



Towards Enhancing  
**ENTERPRISING CULTURE**  
in Nepal

Agenda for Post COVID-19 Economic Recover



**SAMRIDDHI**  
FOUNDATION

# **Towards Enhancing Enterprising Culture in Nepal**

## **Agenda for Post Covid-19 Economic Recovery**

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## **List of Abbreviation**

AVE	Average Variance Extracted
B2B	Business to Business
BDS	Business Development Service
BFI	Bank and Financial Institutions
CA	Cronbach's Alpha
CBS	Central Bureau of Statistics
CFA	Confirmatory Factor Analysis
CR	Composite Reliability
DoI	Department of Industries
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer Act
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
HTMT	Heterotrait-Monotrait Ratio
IBN	Investment Board Nepal
ICT	Information and Communication Technology
IEA	Industrial Enterprise Act
ILO	International Labor Organization
IRO	Inland Revenue Office
MSME	Micro Small and Medium Enterprises
NRB	Nepal Rastra Bank
OECD	Organization for Economic Co-operation and Development
OCR	Office of Company Registrar
PLS-SEM	Partial Least Square – Structural Equation Modeling
SSF	Social Security Fund
SME	Small and Medium Enterprises
SRMR	Standardized Root Mean Square Residual
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WTO	World Trade Organization

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## **Executive Summary**

The onset of COVID-19 pandemic and the measures taken by the government in terms of nationwide and regional lockdowns has inflicted a severe challenge upon the Nepalese economy. The Central Bureau of Statistics (CBS) reported that the Nepalese economy experienced negative growth of 2.12 percent in FY 2020. In view of the situation, Nepal needs to take swift actions that will facilitate in cushioning the economic impact of the pandemic.

Various researches (Sataloff et al., 2016; Poschke, 2013; Dana et al., 2008; Gourio et al., 2015; Maritz et al., 2020) around the globe suggest that growth in entrepreneurship was one of the most import factors that contributed to the revival of crisis driven economies in the past. The literatures elucidate the importance of enterprises and innovative start-ups in facilitating economic recovery of a nation.

Given the same, public policy support to individuals who aspires to open an enterprise and contribute to create new jobs seems to be a very desirable means of kick-starting the economy in the aftermath of the pandemic. In order to expedite the rate of enterprises that enter the Nepalese economy, it is important to identify the different factors that motivate individuals to start their own business.

To ascertain the same, this research aimed to identify the factors that has a positive influence on motivation to start an enterprise and suggest policy measures to improve the same in Nepal.

This study used PLS-SEM technique to identify the effect of Regulation, Capacity Enhancement, Financial and Non-Financial Support, and Favorable Innovation Environment on Motivation to Start an enterprise. The data was collected with the help of structured questionnaire survey amongst 61 sample entrepreneurs based in Nepal. With the help of Path Analysis, the study revealed that Regulation, Financial and Non-Financial support, and Favorable Innovation Environment has a positive and significant impact on Motivation to start an enterprise. However, the study identified that capacity enhancement has no significant impact on Motivation to start an enterprise.

This study further suggests that lenient and flexible business regulations of a country are more favorable towards entrepreneurship. Thus, favorable regulatory environment that incorporates ease of entry, ease in tax payment mechanism, favorable investment environment, and flexible labor regulations are recommended for the purpose of attracting more enterprises to be established in Nepal. Likewise, this study has also proposed methods whereby the enterprises can have greater access to finance, market and business development services. Additionally, it also reveals that Nepal needs to catch up with the rest of the world in terms of acceptance to innovation and thus needs to reform policies related to the same and invest heavily in physical and digital infrastructure.

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## Chapter 1:

# Introduction

The onset of COVID-19 pandemic has inflicted a severe challenge upon the Nepalese economy. Economic restrictions attributable to the imposition of four months long nationwide lockdown in 2020 which was followed by localized partial lockdowns and prohibitory orders up until mid-September, 2020 wreaked havoc on all the imperative economic sectors of Nepal (World Bank, 2021). While the Nepalese economy was experiencing gradual recovery from the previous shock, the inception of the second wave of COVID-19 and the subsequent lockdown imposed since April, 2021 to June, 2021 has once again exposed Nepal towards a greater economic crisis.

The Central Bureau of Statistics (CBS) reported that the Nepalese economy experienced negative growth of 2.12 percent in FY 2020. World Bank estimated that given the persistent effort in combating COVID-19 and the successful roll out of vaccines, the gross domestic product (GDP) of Nepal could grow by 2.7 percent in the current FY and could recover to 5.1 percent by 2023. However, with a further deceleration in services and industrial production in the event of a prolonged outbreak and the newly imposed lockdown, the growth figures of Nepal can further plunge. The World Bank in 2020 also assessed that with rapid increment in COVID-19 outbreak, increase in human toll and strict as well as restrictive measures to combat the pandemic, Nepal could be pushed deeper into a recession and climbing back to normalcy could take a considerable amount of time. This holds especially true due to the fact that the enterprises that faced loss previously have not been able to recover completely, and the additional economic shock as well as rising threat of COVID-19 is bound to contract both demand and supply further, making it more difficult for enterprises to survive.

Furthermore, International Labor Organization (ILO) estimated that between 1.6 and 2 million jobs in Nepal is at risk of being disrupted either in the form of complete job loss or reduction in working hours and wages. Additionally, ILO also estimated the job of 5.7 million workers in informal sector to be at risk if the current scenario of lockdown, disruptions in supply chain, adverse impact on economic sectors, drop in consumer confidence, and low economic activities is to continue.

The impact of COVID-19 has all but demolished economic buoyancy through closure of hundreds of SMEs and millions of workers delegated to the unemployment line. In view of the situation, Nepal needs to take swift actions that will facilitate in cushioning the economic impact of the pandemic. In view of the situation, the government of Nepal introduced different relief packages in the form of interest rate subsidies, refinance facility, income tax waiver and capital investment to provide respite to the economic sectors that were adversely affected due to the pandemic. However, given the continuation of COVID-19 outbreak for over a year now and weak fiscal as well as administrative capacity of the government, the sustainability of such packages is questionable. Currently, given the higher debt to GDP ratio and plummeting government revenue, the government should adopt austerity measures to prevent further financial risk to the national economy. Thus, deviating from monetary measures and prioritizing policy reforms conducive to resilient recovery is more plausible in the case of Nepal.

