that 9 out of 10 enterprises improved technology after privatization. Nepal Bhrikuti Pulp and Paper Limited started using waste paper as raw materials and replaced coal by rice husks (which is cheaper than coal) (Raut, n.d.).
3.2.1.5 Improved quality of goods

PEs in developing economics are characterized by intense government intervention, obsolete technology, overstaffing and constant political interference that impairs the quality of goods produced (Raut, n.d.). After privatization most of the previous SOEs has increased the quality of their services and after sale services because private sector focuses customer satisfaction (Kouser, Azid & Ali, 2011). Another study of PEs in Uganda suggests that privatized public enterprises introduced new products, increased the quality of products and were also exporting (Ddumba-Ssentamu & Mugume, 2001).

3.2.2 Cost of privatizing HCIL

The major cost of privatization might also come from the laying-off of its staff. Currently, HCIL employs 548 employees, including both technical and non-technical personnel. If we go by the contribution per employee, in the year 2011/12, an employee contributed to production of 179.88 MT of cement at HCIL. In comparison, if we look at the number of private cement industries that came into operation in the same year and take the industry average of percentage of total capacity actually produced and the number of employees in these new industries, we can see that one employee contributed to 464.7 MT of cement (see annex III and IV). This stark comparison hints that there is possible room for laying off scores of employees at HCIL just to bring it at par with private cement industries. There is room for increasing the efficiency of HCIL and some existing employees might be compromised in the process.

3.2.3 Challenges to implementing this reform

Although privatization efforts were largely lauded during their initiation in the 1990s in Nepal, there has been much criticism on the process that was adopted. Due to the lack of transparency in the process of privatization, corruption allegations during the earlier privatization process
still remain in Nepal. This kind of general public attitude towards privatization presents major challenges to implement this kind of reform in Nepal.

3.2.3.1 Resistance from Labor Unions

As in the case of NAC, Hetauda Cement also has been overstaffed. Any privatization effort geared towards either reviving the industry or towards completely dissolving the industry will result in employee layoff. Therefore, this reform agenda is likely to face major resistance from labor unions. If these concerns are not duly addressed then such a resistance can lead to social unrest. Therefore, the fate of the employees needs to negotiated and decided before moving forward with the privatization bid.

3.2.3.2 Rent seeking opportunities during the privatization process

The privatization process if not defined properly will present the biggest challenge in this reform process. For it to be credible, the process needs to be transparent with clearly defined terms and conditions. The final choice of the private party should be subject to public scrutiny as well. However, there are many regulatory loopholes that can be created in this process in order to create rent seeking opportunities. Therefore, the major challenge for this reform agenda to move forward would be to maintain a credible and clean process that follows due process and is free from corruption.

3.2.3.3 Resistance from some political groups

So far, PEs have been a lucrative playing ground for many political parties. Many political actors have established their influence and PEs such as Hetauda Cement provides them with opportunities to engage their party cadres and also provides rent seeking opportunities for the favor provided. Privatization would result in a loss of this kind of opportunity for some political actors. Therefore, resistance from these kind of groups can be expected in this reform process.
3.2.3.4 Lack of political will

Above all, in the climate of ideas prevailing in Nepal, privatization of a public enterprise will not be a very popular move for any political party. It will face scrutiny and criticism (based on both past evidence and ideological inclination) from established opinion makers and the media. Therefore, for any political party leader to take a stand for privatization will be a tough stand. This is yet another challenge to implement this reform.
4. Recommendations

4.1 Nepal Airlines Corporation

After weighing the current challenges being faced by NAC against the expected benefits and costs of implementing the organizational restructuring plan, this paper recommends that NAC could go into strategic partnership with an operating international airliner. However, this requires a lot of background work and preparation before implementation.

i. The idea of going for a strategic partnership can be confronted with a serious resistance from labor unions. Therefore, any reform process that is initiated at NAC will require strong communications and buy in of the labor unions. The union leaders need to be convinced of a better outcome for all their members. Ministry of Culture, Tourism and Civil Aviation (MoCTCA), as the governing ministry could therefore intervene. MoCTCA could form a committee that will hold talks with labor unions, heed their grievances and act accordingly. Laying off of employees wherever necessary could have to be achieved by providing them several lucrative severance packages or by providing job placements in other companies.

ii. Given the high degree of political interference at NAC, there will also be strong opposition from the political community. MoCTCA will have to play an active role on this front as well. Before embarking on organizational restructuring, one of the crucial steps would be to garner political support for this reform. MoCTCA could take up this responsibility of garnering political consensus.
iii. The prevailing regulatory policy of NAC, that is, Nepal Airlines Corporation Act, 1963 maintains that NAC is a wholly government owned body. GoN controls the governance structure and has the power to influence the management and it is also the sole beneficiary of all the earnings of NAC. Therefore, in order to make room for strategic partnership, NAC Act either needs to be amended or it needs to be repealed and NAC brought under the Company Act domain.

