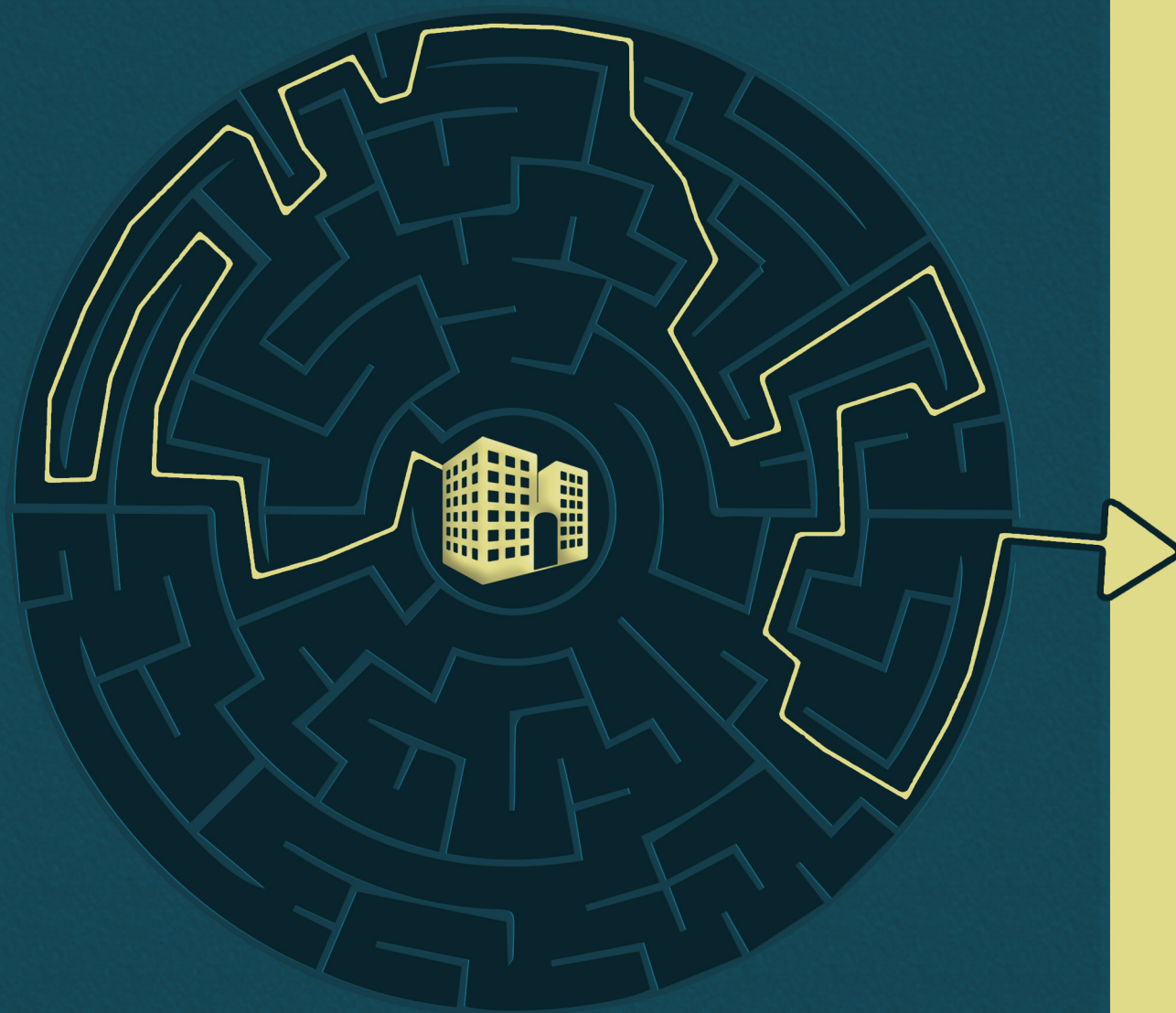


COMPANY

EXIT

IN NEPAL



POLICIES AND PRACTICES



SAMRIDDHI
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She is also part of the executive committee of Debate Network Nepal, a youth-led Kathmandu based debate organization that engages young crowds in improving speaking and argumentation skills. She holds a graduate degree in Development Studies from Kathmandu University.

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Labisha Upreti

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■ ABBREVIATIONS AND ACRONYMS

BAFIA	Banks and Financial Institutions Act
cc	column centimeter
CEO	Cheif Executice Officer
GoN	Government of Nepal
ICAN	Institute of Chartered Accountants of Nepal
NDB	Nepal Development Bank
NPL	Non-Performing Loans
NRB	Nepal Rastra Bank
OCR	Office of the Company Registrar
PAN	Permanent Account Number
SMEs	Small and Medium Enterprises
USA	United States of America
VAT	Value Added Tax

*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)*

1 USD = Rs.108.53 as of March 2, 2016 (issued by Nepal Rastra Bank)

■ EXECUTIVE SUMMARY

Company exit in Nepal is rarely a matter of discussion, except in niche groups of political persons or that of the higher business communities. It is certainly not a glorified topic in our everyday discussions but one that begs examination as it determines the volume of goods available to us as consumers. How? Because the fluidity with which companies can open and close marks our choices. The more fluid the company exit process, the higher the ability for unproductive assets to become more useful. Easy company exits mean not having to worry too much about failing at a venture – it seeds in entrepreneurs the motivation that even if something does not work out, they can always close a venture and move on to the next.

In Nepal, there are primarily three options to exiting a market, based on the company's situation. These are: the cancellation of registration (for companies registered on paper but who have not engaged in any form of transaction), voluntary liquidation (when businesses are active and solvent) and insolvency resulting into either company restructuring or liquidation of the company.

In analyzing these concepts, we find that certain costs are blanket expenses to small entrepreneurs, such as having to hire liquidators compulsorily for voluntary liquidation. Additionally, certain blacklisting policies seem to discourage entrepreneurship rather than punish criminal offences alone. A case in point here is blacklisting shareholders who own more than a stipulated percent in a business run by a defaulter. Questions regarding the ability or the lack thereof of the existing commercial bench in handling cases efficiently have also come to light time and again.

Deliberations have shown a need to bring reforms in the existing Companies Act and blacklisting directives in order to primarily remove blanket costs to entrepreneurs and incentivize business ventures. Another recommendation is creating better human resource in handling company exit at the government administration level and honing expertise in the same. Reducing the cost and time taken for insolvency is also another need of the hour. Only looking to encourage new companies is a job half-done, enabling easier mechanisms for exit are a fundamental necessity and notable of higher economic freedom.

1. INTRODUCTION

Efficient market exit policies are as important as market entry policies, and can help to improve a country's investment and business environment, and consequently, economic freedom and prosperity. Barriers to exit make it more difficult for a company to get out of a particular business than it would otherwise have been. They often include things such as evaluation of the financial performance, the cost of laying off staff, contractual obligations such as the payment of rent as well as regulatory procedures that may take months and years for company to complete (The Economist, 2009). Many reports in the past have indicated that poor countries often regulate businesses the most (Djankov, et.al, 2005; Hafeez, 2003). For instance, while it takes several months for the top performers in industrialized countries to go through bankruptcy proceedings, in developing countries it often takes several years (CESifo DICE Report, 2010)

Nepal ranked 99th out of 189 countries in World Bank's 2016 Ease of Doing Business Report which indicates a much slower and more complicated process in starting and winding up a business in comparison to over half of the countries in the world. Meanwhile, its ranking fell from 82nd (in 2015) to 86th (in 2016) on 'Resolving Insolvency' indicating procedural and administrative bottlenecks in insolvency laws and their application. In 2011, a new Industrial Policy was introduced by the Government of Nepal in order to promote growth of Small and Medium Enterprises (SMEs). With a focus on establishment of Special Economic Zones, separate funds for SMEs (and the state trying to assist in making these enterprises competitive), it can be seen that the government is serious about promoting private entrepreneurship practices. While these steps are important, allowing an enterprise the same degree of ease to exit a market in both law and in practice, is crucial to the development of an economically free nation. However, reality is often beyond the ideal - regulatory barriers and costs associated with them remain a big challenge for companies who wish to mobilize their resources and restructure their businesses to meet market demand.

A company may choose to exit a market for reasons unlimited: the owners may want to look at a new venture, perhaps the company made irrecoverable losses or simply, the proprietor now has had a change of heart about owning a company. When we think of companies, we usually think of faceless buildings and people we have no connections to in real life. Their stories do not touch us. But we are affected directly by options provided for company exit because they affect the choices we have as a consumer. Fluidity in company exit means that more people can enter newer businesses as they close old ventures. It denotes that there is a flow of ease in and out of a market when company entry and exit laws are flexible. Today an entrepreneur seeking to close his/her business in Nepal can choose to undergo two options - cancellation of registration of a company or voluntary liquidation of a company. A third company exit procedure also exists, where regulating bodies or creditors can file for insolvency for the company in question. While most entrepreneurs entering administrative exit may be aware of the existence of these laws, discerning them is an arduous task to state the least. Creating a logical sequence of events for exiting a market and calculating associated costs are primary steps when entering into administrative exit. This is made unfavorable by the jargon-riddled language of exit laws understandable usually only by technical experts such as liquidators.

In an attempt to contribute to smoothening the company exit process in Nepal, this paper aims to streamlining existing laws and regulations under which market exits are guided, and offering road maps, exit strategies and related cost structure. Above all, this paper points out several inconsistencies in current regulations, identifies reasons behind discrepancies between the law and practice and offers an assemblage of policy recommendations to improve its existing policy framework.

2. LEGISLATIVE CONTEXT: COMPANY EXIT REGULATIONS IN NEPAL

2.1 The Companies Act, 2006

Nepal's first Companies Act came into effect in 1950 (2007 B.S.). By 1991, a total of eight amendments had been made to this Act¹. In 1997, a new Companies Act (2053 B.S.) was enacted. The new Act re-titled 'the winding up of a company' (procedures of closing a company) as 'liquidation' and when in 2006 came yet another Companies Act (2063 B.S.), the terminology (liquidation) remained to denote the closing of a company.