For the same, identifying the policies that contributed to economic recovery at times of crisis will be the key guidance for the policymakers to put forward plans and policies for revival and recovery of the Nepalese economy.

Various researches (Sataloff, et al., 2016; Dana, et al., 2008; Poschke, 2013; Gourio et al., 2016; Maritz et al., 2020; Stoica, et al. 2020) on past economic and financial crises that resulted in upsurge in unemployment

and severe downturn of numerous economies around the globe suggest that growth in entrepreneurship was one of the most important factors that contributed to the revival of these crisis driven economies. Cheng, et al. (2020) in their study of policy responses of governments to revive crisis driven economies identified that successful revival policies included measures that helped build the entrepreneurial ecosystem like investment in education and research, provision of challenge grants, and introduction of favorable policies that attract new and innovative enterprises.

According to Carlos, Marta and Carlos (2016) economic crisis and periods of high unemployment can be a powerful push factor that make people reluctant towards self-employment, and the government must leverage the same for successful revival and recovery of economies from shock. To realize the same, the modern theories of economic growth argued that governments should orient their public policies towards facilitating entrepreneurship. Omoruyi, et al. (2017) in their research identified that rise in entrepreneurial activities, especially innovative ventures, make countries more resilient to economic shocks. Therefore, transitioning countries need to promote innovative businesses to experience a sustained economic growth as it raises productivity, promotes competition, accelerates structural change and replaces old and inefficient mechanisms with more vibrant, innovative and efficient systems. Likewise, Dana et al., (2008) also argued that in periods of economic recession, the creation of startups and young businesses is particularly important because, when successful, it helps in generating new jobs, spreading innovation and providing support to the local economy.

Gourio et al., (2015) revealed through their research that a significant decline in entry rate of enterprises can lead to a slow recovery through a missing generation effect – registration of many enterprises would mean that in future some of the registered enterprises would die young, a few would grow and contribute towards economic recovery and employment scenario. This suggests that the lack of entrepreneurial supply could be an obstacle to the recovery of economies after crisis.

The aforementioned literatures elucidates the importance of enterprises and innovative start-ups in facilitating economic recovery of a nation. Given the same, public policy support to individuals who aspire to open an enterprise and contribute to create new jobs seems to be a very desirable means of kick-starting the economy in the aftermath of the pandemic. In order to expedite the rate of enterprises that enter the Nepalese economy, it is important to identify the different factors that motivate individuals to start their own business as well as the available opportunities that attract individuals towards enterprising in Nepal. The policy makers can then come up with evidence based solutions that supports conducive reforms to which individuals would respond positively to.

To identify the same, this research aims to identify the factors that has a positive influence on motivation to start an enterprise and suggest policy measures to improve the same in Nepal.

## Chapter 2:

# Factors Affecting Motivation to Start New Enterprises in Nepal

Economic crises result in multiple challenges in the economy like business closures and unemployment which impairs growth of both the citizens and the country. To avoid such situation, stimulating economic growth by boosting economic activities is imperative. Numerous literatures around the globe have proved that public policy that stimulate entrepreneurship development is key to address the problems of low economic growth.

To ensure the same, the policy-makers need to comprehend the factors that contribute to higher incentive or motivation amongst individuals to operate their own enterprise. Different organizations as well as individuals in the past through extensive study have derived different frameworks to facilitate policy-makers in making decisions regarding instigation of conducive policy for growth of entrepreneurship. For instance, UNCTAD (2005) mentioned that macro-economic stability, labor market regulation, infrastructure, access to finance, ease of entry and exit, and supportive programs like SME development can facilitate entrepreneurship growth. Likewise, OECD (2016) stated that factors like favorable regulations that reduce the administrative barriers towards starting and operating a business, availability of market, greater access to finance, access to Business Development Services (BDS), education and training, and entrepreneurial events are important to improve opportunities and motivations amongst the general people to create and develop their enterprise. The Global Entrepreneurship Monitor Framework (GEM Framework) mentions that factors like institutions, infrastructure, macroeconomic stability, education, training, goods and labor market efficiency, goods and financial market sophistication, technology, research and development, entry regulations, and policies to promote innovation, among others are key to developing attitude towards entrepreneurship in a nation (GEM, 2016).

Hall and Sobel (2006) mentioned that skilled human resource, availability of venture capitals, infrastructure, and business, tax, legal, and economic regulations affect the entrepreneurship development process in countries and if conducive can lead to creation of new and innovative business. Similarly, Lee, et al. (2013) identified that policies that maximize gain of entrepreneurs like reduction in entry barriers to enterprises and promotion of anti-competitive regulations can motivate people towards establishing their own enterprise. Davaria and Farokhmaneshb (2017) through PLS path analysis revealed that legislations of a country that are directly or indirectly linked to enterprises, education towards entrepreneurship promotion, and financial and non-financial support facilities are important factors to create opportunities for individuals to start a business. Similarly, Castaño, Méndez, and Galindo (2016) conducted PLS estimation and identified that factors like research and development, education and entrepreneurship culture promotion have positive effect on entrepreneurship development. On the contrary, complex legal system that makes it difficult for enterprises to start and operate, and lack of access to credit have a negative impact on entrepreneurship growth. The paper suggests to promote innovative economic environment, increase investment in human capital and reduce complex administrative processes in order to enhance entrepreneurship.

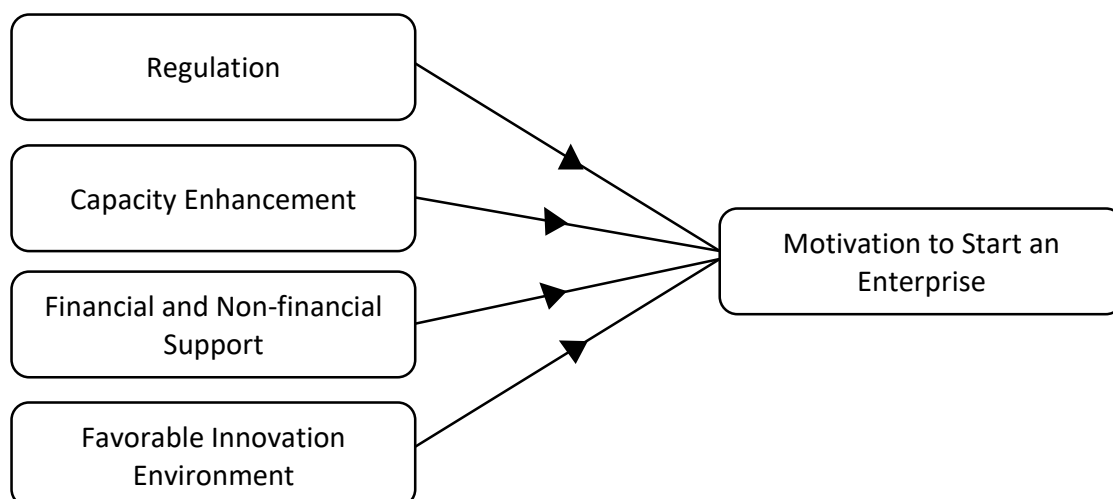
Similar to the aforementioned studies, this study aims to identify the factors that motivate individuals to start their enterprise in Nepal. Given the dire economic situation post the COVID-19 pandemic, this paper intends to guide the policy makers towards drafting of conducive policies that promote entrepreneurship in the country for swift recovery from the economic mayhem.