<table>
<thead>
<tr>
<th>a. Why not outright privatization?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Domestic private sector lacks the expertise and capacity in terms of handling an international passenger carrier.</td>
</tr>
<tr>
<td>• Inbound tourists pay large sums of money to fly to Nepal due to costly air-fares. Selling to a foreign private firm would deprive Nepal of any possibility of earning revenue from these tourists.</td>
</tr>
</tbody>
</table>

b. Why not bring in just a new management?

• The financial burden to the taxpayers still remain the same. No investment diversification.
• Compromises possibilities like code-sharing and international marketing and branding possibilities offered by strategic partner.
• With government ownership and subsidy programs, this will still not create competition in the domestic market.

iv. MoCTCA, could then form a competent team that can handle the task of bringing in a strategic partner at NAC. Strategic partnerships require dealing with critical issues like how much equity to sell, what new management model to set up, how to share the risks and rewards, and more. The credibility, reputation and capacity of the strategic partner should be
such that a partnership with it enhances NAC’s own credibility. These are some of the issues where the knowledge of an ex-officio team (which GoN usually formulates to look into any new matter) might not suffice.

v. NAC currently operates in both domestic and international markets. This function could be unbundled into two. The strategic partner can then concentrate on competing in the international market and doing the necessary home-works therein. On domestic front, the strategic partner would not be active, but the domestic airliner would still function under competitive model. In case NAC needs to subsidize its fares to the people in rural parts of Nepal as it has been doing at present, these subsidies could be provided by the concerned ministry (MoCTCA) by drafting a cheque in the name of the passenger who is subsidized, instead of NAC selling tickets at discounted rates. By doing so, the burden of subsidy would be transferred into the state from NAC, an enterprise. NAC could then concentrate on competition on both domestic and international ends.

4.2 Hetauda Cement Industry Ltd.

A need to structurally reform HCIL has also been established by the paper. After considering other possible reform measures like public-private ownership, change in management and even bringing in a strategic partner, the research has found that privatization is the most suitable reform measure for HCIL and the paper also recommends thus. As is the case with NAC, privatization of HCIL could also face a number of challenges from various stakeholder groups. Therefore a series of steps needs to be taken before privatization can finally be implemented.

i. Privatization could end all possibilities of political interference and this could be a threat to any political force that has been benefitting off such malpractice. This could lead to the reform measure falling prey to a number of opposition from political community. Here, Ministry of Industry (MoI) as the governing ministry could take up the responsibility of garnering political support and mitigating oppositions that could arise in the process.
ii. HCIL could then be privatized by selling the industry to the private sector. It would have to be so guaranteed that the new privatized HCIL will be free of any form of government/political interference and will be allowed to practice complete autonomy. In order to maintain the credibility of the process, it would need to be transparent with clearly defined terms and conditions. The final choice of the private party could be made subject to public scrutiny as well.

iii. There is high possibility that the industry will be downsized once it is privatized. In order to absorb the possible shock this might render on the existing staff, the fate of these employees would have to be negotiated before moving into the privatization, irrespective of which bidder gets to buy the company eventually. This could be achieved by laying down certain terms and conditions in the privatization process.

### a. Why not a management change?

- New management will still be subject to political interference and excessive bureaucracy.
- Like NAC, HCIL will also face the same rigidity in terms of procurement, repair/maintenance of plants and equipment, etc.
- Burden to taxpayers still persists.

### b. Why not strategic partner?

- Growth of private sector in the industry shows that the domestic private sector is capable of taking over the business of HCIL. There are lots of private players that are bigger than HCIL.
- Government does not need to partake in a business that the private sector is already doing more efficiently and profitably. With strategic partner, government will still have a big stake.
- Costlier in terms of time and effort and mitigating oppositions.


4.3 Conclusion

The study of current status of NAC and HCIL has indicated there exists an urgency to bring in serious structural reforms.