The prevailing Companies Act provisions two methods for exit: cancellation of registration of said company, and voluntary liquidation. The cancellation of registration of a company is primarily performed when the company in question has not engaged in any business transaction whatsoever post company registration. Voluntary liquidation, on the other hand, is suggested when a company has engaged in one or more business transactions post-registration and requires the involvement of a licensed liquidator to wind-up the company. These defined provisions are the same for both public and private companies. The Act does not define different provisions for companies on the basis of their net worth or capital, meaning that all companies have to undergo the same procedures.

The registration of a private company can be cancelled based on Chapter 11, Section 136 (Cancellation of Registration of Company) in the Companies Act 2006 if the company meets one of the three criteria:

- (a) If the promoter of the company makes an application, showing a reason for the failure to commence the business of the company, and accompanied by the prescribed fees, for the cancellation of the registration of the company
- (b) If the company is in default in submitting to the Office (i.e. the Office of the Company Registrar (OCR)) the returns as referred to in Section 80 or fails pay the fine as referred to in Section 81 for three consecutive financial years; or
- (c) If based on the proofs received in the course of administration of the company, the Office has a reasonable ground to believe that the company is not carrying on its business or the company is not in operation.

If outstanding debts remain to be settled when the company registration is being cancelled² (which cannot be settled from existing assets, rights or benefits), the Act states that 'the shareholders, directors or officers who were involved in the management of such company and responsible for giving rise to the situation... shall personally bear such remaining loan or liability'.

When applying for a voluntary liquidation, a company is expected to fulfill several important obligations:

¹ Amendments made to the 1964 Companies Act: Companies (Amendment) Act, 2025(1968), Short Procedure Act, 2028(1972), Companies (Second Amendment) Act, 2030(1974), Auditors Act, 2031(1975), Companies (Third Amendment) Act, 2041 (1984), Judicial Administration Reform (Fourth Amendment) Act, 2043 (1986), Companies (Fourth Amendment) Act, 2046 (1989), Administration of Justice Act, 2048 (1991)

² Further details for cancellation of registration are illustrated and elaborated in the next section.

Chapter 10 | Voluntary Liquidation of Company | Companies Act, 2006

Section 126: Liquidation of company able to pay its debts

- (1) Except in case where a company has become insolvent in accordance with the prevailing law on insolvency, the shareholders of the company may liquidate the company either by adopting a special resolution in the general meeting or memorandum of association, articles of association or consensus agreement.
- (2) A company may be liquidated under this Act in the following circumstance:
 - (a) If the company is able to pay its debts or other liabilities in full;
 - (b) If there exists no situation where an application for the review of insolvency of the company is pending under the prevailing law on insolvency or where the company would be in any manner subject to an insolvency proceeding under the prevailing law on insolvency;
 - (c) If the directors of the company, have, after due inquiry, made a declaration in writing that the company is able to pay its debts and other liabilities in full and that the debts and liabilities to be paid on behalf of such company can be paid up or can be fully settled in any other process within one year from the date of the adoption of the resolution to liquidate the company;
 - (d) If the written declaration made by the directors pursuant to Clause (c) was presented in the general meeting called to discuss the matter of liquidation of the company or such declaration was made at the time of discussions on that matter in the general meeting.

As revealed by an OCR personnel, there have been 25 cancellations of registration from 2072/4/12 to 2072/9/1 (2015/7/28 to 2015/12/16) and 19 voluntary liquidation³ of companies in the same period.

2.2 The Insolvency Act, 2006

An additional important exit strategy available to businesses in Nepal is declaration of insolvency which is governed by the Insolvency Act, 2006. Those filing for insolvency can be overarching government regulatory bodies (such as the Nepal Rastra Bank – the Central Bank of Nepal for all banks and financial institutions – except cooperatives which are registered under the Cooperatives Act, 1992 and does not come under the jurisdiction of the Companies Act) or a body of creditors who have a stake of 10 percent or more in the company, or 10 percent of all creditors, in addition to a number of other actors as stipulated below.

The process for insolvency as stipulated by the Act, may be initiated by a number of actors inclusive of:

- (a) A company itself which has become insolvent;
- (b) Out of the total creditors of a company which has become insolvent, at least ten percent creditor or creditors who has or have lent money;

³ Detailed explanations of the process of voluntary liquidation is elaborated in the next section.

- (c) Shareholder or shareholders that has or have subscribed at least five percent of shares, out of the total shareholders of a company;
- (d) Debenture-holder or debenture-holders that has or have subscribed at least five percent of debentures, out of the total debenture-holders of a company;
- (e) A liquidator who has been appointed to liquidate a company; or
- (f) In the case of a company that carries on any specific type of business set forth in Section 8⁴, a body authorized to administer and regulate such business.

According to the Insolvency Act, 2006, 'being insolvent' means "a state of being unable, or appearing to be unable, to pay any or all of the debts due and payable to or payable in the future to creditors or a situation where the amount of liabilities of a company exceeds the value of the assets."

The Insolvency Act allows two options once a company is declared insolvent: liquidation or company restructuring. Decisions are made based on official examination and evaluation. During liquidation, the court appoints a liquidator to take over the managerial and liquidating duties of the company. The liquidator controls the company until all assets are sold and all debts are cleared. In the case of restructuring, the court appoints a restructuring manager to take over all managerial duties whereby he/she will design and enforce a restructuring plan for the company.

To date, there has only been one successful case of insolvency-induced liquidation in Nepal – that of Nepal Development Bank in 2014. No company has undergone restructuring so far. Additionally, the Banks and Financial Institutions Act (BAFIA), 2006 is also an important Act that governs certain requirements (such as the order of payments to stakeholders) when closing banks or other financial institutions. Banks and financial institutions, including insurance companies, require the prior approval of their regulating body.

⁴ Please refer to Appendix II for Section 8.

3. IN PRACTICE: MARKET EXIT PROCESSES IN NEPAL

3.1 The cancellation of registration of a company

As illustrated in Figure 1, in order to apply for a cancellation of the registration of a private company, the company needs to submit three things to the Office of the Company Registrar (OCR): the decision by company board to close company in a general meeting, proof from an auditor of not having commenced business and an affidavit that is to be filed at the OCR. The official cancellation application shall be filed within 15 days after the decision to close a company is made. An appropriate fee is charged based on paid-up capital of the company (application fee for capital below Rs.1,000,000 is Rs.1, 000 while for paid-up capital above this amount, the application fee is Rs. 5, 000).

Post application registration, the OCR writes to the 'related department' under which the company is registered for cancellation approval. For example, cancelling registration of a private school in Nepal requires an approval from the Department of Education. The waiting time largely depends on the administrative efficiency of the relevant departments and could take up to three to seven days or more. The applicant then needs to obtain a letter from the OCR asking the Tax Office (where is it registered) to furnish the applicant a Tax Clearance letter based on clearance of all taxes and dues if any. Obtaining this letter (that the OCR addresses for the applicant) may simply take up to a day. The acquisition of a Tax Clearance letter from the Tax Office often takes two to three days given that company paid all its taxes and dues.

After getting the Tax Clearance letter, the applicant is required to run an advertisement calling for claims of debt in a nationally circulated newspaper within 15 days of having filed the application for registration cancellation. The advertisement size is roughly that of 60 column centimeter (cc) – 100 cc and ranges from Rs.12, 000 – Rs.20, 000 (The Kathmandu Post in World Wide Advertising Network, n.d.) when run in black and white on the inner pages of the paper.

Upon completion of all application procedures, there is a 35-day waiting period whereby claimants may contact the company and/or OCR to register claims. Claims supported by evidences can be filed at this stage. The applicant needs to clear all remaining fines during this waiting time⁵. Once the cancellation is approved by OCR, the company is required to run an advertisement to formally inform the public regarding the closedown of this company. Lastly, the OCR will allow the applicant to lawfully remove their Permanent Account Number (PAN) and then strike the name off the company register.

Cancellation of registration will look at PAN cancellation only and not VAT (Value Added Tax) cancellation – because there is a minimum transaction threshold one must have exceeded in order to be able to register for the VAT. According to Section 6 of Chapter 2 of Value Added Tax Rules, 2053 (1996), as per amendments made in 2072 (2015/16) – entrepreneurs carrying out transactions with a turn over 'not exceeding Fifty lakh (five million) Rupees and in case of goods and services, who has carried on transaction with a turnover not exceeding Twenty lakh (two million) Rupees in the last Twelve months ... is not required to get his transaction registered'.

However, an entrepreneur carrying out transactions smaller than those mentioned can still register 'at his own will' but is not required to do so, according to Sub-Section 2 of Section 6 of the same law. In usual practice, only those exceeding the threshold file for VAT registration because it invites additional compliances such as separate record keeping.

⁵ Details are elaborated in Appendix I.

For PAN cancellation, one will be required then to visit the local Tax Office where one's PAN is registered and fill in forms to de-register the PAN. These forms are also available online at the Inland Revenue Department's website or can simply be filled in at the Tax Office itself. The forms need to be submitted with reasons being specified on why the company wishes to close one's PAN. After submission of the forms with necessary documentation (such as Tax Clearance letters given previously), the processing of PAN de-registration may take from one to five days, depending on the efficiency of the Tax office in question.

While the process can be carried out by company representatives themselves (and usually is), a number of them also chooses to hire liquidators (Tax Officer-name withheld, April 10, 2016) The applicant can appoint a liquidator or another third person – who is to carry a letter with him/her specifying that he/she has been appointed the representative for the actual applicant (letter/power of attorney) when handling registration cancellation in government offices.