## 2.1 Methodology

Based on the aforementioned literatures, the model used for this study is given in the following figure.

Figure 1: Research Model



This study has used Motivation to startup as the dependent variable. Regulation, Capacity Enhancement, Financial and Non-Financial Support, and Favorable Innovation Environment were used as independent variable.

The variables, hypothesis, and, their measurement are presented in Table 1.

Table 1: Variables, Hypothesis, and their Measurements

Variables	Hypothesis	Measurement
Motivation to Startup	-	Perception on motivation for starting a business for profit, for achieving something in life, for financial independence, and for solving the problem of society.
Regulation	+	Perception on ease of starting a business, ease of operating a business, ease of complying to tax laws, ease of bringing in domestic and foreign investment, ease of complying to labor laws.
Capacity Enhancement	+	Perception on role of government training and program, and role of infrastructure.
Financial and Non-Financial Support	+	Perception on ease of access to financial and non-financial support, and ease of access to market.
Favorable Innovation Environment	+	Perception on acceptability of innovative business, relaxation on trade, ease of acquiring patent and trademark, research and development, digital infrastructure, and political stability.

In order to identify the impact of the independent variables on motivation to start an enterprise, this study used survey-based questionnaire to derive primary data from responses of 61 existing entrepreneurs operating their enterprise in Nepal. Cochran's Method was used to calculate the sample size and random sampling was used for selecting samples. The survey was administered through Google forms. The survey questionnaire was designed by using 7-point likert scale, where '1' represented strong disagreement with the statement, '7' represented strong agreement, and '4' represented neutral. Our sample comprises of startups currently operating in major cities of Nepal.

Given the onset of second wave of COVID-19 pandemic and its severe impact on majority household, the non-response rate was high.

Partial Least Squares Structural equation modeling (PLS-SEM) techniques was used for data analysis. PLS combines the characteristics of principal component analysis and multiple regressions to establish correlations between different latent variables. Due to this reason, PLS is useful in addressing the problem of collinearity (Barclay, Higgins, & Thompson, 1995). Multivariate normality condition is not necessary as well. Moreover, given the small sample size PLS-SEM was best suited for this analysis (Marcoulides et al., 2009).

The PLS-SEM was done in two steps. At first, the measurement model was tested and after that analysis of the structural model was done, as given by Anderson and Gerbing (Anderson and Gerbing's, 1988).

In order to test the validity of the model, Convergent and Divergent Validity was tested in the measurement model. Average Variance Extracted (AVE), Composite Reliability (CR) and Cronbach's Alpha (CA) were calculated to assess convergent validity of the model, which is given in Table 2. CA was used to examine the internal coherence of the indicators and CR was used to represent the reliability of the constructs. All of the values of CR and CA were higher than or close to 0.7. Constructs with value above 0.7 are considered reliable (Barclay et al., 1995).

AVE gives the extracted variance of the indicators. AVE of value at least 0.5 is acceptable and is a reliable measure of goodness of fit (Fornell and Larcker, 1981). All the values of AVEs were greater than 0.5 which suggest convergent validity in the model.

Table 2: Measurement Model Results

Constructs	Composite Reliability	Cronbach's Alpha	Average Variance Extracted (AVE)
Regulation	0.842	0.723	0.641
Capacity Enhancement	0.923	0.914	0.670
Financial & Non-Financial Support	0.917	0.834	0.847
Favorable Innovation Environment	0.808	0.658	0.587
Motivation	0.942	0.878	0.641

The divergent or discriminant validity was used to confirm whether constructs which should not have any relationship with each other are not related. The Heterotrait-Monotrait Ratio (HTMT) was used to assess discriminant validity. All the values of HTMT should be less than 0.85 (Henseler et al., 2015). The results of HTMT is reported in Table 3. As seen from the table, all the values are less than 0.85 for all constructs. Thus, the discriminant validity for the model is also established.

Table 3: Heterotrait-Monotrait Ratio

	CAP	FAV	FIN	MO
CAP				
FAV	0.654			
FIN	0.340	0.239		
MO	0.146	0.492	0.364	
REG	0.149	0.359	0.356	0.635

CAP: Capacity Enhancement, FAV: Favorable Innovation Environment, MO: Motivation, REG: Regulation, FIN: Financial and Non-Financial Support

The Standardized Root Mean Square Residual (SRMR) of the model is 0.077, which is less than the threshold of 0.08. SRMR is the difference between the observed correlation and the model implied correlation matrix. Average magnitude of the discrepancies between observed and expected correlations can be assessed as an absolute measure of model fit criterion. If the value of SRMR of the model is less than 0.08, then it is considered a good fit (Hair et al., 2010). This means that the model is a good fit.

Confirmatory Factor Analysis (CFA) was done by examining the relationship between the observed variables with latent variables. All of the loadings were higher than 0.5 in their respective constructs only. This shows that the items reflect their underlying latent constructs.

## 2.2 Findings

After confirming the measurement model, the structural model to study the effect of regulation, capacity enhancement, financial and non-financial support, and favorable innovation environment on motivation to start an enterprise was assessed.

The result of path analysis is presented in Table 4. It consists of hypotheses, path coefficient, p-values and remarks. The results were interpreted by analyzing at the coefficient sign, value and the level of significance.