As evinced by the current status of NAC and the prospects brought forth by strategic partnership with a foreign aviation company, NAC could go for strategic partnership. The prevailing regulatory policy of NAC, that is, Nepal Airlines Corporation Act, 1963 maintains that NAC is a wholly government owned body; government of Nepal controls the governance structure and has the power to influence the management and it is also the sole beneficiary of all the earnings of NAC. Therefore, in order to make room for strategic partnership, NAC Act could be repealed and NAC could be brought under the purview of Company Act.

Similarly, the presented facts and data on HCIL put forward compelling argument for change in the current modality of HCIL. Since private cement industries have been performing well in comparison to HCIL, privatization of HCIL looks to being the best alternative for bringing about positive changes in the performance of HCIL. Only through proper privatization can HCIL be a key player in the cement market of Nepal and hence contribute to the economy without being a burden on the government
References


References


Annexes

Annex 1: Tribhuvan International Airport, Domestic Airlines Wise Movement Data, 2012

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Source: CAAN Report, 2013
Annex II: Market Share of different cement brands in Nepal

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*Source: Nepal Cement Industry Overview*

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Source: Economic Survey 2012/13

Annex IV: List of Private cement industries registered with annual capacity and number of employees

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### Policy Options for Public Enterprises Reform in Nepal

#### A look at two public enterprises

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## Policy Options for Public Enterprises Reform in Nepal

### A look at two public enterprises

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*Source: Industrial Statistics 2061/62-2069/70, Department of Industries*
## Annex V: List of People Consulted for Public Enterprises – Road to Reform

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<td>Brihat Man Tuladhar</td>
<td>Nepal Airlines Corporation</td>
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<tr>
<td>Krishna Prasad Acharya</td>
<td>Administrator, Employees’ Provident Fund</td>
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<tr>
<td>Madan Kharel</td>
<td>Managing Director, Nepal Airlines Corporation</td>
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<td>Mahendra Raj Pandey</td>
<td>Manager, Sajha Yatayat</td>
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<td>Padam Lal Maharjan</td>
<td>Executive Officer, Sajha Yatayat</td>
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<td>Pramod Nepal</td>
<td>Under Secretary, Ministry of Culture, Tourism and Civil Aviation</td>
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<tr>
<td>Prem Shankar</td>
<td>General Manager, Hetauda Cement Industry Ltd.</td>
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<tr>
<td>Rajendra Acharya</td>
<td>Advisor, Class Nepal</td>
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<td>Ranjan Aryal</td>
<td>Joint Secretary, Ministry of Culture, Tourism and Civil Aviation</td>
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<td>Rishi Raj Koirala</td>
<td>Chairman, Hetauda Cement Industry Ltd.</td>
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<td>Salik Ram Timilsina</td>
<td>General Manager, Cultural Corporation of Nepal</td>
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<td>Shankar Lamichhane</td>
<td>General Secretary, UNI Global Union Nepal</td>
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<td>Sugat Ratna Kansakar</td>
<td>Former Managing Director, Nepal Airlines Corporation</td>
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<tr>
<td>Tej Bahadur Budhathoki</td>
<td>Chief Executive Officer, Agricultural Development Bank</td>
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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 - Entrepreneurship development, Improving business environment, Economic policy reform and Promoting discourse on democratic values

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

(More on www.samriddhi.org)
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19. Policy Options for Improving Industrial Relations in Nepal
20. Policy Options for Improved Electricity Transmission System in Nepal

All the publications are available in Samriddhi, The Prosperity Foundation and major bookstores in the country.
This policy analysis paper titled “Policy Options for Public Enterprises Reform in Nepal: A look at two public enterprises” is prepared under the banner of Nepal Economic Growth Agenda (NEGA) 2014, which is preceded by NEGA 2012 and NEGA 2013. NEGA is an annual effort of Samriddhi Foundation to identify key constraints to Nepal’s economic growth and policy options for reform.

This specific policy analysis paper takes a deeper look at two of the thirty six existing public enterprises in Nepal to propose concrete policy options for reform. The two public enterprises studied in the paper – Nepal Airlines Corporation (NAC) and Hetauda Cement Industry Limited (HICL) – have been facing high cumulative losses and presence of unfunded liabilities due to operational inefficiencies and other problems.

Analyzing their poor performance from a policy perspective, the paper identifies practical reform options which are mainly focused on improving organizational efficiency either by bringing changes in the current working modality or by introducing a new modality based on a cost-benefit analysis. Overall, the paper seeks ways to pave way for similar analysis of other public enterprises which are increasingly becoming a burden on taxpayers and consumers.

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