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# Market Study to Understand Job Growth Potential in SMEs in Nepal

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David Irwin and Nada Ibrahim

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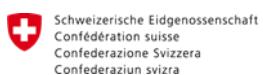
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The analysis was made possible through the financial support of the World Bank's Jobs Umbrella Multidonor Trust Fund (MDTF), which is supported by the Department for International Development/UK AID, the Governments of Norway, Germany, Austria, the Austrian Development Agency, Italy, and the Swedish International Development Cooperation Agency.



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## Abbreviations

Abbreviations that are used throughout the document, other than internationally recognised abbreviations such as GDP, are summarised here. Abbreviations that are only used within a paragraph are referenced the first time that they are used.

BFI	Business finance institution
BSO	Business support organisation
FTE	Full time equivalent
GoN	Government of Nepal
ILO	International Labour Organisation
MFI	Microfinance institution
MolCS	Ministry of Industry, Commerce & Supplies
NRB	Nepal Rastra Bank
NSIC	Nepal Standard Industrial Classification
OCR	Office of Company Registrar
OECD	Organisation for Economic Co- operation and Development
SME	Small & medium enterprise
WEF	World Economic Forum

# Market study to understand job growth potential in SMEs in Nepal

## 1. Introduction

The World Bank and the Government of Nepal are working together to generate more and better jobs by encouraging investment in growth-oriented businesses. The challenge in the modern world, however, is that investment often leads to the replacement of labour by automation. It makes sense, therefore, to encourage growth amongst businesses in labour intensive sectors such as tourism, services and agribusiness and in areas where it is likely that growing businesses will be able to find workers with relevant if basic skills. The unemployment rate in Nepal is relatively low (World Bank 2018a) but masks the outflow of Nepalese workers, which averaged 30,000 people per month in the first half of 2018. The ILO (2017) estimates unemployment at around 250,000, so outward migration in a single year exceeds the number of people left at home looking for work.

India accounts for 65 per cent of Nepal's international trade and 85 per cent of all imports transit through India. There is also believed to be considerable informal trade across 1,750 kilometres of open border (World Bank 2018b<sup>1</sup>). Growth rates are low and driven by private consumption dependent on diaspora remittances (*ibid.*)

Agriculture is the primary employer for 86 per cent of poor people, making growth in the sector critical for poverty reduction (World Bank 2018b). However, small and medium enterprises (SME)<sup>2</sup>, especially those working in the industrial sector, are important. Business Oxygen, a venture capital fund manager, quoting from a 2010 study, claims that SMEs (excluding microenterprises) in Nepal contribute 98 per cent of industrial establishments, employ 57 per cent of the work force, create 83 per cent of industrial jobs and provide 80 per cent the industrial sector's contribution to GDP.

Supporting SMEs to grow will therefore boost economic growth, create jobs, foster innovation, promote sustainable industrialisation and contribute to economic diversification and resilience (OECD 2017). However, SMEs are disproportionately affected by market failures and business environment constraints. Their success depends, *inter alia*, on access to finance, knowledge networks and skilled workers (OECD 2017).

Entrepreneurial ecosystems have been defined as "combinations of social, political, economic, and cultural elements within a region that support the development and growth of innovative start-ups and encourage nascent entrepreneurs and other actors to take the risks of starting, funding, and otherwise assisting high-risk ventures" (Spiegel 2017: 50). A clear example is Silicon Valley – businesses start there because it offers a combination of complementary businesses, easy access to skilled labour, easy access to finance, easy access to applied research, etc. Such ecosystems tend to emerge and are almost impossible for governments to create. In any event, it is not always clear how the various elements in entrepreneurial ecosystems enhance entrepreneurship

<sup>1</sup> Note that we use the western calendar and USD throughout this report except where otherwise stated.

<sup>2</sup> There are many different definitions of micro, small and medium enterprise and we discuss this in appendix 5. For the purpose of this study, we focus on businesses employing 5-99 people since these are the ones most likely to create jobs in large numbers, which is the objective of the World Bank and Government of Nepal. Where we report on performance by firm size, we have done so using employee bands designed to cover all definitions based on employee size.

## **Understanding job growth potential in SMEs in Nepal**

(Alvedalen & Boschma 2017). What is clear, however, is that firms tend to cluster in or close to locations that they see as providing advantage and then thrive on resources such as information, networks and labour markets (Ligori *et al.* 2019). Increasingly, the term entrepreneurial ecosystem is being used (and abused) by third parties anxious to understand the mechanisms in place, deliberately or otherwise that might encourage and support the formation and growth of business. Indeed, the International Trade Centre (und.), a UN agency, talks about the “entrepreneurship support ecosystem” which it defines as “a collaborative arrangement through which institutions that support entrepreneurs combine their resources, capabilities, and products to offer a coherent, entrepreneur-oriented solution”. We will follow the ITC definition though tend to refer to the business support ecosystem, which we see as important in supporting new and growing businesses.

Businesses, however, do not exist in a vacuum. They work within an environment or investment climate that is primarily affected by government policy. Policy that is predictable and stable will encourage investment; instability tends to discourage or at least delay investment. Policy, however, can also make a difference between whether businesses are competitive or not and thus whether they are likely to grow and create employment.

The research on which this report is based, therefore, is intended to assess the SME landscape in Nepal and the role that SMEs play in Nepal’s labour market and to diagnose the challenges, barriers and constraints faced by SMEs and that prevent or deter entrepreneurs from growing their businesses. The study’s findings are therefore intended to support the design of programmes, including through World Bank projects, that might enhance the SMEs’ job creation potential. The research suggests that most entrepreneurs aspire to grow but are held back by lack of information, lack of advice, inability to access appropriate and affordable finance and lack of skilled workers. The business support ecosystem is weak. Improving access to business support and making it easier for businesses to raise investment finance could make a considerable difference to the economy. Our statistical analysis suggests that there is an association between level of investment and revenue.

This report is organised as follows. We explain the research methods used and then look at the profile of SMEs and their performance, the policy environment and then the business support ecosystem which we split into general business support and financial support. We conclude with an overall assessment of the challenges facing Nepal’s SMEs and the implications for their prospects to expand operations and create jobs.

## 2. Research approach

As noted in the introduction, there are three focus areas to our research: the SME sector; the policy environment in which SMEs operate and the various government agencies that shape it; and business advice and support organisations (which includes providers of finance and a wide range of donor funded initiatives as well as some government programmes).

### 2.1 Small and medium enterprises survey

The key source of data was a survey of small and medium enterprises. We focused on four sectors (agri-processing (which is mostly food processing but does include some businesses that are more agricultural in nature including livestock, crops and honey), manufacturing, tourism (including hospitality) and other services (which covers a range including technology and software but also some businesses that are more retail in nature). We focused on six districts (Chitwan, Kaski, Kathmandu, Morang, Parsa and Rupandehi) from five provinces. A detailed description of how the sectors and districts were chosen is provided in appendix 3 together with a description of how the survey was undertaken. The target sampling frame is shown in Table 1. In line with discussions with the World Bank Group, we adopted a broad target for respondents employing 5-99 people<sup>3</sup> and we did not define target for gender ownership, though stated a desire to ensure that we had a proportion in the sample at least equal to the apparent proportion of women entrepreneurs quoted by Louis Berger (2014) as 13 per cent and by World Bank (2013) as 12 per cent.

**Table 1: Target sample population**

Actual	Agribusiness	Manufacturing	Tourism	Services	Total
Kathmandu	30	40	80	92	242
Chitwan	38	46	40	58	182
Morang	36	73	27	46	182
Parsa	40	25	15	20	100
Kaski	40	25	15	20	100
Rupandehi	40	25	15	20	100
	224	234	192	256	906

Identifying firms and completing the survey was more challenging than had been anticipated. The number of usable responses achieved is shown in Table 2. We actually interviewed more than this number but some responses had to be discarded, because they were in the wrong district, or were in the wrong sector, or too many of the answers gave cause to believe that the respondent was not being as accurate as possible.

**Table 2: Actual sample population**

	Agribusiness	Manufacturing	Tourism	Services	Total
Kathmandu	28	47	75	90	240
Chitwan	37	52	52	60	201
Morang	45	64	26	49	184
Parsa	19	10	14	25	68
Kaski	35	32	18	38	123
Rupandehi	35	35	17	29	116
	199	240	202	291	932

<sup>3</sup> Whilst we aimed to pre-screen potential respondents, firms did not always give the same answer for number of staff when asked during the survey itself. As a result, a limited number of micro firms and large firms were included in the survey. See appendix 5 for more detail on SME definitions.

## Understanding job growth potential in SMEs in Nepal

A comparison of sample respondents to our target is shown in Table 3. In most cases, we came close to or exceeded the target, though we had some difficulty in reaching the target in Parsa. Some 81 respondents (9 per cent) were located in rural municipalities (Rupandehi: 27 per cent; Kaski: 20 per cent; Parsa: 12 per cent; Morang: 9 per cent). Amongst agribusiness, 26 per cent were rural (located in a government defined rural municipality) compared to eight per cent for manufacturing, four per cent for tourism and one per cent for services.

**Table 3: Sample achieved versus target**

	<b>Agribusiness</b>	<b>Manufacturing</b>	<b>Tourism</b>	<b>Services</b>	<b>Total</b>
Kathmandu	93%	118%	94%	98%	99%
Chitwan	97%	113%	130%	103%	110%
Morang	125%	88%	96%	107%	101%
Parsa	48%	40%	93%	125%	68%
Kaski	88%	128%	120%	190%	123%
Rupandehi	88%	140%	113%	145%	116%
	89%	103%	105%	114%	103%

The survey was not expected to be statistically representative, which would have been difficult in advance of the publication of the national economic census results; rather, its objective was to allow an in-depth analysis of a sample of SMEs large enough to infer patterns across our parameters of interest: firm size, specified sectors, gender of ownership and rurality.

The questionnaire is shown in appendix 4. As there is a large number of questions it was written as far as possible to use closed questions. The intention was then to follow up around 60 of the respondents with a more in-depth, semi-structured interview, to look further at some of the underlying issues and to seek more insight. We found, however, that most businesses were reluctant to participate as they said they do not have time to spare for a second interview. Indeed, they were generally irritated when we asked them for their time for the follow up interview. As a result, we experimented with a focus group discussion format in Chitwan, which attracted three participants. In addition, we were able to undertake 23 in-depth interviews, with three or four interviews in each of the six districts (Table 4). Four (two in Kaski and one in each of Parsa and Rupandehi) were in rural locations.

**Table 4: In-depth, follow-up interviews**

	<b>Agribusiness</b>	<b>Manufacturing</b>	<b>Tourism</b>	<b>Services</b>	<b>Total</b>
Kathmandu	0	3	1	0	4
Chitwan	2	1	1	3	7
Morang	1	1	1	1	4
Parsa	1	0	1	1	3
Kaski	2	0	2	0	4
Rupandehi	3	0	0	1	4
	9	5	6	6	26

## 2.2 Business support organisations

Business support organisations, which might include for-profit and no-profit advisory organisations, banks, microfinance institutions, investors, universities, etc, were identified through Antarprerana and IMC's existing knowledge, web searches, desk research and asking SMEs whether they had received advisory support. Services might include training and mentoring, grants, loans, workspace and a range of other services

including market intelligence, participation in trade missions and trade fairs, financial readiness and financial packaging, networking events, etc. Some organisations focus on providing just one or two services such as angel finance or seed capital. Following identification of networks, Antarprerana continued to expand their database of organisations. Antarprerana interviewed some 22 organisations, drawn from across the range of services, with a semi-structured questionnaire intended to help in understanding the background of the organisation, the services provided, the challenges encountered, their future strategies and the improvements in the ecosystem that they would like to see. Antarprerana are active in this space and know many of the other players so securing interviews was relatively straightforward.

### **2.3 The enabling environment**

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The enabling environment was largely assessed through desk research – many organisations including World Bank and World Economic Forum – undertake analyses of the enabling environment and the challenges facing businesses. However, this was supplemented by asking several questions in the survey of business. Additionally, it was a topic that was covered in key informant interviews undertaken by Antarprerana with five organisations, including Ministry of Industry, Ministry of Finance and Confederation of Nepalese Industries. Semi-structured interviews were undertaken to understand the interviewees' perspective on SMEs' contribution to economic growth and to explore their role and challenges at the policy level. Antarprerana found it rather more difficult to secure interviews with government representatives.

### **2.4 Validation**

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A workshop was held in Kathmandu on 24 July at which we shared our results and conclusions (through a three-page briefing document and a presentation). The aim had been for about 24 participants but in the event some 34 people participated.

Participants were asked to sit at round tables. A brief presentation of the work and the results was shared. Each table was then given a question to discuss (listed in appendix 6). Notes were taken by a member of the IMC/ Antarprerana team. A spokesperson from each table was invited to make a short presentation of their conclusions. This was followed by a further discussion and concluding remarks from the Ministry of Industry. Participants were generally positive about the conclusions from the survey and other research as well as offering further insights to explain some of our observations.

### **2.5 Completing the research**

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The survey had not quite been completed by the date of the validation workshop, so it was completed during August. The additional results did not change the overall conclusions but did provide additional detail, especially for example in relation to rurally based businesses and the three additional districts. Very few follow-up interviews had been completed before the presentation so these too were completed during August. These offered qualitative insight. Figure 1 (next page) summarises the main project activities and show approximate timeline.

### **2.6 Lessons for future research design**

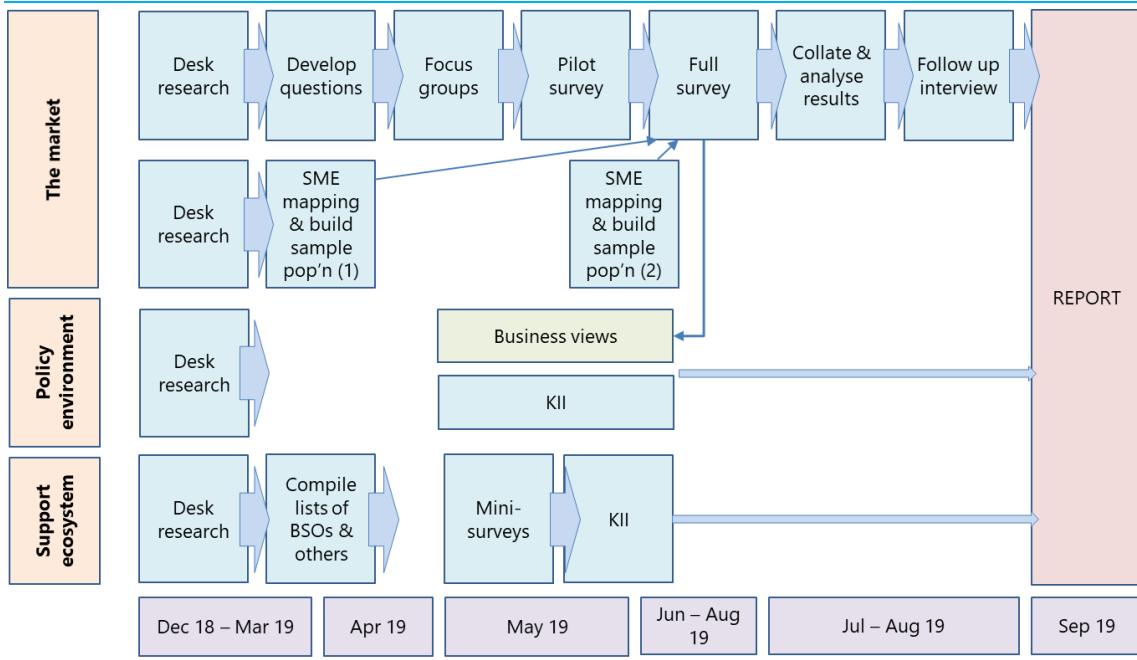
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There is always a trade-off in survey design between a desire to ask every possible question and the likelihood that respondents will stay sufficiently engaged to answer all the questions. This is a particular problem in a country like Nepal where there is a

## Understanding job growth potential in SMEs in Nepal

degree of 'survey fatigue', particularly so soon after the national economic census undertaken in 2018 and which covered much of the same ground, albeit in less detail.