Table 4: Path Analysis Results

Hypothesis	Path Coefficient	P-Value	Remarks
1. Regulation has an impact on Motivation to startup	0.37	0.003 (2.93)	Hypothesis is supported
2. Capacity Enhancement has an impact on Motivation to startup	0.094	0.716 (0.364)	Hypothesis is not supported
3. Financial & Non-Financial Support has an impact on Motivation to startup	0.268	0.009 (2.595)	Hypothesis is supported
4. Favorable Innovation Environment has an impact on Motivation to startup	0.244	0.036 (2.098)	Hypothesis is supported

Note: T-value in parenthesis

As per the above table, this study confirms that Regulation, Financial and Non-Financial support, and Favorable Innovation Environment has a positive and significant impact on Motivation to start an enterprise. All of the p-values were significant at 0.05, regulation and financial and non-financial support were significant at 0.01. The path coefficients show regulation affect motivation to startup by 0.37( $t > 1.96$ ), Financial and Non-Financial Support affect motivation to startup by 0.268( $t > 1.96$ ) and Favorable Innovation Environment affect motivation to startup by 0.244( $t > 1.96$ ).

However, the study identified that capacity enhancement has no significant impact on Motivation to start an enterprise.

The analysis shows that regulation is the most important factor to consider for motivating individuals to start their own enterprise. It further reveals that regulations that are less stringent and restrictive in nature are viewed more positively by entrepreneurs. Such regulations ensure ease of compliance while starting and operating a business. Likewise, entrepreneurs also are motivated if the compliance process while paying taxes are easier. Regulations that support entrepreneurs to access investment opportunities from both domestic and foreign investors also has a positive impact on motivating individuals towards starting an enterprise. Similarly, labor regulations also play a key role in ensuring the same.

The study also shows a positive and significant impact of financial and non-financial support on motivation to start an enterprise. This implies that access to finance plays a major role in influencing individuals to start their own enterprise. Additionally, Business Development Services (BDS) like angel investors, venture capitalist, and incubation centers also are key influencers of entrepreneurship development. Likewise, access to both domestic and international market motivates people to start their own enterprise.

Favorable innovation environment also contributes towards motivating individuals to start their own enterprise in Nepal. For the same, it is imperative for government to accept new and innovative enterprises in the country. Likewise, relaxation of trade barriers for easy adaptation of new and innovative technology should also be ensured. Equally important is regulations whereby an entrepreneur can easily acquire patent and trademark for its enterprise. Other factors like increased investment on research and development, and improvement of digital infrastructure also significantly affects the motivation of individuals towards enterprising. The fundamental aspect of ensuring favorable innovation environment is political stability in the country for individuals to ensure predictability and certainty in the country.

The study shows that capacity enhancement factors like government training and programs and infrastructure do not play any role in motivating individuals. This can be attributed to the fact that the current training and skill development programs do not match the demand of skillset in the economy. Additionally, given the infrastructural hindrance that prevents trade from many parts of Nepal, it is comprehensible that the entrepreneurs perceive physical infrastructure to not have significant impact on their business. Given the improvement in these aspect, the results might have differed.

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## Chapter 3

# Current Practices and Recommendations

## 3.1 Regulation

This study suggests lenient and flexible business regulations of a country are more favorable towards entrepreneurship. Similar recommendations are mentioned in the frameworks presented by UNCTAD (2005), OECD (2016), and GEM (2016), whereby ease of entry, tax regulations, investment environment, and labor regulations are given emphasis for promoting entrepreneurship in a nation.

Based on the aforementioned frameworks and the findings of the study, this section deals with the current practices of business registration, tax payment, bringing in investment, and labor of Nepal in order to identify the gaps and suggest policy interventions to mitigate the same.

### 3.1.1 Business Registration

The complexity in business registration procedure in Nepal has been one of the fundamental problems that has mired the development of entrepreneurship and promoted informality. Cumbersome compliance process which requires individuals to visit multiple government agencies, duplication of process, bureaucratic hurdles, and archaic laws are the major causes of high cost and time of registering an enterprise in Nepal.

World Bank (2019) has identified that the total time required to register a business in Nepal is 23 days, while the average of South Asian countries is approximately 15 days which in itself is already a tall figure when compared to other countries around the globe. While Nepal marginally improved in this aspect by reducing the time to 17 days in 2015 from 31 days in 2010, recent changes in different regulations like the labor law has once again increased the compliance.

Currently, an entrepreneur needs to complete 9 procedures to formally establish a business. In order to comply with the procedure, an entrepreneur needs to visit at least three agencies – Office of Company Registrar (OCR), Department of Industries (DoI), and Inland Revenue Office (IRO) and needs to complete layers of task under each procedure. While the cost of registering an enterprise is already high in Nepal, the indirect cost associated with visiting multiple agencies and hiring external parties like lawyer to complete the registration procedure has inflated the cost further. Moreover, the inefficiency of bureaucrats towards public service delivery has caused additional challenges.

For many years now, the government has promised the instigation of one-window service for business registration in Nepal. Likewise, steps towards digitization of the registration process has been initiated. However, the said reforms has not yet materialized. Despite digital registration, the entrepreneurs still need to visit the offices to present physical copies of the required documents.

Additional challenge in entrepreneurship promotion has been posed by archaic laws in the country. The Industrial Enterprise Act (IEA), which has been obsolete in many countries, still plays a prominent role in company registration in Nepal. It has created duplication of compliance for entrepreneurs as they need to register under both Companies Act in OCR and IEA at DoI. Furthermore, IEA allows registration only under 8 sectoral categories and 167 sub-categories mentioned in the act. This has impaired many innovative businesses not listed under IEA to formally register, or has created

hindrance in registration pushing the total time of formal registration between 6 and 7 months for some enterprises. Other requirements, like mandatory business address has also created barrier for formal registration of mobile business or e-commerce ventures. The act has failed to take into account the dynamic changes of the 21st century and prevented growth of innovative enterprise in Nepal.

### 3.1.2 Tax

The incorporation of digital tax payment mechanism as promised in the budget will be a huge boon for Nepali enterprises. However, currently tax payment mechanism in Nepal is abysmal. For instance, the tax regime of Nepal requires business to be present physically in order to tax them thus making it mandatory for all type of businesses to open a branch office in Nepal to be able to legally conduct any financial transaction. The law completely disregards the potential of cross border transaction through modern technological use where companies can operate without having a physical office in the nation.