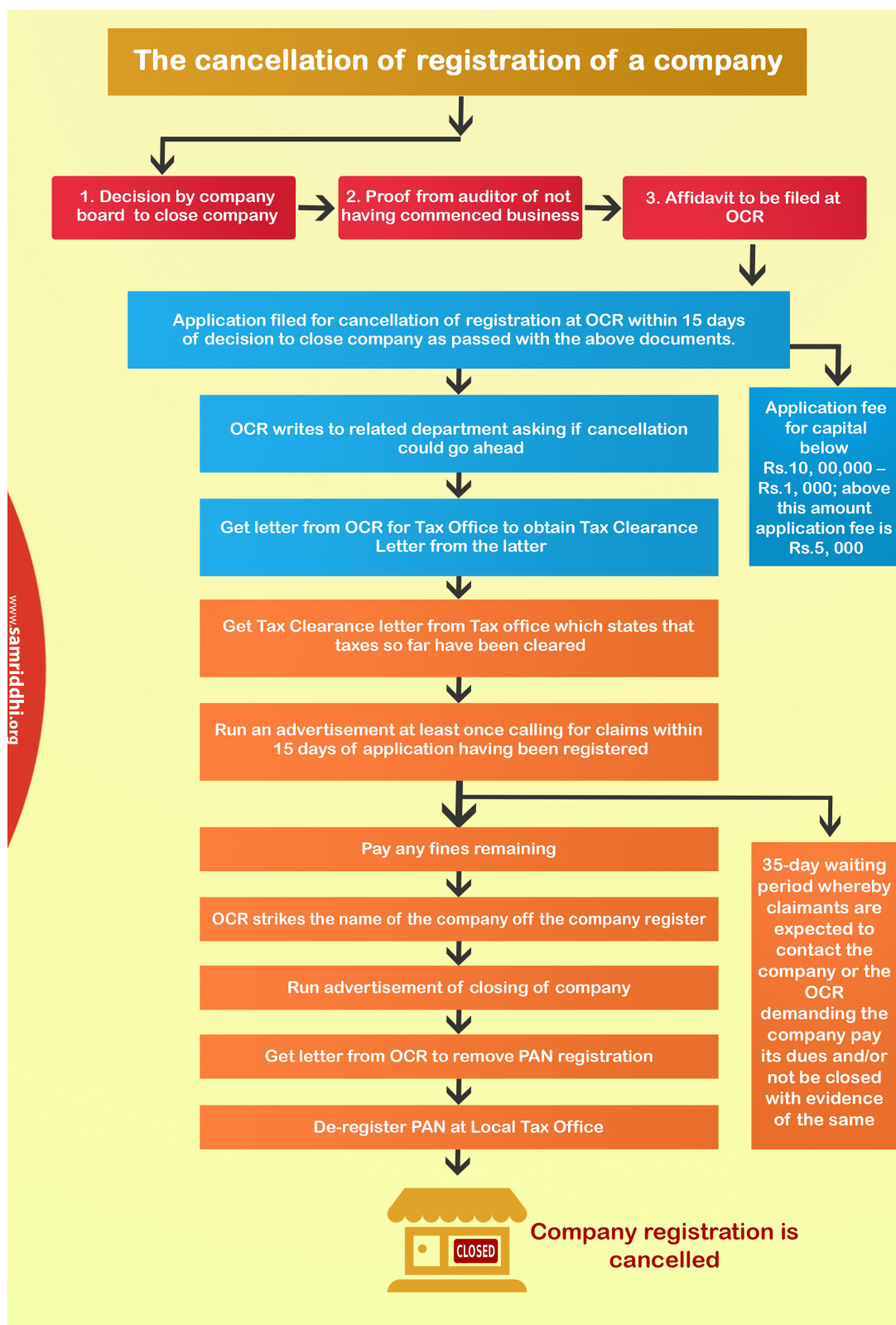


Figure 1. Cancellation of registration of a private company

*Author's compilation based on legal provisions and information from interviews with experts

Table 1. Estimated Time and Costs for Cancelling the Registration of a Company

	Work description	Time taken	Cost associated
1.	Decision by company board to close company in a general meeting	1 day	Rs.0
2.	Proof from auditor of not having commenced business (Audit report to be dated at least 15 days before applying for cancellation) ⁶	Approx. 2 weeks (depending on size of company)	Audit fees as directed by the Revised Minimum Audit fee notice by ICAN*
3.	Affidavit to be filed at OCR	Same day as filing application for cancellation	Rs.0
4.	Promoter applies for cancellation of registration at OCR within 15 days' of decision to close company	1 day	Application fee for capital below Rs.10, 00,000 – Rs.1000; above this amount application fee is Rs.5, 000 ⁷
5.	OCR writes letter to related department ⁸ asking if cancellation could go ahead	Approx. 3 – 7 days (largely dependent on internal efficiency of department in question)	Rs.0
6.	Get letter from OCR for Tax Office to obtain Tax Clearance letter for company cancellation from the latter (Post -confirmation from the related department)	1 day	Rs.0
7.	Get Tax Clearance letter from Tax office which states that all taxes so far have been cleared and there had been no transactions	2-3 days	Rs.0
8.	Run an advertisement at least once calling for claims within 15 days of application having been registered in a nationally circulated A-grade newspaper ⁹	1 day	1 advert run: Rs.12,000 – 20,000
9.		35-days waiting period whereby claimants are expected to contact the company and/or to the OCR to file claims or demand the company not be closed with evidence for the same ¹⁰	
10.	Pay any fines remaining	1 day	*As stipulated in Appendix I
11.	Compile evidence of all of the above documents and submit to OCR	1 day	Rs.0
12.	OCR strikes name off company register	1 day	Rs.0
13.	Run advertisement of closing of company	1 day	1 advert run: Rs.12,000 – 20,000
14.	Get letter from OCR to remove PAN registration	1 day	Rs.0
15.	De-register PAN at local Tax Office	1-5 days	Rs.5 for stamp ticket on form
Total time and cost of cancellation		64 - 73 days	Rs.25,005 (230.39 USD) to Rs.45,005 (414.67 USD) (excluding fines and audit fees ¹¹)

*Author's approximate estimates based on legal provisions and information from interview with experts

⁶ Company Directive, 2072 (2015 AD)

⁷ Section 136 (1) of Companies Act, 2006

⁸ Related department here is to mean the department that had initially given permission for company operation. For example: a travel and tour company comes under the jurisdiction under the Department of Tourism.

⁹ Company Directive, 2072 (2015 AD)

¹⁰ Though the Act stipulates a period of 35 waiting days, a number of liquidators interviewed stated that the time frame used was usually 15 to 35 days rather than 35 full days

¹¹ Audit fees subject to class of auditor used – see Table 2.

Table 2. Audit expenses

Auditor Classification	* Amended Audit Fee (NRs.)
Class 'D' registered Audit members/Audit technical experts	Rs.5,000
Class 'C' registered Audit members	Rs.10,000
Class 'B' registered Audit members	Rs.15,000
Fellow Chartered Accountant member/Chartered Accountant Member	Rs.20,000

Source: Revised Minimum Audit Fee, ICAN, 2071 B.S. (2015 AD)

3.2 Voluntary liquidation of a company

A voluntary liquidation may be commenced by the management/ board of directors of a company to offer resolution to the company's financial situations. A fundamental difference between cancellation of registration and voluntary liquidation is that the latter requires an appointment of a liquidator. Firstly, the board members of a company need to come up with and adopt a special resolution to liquidate a company in a general meeting. They then need to submit a copy of their final decision supplemented with the application form to liquidate a company with an application fee as determined by its paid-up capital. The company is required to file for liquidation at the OCR within 7 days after the passing of the special resolution from its board members. A liquidator and auditor are to be appointed by the company in no later than 7 days of the adoption of the same resolution. Though liquidator salaries are largely dependent on their experience and size of company to be liquidated, on average liquidator salaries range from Rs. 20, 000 – Rs. 30, 000 per month in Nepal.

Likewise, cancellation of registration, the OCR writes to the related department under which the company was registered for relevant approval for liquidation. This, as previously stated, will depend largely on work load and schedule of the department in question and could be between three to seven days. Upon approval from the Department, the liquidator and auditor step in and commence their duties. It usually takes approximately two to three weeks for a small to mid-size business¹² (but this is largely dependent on company size and could rise significantly as volume of and size of business transactions increase) to complete its auditing process.

The liquidator performs these specific duties as outlined in the Companies Act, 2006:

Powers and duties of liquidator

- (1) The liquidator appointed under this Act shall, mutatis mutandis, exercise and perform all the powers and duties which may be exercised and performed by a liquidators under the prevailing law on insolvency.
- (2) It shall be the duty of the liquidator to do the following acts, without prejudice to the generality of Sub-section (1):
 - (a) To prepare and submit to the office, the statements and accounts of incomes and expenditures in the course of liquidation in every six months after the appointment of the liquidator
 - (b) To inform the shareholders of the company about the progress on the liquidation proceedings every six months after the appointment of the liquidator

¹² According to Industrial Policy, 2011, small businesses are defined by fixed asset holdings of less than 50 million (including land and building). Medium businesses are defined by fixed asset holdings of 50 - 150 million (including land and building)

- (c) To obtain and recover all properties or amounts required to be obtained and recovered on behalf of the company and repay and discharge the debts and other liabilities of all the creditors of the company;
- (d) Following the completion of the act as referred to in Clause (c), to call the general meeting of shareholders and present therein a proposed report and return on the distribution of the remaining properties of the company to the shareholders:
- (e) If the shareholders holding at least seventy five per cent of the paid up share capital consent to the return as referred to in Clause (d), to make payment of amounts to the shareholders accordingly:
- (f) At the completion of liquidation proceedings, to prepare a report on the properties recovered, payments made to the creditors and distributions made to the shareholders, on behalf of the company, and submit such report, certifying that the company has been liquated, accompanied by the auditor's report, to the Office.