**Figure 1: Approach to the research**



We recognise that there was an issue with the objective of the survey being amended, but we would have liked to have seen a much shorter questionnaire, more focused on what firms needed to do to grow successfully. Other aspects could have relied on a combination of results from the national economic census and other third-party surveys backed up by focus group discussions and semi-structured interviews.

There was so much variation in the answers to the open questions that it became difficult to analyse. This was also true of the 'other' option in closed questions when respondents were asked to explain other. In both cases, it would be better to test more options in the early focus group discussions and then rely on clearly differentiated answer options and exclude altogether the option of 'other'.

Too many questions allowed for the respondent effectively to guess the answer (e.g., proportion of sales that are international or days worked by temporary staff). Whilst we recognise that the answers to these questions may be important, having answers that are unreliable will not help in developing project or policy responses.

It was challenging to secure answers related to financial matters, as these are sensitive topics in Nepali culture. Moreover, if the respondent was not also the principal, the chances of getting accurate answers to financial questions were slim.

One unexpected problem was that responses that were expected to be figures were often text. For example, sales revenue was more often recorded as 10 crore, or 80 lakhs as it was 10,000,000. This required extra work to clean the data before it could be analysed.

A longer period to test the questionnaire and in particular to undertake some statistical analysis of these pilot results might have allowed us to identify additional factors that contribute to firms making a decent level of sales revenue or excluding factors that seemed to have little impact.

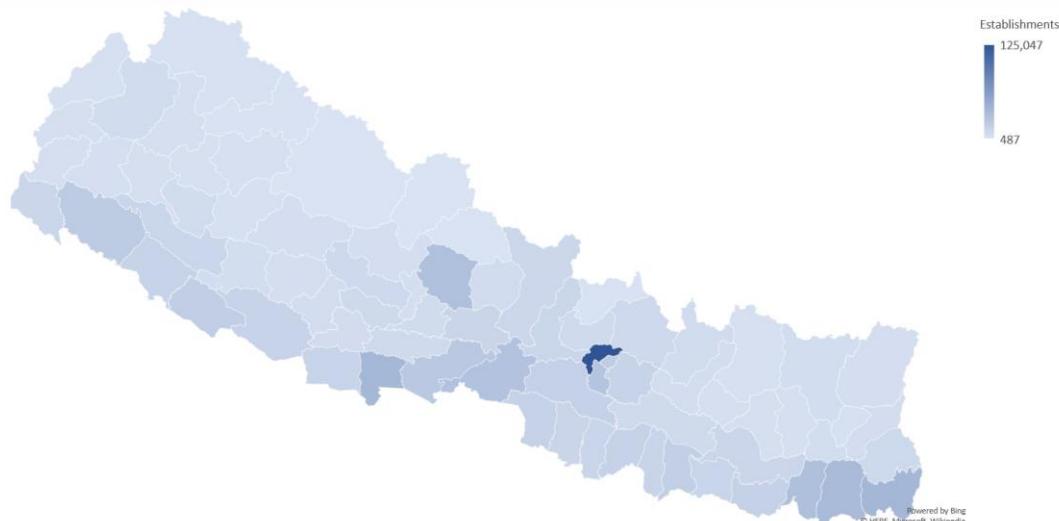
### 3. SMEs in Nepal

#### 3.1 Snapshot of SMEs within the national context

The recent national economic census (GoN 2019) reports that there are 923,000 establishments<sup>4</sup> of which almost 98 per cent are single entity (so independent businesses), 50 per cent are registered, 30 per cent are female owned (22 per cent in manufacturing and less than 10 per cent in IT, but 40 per cent in accommodation and food) and 55 per cent are owned by a young (under 40 years) person. Just one per cent is foreign owned. Some 40 per cent are home-based businesses. On average, there are 3.5 persons (including the owner) employed per establishment captured in the census. About 11 per cent of establishments are engaged in manufacturing; about 14 per cent are engaged in accommodation and food services; just under three per cent are engaged in agriculture, forestry and fishing (this is so low because most farmers are not registered) (Sigmund 2012).

The census notes that some 394,000 establishments (43 per cent) started between April 2015 and April 2018. If no establishments closed during the period, this increase would be equal to 20 per cent per annum. We can however assume that there would have been some closures, so the number businesses created would have been higher and thus the growth rate lower, perhaps closer to 12-15 per cent per annum. This is approximately equal to the growth rate in the UK over the last three years which has averaged around 14 per cent (with a closure rate of around 11 per cent). This rate does suggest, however, that a large number of people want to start their own business, which is very encouraging. The highest level of establishments is in Kathmandu (Figure 2).

**Figure 2: Establishments**



Source: National Economic Census (GoN 2019)

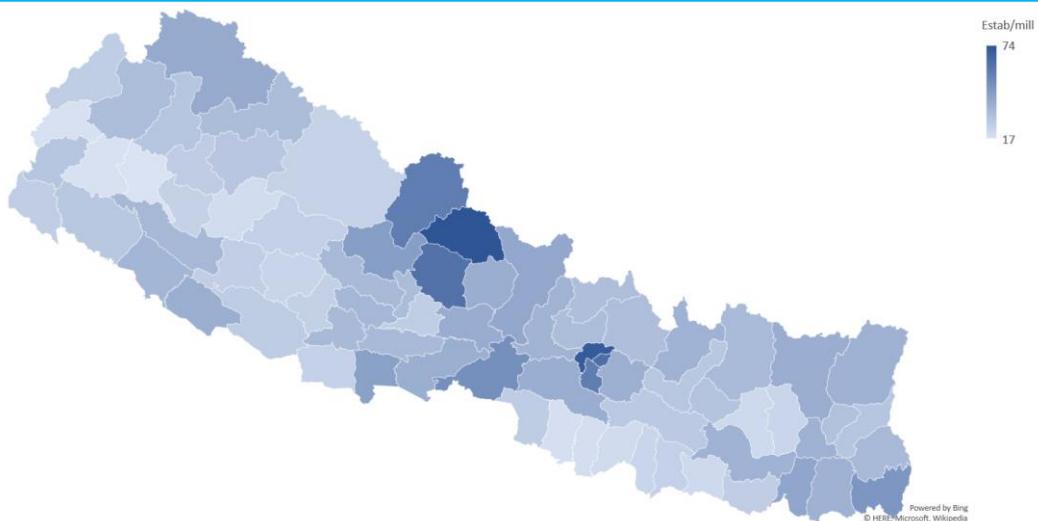
It is more revealing, however, to look at the number of businesses per 1,000 population (Figure 3). The census notes that there are 32 establishments per 1,000 population. This compares with a business density in the UK of around 107 per 1,000 population, so there is considerable room to grow. Kathmandu (72) has a high density as well as a high number of establishments, but Manang has the highest density (74). Third is

<sup>4</sup> An establishment is a single economic unit. The census covered all establishments except those involved in public administration, household employers and extraterritorial organisations. In the case of agriculture, forestry and fisheries, however, the business had to be registered.

## Understanding job growth potential in SMEs in Nepal

Bhaktapur (64) and Kaski is fourth (62). It is notable that the highest density of business generally appears to be in the middle third of the country, primarily in Gandaki Province (province number 4).

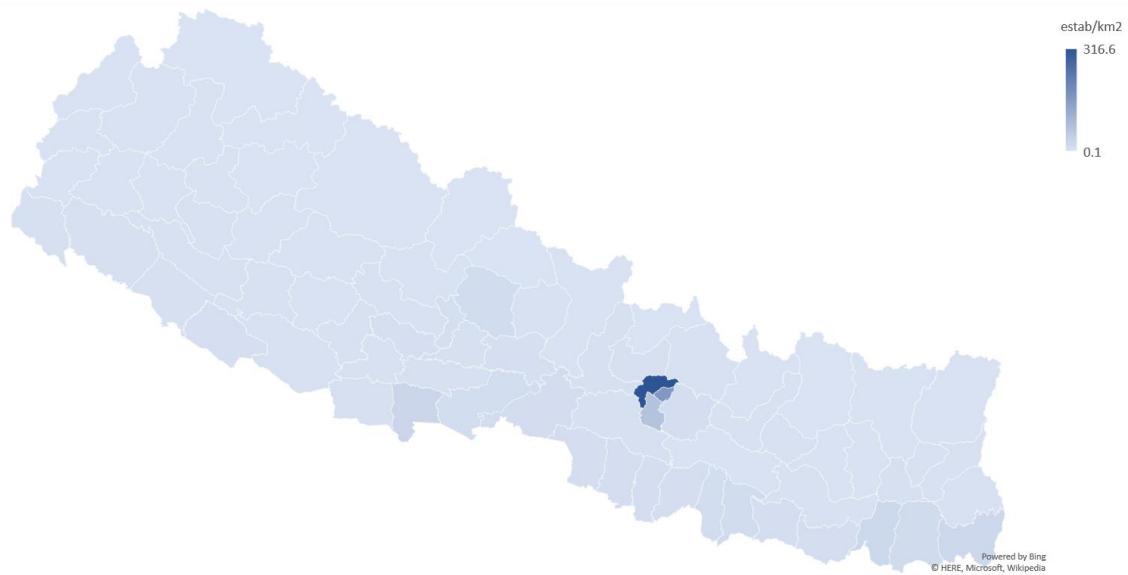
**Figure 3: Establishment density (per 1,000 population)**



Sources: National Economic Census 2018 (GoN 2019) & National Population & Housing Census 2011 (GoN 2012)

However, if we look at the concentration of businesses per square kilometre, it is immediately apparent that the greatest concentration is in and around Kathmandu, with the concentration fairly evenly spread across the rest of the country. Concentration is important because it is an indicator of how easily businesses can work with, or trade with, one another. This explains why most of the business support is, in fact, provided in Kathmandu.

**Figure 4: Establishment concentration (per km<sup>2</sup>)**



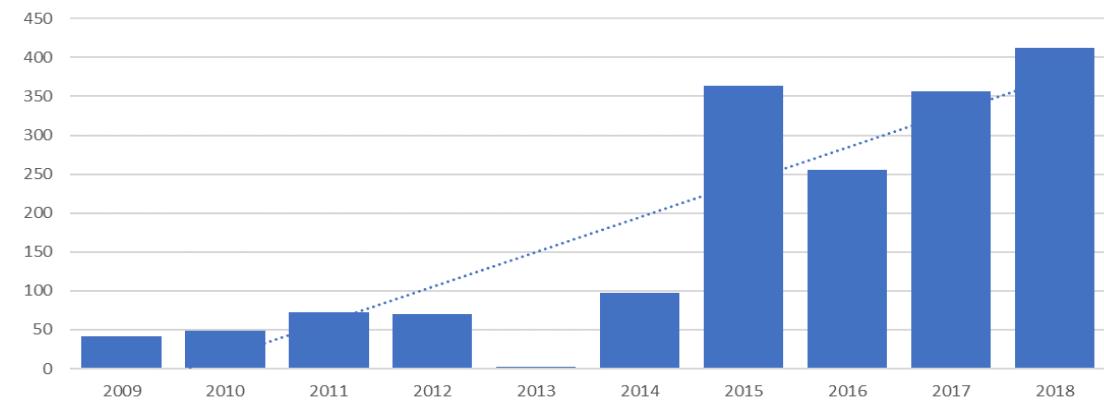
Sources: National Economic Census 2018 (GoN 2019) & [en.wikipedia.org/wiki/List\\_of\\_districts\\_of\\_Nepal](https://en.wikipedia.org/wiki/List_of_districts_of_Nepal)

The Office of the Company Registrar maintains a record of company registrations. Data is available online up until the middle of 2018.

This indicates a total of 184,000 companies, with sector (as shown by NSIC code) and district. It should be noted that there will be many more businesses since sole proprietors and partnerships are not incorporated and thus not recorded in this data.

The OCR data covers all companies so includes large companies as well as small ones. However, it provides a good proxy of where companies are located. To give a better feel for the geographic density of companies, Figure 5 shows the company population normalised by the actual population<sup>5</sup> for 20 selected districts. It will be noted that the highest company density is found in Kathmandu, followed by Lalitpur and then Kaski. The growth in company incorporations has accelerated over the last four years and is consistent with the assertion in the economic census report (GoN 2019) that growth has accelerated over the last three years. The chart in Figure 5 shows incorporations each year in Kathmandu specifically in the tourism sector.

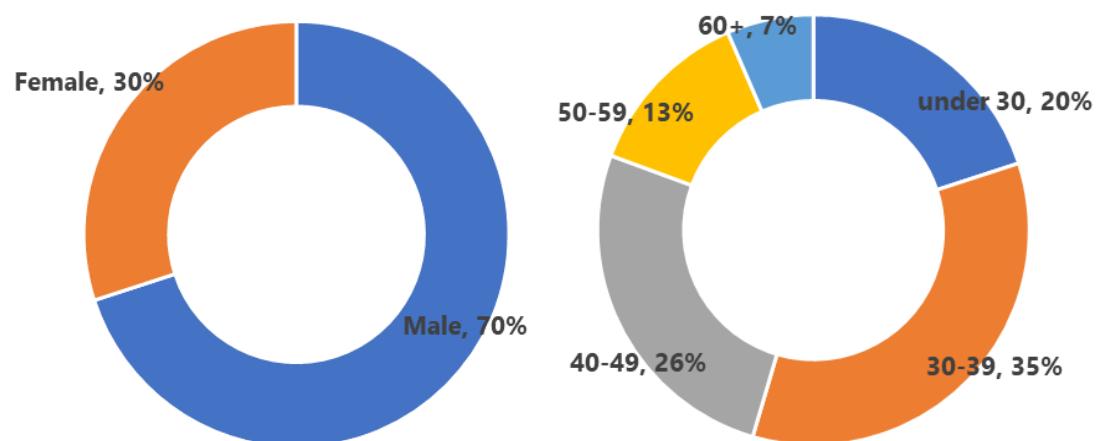
**Figure 5: Company incorporations (Kathmandu, tourism)**



Source: derived from data from the Office of the Company Registrar

Other sectors and other geographies show a broadly similar profile. We are unable to explain the dip in 2013 though most likely it was caused by the uncertainty following the dissolution of the first constituent assembly in 2012 leading to both frustration and a declining economy. A second constituent assembly election was held at the end of 2013. It is likely that people continued to hold back and, once they had decided that stability had returned, again started to form companies, hence the peak in 2015, and the subsequent return to the overall trend. The recent national economic census reports that most managers (and since most establishments are single entity, most owners) are male and the majority of businesses (55 per cent) are owned by people aged under 40 years.

**Figure 6: National census: manager by gender; owner by age**



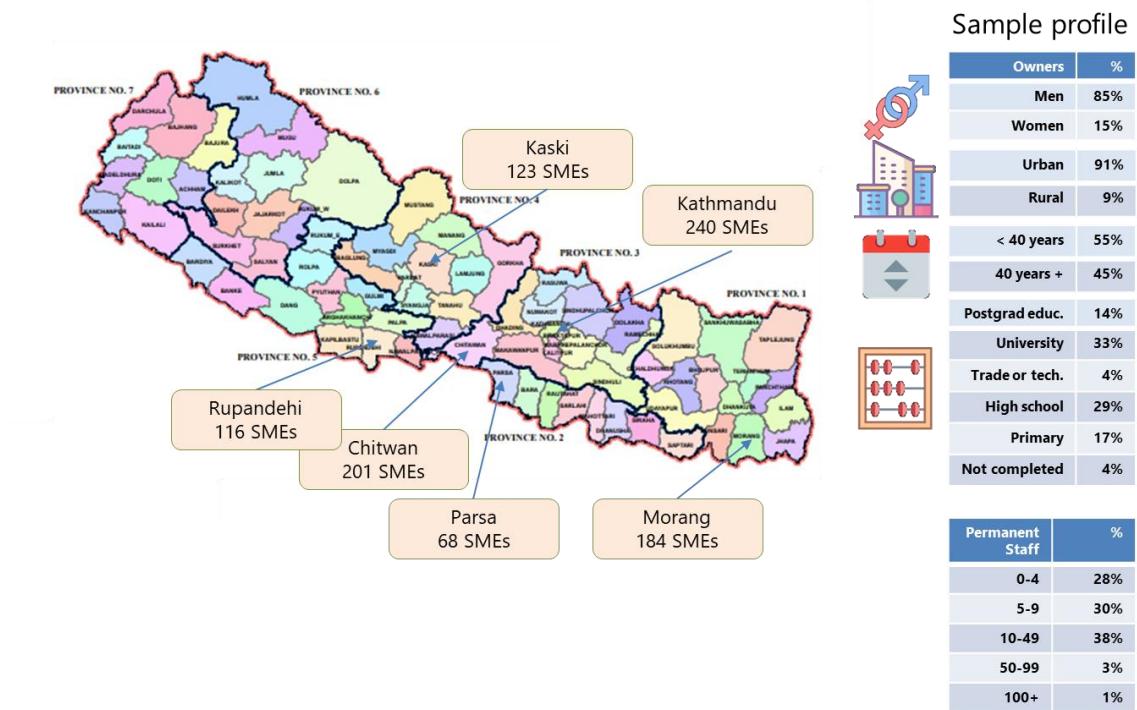
<sup>5</sup> Population figures from 2011 have been used. The total population at the time was around 26m and it is now 29m.