The World Bank Doing Business Report 2020, indicates Nepal to be on 175th rank amongst 190 countries in terms of ease of paying taxes. According to the report, an average Nepali spends 337 hours to pay a total of 34 different kind of taxes. This implies that an average Nepali spends 10 hours to pay one tax in Nepal. The complexity of the procedure requires organizations to hire additional financing officers for audit purposes which increases their cost of paying taxes. The cost is in addition to the already soaring amount of taxes in the country. Currently, the corporate tax rate in Nepal stands at 25 percent. While countries in South Asia have comparable rate of corporate income tax, the additional taxes in import of goods has increased the tax burden of businesses by multifold.

Such stringent tax payment procedure and high rate of tax has made many businesses to operate informally or conduct illegal trade activities. As per Pyakurel et al. (2013) tax evasion by bribing officials result in leakage of approximately NPR 5 billion annually. It is one of the leading cause of highest tax accumulation from indirect taxes, whilst tax from direct sources are as low as 3 percent (Lough, et al., 2013).

Taxation complexity can be considered as one of the major hindrance towards enterprising in Nepal. Additionally, after the advent of federalism, the Nepalese tax system has degraded as with unclear provisions towards taxation, each level of government has imposed taxes arbitrarily that has created additional burden on businesses.

The tax law in Nepal is also premature in terms of taxing e-commerce businesses. Given the digital operation of businesses and absence of its physical presence within Nepal along with complex digital transactions, the Nepali taxation laws do not cover all the service provided and acquired from such entities. This has created barrier for ecommerce ventures to conduct formal financial transactions within and outside the country.

Additionally, the tax law does not align with the Companies Act which has granted companies with yearly transaction of less than 5 million is not required to submit its audit report to OCR. The instigation of such legislation is commendable as it would provide relief to small enterprises with limited financial capacity who had to pay substantial amount of money to hire auditors to prepare the audit report. However, the Income Tax Act of Nepal has not granted such benefits to the SMEs, as the audit report still needs to be submitted to the Inland Revenue department.



### **3.1.3 Investment**

Nepal has realized substantial improvement in its foreign investment sphere in recent years. UNCTAD (2020) reported that Foreign Direct Investment (FDI) in Nepal increased to \$185 million in 2019 from \$67 million in 2018. The highest number of FDI inflows is experienced by service sector (70 percent) followed by manufacturing sector (15 percent) and energy sector (13.9 percent).

The new FDI regulation in Nepal as per Foreign Investment and Technology Transfer Act (FITTA) has introduced a plethora of reforms in the form of leniency in repatriation of profit, easier compliance to establish foreign companies, ownership of stocks, flexibility in expansion of enterprises of foreign investment, and provision of residential VISA for foreign investors. Likewise, Nepal Rastra Bank (NRB) has also introduced policies related to automatic route and one-window service for bringing in foreign investment which has made the sector attractive for investors.

Despite these achievements, bringing FDI is still plagued with numerous challenges which can potentially create barriers for Nepalese enterprises to access FDI. World Bank (2020) recorded that the FDI inflow in the country averaged over the last decade amounted to a mere 0.2 percent of GDP, one of the lowest in the world. This implies that entrepreneurs continue to refrain from bringing in investment in Nepal in light of its cumbersome process. The general problems in the sector is largely attributable to the bureaucratic corruption, lack of transparency, and legal and regulatory barriers.

The minimum cap for foreign investors to invest in Nepal is NPR. 50 million. The cap was increased in 2019 from its previous requirement of NPR. 5 million. This can be regarded as a primary barrier for Nepalese enterprises to bring in investment. Given the requirement of huge capital inflow, small and medium enterprises (SMEs) in Nepal cannot access FDI. Firstly, these enterprises, despite facing capital crunch, do not need such huge amount of investment. Secondly, the enterprises do not have sufficient capacity to comply with the complex procedures involved in bringing foreign investment. Bringing in foreign investment requires the entrepreneurs to comply to the regulations of Department of Industries, Investment Board Nepal, and Nepal Rastra Bank. Additionally, the approval process takes as much as 5 months, which implies huge opportunity cost for SMEs.

The regulations also consist of an extensive list of activities where foreign investment is prohibited. The Negative list includes poultry farming, fisheries, bee-keeping, fruits, vegetables, oil seeds, pulse seeds, milk industry and other sectors of primary agro-production, cottage and small industries, personal service business like hair cutting and tailoring, travel agency, guide involved in tourism, trekking and mountaineering guide, rural tourism including homestay, management, account, engineering, legal consultancy service and language training, music training, computer training, despite these being the most attractive sectors in the country.

### **3.1.4 Labor**

New enterprises, especially MSMEs in Nepal find it difficult to comply with different regulatory requirements related to labor. Provisions regarding the minimum wage and registering under social security is especially viewed as burdensome by enterprises.

Currently, the minimum wage of Nepal stands at NPR. 15000. However, MSMEs often find themselves in positions whereby they cannot afford to pay the minimum wage to the workers. Consequently, these enterprises choose to operate informally or hire workers informally. Additionally, hiring seasonal workers are deemed as more expensive by the enterprises.



Likewise, the Contribution Based Social Security Act of Nepal mandates both employers and workers to contribute 31 percent of the worker's basic salary to the social security fund (SSF), where 11 percent is deducted from the worker's salary and the remaining 20 percent is contributed by the employer. This implies that companies need to contribute an additional 20 percent of the salary of its employee to the SSF. The provision has added a huge financial burden to the MSMEs who already have a tight liquidity and are labor-intensive. The added burden can discourage enterprises from formal registration.