Post company liquidation, the process is similar to that of cancellation of registration whereby the major difference remains that the activities are carried out by a liquidator rather than the company head/applicant. The liquidator needs to obtain a No Objection Letter from the Tax Office as proof of the company having cleared all its taxes. However, if the Tax Office finds 'reasons' to suspect the company in question of engaging in fraudulent transactions and/or of misusing the VAT bill, obtaining this letter could take months.¹³

Following the acquisition of the letter, an advertisement needs to be run in a national daily by the company calling for claims from creditors. There is a 35-day waiting period after this as the OCR and the company wait for claims. Following this 35 day period, liquidation and audit reports are submitted to the OCR. The OCR then oversees the settlement of fines, if any. Then the company is removed from the company registry and the liquidator applies for removal of their PAN and/or VAT registration from the Tax Office.

¹³ Misuse of the VAT bill could mean instances where the company has used fake VAT bills or hidden actual number of bills issued among others.

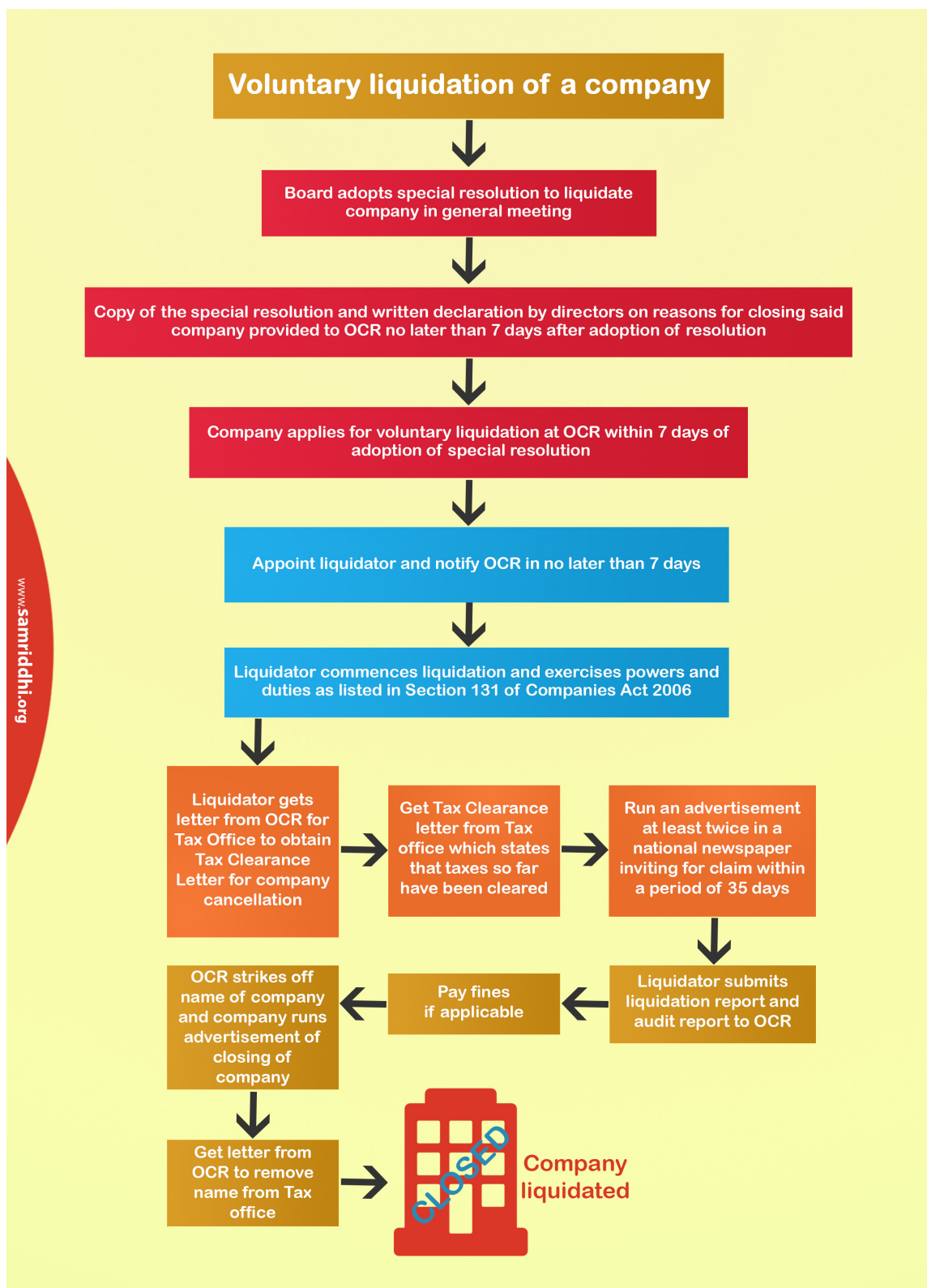


Figure 2. The process for voluntary liquidation

*Author's compilation based on legal provisions and information from interviews with experts

Table 3. Estimated Time and Cost for Voluntary Liquidation in Nepal

	Work description	Time taken	Cost associated
1.	Board adopts special resolution to liquidate company in meeting	1 day	Rs.0
2.	Copy of the special resolution and written declaration by directors on reasons for closing said company provided to OCR no later than 7 days after adoption of resolution	Could be created on same day as board adopts special resolution	Copying cost – Rs.50 – Rs.100
3.	Company applies for voluntary liquidation at OCR within 7 days of adoption of special resolution	1 day	Application fee for capital below Rs.10,00,000 – Rs.1000; above this amount application fee is Rs.5,000 ¹⁴
4.	Appoint liquidator and auditor and notify OCR in no later than 7 days	2-6 days approx.	(Mid-range) Liquidator salary – Rs.20,000 – Rs.30,000 per month.
5.	OCR writes letter to related department asking if liquidation could go ahead	Approx. 3 – 7 days (largely dependent on internal efficiency of department in question)	Rs.0
6.	Liquidator commences liquidation and exercises powers and duties as listed in Section 131 of Companies Act 2006 Auditor commences audit proceedings	*Dependent on company size and volume of transactions Approx. 2-3 weeks for auditing (also largely dependent on company size and transactions)	Liquidator's salary x months taken for liquidation Auditor fees as directed by the Minimum Audit fee notice by ICAN
7.	Post-internal liquidation of company, liquidator gets letter from OCR for Tax Office to obtain No Objection Letter for company cancellation from the latter	1 day	0
8.	Get no objection letter from Tax office which states that taxes so far have been cleared	2 -3 days (if the Tax office finds no fraudulent transactions to investigate)	
9.	Run an advertisement at least once in an A-grade newspaper calling for claims	1 day	1 advert run: Rs.12,000 – 20,000
		35 day waiting period waiting for claims	
10.	Liquidator submits liquidation report and audit report to OCR	1 day	0
11.	Pay fines if applicable	1 day	As explained in Appendix I
12.	OCR strikes name off register and company runs advertisement of closing of company	1 day	1 advert run: Rs.12,000 – 20,000
13.	Get letter from OCR to remove name from Tax office	1 day	0
Total time and cost of a Voluntary Liquidation		64 - 80 days	NRs.45,050 (415.09 USD) to NRs.75,100 (691.97 USD) (not including fines and audit fees) – assuming one month of liquidator's salary

*Author's approximate estimates based on legal provisions and information from interview with experts

¹⁴ Section 136 (1) of Companies Act, 2006

3.3 Insolvency

Insolvency in Nepal is governed by the Insolvency Act 2006. As outlined in Figure 3, a number of actors can file for company insolvency, including the company itself, shareholders/ creditors/ debenture-holders that hold certain percentage stake in the company (as described in 2.2) or a liquidator who has been appointed to liquidate the company.

The process begins when case is filed at the Appellate Court by any of the stipulated actors mentioned in 2.2. The court will review the evidences and host a hearing within seven days unless it uses its right to dismissal – meaning that the court accepts the case for review.¹⁵

Within the seven days' time period, the company in question is allowed to offer evidence-based counter arguments as to why it should not be declared insolvent and forced to liquidate its assets, except when the applicant is the company itself. When the court decides it has found no reason to stall the liquidation procedure, it will appoint an inquiry officer to evaluate the company's financial state of affairs. This investigation often lasts for a period of 90 days after which the inquiry officer will generate a report explaining whether the company could be restructured or needs to be liquidated. Post report-generation, the inquiry official shall convene a meeting with creditors in order to understand their view on the future of the company. However in practice, the Appellate Court then, based on the inquiry officer's report, holds a meeting with the applicant on finalizing the best course of action.

The court hires either a liquidator or a restructuring manager based on the review and discussion. The liquidator or the restructuring manager will scrutinize the previous review and report a plan on the way forward. It is also possible that the appointed liquidator/ restructuring manager finds that the company should not undergo the initial decision; the liquidator could find that the company could be restructured or the restructuring manager finds that the company needs to undergo liquidation.

If a liquidator is hired and he/she plans to execute liquidation, he/she will exercise such powers as listed in the Insolvency Act, 2006, Clause 40:

Functions, duties and powers of liquidator:

- (1) The functions, duties and powers of the liquidator in addition to the other provisions set forth in this Act shall be as follows:
 - (a) To institute or defend any case or legal action on behalf of the company;
 - (b) To appoint employees to assist in the discharge of his or her functions;
 - (c) Where any installment on any share of the company is due, to make a call on the shareholder for payment of such installment;
 - (d) To do and execute, or cause to be done and executed, all such acts and deeds or documents as required to be done and executed on behalf of the company and in the name of the company and use the seal of the company for that purpose;
 - (e) To borrow loans against security of the assets of the company;

¹⁵ A court can usually exercise two kinds of dismissal – with prejudice and without prejudice. The first refers to the case being permanently dismissed and the person cannot re-file the case whereas the second means temporary dismissal and the case can be re-filed by the applicant.