Source: GoN (2019)

### 3.2 Profile of SMEs in our sample

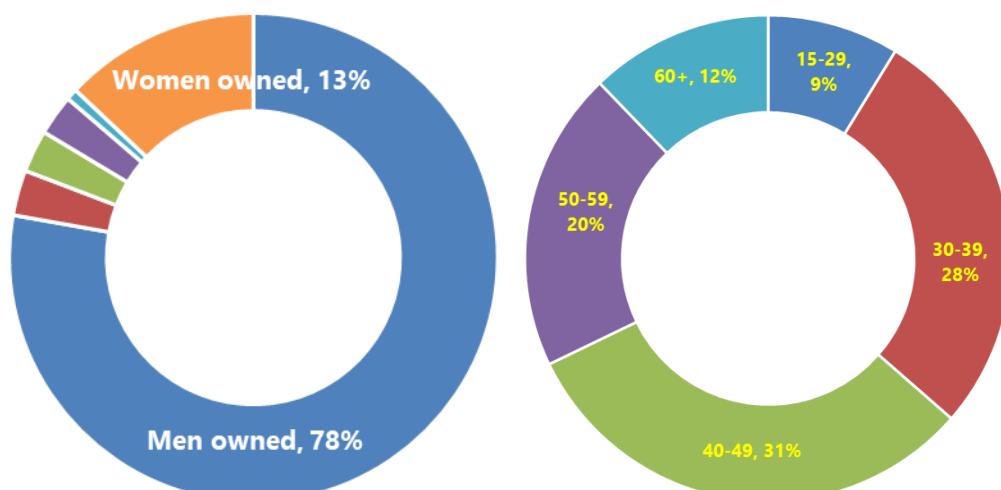
A snapshot of the sample population is provided in Figure 7.

**Figure 7: Summary of sample population profile**



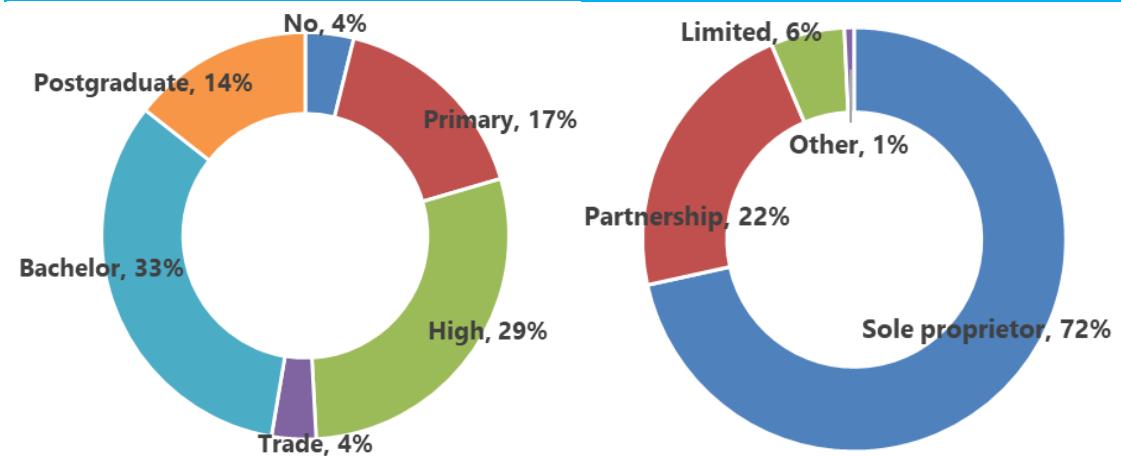
Our sample of 932 firms reflected somewhat different characteristics compared to the private sector as a whole, though we were specifically seeking businesses employing at least five people and it is much easier to find businesses that are formally registered than to find unregistered businesses. We have already commented on the challenge of finding female entrepreneurs. In our sample, 13 per cent are wholly owned by women, and a further four per cent have women owning more than half the business, giving a total of 17 per cent, thus exceeding the informal target set by the Louis Berger report. Women have minority stakes in a further six per cent of businesses. Some 37 per cent of businesses are owned by people aged under 40 (Figure 8).

**Figure 8: Sample: owner by gender, owner by age**



Our sample included a broad spread of educational attainment (Figure 9) with just under a third having completed a high school education, a small number having technology or vocational, trade-related training, just over a further third having completed a first degree and some 14 per cent having a post graduate qualification. Somewhat surprisingly, just five per cent of the sample population had set up a limited company. This could imply that people see being in business as a short-term activity, or that they have moderately low risks and so do not need the protection conferred by limited liability or have never had the benefits of limited liability explained. Our figure of 72 per cent sole proprietorship matched the findings of the World Bank Enterprise Survey (World Bank 2013).

**Figure 9: Sample: owner by educational attainment; business by legal status**



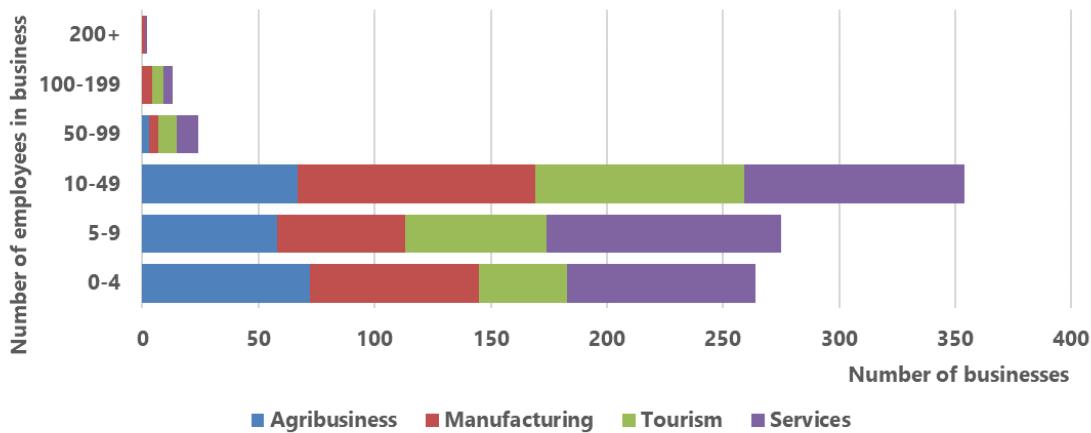
The majority of the sample (68 per cent) employed 5-49 salaried staff, and over a quarter (28 per cent) employed fewer than five salaried staff (see Figure 10, which breaks down the figures by sector also).<sup>6</sup> Only two of the sample employed more than 200. Note that (i) some firms in the 0-4 category had fewer than 5 *salaried* employees but more than 5 *total* employees, hence are included in the SME survey; and (ii) some firms met the 5-99 size criteria at pre-screening, but then reported fewer than 5 total employees or greater than 99 employees when interviewed. These firms were nevertheless retained in the sample due to the difficulties encountered in finding enough firms to participate in the survey.<sup>7</sup>

<sup>6</sup> If we include temporary and seasonal staff, then 73 per cent of the sample population employ 5-99 people.

<sup>7</sup> The inclusion of large firms (i.e., those with more than 99 employees) did not have a significant impact on the survey findings.

## Understanding job growth potential in SMEs in Nepal

**Figure 10: Distribution of sample by number of salaried employees and sector**

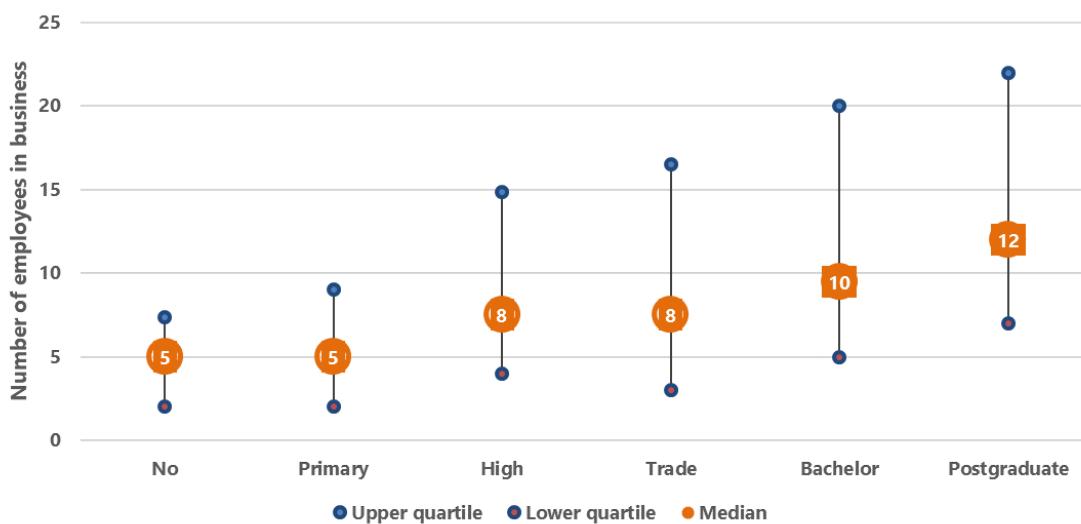


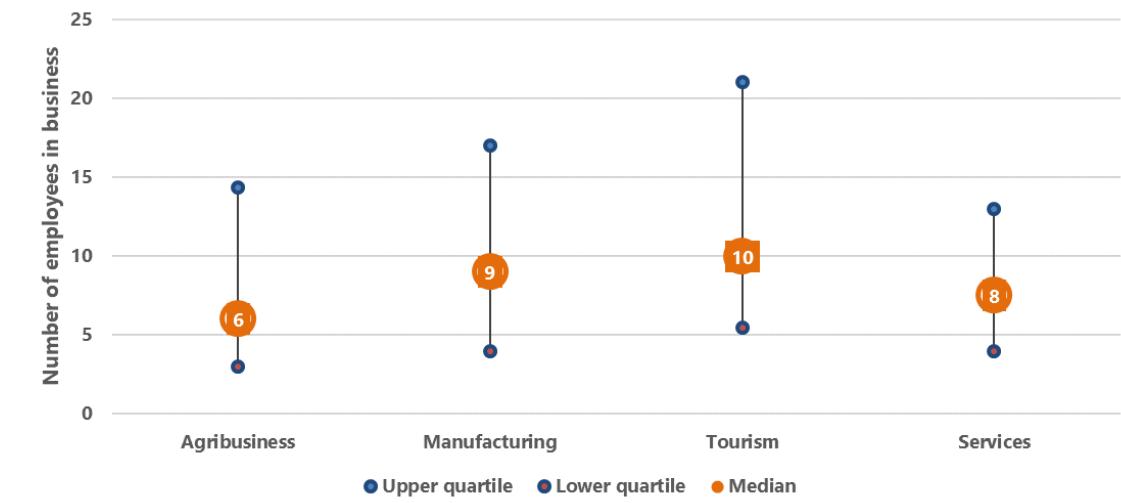
### 3.3 Results of SME survey

#### 3.3.1 Employment

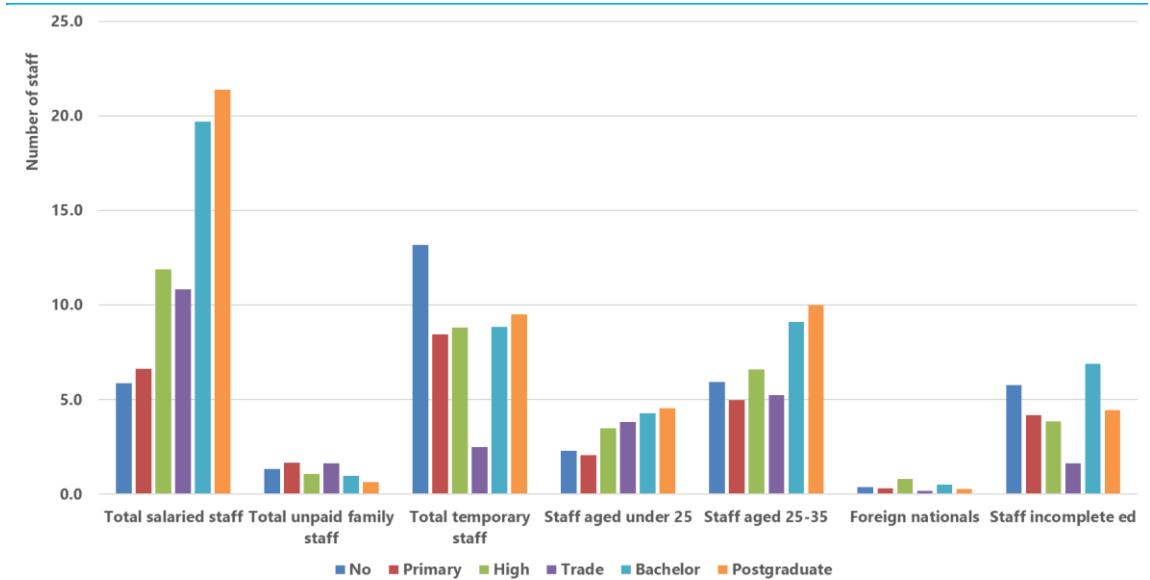
Firms led by employers with higher levels of education seem to be larger, suggesting a potential link between firm growth and entrepreneurs' schooling (Figure 11). This positive correlation holds with respect to the median number of employees as well as inter-quartile ranges. The median firm size for those with no or only primary education is five employees, and rises to 12 for those with a postgraduate qualification. Higher levels of education tended towards a higher upper quartile as well. Note that whilst there appears to be an association, we are making no claims about causation. It could be, for example, that post-graduates are simply more likely to cease business if it does not grow quickly enough to satisfy their aspirations. Figure 12 shows employment by sector. Perhaps not surprisingly, since it is a 'people business', it is tourism that has the highest median employment though in fact all sectors are quite close.

**Figure 11: Employment by educational attainment (based on salaried staff)**



**Figure 12: Employment by sector (based on salaried staff)**

On average businesses had some 21 per cent of their staff aged under 25, a further 45 per cent aged 25-35 and just three per cent of the workforce were foreigners. Respondents estimated that 29 per cent of their workforces had an incomplete secondary education. In Figure 13, which shows averages rather than medians, we see the same trend in higher employment as educational attainment increases. This broadly true for younger staff as well.