### **3.1.5 Recommendations**

In order to improve its regulatory environment, Nepal can initiate reforms in the following policies or procedures:

- i. Operationalization of one-window system at Department of Industries would save a significant amount of time, cost, and effort of new businesses spent on visiting multiple agencies like DoI, IRO, and OCR to submit similar documents. Instead, the government can maintain a centralized directory that consists of all the required information of all registered enterprises that can be accessed by any government agency. Establishment of a centralized directory would also allow the government to amend section 3 and 4 of Industrial Enterprise Act, whereby industry registration of branch industries in other provinces in case the parent company has already been established in any one province can be exempted.
- ii. Hiring of new human resource with sound technical capacity, or training the existing officials for the same would allow the government to swiftly implement e-registration services for businesses without them having to present physical copies at different departments or offices.
- iii. Harmonization of Income Tax Act with Companies Act such that companies with less than 5 million yearly transactions are exempt from submitting audit report would help SMEs save time as well as cost of complying to and submitting the audit report. Additionally, it could act as an incentive for SMEs operating in informal economy to formalize. In order to promote SMEs in Nepal, the government can provide complete tax exemption for innovative start-ups for a period of five years, or could direct subsidized loans to the same.
- iv. Reduction in import duty for goods used as raw materials by industries would help reduce the input cost for industries. Additionally, removal of excise duty on goods that do not have any public health concerns would allow numerous such businesses to increase their profitability and size. The government should also reform VAT filing period from monthly basis to quarterly basis in order to prevent depletion of working capital for SMEs.
- v. Reforming Income Tax Act by incorporating taxation mechanism for ecommerce ventures that provide B2B services internationally, could facilitate the startups based on electronic transaction to provide their business services globally.
- vi. The removal of business other than those that pose national threat from the negative list of FITTA would allow numerous companies to access foreign investment. Likewise, removal of minimum cap on foreign investment would also attract foreign investment in numerous SME business ventures.
- vii. The minimum wage needs to be revisited in light of the limited fund of MSMEs. Likewise, assessing the capacity of the different level and size of businesses registered in Nepal, the government can

impose different rates of contribution on SSF for the enterprises in Nepal that could ease financial burden from MSMEs. Additionally, changing the mandatory requirement of contributing to MSMEs to optional could provide respite to numerous new businesses and MSMEs in Nepal.

## 3.2 Financial and Non-Financial Support

Confirming to the studies conducted by Hall and Sobel (2006), Davaria and Farokhmaneshb (2017), OECD (2016), and UNCTAD (2005) this study also suggests that access to finance, BDS, and market has a positive impact on motivating individuals towards starting their enterprise.

With regards to the same, this sections scrutinizes on the existing challenges in the sector. Likewise, it also provides recommendation for the improvement of the same.

### 3.2.1 Access to Finance

Access to finance has been a major problem behind sluggish growth of enterprises in Nepal. The World Bank Enterprise Survey (2013) has recorded that only 35 percent of enterprises in Nepal have access to capital from BFIs.

In recent years, the financial sector of Nepal has realized substantial expansion and growth which has increased financial inclusion of individuals in formal financial institutions. Despite the development, access to finance is not adequate in Nepal as multiple challenges still persist in the sector.

Nepal offers a wide variety of financial services, in the form of loan schemes to deprived sector, women entrepreneurs, agricultural businesses, and small and medium enterprises. However, individuals who aspire to start their own enterprise still find it difficult to access credit facilities from the formal channels. Consequently, these enterprises need to depend on credit from informal sector like friends and family or micro credit institutions. The major problem with accessing loan from informal sector is the high amount of interest– which can soar as high as 48 percent. In order to increase enterprises in Nepal, addressing the problems is essential.

The aforementioned programs have not been able to generate desired result as it does not resolve the underlying problems of the people who do not have capacity to acquire financial services from the formal institutions. Acquiring loans from banks and financial institutions (BFIs) require the individuals to prove their bankability by fulfilling the collateral requirements. However, in the absence of collateral, enterprises, especially small and medium, are unable to access the loan facilities. Moreover, the businesses need to provide documentations of immovable assets which bars loan accessibility of mobile businesses. Additionally, the complex compliance process that requires substantial amount of time and documents discourage individuals from accessing the available services. Consequently, individuals choose to operate in the informal economy and take credits from the informal sector. This practice has limited the growth of enterprises in Nepal.

The BFIs also refrain from providing small amount of loans that has huge default risk. Given the impact on efficiency while processing small loans, the disbursement of such loans is not profitable for BFIs. Thus, BFIs often choose to pay penalty by defaulting on the required credit disbursement amount.

One of the fundamental problems that leads to low financial availability for small businesses is the unavailability of credit rating agencies that ensure the BFIs regarding the lenders loan repayment

history. Additionally, many individuals in Nepal are unaware of the available services and schemes provided by BFIs, which results in decreased access to finance.

### ***3.2.2 Access to Private Equity and Business Development Services***

The concept of Business Development Services is new to Nepal. Business Oxygen Pvt. Ltd was the first company to be established as onshore private equity fund in 2012, which now also focuses on providing technical assistance for growth of Nepalese businesses, especially SMEs. Over the years, the sector has experienced moderate growth. However, BDS operating in Nepal are small when compared to other developing countries.

There are numerous obstacles faced by such businesses that has barred their growth. Majority of the challenges persist in the form of regulatory hurdles that has created barriers for registration or expansion of service delivery of the companies. While Nepal introduced Specialized Investment Fund Regulation in 2019 that instigated significant reforms in the sector whereby Private Equity/Venture Capital (PEVC) companies do not have to comply with restrictive policies under Companies Act regarding making investment and decision making, other forms of policy restrictions still persists in the sector. The IEA, 2016 removed investment companies from the list of companies that can be registered as industry in Nepal. This implies that new onshore PEVC companies cannot access international fund as in order to bring in FDI, a company needs to be registered as an industry in Nepal. While at that, the capital available domestically in Nepal is insufficient for companies to operate. While Nepal allowed insurance companies to invest in investment companies in 2014, the provisions are unclear as to whether PEVC are eligible for taking the investment. Additional challenge for onshore PEVC are created by the blacklisting system of NRB whereby if the companies default on a loan shareholders having more than 15 percent of shares and director of the company are blacklisted which bars them from taking additional loans for operation. However, as offshore investors are considered as foreign investors by DoI, the offshore PEVC are waived off blacklisting.

Most of the PEVC companies are offshore in nature, that is, they are established outside the country and can fund directly to Nepalese companies but not to onshore PEVC companies. The companies thus are not regulated by the Specialized Investment Fund Regulation but instead need to follow different regulations that control FDI in Nepal. The first and foremost problem faced by such companies is the negative list as provided by FITTA where investment is restricted. Additionally, offshore PEVC cannot invest in companies not registered as industries. Furthermore, in order to invest in a Nepal based companies the offshore PEVC need to comply with the cumbersome process of bringing in investment in Nepal. Following the same, it is mandatory to take approvals from DOI, Investment Board Nepal (IBN), NRB, OCR, and other sectoral approvals for each investment as Nepal only allows investment on project-by-project basis. Taking approvals of multiple agency and accumulating plethora of documents for the same implies that it takes several month for investments to enter Nepal. Additionally, in order to provide fund management service in Nepal, the offshore PEVC need to establish a branch office in Nepal to have a physical presence. However, FITTS permits foreign companies to hold only 51 percent shares in local companies providing such services which implies that the foreign branch cannot be opened. Thus, offshore PEVC must first identify local companies that are ready to provide management services.