- (f) Where the liquidator considers that the sale and disposal of any property or termination of any contract or liability will render benefits to the company, to sell and dispose of such property or terminate such contract or liability;
 - (g) To enter into compromise with any creditor of the company or any person who claims to be a creditor of the company in relation to the claim made by such creditor or person;
 - (h) To enter into compromise with any person against whom the company may make a claim in relation to any loan, liability or any other claim;
 - (i) To sell the assets of the company and distribute the proceeds of such sale pursuant to this Act; and
 - (j) To perform, or cause to be performed, all such other acts as may be necessary to liquidate the company.
- (2) It shall be the duty of the liquidator to perform the following functions, in addition to those set forth in Sub-section (1):
- (a) To collect, protect and sell the assets of the company;
 - (b) To examine the business and financial situation of the company;
 - (c) To accept debt claim of any creditor subject to Chapter-6;
 - (d) To distribute the proceeds of sale of the assets of the company subject to the order of priority determined for the payment of liability pursuant to this Act;
 - (e) To call and conduct the meeting of creditors;
 - (f) To prepare a report on his or her acts and actions and present it to the Court and the Office;
 - (g) To facilitate the cancellation of registration of the company; and
 - (h) To examine or inquire into whether any director or employee or shareholder of the company or any person has committed any fraud, cheating or deception against the company or its creditors and institute necessary legal action against such person.
- (3) In addition to the functions, duties and powers set forth in Sub-section (1) or (2), the liquidator may also perform other functions such as to get back any property of the company if such property is used by any person or to institute legal action to get back such property or amount involved in a void transaction. Provided that the liquidator shall not be entitled to make such expenses as may not be payable from the assets of the company.
- (4) Even though the company does not have adequate amount to pay necessary expenses or remuneration to the liquidator for the exercise of the powers or performance of the duties set forth in Sub-section (1), (2) or (3), the liquidator shall exercise such powers and perform such duties.
- (5) Where the liquidator faces any difficulty with the exercise of any power or the performance of any duty pursuant to this Chapter, the liquidator may make an application to the Court for the removal of such difficulty; and where an application is so made, the Court may, if it holds the application to be reasonable, remove difficulty.
- In case the court decides on restructuring the company based on the inquiry officer's review and discussion with

applicant/s, a restructuring manager is appointed by the Court. The restructuring manager calls for a meeting with creditors calling for all claims (with evidence), and thereafter will prepare a report assessing the financial nature of the company and create a restructuring program for the same.

The restructuring manger takes over company operation in the following manner as outlined in the Insolvency Act 2006:

Restructuring manager is to operate company:

- (1) The restructuring manager shall operate the company during the currency of the restructuring period.
- (2) In operating the company pursuant to Sub-section (1), the manager may exercise the following powers:
 - (a) Management and control of the business, properties and transactions of the company;
 - (b) Termination, sale and disposal of any business or property of the company;
 - (c) Doing or exercising any such act or power that the company or its officer may do or exercise.
- (3) In exercising the powers referred to in Sub-section (2), the restructuring manager shall have power to inspect all books of account, ledgers, records, accounts and documents of the company.
- (4) In doing or exercising any act or power set forth in this Section, the restructuring manager shall act in capacity of an agent of the company.
- (5) If so sought by the restructuring manager, the director and other officer of the company shall provide any kind of such assistance as may be necessary for the management and control of the company.
- (6) No director and officer of the company shall, except with written direction of the restructuring manager, exercise any power or do any act of the company in capacity of the director or officer of the company.
- (7) The director of the company shall provide such information about the company and its business, property and transaction to the restructuring manager as sought by the restructuring manager.

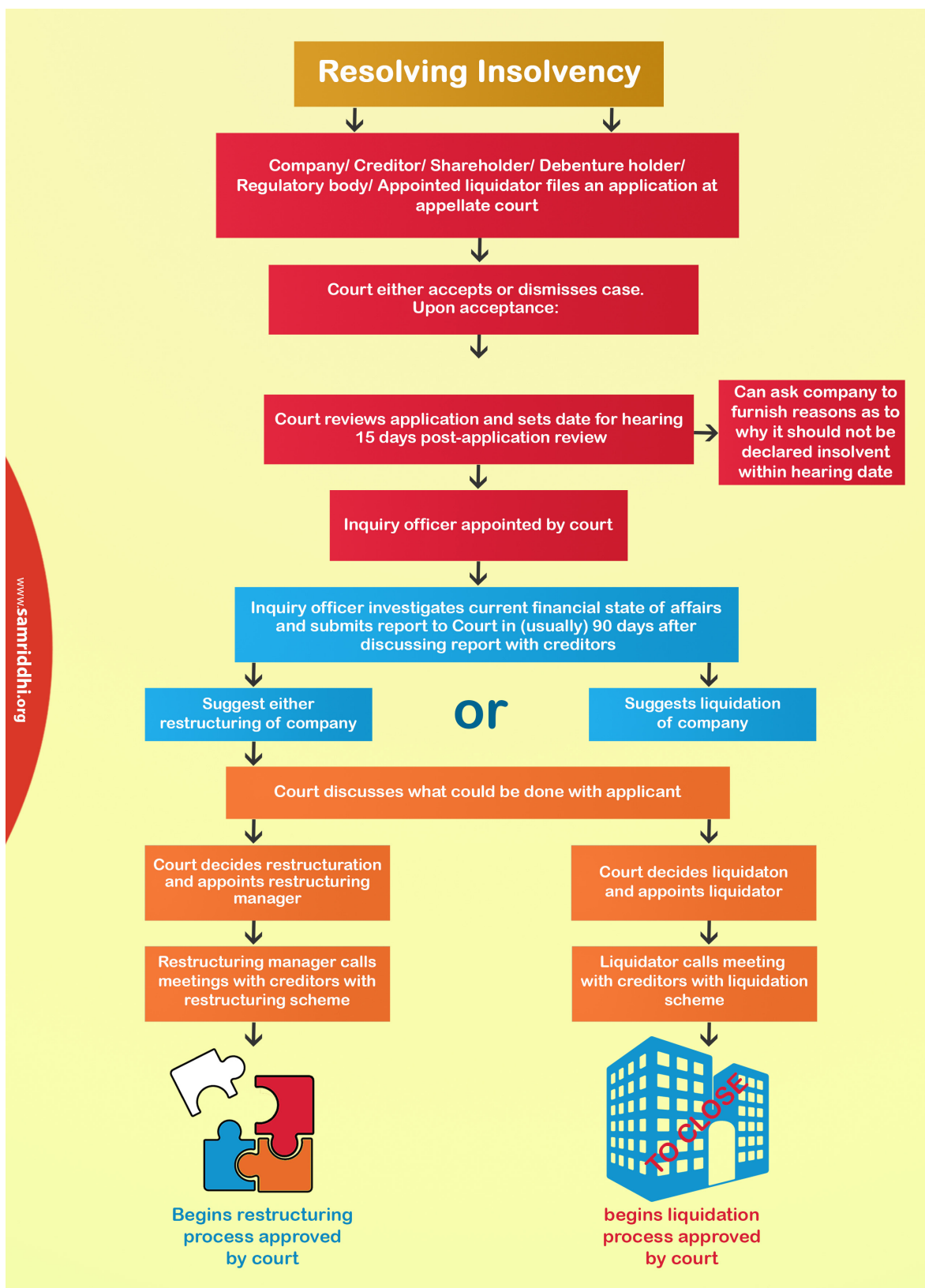


Figure 3. Insolvency proceedings in Nepal

*Author's compilation based on legal provisions and information from interviews with experts

It is difficult to map a generalizable cost and time taken to declare insolvency in Nepal, because so far only one successful liquidation (under the Insolvency Act) has occurred in the country – taking an estimated 5.5 years. The reason for its having taken 5.5 years is that Nepal Development Bank was a sizeable financial institution and the settlement of deposit holders and borrowers naturally took a rather long time.

Insolvency is difficult to compute in terms of cost and time because companies forced to undergo insolvency are usually large in terms of capital and number of people employed. Additionally, the lack of more liquidation cases makes it difficult to generalize the costs from one case alone. Though insolvency cases are much less frequently administered, considering they are absolute last resort tools, the need not lengthen the procedure incessantly. When a company struggles with lengthy insolvency, it directly affects the staff's ability to move flexibly into newer working areas.

The following case study gives a small insight into the liquidation process of the Nepal Development Bank.

Case study: Liquidation of Nepal Development Bank

Nepal Development Bank (a class B private financial institution)¹⁶, the first development bank of Nepal, had been struggling a fair number of years due to bad management practices (Chalise, 2009). By the time it was forced into liquidation by its regulatory body (Nepal Rastra Bank), its bank deposits and cash deposits totaled only up to Rs.196.20 million with a cumulative loss of Rs.690.2 million (Sapkota, 2009). Non-Performing Loans (NPL)¹⁷ accounted for over 50 percent of its loan portfolio and the negative Capital Adequacy Ratio was 48.31 percent as opposed to the usual 11 percent as allowed by the NRB (Sapkota, 2009).

Despite advice from lobby groups such as the Association of Nepali Development Banks – of which the bank in question was not a member - and the Association of Finance Companies, the bank had actively pursued to defend its incompetency and asked the NRB to reconsider its pushed liquidation (ResCon, 2009). Attempts to revive the bank through massive capital injections (through Sunanda Shrestha and the group's Rs.86.2 million and Dreams Capital Ltd.'s Rs.280 million) failed due to a reluctance of the-then management to step down (The Himalayan Times, 2009). NRB had already re-confirmed NDB as an ailing company in October 11, 2007 (The Himalayan Times, 2009).

According to Mr. Narayan Bajaj, leading liquidator of the case, the liquidation process took approximately 5.5 years. At the Nepal Economic Forum's 2012 conference on insolvency, Mr. Bajaj stated that NDB's fate was a result of bad management. He was quoted saying that the bank's insolvency rose from an asset-liability mismatch, which eventually led to interest liability of the organization exceed its interest income (Nepal Economic Forum, 2012). Additionally, he elaborated that one of the reasons for asset-liability mismatch could be 'related-party lending' where the borrower is connected to the management, and fraudulent transactions become probable 'especially with an organizational structure wherein one does not know where a role starts and where it ends' (Nepal Economic Forum, 2012). Mr. Bajaj has been practicing law for nearly 35 years now and is also the past-president of the Institute of Chartered Accountants of Nepal (ICAN).