**Figure 13: Average employment by educational attainment of principal**

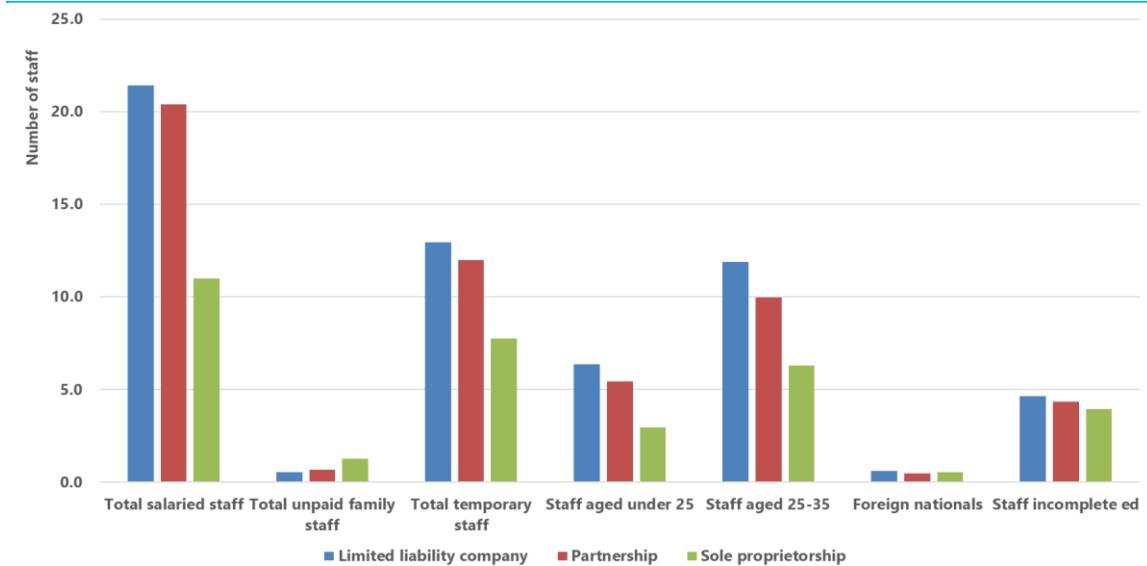
It is notable that limited companies and partnerships have much higher average employment than sole proprietors, at least in part reflecting the opportunity entrepreneurship<sup>8</sup> of those who start as a limited company or partnership. It is also notable that, whilst the numbers are small for all categories, limited companies and partnerships have fewer unpaid family members working in them. There is very little reliance on foreign workers, with an average of 0.5 across our sample (out of an

<sup>8</sup> Opportunity entrepreneurs start a business as a positive choice because they see a market opportunity or need that they may be able to fill; necessity entrepreneurs are those who cannot find employment and start a business out of necessity

## Understanding job growth potential in SMEs in Nepal

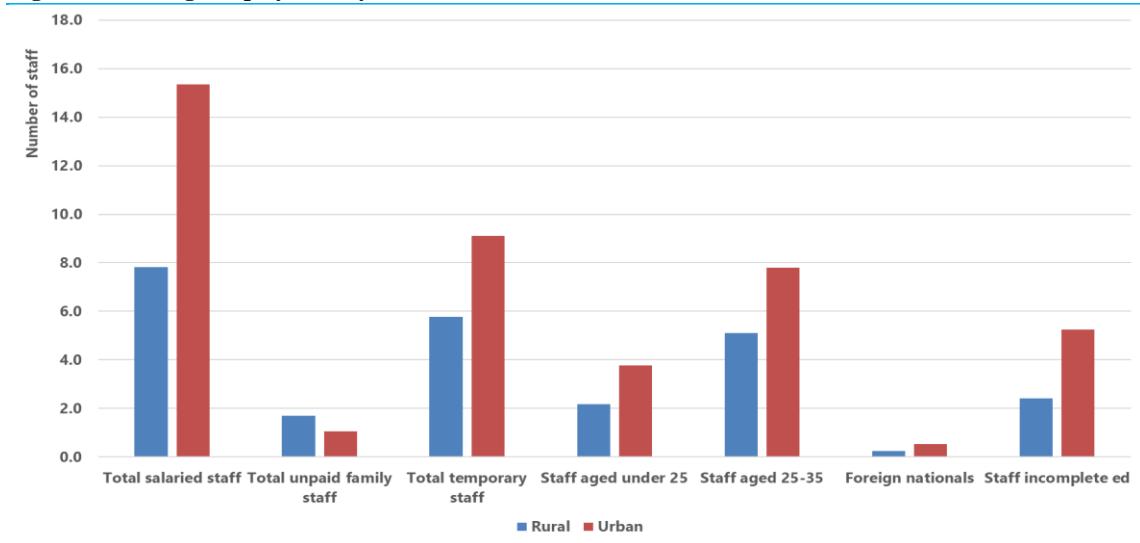
average of 14.7 people employed). Opportunity entrepreneurs averaged 0.7 foreign staff out of an average of 16.5 employees. Manufacturing averaged one out of 14.6.

**Figure 14: Average employment by legal status**



Urban businesses employ almost twice as many people on average – 15 salaried staff in urban locations versus eight in rural locations. They have more unpaid family members: 1.7 versus one. They have a smaller proportion of young people, fewer foreigners and less than half the average of staff without at least a basic education.

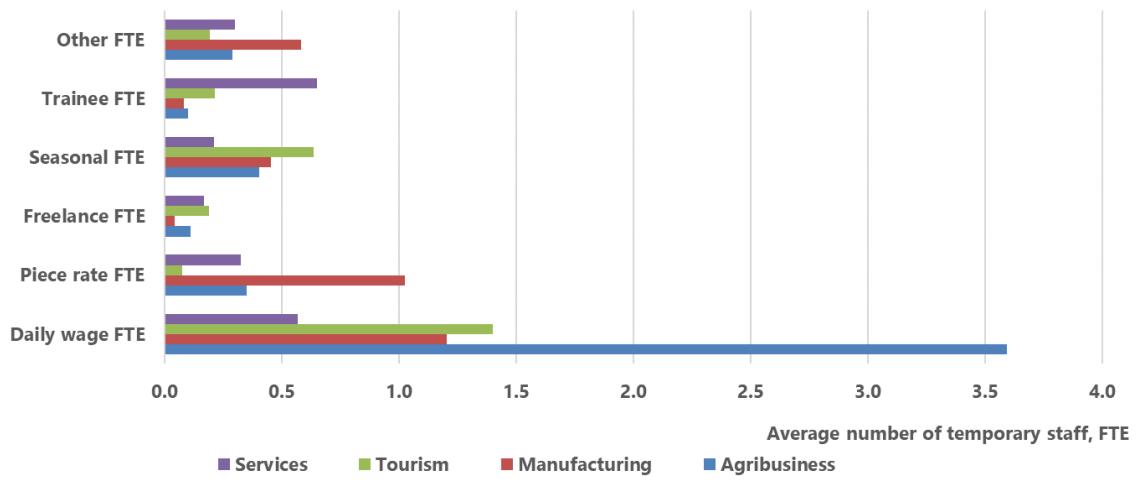
**Figure 15: Average employment by rural/urban location**



Respondents were asked to say how many people undertook work of a temporary nature last year and to estimate how many days work they did on average. We then treated 300 days as being equivalent to full time to give the results shown in Figure 16. There are four results that stand out – manufacturing needs people on piece rates and daily wages; agribusiness and tourism both employ people on daily wages. There is undoubtedly an element of businesses managing seasonal requirements by using temporary labour but there also appears to be a high degree of avoidance of labour law requirements by not offering people salaried jobs even when it is clear from the

evidence that people are effectively working full time (one business for example told us that 'temporary' staff were needed every day of the year to look after poultry).

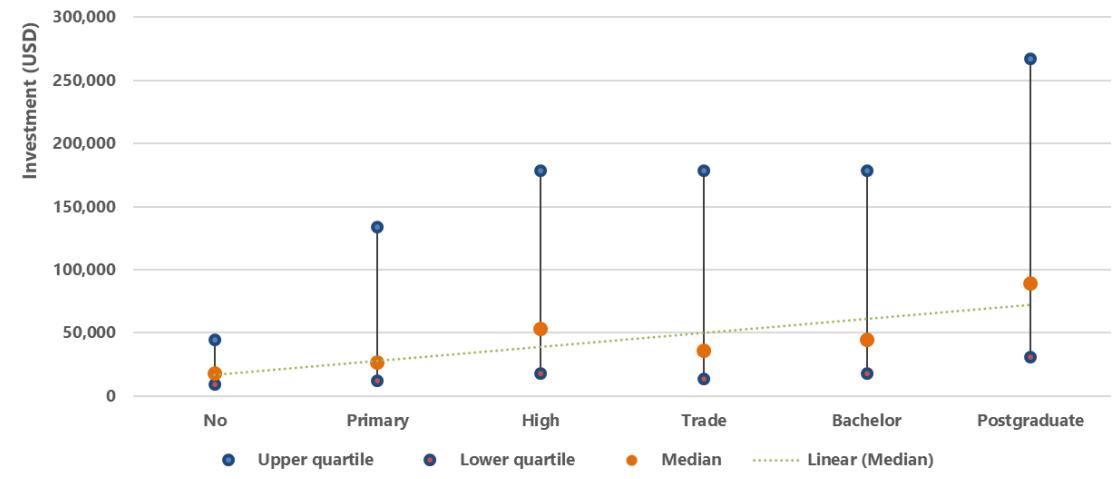
**Figure 16: Average temporary staff by sector**



### 3.3.2 Investment

Investment largely follows the same pattern as employment (Figure 17) with postgraduates having the highest median investment (shown in USD).

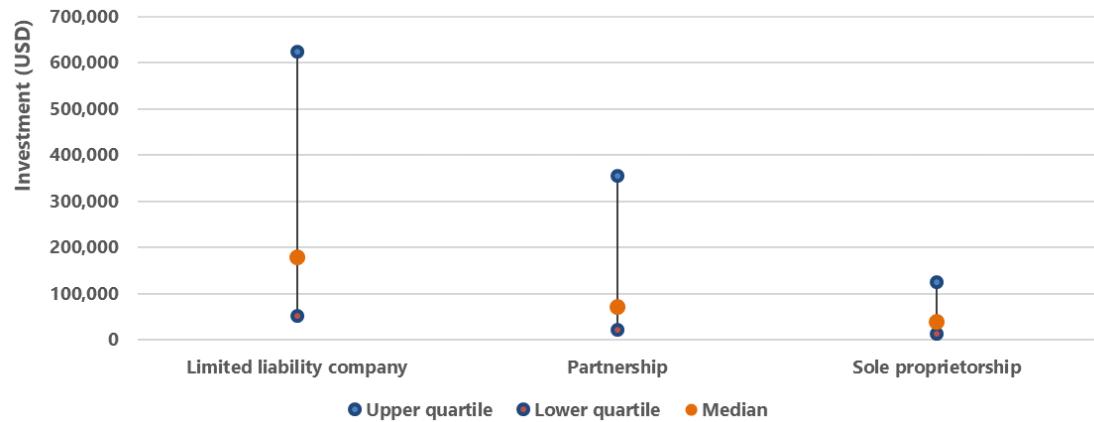
**Figure 17: Investment by educational attainment**



When we look at investment by legal status, we see that there is an increase in the median and the upper quartile for partnerships over sole proprietors and for limited companies over partnerships (Figure 18). Whilst this is what we might expect, it does confirm that businesses are more likely to incorporate if they need to raise much higher levels of capital.

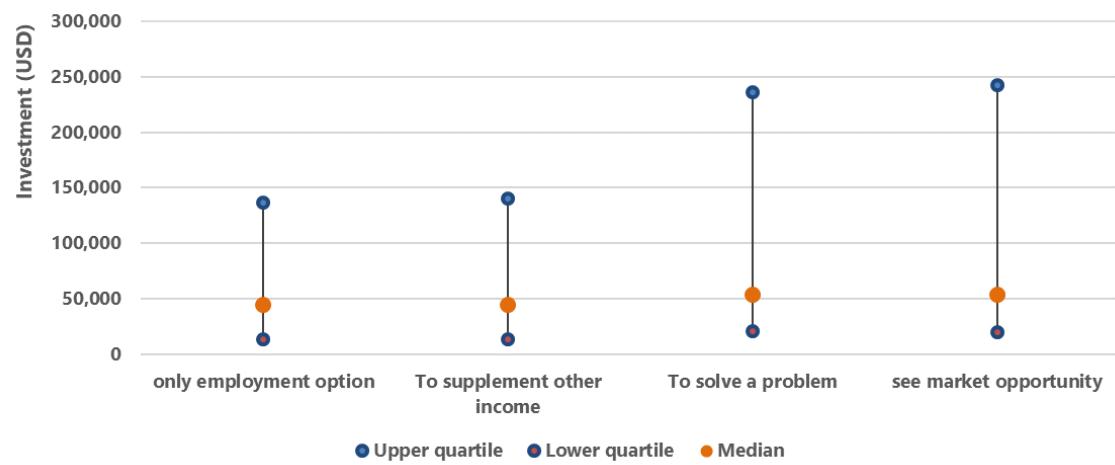
## Understanding job growth potential in SMEs in Nepal

**Figure 18: Investment by legal status**



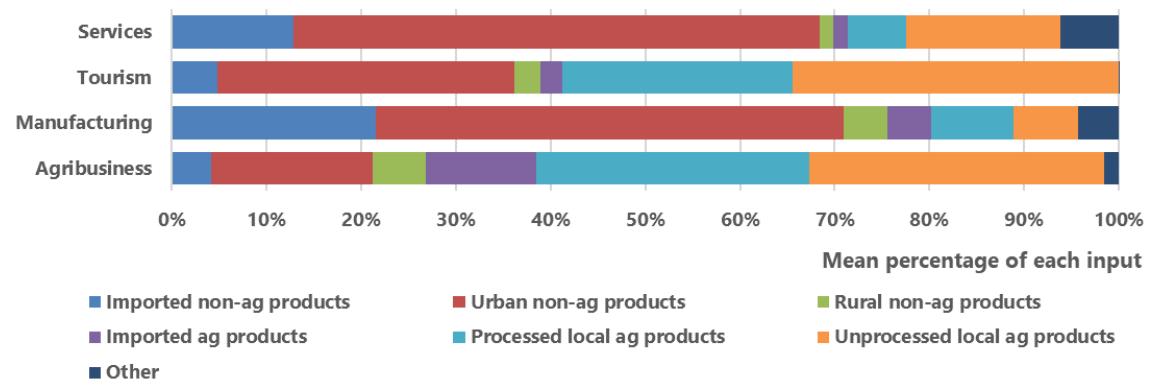
Investment level by reason for starting a business is revealing (Figure 19). Whilst the median is very close for all four groups (\$44,500 for only employment option and income supplement and \$53,500 for market opportunity and solving a problem) the spread is much wider for the opportunity entrepreneurs indicating that more businesses in these categories are seeking much higher levels of investment.

**Figure 19: Investment by reason to start**



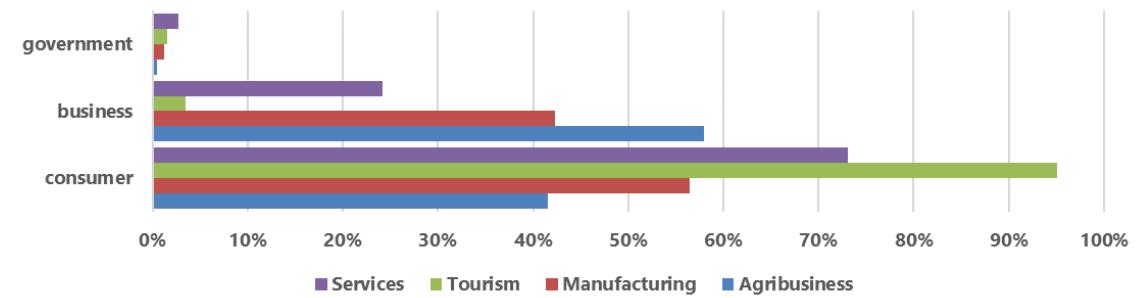
### 3.3.3 Inputs

Respondents were asked from where they source their inputs (Figure 20) by giving a percentage of total inputs of imported non-agricultural products, non-agricultural products sourced from urban locations in Nepal, non-agricultural products sourced from rural locations in Nepal, imported agricultural products, processed agricultural products sourced in Nepal, unprocessed agricultural products sourced in Nepal and other (which, for those who explained, often described products imported from India). The answers are exclusive but rely on respondents knowing the source so they might, for example, procure imported products locally and think of them as locally sourced. Some respondents either failed to answer this question or gave answers that did not sum to 100 per cent but the results still cover 516 respondents. The results reflect intuition: manufacturing has the highest reliance on non-agricultural products, both imported and locally sourced; agribusiness has the highest reliance on agricultural products. Tourism, which includes restaurants and hotels, claims a high reliance on agricultural products, but this will cover all the food that they serve.