Apart from the regulatory hurdles mentioned above, BDS and accessing finance through PEVC is a new concept for the Nepalese markets and thus entrepreneurs and SMEs have limited knowledge regarding their services. Majority of new enterprises thus refrain from accessing their services due to ambiguity regarding the benefits of BDS or allowing PEVC to enter the shareholder base.

### **3.2.3 Access to Domestic and International Market**

The landlocked nature of Nepal along with difficult geographic characteristic has been a major hindrance towards access to both domestic as well as international market in Nepal.

The difficult terrain of the country and lack of adequate infrastructure has created significant challenges in trade of goods and services within the country. Consequently, the cost of distribution of goods and services in Nepal is high. The goods imported from India are often cheaper than the ones produced in Nepal. This barrier has barred many rural parts of Nepal with economic opportunities to convert the available resources into entrepreneurial endeavors.

Likewise, the geography of Nepal also impacts its access to international markets. The primary seaport for the country is based in Kolkata, which is approximately 460 miles from the border between Nepal and India. Currently, the access to Vishakhapatnam port in India and the inauguration of integrated checkpoint in Birgunj has improved market access to some extent. The transit time has reduced significantly with these new developments. Additionally, China has granted three seaports and four dry ports to Nepal, which after coming into operation will enhance Nepal's international market access. But, the challenges in transport of goods and services arising from having only one international airport remains. While at that, completion of Bhairahawa, Pokhara and Nijgadh international airport can provide some respite in the days to come.

While the solutions to the problems related to access to seaports and air transport have been commenced and is likely to improve in near future, other challenges in the form of inadequate accreditation and testing facilities, insufficient technology to export processed products, and cumbersome export compliance has also created hindrance for Nepali traders to access international markets.

Lack of accreditation services and standard testing laboratories have made it difficult for Nepali products to compete in the global market. Attributable to the same, despite having comparative advantage on goods like tea and ginger, the products cannot find space in international market and thus their export is not up to Nepal's potential (WTO, 2012). Additionally, trade barriers towards accessing modern technologies have impaired Nepal from exporting processed products. For instance, Nepal exports majority of ginger in raw form to India, where the ginger are grounded and crushed and is further exported with higher value addition. Apart from this, procedural obstacle while exporting products and the necessity of informal payments due to bureaucratic corruption also persists in Nepal. Moreover, Nepal is not free from non-tariff barriers while exporting its product to other nations.

### **3.2.4 Recommendations**

- i. In order to ensure proper flow of information to Bank and Financial Institutions that could help reduce the cumbersome compliance of accessing loans by entrepreneurs, it is important for the government to create a central registry that would enable BFIs to easily access information regarding the assets owned by a company. It would also allow numerous MSMEs to take loan on the basis of movable collateral – which is the major mode of conducting business of many Nepalese enterprises, especially MSMEs. Furthermore, it is equally important to strengthen the Credit Information Bureau Nepal. Currently, it consists of records of only those borrowers who have taken credit of more than NRs. 1 million. Additionally, it takes a prolonged period of time to upgrade the information. Strengthening of the institution could ensure swift delivery of information through electronic medium. The availability of historic information could reduce the loan disbursement compliance for enterprises. Likewise, credit rating system should be promoted

by promoting private credit rating agencies.

- ii. As aforementioned, the deprived sector or priority sector lending programs implemented by the government do not have desired results as there are significant barriers faced by both creditors and BFIs while borrowing and lending such loans. Thus, the programs can be closed and the amount of money spent on these programs could be directed towards providing technical assistance to BFIs in creating products and services for the deprived sectors that would be in the best interest of both the parties, Likewise, strengthening of other sectors like insurance is equally important.
- iii. Establishment of quality testing labs and private certification companies would ensure that the Nepali good get broader international market and can compete with goods of other nations.
- iv. Expansion of trade agreements with multiple countries with focus on measures to avoid tariff and non-tariff barriers in cross border trade would remove a significant barrier faced by Nepali exports while entering the global market. The agreement has to also eliminate or substantially reduce the para-tariffs so that a level playing field is created.
- v. Nepal also needs to improve its banking and legal system where enterprises can easily conduct cross border financial and economic transaction.
- vi. Other measures to reduce the cost of exporting goods from Nepal would open greater trade avenues for the business houses.

### 3.3 Favorable Innovation Environment

This study suggests that innovative enterprises, easy access to patent and trademark, research and development, sound political environment, and digital infrastructures have positive and significant impact on motivating individuals towards starting their enterprise.

With regards to the same, this sections scrutinizes on the existing challenges in the sector. Likewise, it also provides recommendation for the improvement of the same.

#### 3.3.1 Acceptance of Innovative Enterprises

It is undeniable that the world is moving at a rapid pace and with it numerous innovative ventures have been established. In fact everywhere around the world, innovation moves faster than the government regulation. The case is similar for Nepal. However, in presence of archaic laws and bureaucracy, it is difficult for innovative enterprises to formally operate in Nepal.

The exhaustive list of enterprises allowed to formally operate as provided by Industrial Enterprise Act bars the establishment of new and innovative enterprises based in ideas that previously did not exist. Additionally, it signals the bureaucrats that enterprises other than those listed are non-permitted activities. While the law has prevented the establishment of numerous business in the past, the ones who managed to formally register operate with immense barriers. For instance, ride sharing businesses, Tootle and Pathao, despite being innovative and successfully resolving a grave problem faced by general Nepalese, faced numerous legal hurdles and received notice to close their enterprise numerous times. This signals to the investors that the government is not open towards innovative ventures in Nepal, creating reluctance of individuals towards formally testing their ideas in the market.



### **3.3.2 Patent and Trademark**

Patents and trademark are important aspect of innovation as it provides intellectual property rights to the innovators, whereby the innovator has exclusive right over its invention. It is imperative to encourage people to roll out their ideas as patents and trademarks ensure that the possibility of theft of idea is minimal to nil.