¹⁶ As defined by the Bank and Financial Institutions Act, 2006, Class A banks mean commercial banks, Class B mean development banks, Class C mean finance companies and Class D mean micro-credit development banks.

¹⁷ A Non-Performing Loan (NPL) is the sum of money (borrowed) by the debtor, upon which he/she has not made scheduled payments to the loan-giving entity for at least 90 days (or as determined by contracts, if any).

During a one-on-one consultation with the researcher, Mr. Bajaj mentioned that liquidation was a lengthy process in Nepal particularly right now because the act is so new and there is an abject lack of experience. He remains among the few people in the country who trained commercial judges on how to handle insolvency cases post drawing up of the Insolvency Act. Mr. Bajaj opines that there should be provisions of removing the management of a company in a liquidation due to insolvency case or potential replacement by interested buyers.

Mr. Bajaj asserted that issues of cross-border insolvency have also not been addressed in the Act. *“If a parent Company, say Coca-Cola, shuts down in the USA, what happens to the bottlers who are their direct subsidiaries here? The Act remains silent on that,”* says Mr. Bajaj.

He also recalled instances in which government offices involved in insolvency, particularly the OCR and the Tax office would pester him after the completion of liquidation process to collect outstanding fines to these offices from the liquidated company. In reality, companies do not have the resources remaining to pay for these fines once the company is liquidated. This was largely due to a failure of the related government offices to respond to the company advertisement on its call for claims during its liquidation process in the first place.

Mr. Bajaj was also skeptical about the language of the Act, forcing the liquidator to refer to the court every time he/she had a confusion. *‘Liquidation is an administrative process, but the Acts makes it a judicial one’.*

4. ANALYSIS OF THE EXIT PROVISIONS IN NEPAL

Nepal's revised versions of the Companies Act and the Insolvency Act are still fairly young since it was formulated only a decade ago. However, there are a number of areas that the Act could be revised on in order to ensure easier exit provisions and concurrent practices.

4.1 Appointment of inquiry officer redundant

Liquidation under insolvency is the last resort for any company. Naturally then, regulatory bodies or creditors of the company will not have filed for application without substantial homework. In particular, when the insolvency filer is a regulatory body, well aware of government proceedings and following due process, the inquiry official appointment, whose work can again be reviewed by the liquidator makes for redundancy.

As per the prevailing Companies Act, the inquiry official is given 90 days to produce a report to be submitted to the court, which shall be merely redundant considering that prior homework on the company in question can directly be made available to the liquidator. The liquidator is supposed to review the decision and then again present a report to the court based on his/her review. If the liquidator finds the applicant's case and the subsequent review reaching incorrect conclusions, he/she still has the power to turn in the report over to the court and ask for it to appoint a restructuring manager. While appointment for an inquiry official is warranted in cases of body/bodies not too familiar with the due process, the decision to review a regulatory body's decision twice (first, by the inquiry official and second, by the appointed manager/liquidator) could be relaxed – for it may only work to lengthen the procedure.

4.2 Ambiguous legal language regarding conflict of interest and impartiality of liquidators

A loophole in the existing Companies Act lies in its ambiguity of language. In the 'Voluntary Liquidation of the Company' chapter of the Companies Act, Section 127 on 'Appointment of Liquidator and Auditor' provisions that after a liquidator is appointed by the company, *the directors and officers of the company shall be relieved of their office and the liquidator shall exercise all such powers with respect to the operation and management of (the) company as may be exercised by the directors and officers of the company.*

The law fails to address potential conflict of interest between former executives and appointed liquidators. While it is stated that the directors shall be removed from their positions, **no terms clearly state that the board as such will have absolutely no power to interfere in the proceedings of the liquidator.** Without a clear statement as such, the board may feel they still have the power to advise the liquidator on liquidation proceedings. A liquidator's failure to observe complete impartiality in the exercise of his/her duties may give rise to a perception of a prima facie conflict of interest that warrants removal of that liquidator. It is important for appointed liquidators to remain independent in the winding up of a company. Same ambiguity applies in laws addressing a liquidation under insolvency.

4.3 Lack of a specialized functional unit and inefficiency of the commercial bench

Even after 8 years of having passed the Insolvency Act, an Insolvency Administration Office as mentioned in Section 65 of the Act, is yet to be incorporated. The Act calls for the establishment of an Insolvency Administration Office which is to perform the following functions –

- (a) To administer insolvency practice;
- (b) To register insolvency practitioners, issue licenses to them, and renew such licenses;
- (c) To carry out general supervision of the management of companies which have become insolvent;
- (d) To conduct investigations of the code of office required to be observed by insolvency practitioners;
- (e) To maintain records of each company which has become insolvent; and
- (f) To perform such other functions as prescribed.

While it does state that in absence of an Insolvency Administration Office, the Government of Nepal may designate any existing office the tasks of the Insolvency Office, currently the OCR and the commercial bench of the Appellate Court are true administrators of the insolvency practice in Nepal.

Commercial benches were added to four Appellate Courts in Biratnagar, Patan, Butwal and Nepalgunj in January 2009 and later added to Hetauda in April 2010 (Sharma, n.d.). The bench was established under financial sector reform with assistance from the Asian Development Bank (Sharma, n.d.).

The plan was to form a full-fledged commercial court but due to lack of resources (human and financial), a commercial bench was established instead (G. Pandit, personal communication, September 28, 2016). But as can be seen from Table 4, the number of pending cases, particularly at the Patan Court is very high.

One of the biggest problems with the bench, as cited by experts, is the lack of trained human resources to deal with commercial law. Despite a National Judicial Academy having been established in 2004 in order to train lawyers in a variety of fields, including that of commercial law, these trainings are far from rigorous and are carried only as small lecture sessions and hardly entail follow-up (G. Pandit, personal communication, September 28, 2016). Experts state that cases in the commercial court are primarily resolved on basis of procedural problems rather than legal problems – such that there is more discussion on the process of how the case got into court (the filing and the time taken for such things) rather than understanding the heart of the dispute.

Table 4. Fiscal year 2069/70 cases regarding commercial bench

Appellate Courts	Cases recorded	Solved cases	Pending cases
1. Patan	352	166	184
2. Hetauda	17	08	09
3. Butwal	04	02	02
4. Nepalgunj	03	01	02
5. Biratnagar	07	07	00

Source: Sub. Registrar's office Supreme Court in Sharma (n.d.).

4.4 Delayed government action adding cost to entrepreneurs

A major challenge for entrepreneurs and liquidators is the government's delay in making claims of outstanding fines to the company mostly after the company has been liquidated. As shown in the previous process maps for all exit strategies, the liquidator will have already reached a settlement in claims and loans payable to creditors in course of company cancellation/liquidation. When cancelling registration of a company, the OCR may often demand fines from the company for issues such as not having conducted yearly audits. But by then, the company will have settled all bills and will have no additional fund to pay for claims as asked for by the OCR. The government, who also becomes a creditor in this manner, does not (in practice) file for claims (of fines) when the company runs its advertisement calling for claims in a nationally circulated newspaper. Entrepreneurs seeking to close their businesses may often end up paying more than expected or in cases of large fines and claims, owing largely to delayed government proceedings.

4.5 OCR's lack of response to non-active companies

Though there is a provision for the OCR to cancel registration of companies that are inactive for 3 or more years, this is not the case in practice (K.P. Pandey, personal communication, January 26, 2016). It is estimated that of around 155,000 companies that are registered at the OCR - only 45,000 file monthly and/or yearly audit reports at the OCR (K.P. Pandey, personal communication, January 26, 2016). This means that roughly 110,000 are shell companies (companies without active business operations) and have been so for years.

The OCR, in writing, retains the right to cancel these companies. However, it has refrained from doing so because the office feels that without having a deeper understanding of the circumstances of the company in question, it cannot simply strike off the company's name off its register. The company may have taken loans and be liable to a number of shareholders. To date, the inactive companies will now have understandably found harder to close because their lack of activity throughout the years will have accumulated as fines in thousands of rupees every year. The tendency to try and operate at a minimal level rather than exit a market because the latter is more expensive gives rise to 'zombie firms' (Regulatory Policy Institute, 2013). Though not very problematic at first sight, these zombie firms 'often retain a higher level of supply in the market, and therefore make entry and expansion more difficult for other firms who may be more efficient than those hanging on' (Regulatory Policy Institute, 2013). The cost of exit for such companies then rises significantly, which is why they find it easier to not act at all. This has become a major concern for the OCR and has accounted for thousands of unresolved dusty records.

The name of the company itself is also a resource. The law stipulates that no two companies can have the same name, and considerable time may be spent by entrepreneurs and their legal aides in looking up an unused name. If shell companies that have not engaged in any business are closed down, it will free up used names and reduce burden for newer entrepreneurs to find newer and more unusual names for their businesses.

Problems like these could be resolved by introducing information technology into reporting activities carried out by the regulators. A system maintained by relevant government offices whereby the banks and financial institutions can update financial records and provide related government agencies timely information about their performance and financial status would be a much better alternative to the existing manual hassle of record keeping.

4.6 Blanket policies adding cost to small scale entrepreneurs

There is a **need to replace a compulsory appointment of liquidator with voluntary liquidation for micro-enterprises**. Though the definition of micro-enterprises vary from country to country with employee count ranging from five to ten in most Asian countries (Ghimire, 2011), these companies are usually characterized by limited capital, proprietorship and/or a small number of shareholders. If the company is to close, the micro-enterprise can easily distribute assets and capital in accordance with the auditor's reports without the help of a liquidator, who in such cases would only be increasing the cost of company exit for these small companies.

4.7 Blacklisting regulations that kill entrepreneurs

The oversight authority for blacklisting companies is the Credit Information Bureau Nepal which was formally registered as a company in 2004 and operates under the NRB Act 2058 – Article 88. The formal conditions for blacklisting are laid out by the NRB issued Unified Directives 2010 (Directive-12) to licensed banks and financial institutions.