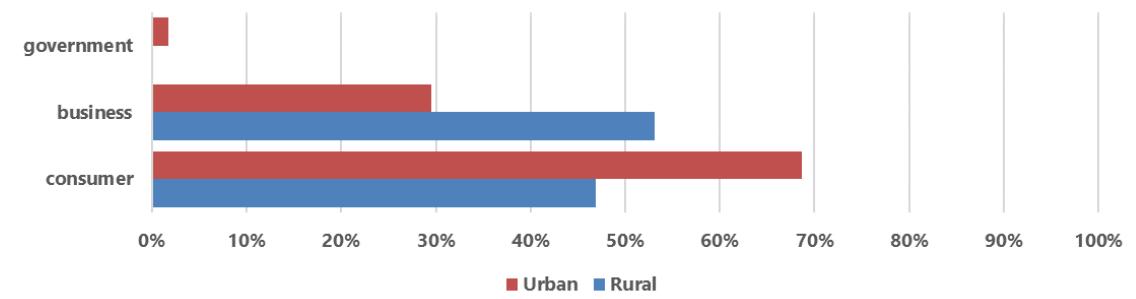
**Figure 20: Source of inputs**

### 3.3.4 Customers

Most businesses sell directly to consumers (Figure 21) rather than to other businesses or government. This is almost exclusively the case for tourism firms, but also largely for service sector firms. Agribusiness however sells more to other business than it does to consumers.

**Figure 21: Key customer groups by sector**

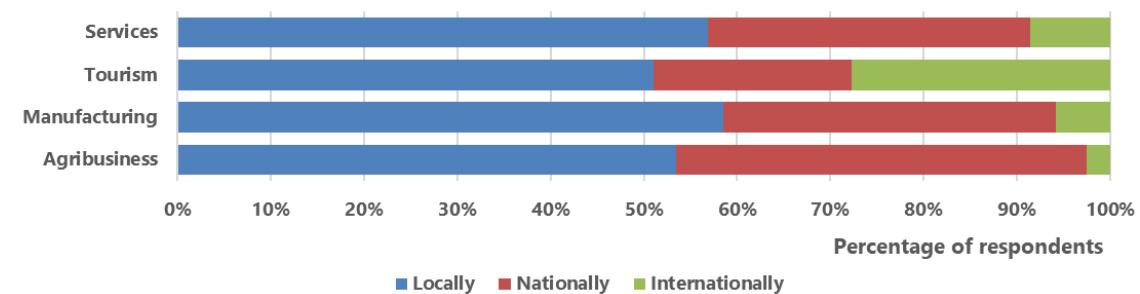
There is a regional component to this trend, namely urban businesses mostly sell to consumers while rural businesses (or at least rural agribusiness and manufacturing businesses) mostly sell to other businesses (Figure 22). This is not surprising, however, as a large proportion of agribusinesses are food processors and they are likely to be selling to wholesalers and retailers.

**Figure 22: Key customer groups by urban vs rural firms**

We asked two questions about exporting. In the first, we asked whether the firm sold mainly locally, nationally or internationally. Based on this answer, of our total sample, some 11 per cent of firms export (Figure 23).

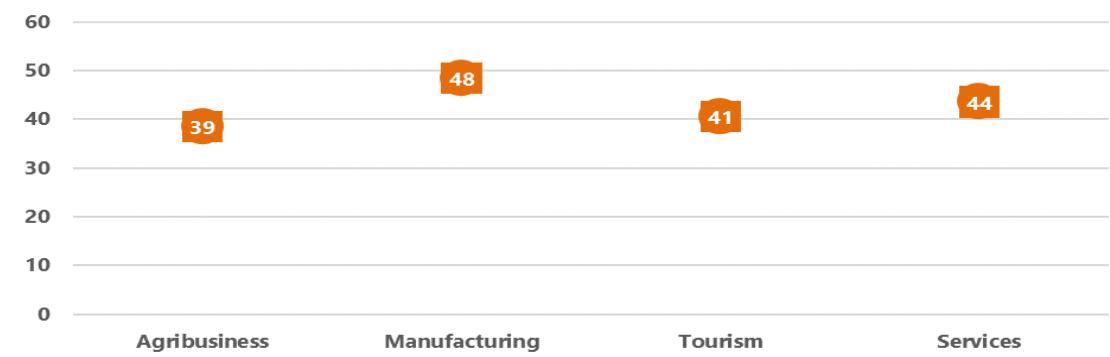
## Understanding job growth potential in SMEs in Nepal

**Figure 23: Location of customers by sector**

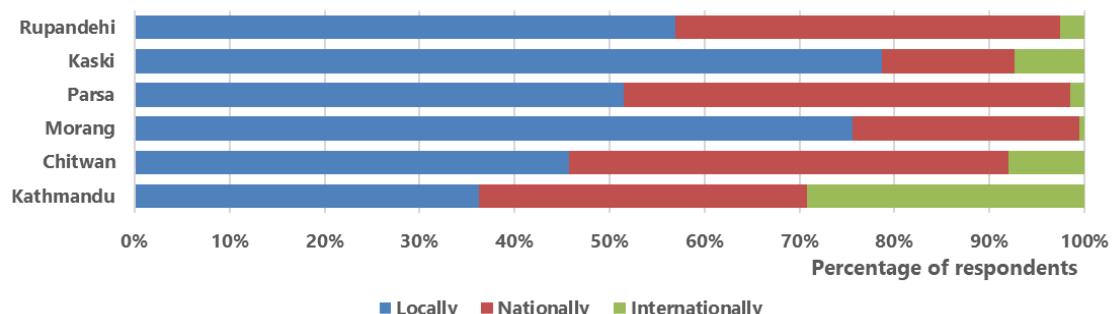


In the second question, we asked respondents how much of their output was exported. Not every firm that said that it exported answered this question, but 31 (that is, 3.3 per cent) said that they exported more than 10 per cent of their output, which compares with an Enterprise Survey finding of 5.1 per cent (World Bank 2013). In our sample, of those firms exporting, a median of 40 per cent of their total production is destined for foreign markets. By far the biggest proportion of exporting firms are in the tourism sector (Figure 17). Exports account for seven per cent of reported sales for the sample population (which compares to 1.8 per cent reported in the Enterprise Survey (World Bank 2013)). Whilst we have used medians for many other statistics, it is more appropriate to use the mean to report exports, partly because outliers cannot exceed 100 per cent, and partly because the mean is somewhat higher than the median (Figure 24). Exports cover a wide range of products including silk, felt, garments, ginger, spices, handmade bags, furniture, software and pickles. The largest single sub-sector was carpets. Of the 14 manufacturers who said that they export, six (43 per cent) were carpet manufacturers.

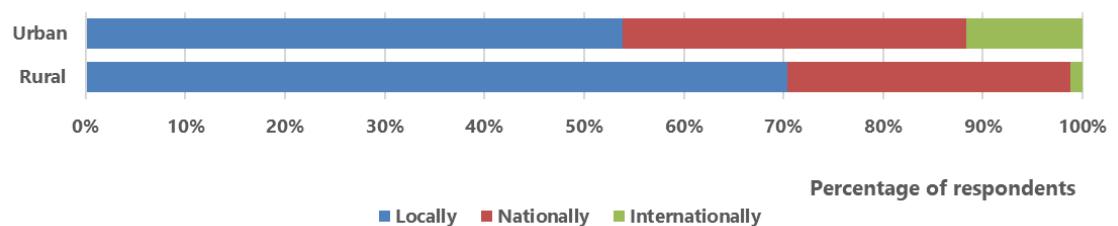
**Figure 24: Mean percent of output exported (by those firms that export)**



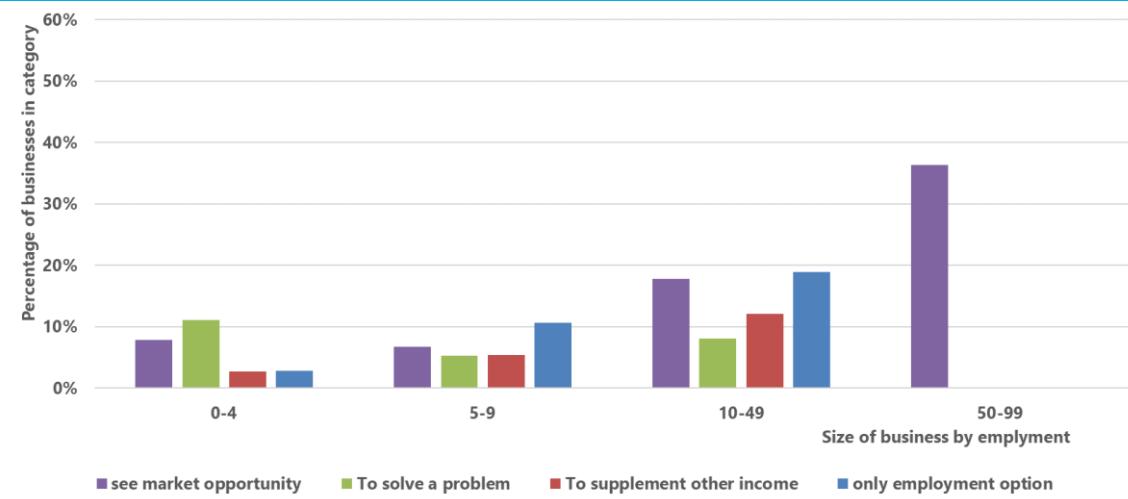
It is interesting to explore sales destination by district (Figure 25). The district with the highest proportion of international sales is Kathmandu (29 per cent). Eighteen of the 123 Kaski respondents said that they were in tourism. Only nine of the total, and only three of those in tourism claim to be selling internationally. This either means that half of those sell predominantly to local people or, more likely, they simply do not see selling tourism services as selling internationally. This could be a fault in the way that the question was worded. Similarly, 52 of the respondents in Chitwan said that they were in the tourism sector, and none claim to be selling internationally. Overall, 56 of the 202 businesses in the tourism sector (28 per cent) see themselves as selling internationally.

**Figure 25: Location of customers by district**

Some 70 per cent of rural businesses sell locally (Figure 26) and almost none sell internationally. There could be many reasons for this, including transport challenges, difficulty in accessing markets or even knowledge about markets and lack of ambition.

**Figure 26: Location of customers for urban vs. rural firms**

Whilst the number of firms selling internationally is low overall, it is predominantly the ones started by entrepreneurs who see a market opportunity or to solve a problem that are selling internationally.

**Figure 27: Firms selling internationally by reason to start**

### 3.3.5 Use of technology

Most firms use at least some form of technology in their operations, and most firms use technology for several aspects of running their business (Figure 28). On average, businesses report using technology in four areas of activity, most prevalently in accounting functions and internal communications, followed by customer interactions,

## Understanding job growth potential in SMEs in Nepal

procurement and stock control. Postgraduate entrepreneurs used technology the most whilst those with a trade or technical training seemed to use technology the least.

**Figure 28: Use of technology by sector**

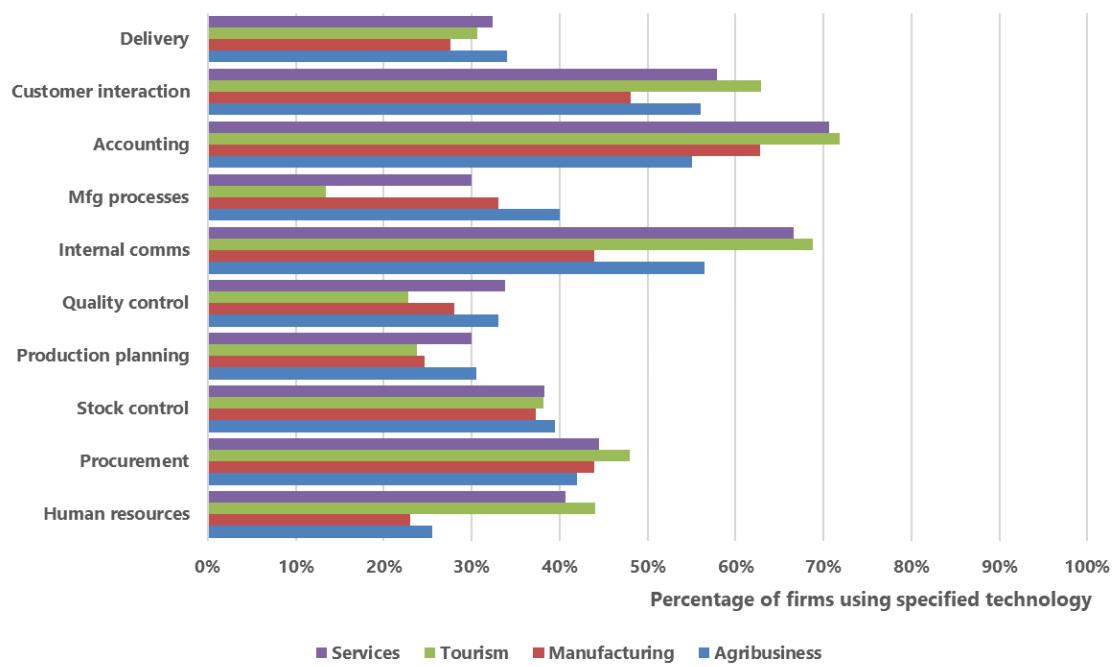
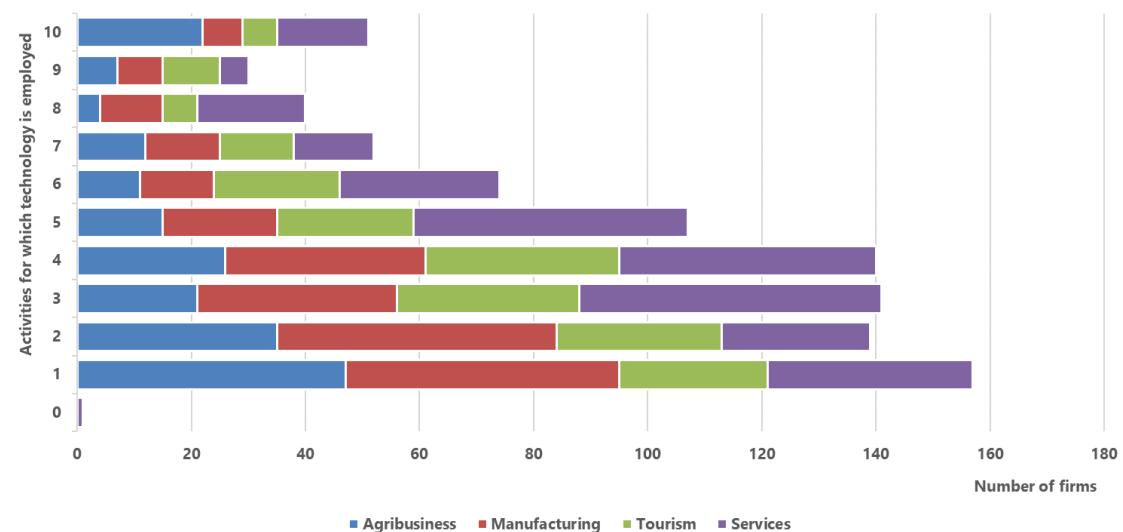


Figure 29 shows the number of businesses, by sector, and the number of aspects of running their business in which they use technology to help them. Note that only one respondent out of our total sample population of 932 said that they do not use technology at all.