However, acquiring patents and trademarks are difficult in Nepal. Firstly, lack of expertise in Industrial Property Section under Department of Industries has made it difficult for the authorities to identify if the proposed idea is entirely a new invention and is novel and non-obvious for it to be patentable. Given the requirement of experts related to diverse field who has immense knowledge on the subject matter, Nepal lacks the vital human resource. Secondly, the database management system of Nepal is weak. Thus, identifying if the proposed idea is new and innovative is a daunting task for the officials. In the presence of the concerned database, it would be comparatively easier to identify the sincerity of the proposal. Consequently, it takes numerous months to acquire a patent after filling an application in Nepal.

In Nepal, only eight patents were registered in the past decade and in total only 76 patents have been registered in the country.

### **3.3.3 Digital Infrastructure**

Over the past decade, Nepal has experienced an upsurge in digital or ICT related services. With an increase in mobile penetration and internet penetration, the demand for digital technologies and services related to the same has also surged. However, the sector is still in its infancy. The Network Readiness Index 2020 reports that Nepal ranks 113 out of 121 countries in terms of technological readiness. Nepal has digressed from the previous rank of 106 in 2019, and its score has also declined from 32.96 in 2019 to 31.81 in 2020. The score is lower than the average of lower middle income country. This implies that while other nations are swift in installing the digital infrastructures and adapting digital technologies, Nepal's progress has been sluggish.

Nepal has, since 2015, experienced a significant growth in companies that are ICT based. However, these companies depend mostly on digital infrastructure which includes quality broadband services, wider network coverage, cyber security, and digital payment mechanism of the nation for operation, which is inadequate in Nepal.

The foremost priority in the sector is required in the physical infrastructure which will ensure broadband connectivity. According to Ministry of Communication and Technology (2019), despite the connectivity in Nepal has grown over the past years, its expansion is largely skewed in distribution across access, availability and affordability. Moreover, majority Nepalese have not yet accessed quality broadband connections including 4G network services as the prices are still higher when compared to GNI per capita of Nepal. Additionally, Nepal lags behind other countries in terms of satellite, optic cables and 5G networks. One of the fundamental aspect that Nepal is still struggling on is adequate access of electricity throughout the nation which has impeded internet access to many parts of the country.

Another fundamental aspect that Nepal lags behind is its digital payment services. While Nepal has experienced progress in the sector, nationwide digital payment penetration is still inadequate. While urban areas have highly adopted the concept of digital financial transaction, the same cannot be inferred to the entire population of Nepal. Additionally, despite developments, Nepalese still face difficulty in international monetary transaction.

Cyber security is a huge issue that has created barriers for internet based enterprises. With frequent cases of

data breaching, it is evident that data protection, security and privacy aspects are poor in Nepal. While it is imperative to generate trust of consumers for engaging in the digital economy, the existing practice is not favorable to ensure the same.

Apart from the aforementioned sectors that require swift improvements, the regulations and policies also need an equal focus. While Nepal has introduced a new e-commerce bill in 2020, it has been introduced without consultation with relevant stakeholders and fails to define what ecommerce businesses are. Likewise. The intellectual property right policy of Nepal also needs to be re-assessed as per the new developments in the digital world. Likewise, policies of digital ventures with financial sector does not align in Nepal. As ecommerce ventures know no geographic barrier, international transactions policy along with taxation procedures needs a revisit.

### **3.3.4 Recommendations**

- i. Nepal should refrain from putting a ban on innovative enterprises for which policies have not yet been crafted. Instead, such enterprises should be welcomed and for governing the same, the government can introduce a draft bill which can be amended as the understanding of the type of business grows or abolished if the business is not sustainable. Likewise, promoting anti-competitive practices by supporting syndicates and cartels to prevent any new and innovative business should be subject to punishment by the law.
- ii. In order to ensure swift disbursement of patent and trademark, the human resource at Industrial Property Section of DoI should be trained such that they are capacitated to conduct research regarding different types of business ventures established around the world and in Nepal. For the purpose of identifying patent worthy ideas, consultants of the respective field can be hired by the government. Additionally, the government should instigate a centralized directory that will consist of information of all companies throughout Nepal to reduce the hassle of ensuring that no such type of business has been registered in Nepal.
- iii. Prior to finalizing the ecommerce bill, the government should run a discourse with all the relevant stakeholders who can give feedback and suggestions on making the legislation relevant and practical.
- iv. The government should invest in physical infrastructure that would allow broadband services to expand throughout the country. Likewise, investment in data security and privacy services should also be of equal priority.
- v. Removal of restrictions of international payment would open avenues for numerous economic opportunities in Nepal, which can be leveraged by ecommerce ventures.
- vi. Building strategic alliance with different countries would open Nepal's access to satellites, optic cables and 5G network.

## Chapter 4:

# Conclusion

The impact of COVID-19 has all but demolished economic buoyancy through closure of hundreds of SMEs and millions of workers delegated to the unemployment line. In view of the situation, Nepal needs to take swift actions that will facilitate in cushioning the economic impact of the pandemic. Various researches (Sataloff et al., 2016; Poschke, 2013; Dana et al., 2008; Gourio et al., 2015; Maritz et al., 2020) on past economic and financial crises that resulted in upsurge in unemployment and severe downturn of numerous economies around the globe suggest that growth in entrepreneurship was one of the most import factors that contributed to the revival of these crisis driven economies. This research thus aimed to identify the factors that have a positive influence on motivation to start an enterprise and suggest policy measures to improve the same in Nepal.

In order to identify the same, the study used PLS-SEM techniques on data collected from structured questionnaire method from 61 entrepreneurs across Nepal. This study has used Motivation to startup as the dependent variable. Regulation, Capacity Enhancement, Financial and Non-Financial Support, and Favorable Innovation Environment were used as independent variable. The findings of the study revealed that Regulation, Financial and Non-Financial support, and Favorable Innovation Environment has a positive and significant impact on Motivation to start an enterprise. However, the study identified that capacity enhancement has no significant impact on Motivation to start an enterprise.

Based on the aforementioned findings, the study further delved into the current scenario and challenges that persisted in the sectors that had a significant impact on motivating individuals to start their enterprise. A thorough analysis of the same helped generate recommendations that largely suggests the government to concentrate its effort on reforming policies to ensure ease of business registration, bringing in foreign investment and tax payment. The study has also suggested to remove restrictive provisions that either add burden to MSMEs or create barriers to foreign investment or business development services and private equity providers or to new and innovative enterprises. Furthermore, numerous areas of investment like physical and digital infrastructure, and increasing capacity of government officials has been deemed as imperative by the study.



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