The rules lay out standard procedures to blacklist any persons/parties who have 'obtained a loan/facility of Rs.2.5 million or above from a licensed institution' and they engage in one of the following:

- a. If the payment of the principal or any installment thereof or the interest is overdue by 12 months (where the customer is enjoying facilities of various credits/facilities, then overdue in payment of any of the loans).
- b. If misuse of the loan/facility is proved, For this purpose, the loan or facility shall be deemed to be misused if the loan is not utilized for the intended purpose in case the loan is granted specifying the purpose, the project is not in operation, proved as misused by the supervisor, auditor in course of inspection and supervision.
- c. If misuse of the goods placed in collateral security is proved;
- d. If the borrower disappears;
- e. If the borrower is declared to be bankrupt according to existing law
- f. If the licensed institution has filed a lawsuit against the borrower in a court of law.
(NRB Unified Directive, 2010)

The directive also looks at parties other than the real defaulter who are to be included in the blacklist. This includes, apart from those involved directly in the management of the company:

- a. Shareholders holding 15 percent or more share ownership (either of public or private firms)
- b. Where the blacklisted individual or organization owns individually or institutionally 15 percent or more shares in any other firm/company/corporate body, the Director and Chief Executive of such firm, company, corporate body.

This means that regardless of whether these shareholders engage in active management of the company, if they hold 15 percent or more ownership in the firm – they are blacklisted. Additionally, if the loan defaulter is a shareholder of 15 percent or more in another firm (that may or may not have any active links to the company being blacklisted) the Director and Chief Executive Officer (CEO) of such firm are also put on the same blacklist. This is effectively punishing investment and demotivating further ownership. If there has been no proven involvement of the shareholder in the management of the company leading to loan defaulting, blacklisting him/her is simply discouraging him to ever invest more than 15 percent in other ventures. Similarly, the fairness of blacklisting persons in authority of another firm that may have had to do little with the defaulter (who is only a shareholder) is questionable.

When the policy first came into being, it received criticisms about the way it seemed to punish entrepreneurship and reward ineptitude of the banking sector (Upreti, 2003). Over time, certain reforms were made - such as barring family members related to the defaulter from receiving loans (Upreti, 2003). While it is a given that defaulters involved in fraud and embezzlement should be punished accordingly, the manner in which provisions are laid down seem to demotivate ownership of business.

Additionally, there are other more common concerns when closing a company including that of labor issues. Because this paper deals primarily with the administrative closing and shutting down of a company, labor issues have to be understood as largely solved when having reached this stage¹⁸. There are also provisions for people with claims to come forward during the process of registration cancellation and liquidation whereby workers too can file for claims with evidence.

¹⁸ Samriddhi Foundation has a separate paper devoted to understanding the cost of firing in Nepal – it deals with outlining and understanding internal disputes between workers and proprietors that influence relationships between the two and ultimately increase the cost of doing business. For more information, see *The Cost of Firing in Nepal* (Samriddhi Foundation, 2015)

5. RECOMMENDATIONS

5.1 Reducing time required for insolvency proceedings

The appointment of an inquiry official from government is redundant and could be done away with. Doing so would largely reduce the time required for a liquidation process and thus lower cost of doing business. As noted previously, the applicant will have already done strenuous homework that is reviewed again by the court appointed liquidator or restructuring manager. This review is done in order to determine whether the company should really be liquidated or restructured. The time period of 90 days that the inquiry officer takes in order to investigate the state of affairs only aids to lengthen the process of insolvency.

5.2 Removal of ambiguities from the governing Act

The law needs to clarify on the independence and impartiality of liquidator from former executives and board members of the company in question. Simply stating “that once a liquidator is appointed, the director/s and officers are relieved of their office and all powers are transferred to the liquidator” is far from enough. In reality, the board may still feel that it can advise the liquidator on the way to proceed. Thus, **it needs to be stated clearly that the board is dissolved completely and holds no power to influence liquidation proceedings post appointment of the liquidator. In addition to that,** a liquidator’s failure to observe complete impartiality in the exercise of its duties may give rise to a perception of a prima facie conflict of interest that warrants removal of that liquidator. Removal of ambiguities as such should apply to both voluntary liquidation and liquidation due to insolvency proceedings.

5.3 Establishing an Insolvency Administration Office and work on strengthening the commercial bench

While the Insolvency Act calls for the establishment of the Insolvency Administration Office, the body is yet to be incorporated. The establishment of an Insolvency Administration Office would mean that all insolvency cases get directed to one particular branch of the government. Currently liquidation due to insolvency processes are spread out over a spectrum for the Appellate Court and the OCR. **An Insolvency Administration Office would streamline the process and become a one-point solution to all those filing for it.** Establishing this office would thus reduce time and cost of having to move around other government offices to attain the same services.

In the meantime, it would make exit easier for companies if the **government, as one of the creditors of the company in question (with regard to its fines owed to the government), make claims to the company as timely as other commercial creditors do.** As explained earlier, the government not making claims during the time period of roughly 35 days post-advertisement waiting period usually causes almost all of assets and capital of the company to have been paid away, leaving little room for fine payment.

While resources may be currently inadequate to establish a commercial court, the existing commercial bench can still be strengthened. In order to make judges and lawyers competent in commercial law practices, there is a need to focus on specialized rigorous training rather than plain hour-long lectures delivered one in a while. Trainings that encourage examination of new cases at home and abroad, and innovations in commercial dealings all over the world need to be designed. They also require active follow-up so that newer material is introduced and older concepts are refreshed. Only focusing on one-time lecture learnings will be far from effective in creating strong human resource.

The Moldova Case

In 2014/15, Moldova created governing and supervisory bodies for the profession of insolvency administrators, introduced a licensing system and stricter admission rules and created a centralized registry of authorized insolvency administrators. (World Bank, 2016)¹⁹

5.4 Allowing the OCR to take up authority to reduce exit costs

A number of advocates of easier company exit in Nepal had discussed with the Department of Industry, notably in 2014, about allowing the OCR to exercise the right to cancel registration for inactive companies and to waive their outstanding fines. While the government had been fairly responsive to the idea, it is concerned about pardoning the fines for inactive companies because of a lack of any legal instrument defining clauses for the same (K.P. Pandey, personal communication, January 26, 2016). **The government thus could call for cancellations of ailing companies openly, between a certain specified time-period, where outstanding fines over/under a certain amount are waived partially or reduced.**

This would largely reduce the number of companies that the OCR has to currently monitor and also cause exit expenses of small companies to go down substantially. Post this step, the OCR could better monitor existing companies and reach out to understand company situation individually if they become inactive for 3 years or more. There needs to be an introduction of information technology into this monitoring mechanism whereby companies can easily update their audit and other necessary information, making it much easier for the OCR to view and dig out shell companies.

5.6 Making it non-compulsory to hire liquidators for micro-enterprises

An Act of any government that is committed to fostering entrepreneurship to promote economic growth would have to lay down clear and simple provisions for 'easy' entry and exit. In these terms, compulsory provisions of having to hire a liquidator in voluntary liquidation proceedings for micro-enterprises adds to their burden of exit. **The number of stakeholder and the size of its capital make it easy for small size companies to settle debt issues amongst themselves with the help of an auditor alone.** Many of these companies may not be able to afford the cost of hiring a liquidator. Thus, legal provisions that allow small enterprises of certain size to exit at reasonable timeframe and affordable cost is not only necessary, but essential to economic prosperity.

5.7 Blacklisting policy changes to encourage, not discourage entrepreneurship

The Unified Directive that governs blacklisting policies need to be changed in order to motivate business and proper business ethics rather than discourage the same. Blacklisting shareholders who own certain percent of the business but are not actively engaged in management of the company is certainly a provision that needs to be revised. This only aids to deter ownership. Additionally, blacklisting persons of authority of firms where the defaulter has shares also needs to be removed, unless proven (by due process) that the persons in question were also involved in wrongful defaulting.

¹⁹ See detailed listings of international insolvency practices in the years 2014/15 in Chapter 7

6. CONCLUSION

Company exit is considered an important indicator of economic freedom because it allows for freeing resources that could be put to better use in another venture. Its ease gives aspiring entrepreneurs a safety net to fall back on – if an idea fails then they can always close down and move to something more promising. Established business persons often talk of frequent failures before having been successful. An environment that allows for people to worry less about the consequences for failing and execute good business practices will be most conducive to economic growth.

Easy entry to markets has received well deserved scrutiny leading to reforms in a number of countries. While easing entry is necessary, so is easing exit. It would be only a job half done if entry procedures are well provisioned while exit processes remain difficult. People will want to enter businesses and take risks if they believe that it will either work out or if not, they can always try a new venture. Governments have a responsibility to ensure that its citizens are able to employ their entrepreneurial skills to the best of their abilities. Allowing policy reforms that cushion and not punish failure will encourage enterprise and business growth.

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ANNEX I: BRIEF REFLECTIONS ON INTERNATIONAL EXIT POLICY REFORMS

In February 2016, the Finance Minister of India, Arun Jaitley, presented in the Indian Parliament a concept called the ‘Chakravyuha Challenge’ – a terminology borrowed from the epic of Mahabharata – citing India’s improvement in business entry but not exit. He elaborated how in the course of six decades, India had moved from “socialism with limited entry to “marketism” without exit” (Government of India, 2016).