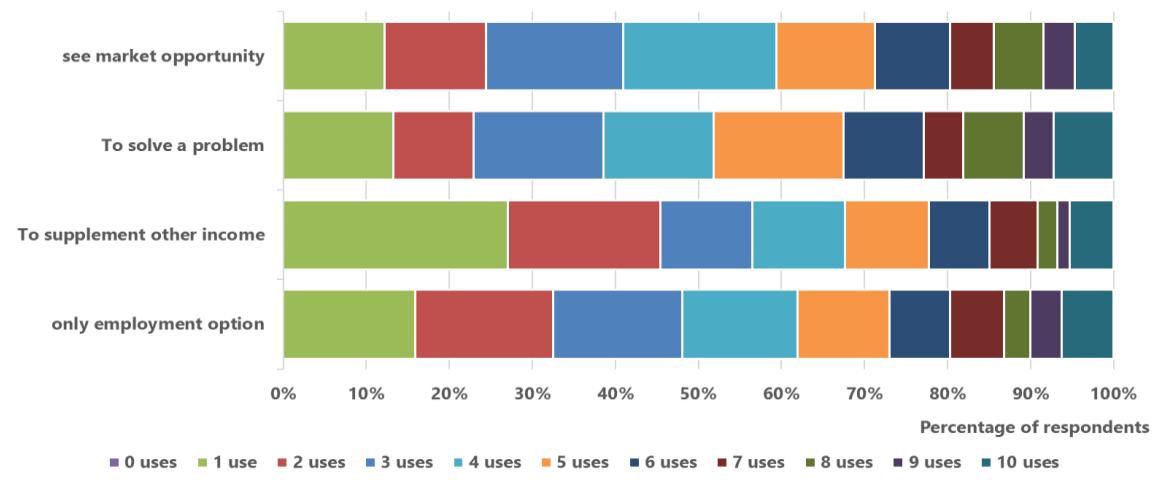
The in-depth interviews revealed, however, that technology in production processes is either less prevalent, or outdated, but that acquiring the latest technologies is expensive and time consuming since it all has to be imported. Often the latest technologies also require skilled operators so firms have to import skills from India as well as the equipment.

**Figure 29: Businesses by sector and number of technologies used**



It is notable, when we look at use of technology by reason to start (Figure 30), that those who see a market opportunity or want to solve a problem make rather more use of technology than the other two groups, though the differences are not great.

**Figure 30: Use of technology by reason to start**



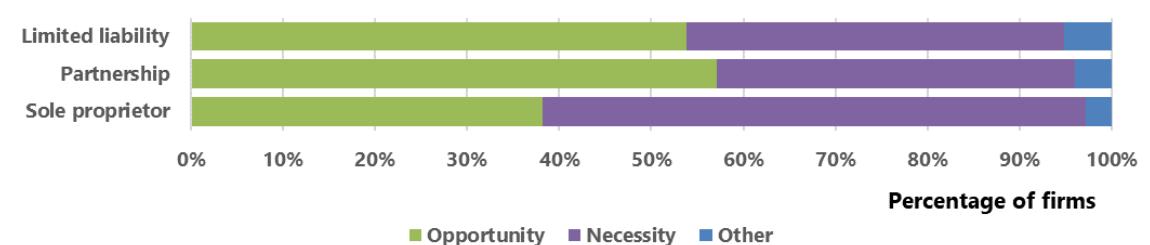
The in-depth interviews revealed that it is often hard to source manufacturing technology in Nepal and generally it is imported from China or India. This, businesses claimed, is challenging because of high import tariffs.

### 3.3.6 Reasons for starting in business

Respondents were asked about their motivation to run their own business. Respondents could choose from running a business being the only employment option, supplementing other income, solving a problem or seeing a market opportunity or other. Some of the other answers have been recategorized, based on their description. About three per cent could not or would not say. In the charts, the only employment and income supplementing options have been combined into necessity entrepreneurship; solving a problem and seeing market potential have been combined into opportunity entrepreneurship. Overall, 43 per cent of entrepreneurs see the opportunity.

Given the high proportion of necessity entrepreneurs, we might expect that most of these are sole proprietors (Figure 31). We do indeed find a high proportion (59 per cent) of sole proprietors are necessity entrepreneurs. Partnerships and companies both have more than 50 per cent being opportunity entrepreneurs. Given that forming a partnership requires more than one person to see the opportunity, and that forming a company requires a degree of proactivity in terms of paperwork, this is probably not surprising.

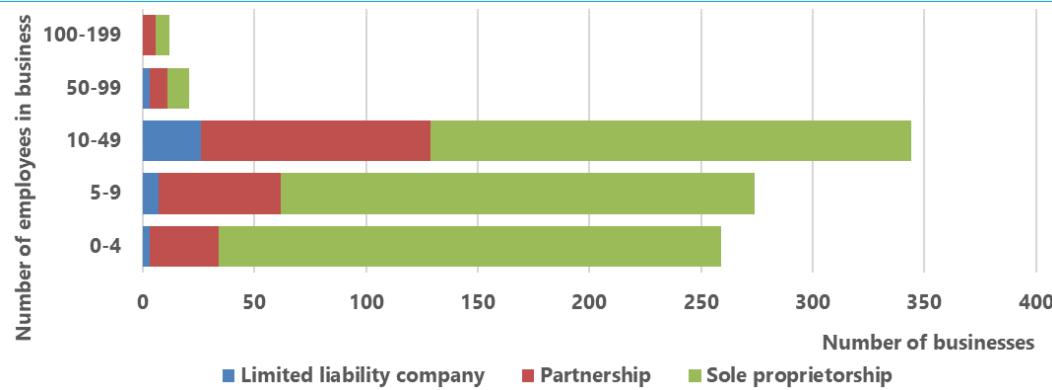
**Figure 31: Reason to be in business by legal status**



## Understanding job growth potential in SMEs in Nepal

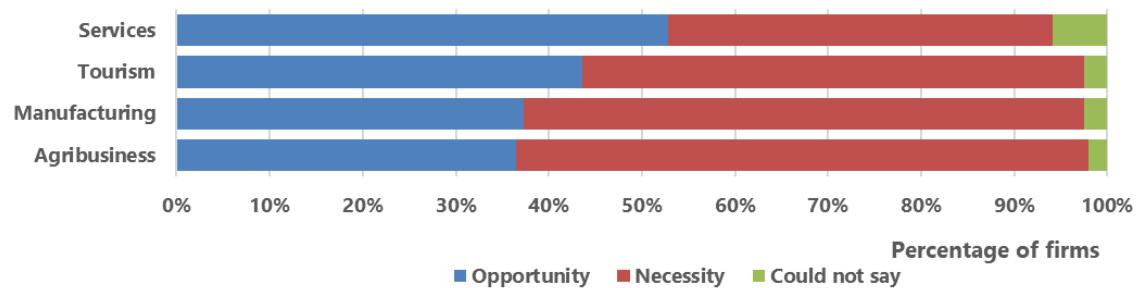
It is interesting to note that companies and partnerships are likely to be larger (Figure 32) with most companies and a large proportion of partnerships in the 10-49 employee band. This perhaps implies that entrepreneurs forming partnerships and companies are more ambitious to grow their business and supports the thesis that they are more likely to be opportunity entrepreneurs.

**Figure 32: Size of business by legal status**



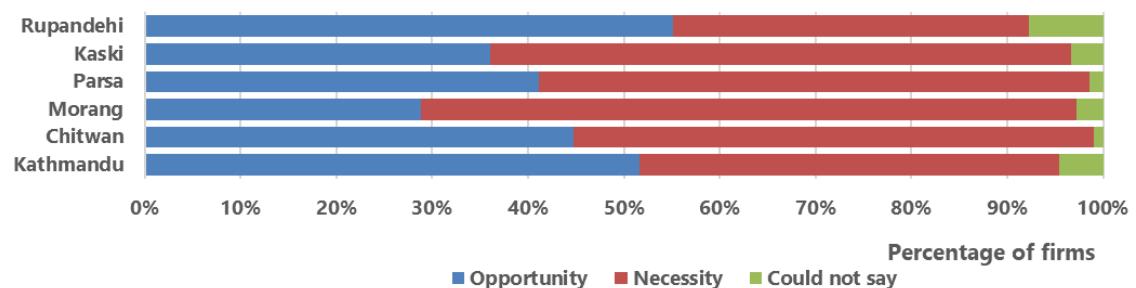
Returning, now, to entrepreneurship which differs across sectors, with services having 53 per cent opportunity entrepreneurs and manufacturing and agribusiness both at 37 per cent. Whilst we cannot explain this, it seems likely that it is bound up with risk: service businesses need lower levels of capital than manufacturing or agribusiness, so the risk is less, so entrepreneurs who see an opportunity are more likely to try it.

**Figure 33: Reason to be in business**



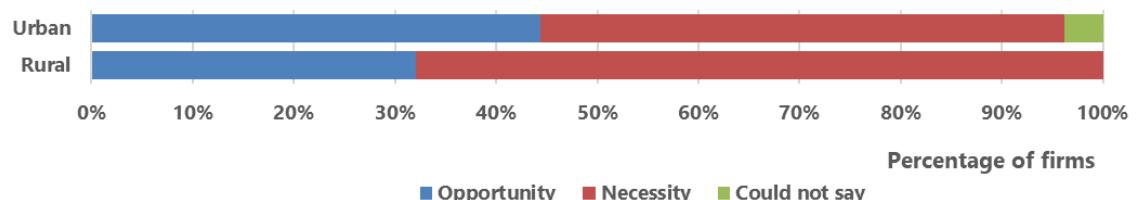
Interesting differences emerge when we look at reason by district. Some 50 per cent of the respondents in Kathmandu and 55 per cent in Rupandehi were opportunity entrepreneurs; conversely, entrepreneurs in Morang and Kaski were most driven by necessity (Figure 34). This may be because Rupandehi has recently developed in terms of infrastructure, local development and diverse business potential whereas Morang (trading and industry) and Kaski (tourism) have not changed.

**Figure 34: Reason to be in business by district**



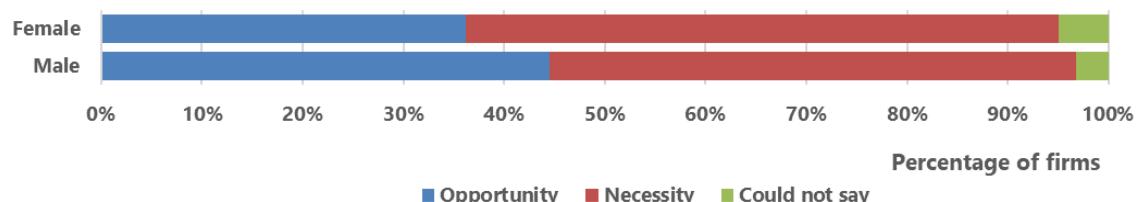
There is a marked difference, too, when we look at the split between urban and rural businesses (Figure 35) with 68 per cent of rural businesses started because it was the only way to find employment or to supplement their income. This observation is consistent with the limited employment opportunities available in rural settings, as well as the greater ease of reaching consumers in large urban markets.

**Figure 35: Reason to be in business by urban vs. rural location**



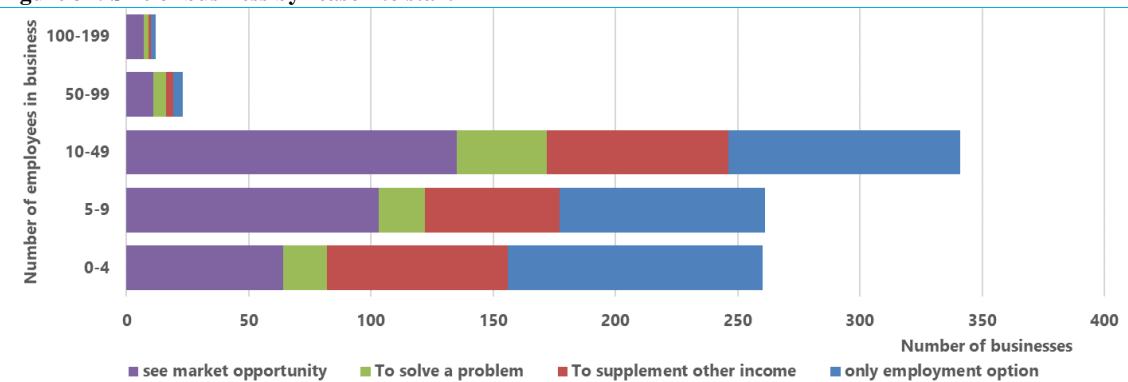
It seems that men are somewhat more likely to be opportunity entrepreneurs compared to women (Figure 36) with 45 per cent of men but only 36 per cent of women seizing the opportunity.

**Figure 36: Reason to be in business by gender**



It is worth reflecting for a moment on the characteristics of businesses started by opportunity entrepreneurs and, in particular, those started by people who want to solve a problem. Just over 50 per cent of businesses employing 10-49 people are managed by opportunity entrepreneurs. It seems that the larger a business grows, the more likely it is to be managed by an opportunity entrepreneur.

**Figure 37: Size of business by reason to start**

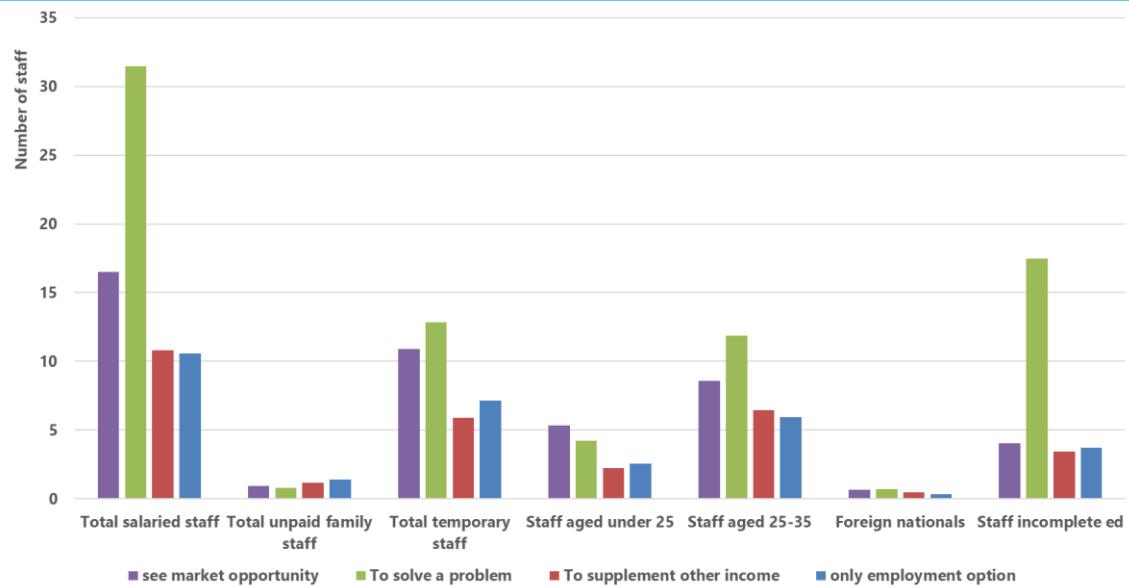


The group that stands out across almost all staff indicators is those people who started to solve a problem – except for unpaid family members where they are the lowest. They employ, on average, the most salaried staff and the most temporary staff. It is perhaps curious that they also employ the most people with an incomplete education but we

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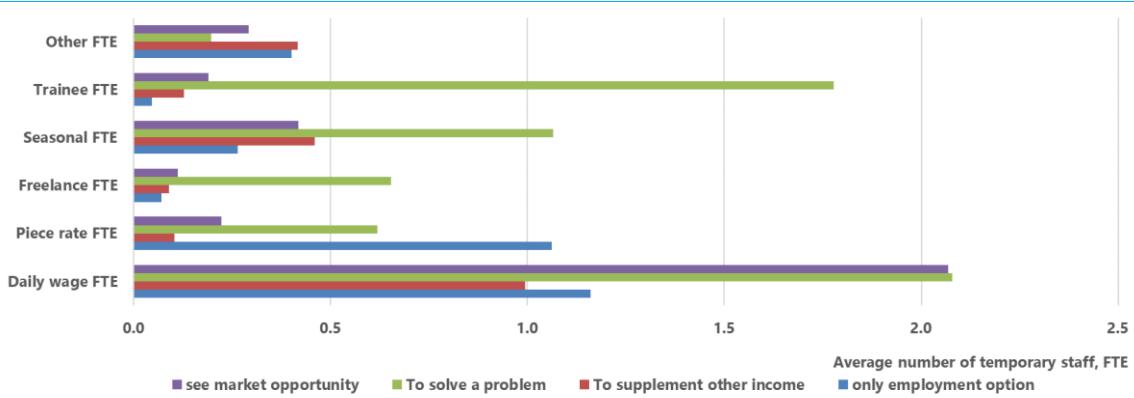
surmise that this is because they need to find people who can work for them and there are not more skilled people available.