The presentation touched upon three main problems that barriers to exit brought about (touching both private and public corporations):

1. Fiscal Costs – whereby the state had to pour in more money, usually in form of subsidies, to support the companies
2. Economic Costs – where resources that could have been useful elsewhere remain unused
3. Political Costs – where when the state tries to save a failing public corporation could be seen as favoring particular political associations over others

The Economic Survey 2015/16 of India – based on which the ‘Chakravyuha Challenge’ was highlighted made certain recommendations on how these problems (for both the public and private sector) could be mitigated:

The first is promoting competition via private sector entry rather than change of ownership from public to private. Secondly, direct policy action through better laws like the Insolvency and Bankruptcy Code 2015 will expedite exit. Also institutions need to be made stronger but flexible by empowering bureaucrats and reducing their vulnerability. Thirdly, increase the use of technology to remove persistent distortions by bringing down human discretion and layers of intermediaries. The fourth is increasing transparency and highlighting social costs and benefits of various schemes and entitlements. Finally, showcasing exit as an opportunity towards a newer and better tomorrow. (Government of India, 2016).

Many countries have pioneered in reforms with their exit policies between 2014 and 2015. These practices were highlighted by World Bank’s 2016 Doing Business Report and shed light on what certain countries did to improve their scores particularly on the insolvency indicator. This indicator identifies weakness in existing insolvency law and the main procedural and administrative bottlenecks in the insolvency process²⁰. The following table thus, in essence, aims to highlight major changes with exit policies in countries around the world until June 2015:

²⁰ Doing Business Report (World Bank, 2016)

Countries that reduced regulatory barriers and cost for companies to exit and improved their legal institutions in 2014/15

Feature	Economies	Some highlights
Improved provisions on treatment of contracts during insolvency	Chile, Jamaica, Romania, Rwanda, St. Vincent and the Grenadines, Vietnam	Chile made continuation of the debtor's business during insolvency proceedings easier by prohibiting termination of contracts on the grounds of insolvency.
Improved the likelihood of successful reorganization	Chile, Cyprus, Jamaica, Kazakhstan, Romania, St. Vincent and the Grenadines	Kazakhstan introduced provisions allowing debtors to apply for post-commencement finance with corresponding priority rules and allowing creditors to initiate reorganization proceedings
Regulated the profession of insolvency administrators	Jamaica, Moldova, St. Vincent and the Grenadines, Vietnam	Moldova created governing and supervisory bodies for the profession of insolvency administrators, introduced a licensing system and stricter admission rules and created a centralized registry of authorized insolvency administrators.
Introduced a new restructuring procedure	Cyprus, Jamaica, St. Vincent and the Grenadines	Cyprus established a reorganization procedure for insolvent but viable companies.
Streamlined and shortened time frames for insolvency proceedings	Chile, Romania, Vietnam	Romania introduced shorter time frames for several stages of reorganization proceedings as well as a three-year time limit for implementing the reorganization plan.
Strengthened creditors' rights	Cyprus, Jamaica, St. Vincent and the Grenadines	Jamaica granted individual creditors the right to request information from the insolvency representative on the debtor's business and financial affairs.

Source: Doing Business Report, 2016

In addition to these, the same report also underscores important practices that can help an insolvent company restructure itself in the following manner:

- New funding provided to an insolvent company after the start of insolvency proceedings—known as post-commencement finance²¹—can enable the business to continue operating during insolvency.
- The authorization of post-commencement finance and the treatment of the claims of post-commencement creditors are two important areas that need to be addressed in insolvency law. But half the 189 economies covered

²¹ Post commencement finance is usually loaned by private commercial banks for companies that want to operate in times of restructuring/rescue.

by Doing Business have no provisions in these areas.

- Clear and effective regulations on post-commencement finance may improve the availability and terms of new funding for viable firms undergoing insolvency proceedings—funding that can support their successful reorganization or enable their sale as a going concern in liquidation.
- Financially distressed businesses are more likely to pursue reorganization— and more likely to emerge from insolvency proceedings as a going concern—in economies that have provisions on post-commencement finance.
- Many economies are introducing provisions on post-commencement finance as part of an overall effort to strengthen mechanisms for business rescue.

APPENDIX I

Section 81, Companies Act, 2006

81. Fine to be imposed in case of failure to submit returns:

- (1) Any return, notice or information required to be provided by the company to this Office or information required to be provided by the officer or shareholder to the company pursuant to this Act shall be provided by the director of the company or the officer or shareholder who has the duty to provide such return, notice or information to the Officer or the company, as the case may be, within the time limit, if any, prescribed by this Act for the provision of such return, notice or information.
- (2) The following director of a company or its officer who is in default in providing the return, notice, information or reply as referred to in Section 51, 78, 80, 120, 131 or 156 within the time limit as referred to in Sub-section (1) shall be punished by the Registrar with fine, as follows:
 - (a) a fine of one thousand rupees if the paid up capital of the company is up to two million five hundred thousand rupees, a fine of two thousand rupees if the paid up capital of the capital is up to often million rupees, and a fine of five thousand rupees if the paid up capital of the company is more than ten million rupees, for a period not exceeding three months after the expiry of the time limit;
 - (b) a fine of one thousand five hundred rupees if the paid up capital of the company is up to two million five hundred rupees, a fine of three thousand rupees if the paid up capital of the capital is up to ten million rupees, and a fine of seen thousand rupees if the paid up capital of the company is more than ten million rupees, for and additional period not Amended by the Act Amending Some Nepal Acts, 2064 exceeding three months after the expiry of the time limit as referred to in Clause (a);
 - (c) A fine of two thousand five hundred rupees if the paid up capital of the company is up to two million five hundred thousand rupees, a fine of five thousand rupees if the paid up capital of the capital is up to ten million rupees, and a fine of ten thousand rupees if the paid up capital of the company is more than ten million rupees, for an additional period not exceeding six months after the expiry of the time limit as referred to in Clause (b);
 - (d) A fine of five thousand rupees, for each year, if the paid up capital of the company is up to two million five hundred thousand rupees, a fine of ten thousand rupees , for each year, if the paid up capital of the capital is up to ten million rupees, and a fine of twenty thousand rupees, for each year, if the paid up capital of the company is more than ten million rupees, in cases where even the time limit as referred to in Clause (c) has also expired.
- (3) In the case of a company not distributing profits which is in default in providing such statement, in formation or notice within the time limit as referred to in Sub-section (1), the director or officer of such company shall be liable to the same fine as is imposable on a company of which paid up capital is up to ten million rupees.
- (4) Any director, office or shareholder who is liable to pay the fine as referred to in Sub-section (2) shall pay it to the Office and submit to the Office or the concerned company such returns as required to be forwarded.
- (5) In calculating the period of expiration of the time limit pursuant to Sub-section (2), it shall be calculated from the date of commencement of this Act.
- (6) Any director, officer or shareholder of a company who is in default in providing such other statement, notice or information as is required to be forwarded to the Office pursuant to this Act shall be punished with a fine of two hundred rupees for every month, after the expiration of one month of the date of expiry of the time limit within which such statement, notice or information is required to be provided.

APPENDIX II

Section 8 (Companies Act, 2006)

8. Application for insolvency proceedings:

- (1) Notwithstanding anything contained in Section 4, no application may be made to the Court for insolvency proceedings in relation to the following company without obtaining prior approval of the following authority:
 - (a) In the case of a bank or financial institution carrying on banking and financial business, the Nepal Rastra Bank, or
 - (b) In the case of an insurance company carrying on insurance business, the Insurance Board formed pursuant to the Insurance Act, 2049(---), or (c) In the case of a company which cannot undergo voluntary liquidation without approval of the competent body or authority, except that mentioned in Clause (a) or (b), such authority.
- (2) Every application to be made for insolvency proceedings in relation to a company mentioned in Sub-section (1) shall be accompanied by a copy of the approval given by the authority set forth in that Sub-section for that purpose.

VAT RULES, 2053:

Chapter - 5

Records of Transaction

- (1) For purposes of the Act and these Rules, a registered person has to maintain the records of the following notice, documents and details:
 - (a) Notices as referred to in Schedule - 7.
 - (b) Records relating to business, account, cash receipt and payment.
 - (c) Tax invoices and short tax invoices issued by him.
 - (d) Tax invoices and short tax invoices received by him.
 - (e) All documents related with import and export made by him/her.
 - (f) All debit and credit notes which certify the increase and decrease of the price of the goods and service purchased and sold by him and other documents pertaining thereto.
 - (g) Books of purchase and Sales as mentioned in Schedule-8 and Schedule -9.
- (2) Notwithstanding anything contained in Sub-rule (1), the Department may so prescribe as to require a registered person to maintain only any of the records mentioned in the said sub rule for trade or business of any special type.
- (3) A registered person may, with the permission of the Department, maintain the records required to be maintained under these Rules by using computers or another similar mechanical system or the method as prescribed by the Department.
- (4) The Tax Officer may, at any time during business hours, inspect the records maintained by the registered person under these Rules.

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ABOUT SAMRIDDHI FOUNDATION

Samriddhi Foundation is an independent policy institute based in Kathmandu that focuses on economic policy reform. Established in 2007, Samriddhi aims at facilitating a discourse on pragmatic market based solutions for a free and prosperous Nepal.

Known for bringing together entrepreneurs, politicians, business leaders, bureaucrats, experts, journalists and other groups and individuals to make an impact on the policy discourse of Nepal, Samriddhi works with a three-tier approach - Research and Publication, Educational and Training, Advocacy and Public Outreach. Some of its highly successful efforts include the annual economic policy reform initiative named "Nepal Economic Growth Agenda (NEGA)", a sharing platform for entrepreneurs named "Last Thursdays with an entrepreneur" and a regular discussion forum on contemporary political economic agendas named "Econ-ity". Samriddhi also hosts the secretariat of 'Campaign for a Livable Nepal', popularly known as Gari Khana Deu campaign.

One of Samriddhi's award winning programs is a five day residential workshop on economics and entrepreneurship named Arthalya, which has produced over 400 graduates over the past few years, among which more than two dozen run their own enterprises now.

The organization is also committed towards developing a resource center on political economic issues with its Political Economic Resource Center (PERC). Besides this, Samriddhi also undertakes localization of international publications on the core areas of its work. Samriddhi was the recipient of the Dorian & Antony Fisher Venture Grant Award in 2009 and the Templeton Freedom Award in 2011.

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