**Figure 38: Employment by reason to start**

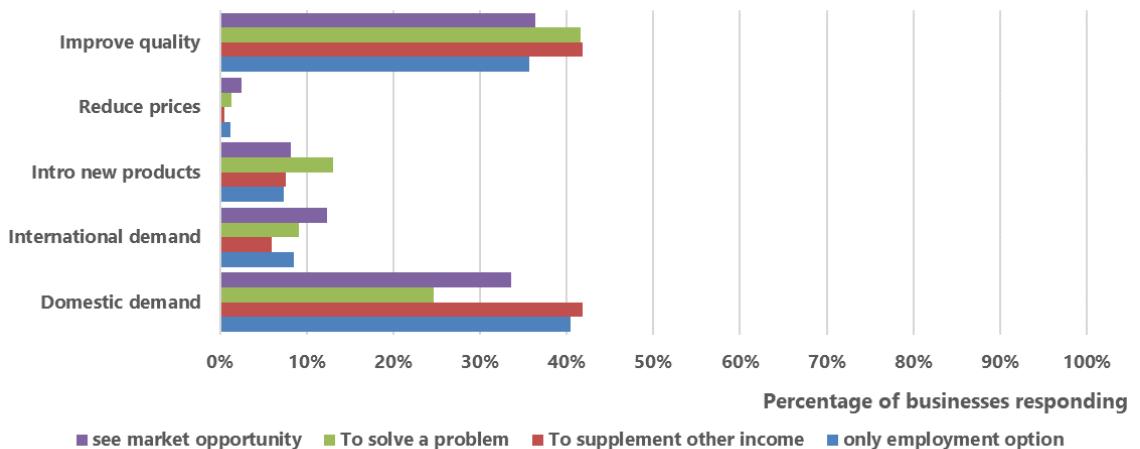


As noted above, businesses managed by opportunity entrepreneurs make most use of temporary staff (Figure 39) and this seems to be true across most categories. Given the large number of staff with incomplete education, it is interesting to note that it is businesses aiming to solve a problem that make most use of trainees. We cannot say whether this reliance on temporary staff is a short-term route to growth that eventually results in higher employment or whether it is simply expedient but given the high number of trainees we would suggest that it is the former.

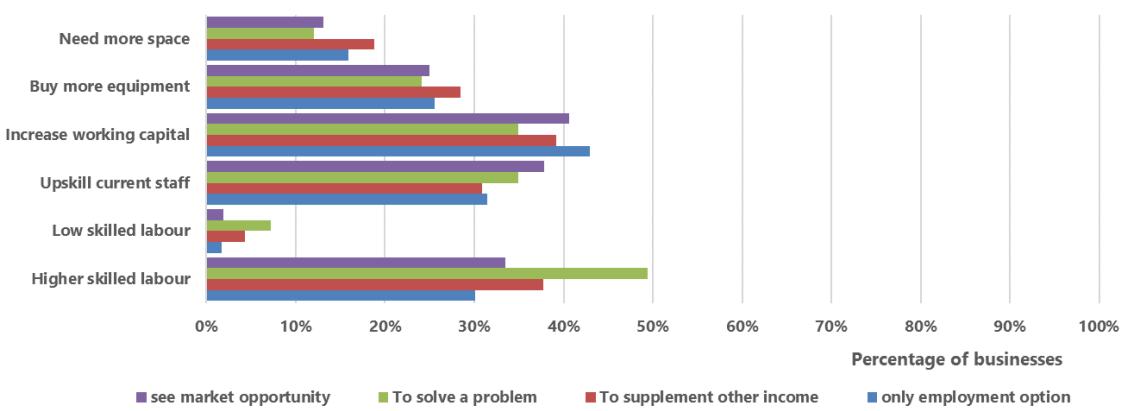
**Figure 39: Use of temporary staff by reason to start**



It will be no surprise that those solving problems are most confident about growing their business. What is interesting, however, is how they plan to do that (Figure 40). They are the group that is least expecting to grow through increasing domestic demand and the group most expecting to introduce new products. They score well, as does the group that is simply supplementing their income, on improving quality.

**Figure 40: Plans to grow by reason to start**

There is little difference between the groups regarding the requirements to grow – though a greater percentage of opportunity entrepreneurs are seeking higher skilled labour and expecting to train their existing workforce.

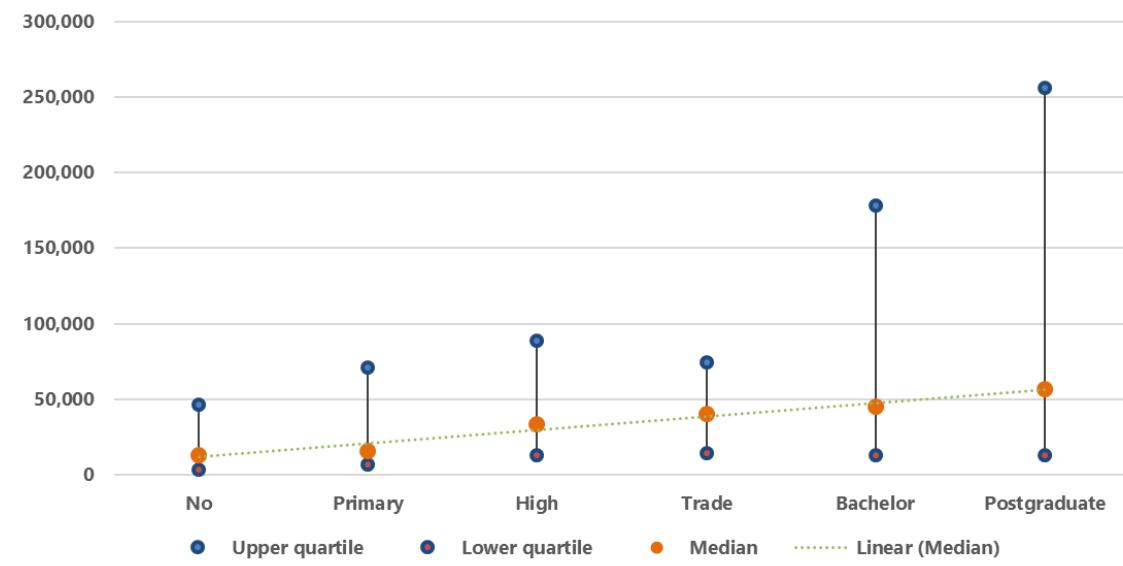
**Figure 41: Requirements to grow by reason to start**

### 3.3.7 Performance

We turn now to look at the performance of SMEs. Figure 42 shows sales revenue by educational attainment and we see that revenue rises with education. We have undertaken a regression analysis (appendix 10) which confirms educational attainment as a factor contributing to higher revenue, though we are not claiming that higher levels of education drive higher revenue. It may simply be that those with a higher education who do not quickly grow decide to do something else. This might suggest however that those with a higher education who are still in business could be a good target for additional support.

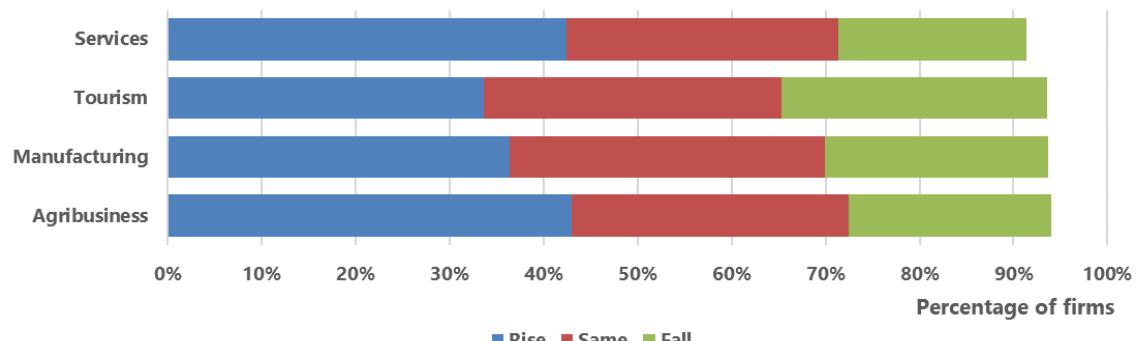
## Understanding job growth potential in SMEs in Nepal

**Figure 42: Sales revenue by educational attainment**

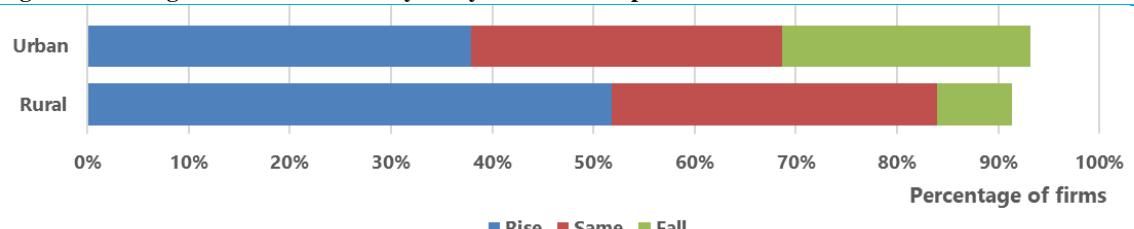


Some 39 per cent of respondents said that their revenue had grown last year, 31 per cent reported no change and 23 per cent reported a fall. Agribusiness saw the most firms (43 per cent) reporting increased sales, with services (42 per cent) close behind (Figure 43). Tourism was the weakest sector, with just 34 per cent of firms reporting an increase in sales and 28 per cent reporting a fall (the highest of any sector). This is surprising as the World Travel & Tourism Council reports growth in 2017 and was expecting further growth in 2018 (WTTC 2018).

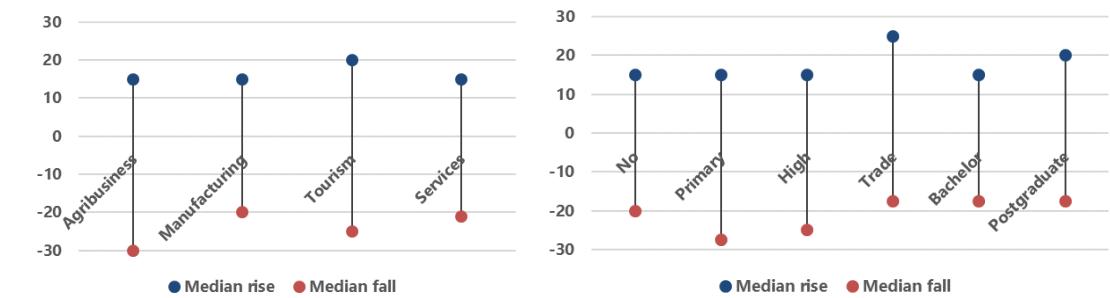
**Figure 43: Change in sales revenue last year by sector**



Interestingly, despite rural businesses being predominantly necessity businesses, more than half (52 per cent) said that their revenue had grown (Figure 44) and only seven per cent reported a fall. When the figures are reviewed on the basis of reason to start, there is little difference: businesses aiming to supplement other income are just ahead on growth in revenue. The main difference is that business who see a market opportunity were least likely to see a fall in revenue (19 per cent) and those who saw being in business as their only employment option were most likely to see a fall in revenue (28 per cent).

**Figure 44: Change in sales revenue last year by urban/ rural split**

The charts in Figure 45 show the median rise (for those businesses whose sales revenue rose) and the median fall (for those whose sales revenue fell) both by sector and by educational attainment of the principal. Tourism sector businesses saw the greatest rise (confirming the assessment of the WTTC). Entrepreneurs with a technical or trade training saw the greatest increase and also the least fall. The key observation from this is that whilst more firms saw an increase in revenue, the scale of the increase was rather less than the scale of the fall for those firms who saw a decrease in sales revenue. In other words, more firms are growing than contracting but the average across all firms is more or less standstill. This may imply that growth in some firms is coming at the cost of contraction in others, which is consistent with most firms' focus on the domestic market.

**Figure 45: Change in sales revenue**

### 3.3.8 Productivity

We have attempted to look at labour productivity, which is usually defined as value added per full time worker. Our sample population has total reported salaried employment of almost 16,000 but relies on a further 9,000 workers providing temporary or seasonal contribution. Whilst it is relatively easy to ask respondents about the number of salaried staff, they find it harder to estimate the total contribution by their temporary staff. Furthermore, whilst we have figures for revenue, we do not have figures for value added, though we can perhaps estimate. If we look at the whole sample, as with sales revenue, there is trend of productivity increasing with the educational attainment of the principal. The median is \$2,000 per full time equivalent worker (including temporary workers) for principals who did not complete their school education rising to \$4,000 for those with a postgraduate qualification and almost as high for those with a trade qualification (Figure 46).

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**Figure 46: Productivity (revenue/FTE) by educational attainment of principal**

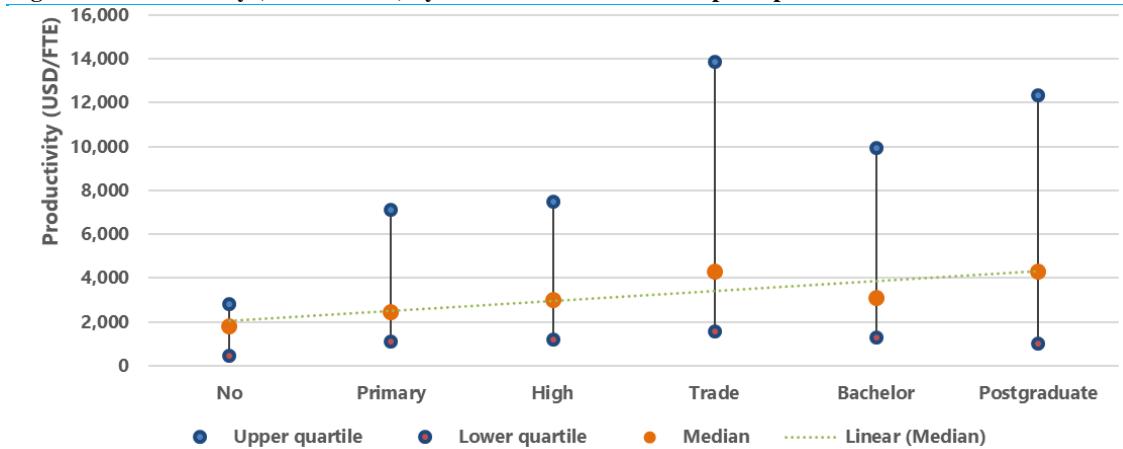
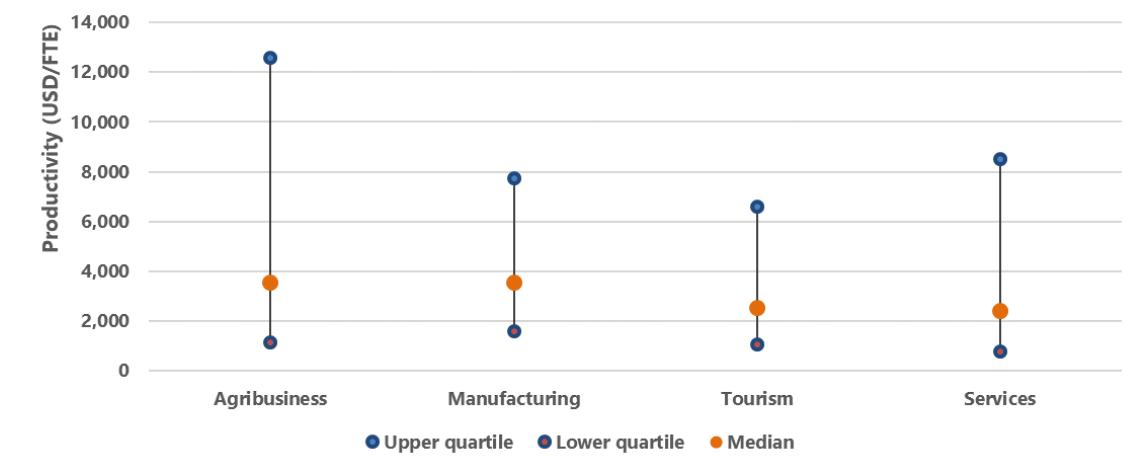
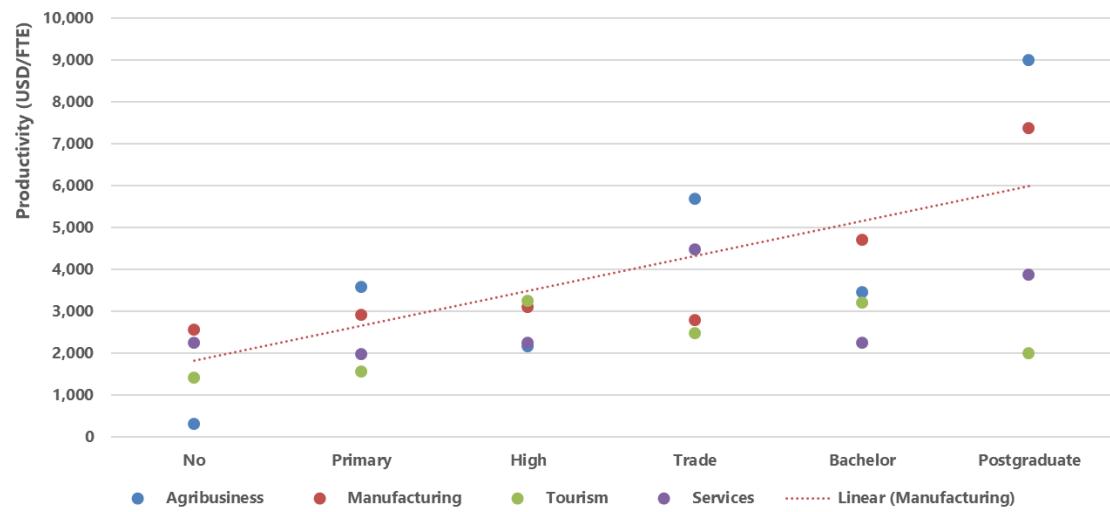


Figure 47 shows productivity by sector. Manufacturing and agribusiness are likely to spend at least a third and possibly a half of their revenue on inputs, so their productivity measured as value added/FTE probably falls to \$1,800. Services will have a much lower level of inputs, perhaps 10 per cent, so the services value added/FTE is around the same level of \$1,800. These figures are comparable, and slightly ahead of, those reported by Basnett *et al.* (2014) of \$1,110 for industry and \$1,486 for services.

**Figure 47: Productivity (revenue/FTE)**

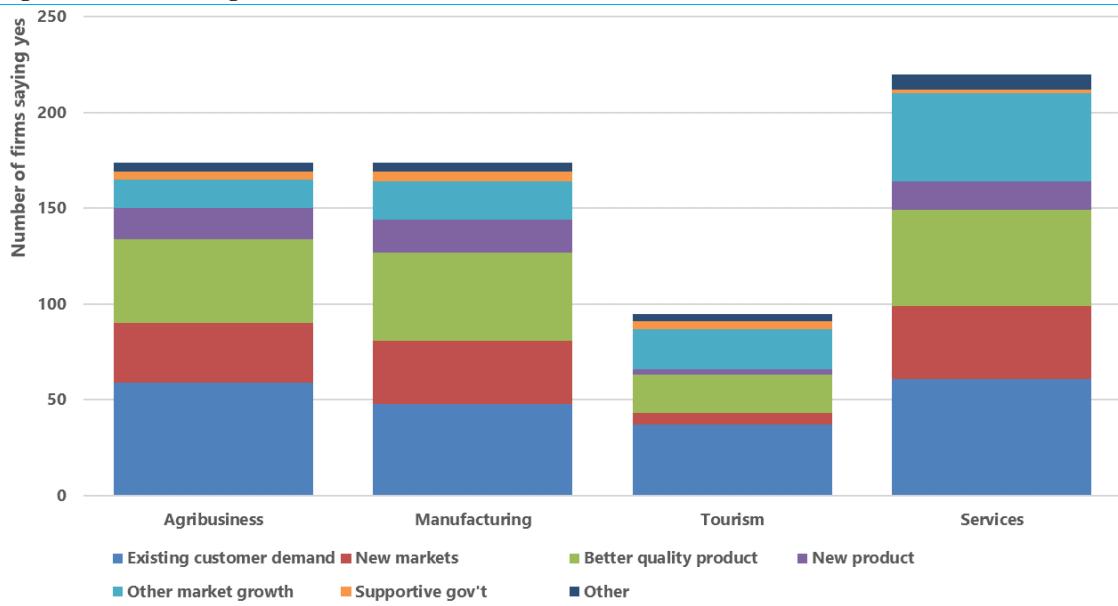


The figures mask quite large differences, however. For example, postgraduate entrepreneurs in agribusiness have median productivity of \$9,000 (Figure 48). The only sector for which there appears to be any sort of trend is manufacturing. Whilst it is quite likely that more educated entrepreneurs are able to design their businesses to deliver higher productivity, we are cautious about claiming any causation. The productivity figures for tourism suggest that there is little to choose between the differently educated entrepreneurs, though this could be due to the nature of tourism businesses which rely almost exclusively on people.

**Figure 48: Productivity (revenue/FTE) by education and sector**

### 3.3.9 Explaining growth

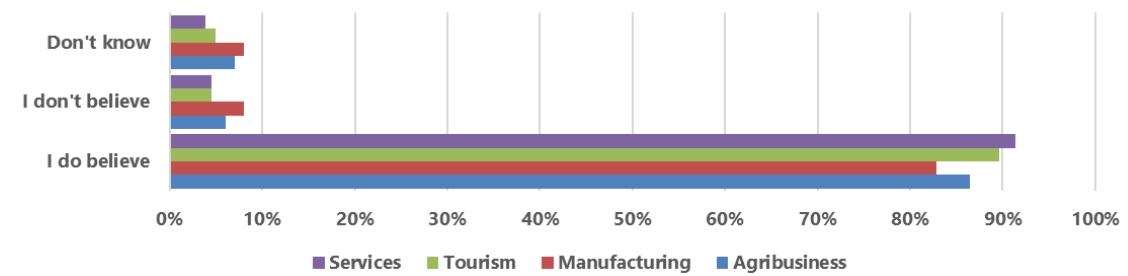
Respondents who were growing were asked about the possible reasons for their growth and could answer yes to more than one reason (Figure 49). Most seemed to think that it was simply from growing demand amongst existing customers, though a significant proportion put it down to offering a better-quality product. The services sector saw most firms growing; the tourism sector saw least firms growing but, as noted above, tourism firms saw the greatest median increase in sales revenue.

**Figure 49: Reason for growth in sales revenue**

Respondents were asked whether they thought that there was scope to grow their business further – to which the overwhelming response was yes (Figure 50) – with little variation between sectors.

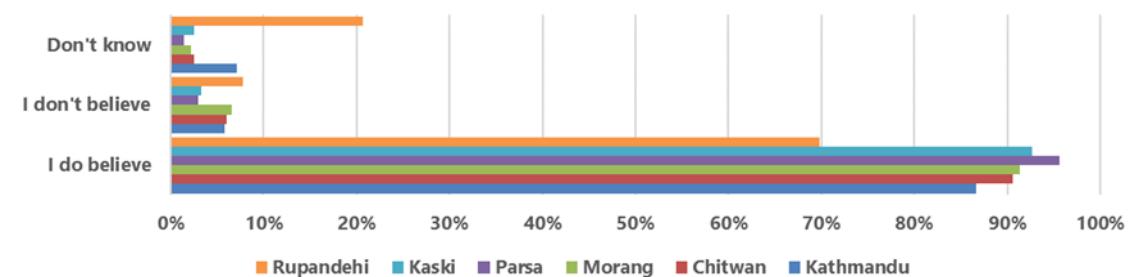
## Understanding job growth potential in SMEs in Nepal

**Figure 50: Scope to grow business (by sector)**



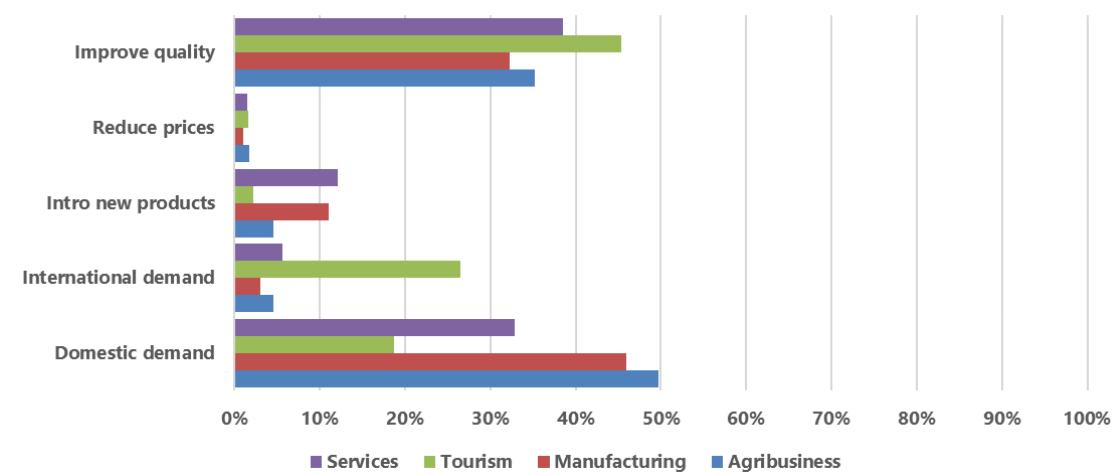
An interesting paradox emerges in Rupandehi, however, where most entrepreneurs launched businesses because they saw potential, but seem less confident about their scope to grow compared to other districts (Figure 51).

**Figure 51: Scope to grow business (by district)**



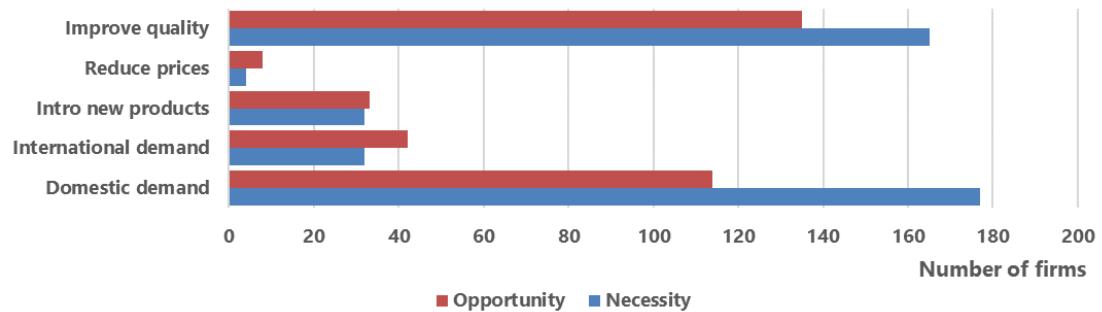
When asked what they thought they had to do to grow successfully, around a third said that growth would come from further increases in domestic demand (36 per cent) and a further third said that it required further quality improvement (38 per cent). Whereas this is broadly consistent with the views on where growth is currently occurring, it reflects a passive attitude rather than a focus on introducing new products or looking for new markets, especially external markets. Tourism firms are the exception in that their primary focus is international markets, and their greatest need in order to expand operations is to improve the quality of their services. Service sector firms also acknowledge the importance of upgrading the quality of their offerings. Agribusiness and manufacturing are most concerned with targeting domestic consumers, followed by improving the quality of their products.

**Figure 52: How to grow successfully by sector**



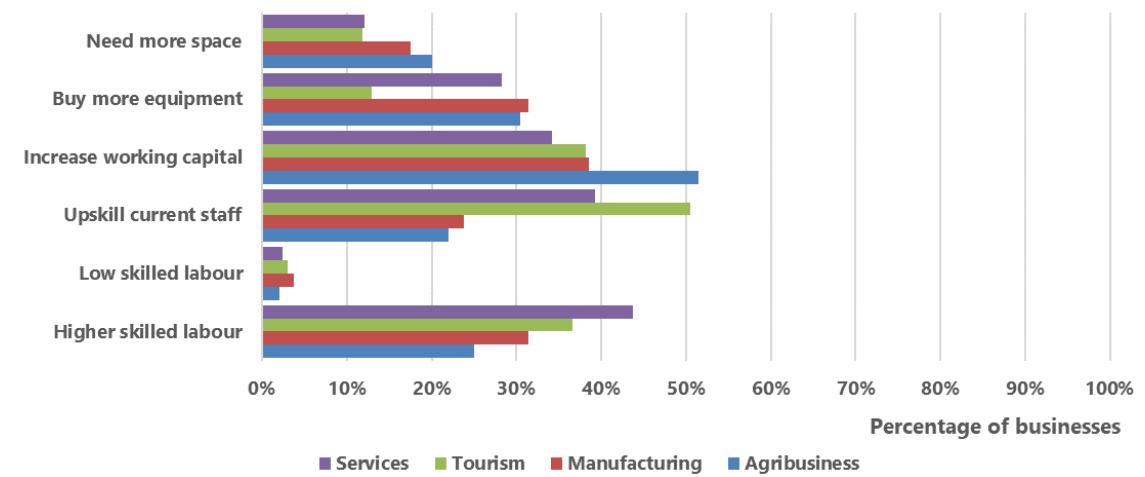
One might expect necessity entrepreneurs to focus more on satisfying domestic demand and opportunity entrepreneurs to do more to introduce new products, to improve quality, to drive down prices and to grow international demand. This is largely the case, though necessity entrepreneurs seem more focused on improving quality. Whilst opportunity entrepreneurs are ahead on each of the other contributors, the difference is small (Figure 53).

**Figure 53: How to grow successfully by type of entrepreneur**



Respondents were asked what requirements had to be met to grow their business (Figure 54). The greatest needs were an increase in working capital (40 per cent) followed by hiring higher skilled labour (35 per cent) and upskilling existing staff (34 per cent). Note that agribusiness has a greater need for additional working capital (52 per cent), while tourism firms want to upskill their existing labour (50 per cent). This general demand for skilled labour is confirmed by Louis Berger (2018). There is little demand for hiring low skilled labour.

**Figure 54: Requirements to grow business**



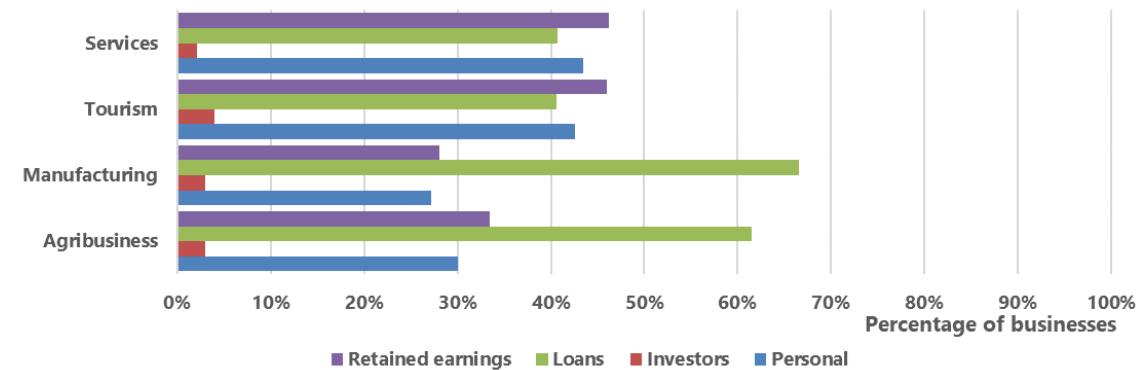
### 3.3.10 Funding growth

Respondents were asked how they might finance their expansion (Figure 55) and could answer yes to more than one source. The primary source was considered to be loans, followed by retained earnings and then personal savings. Manufacturing and agribusiness, which presumably need to spend more on capital equipment, were much more likely to rely on loan finance. Businesses which need to invest substantial sums are unlikely to be able to grow organically (that is, through retained earnings) and it is unlikely that the principals would have sufficient additional savings to put into the

## Understanding job growth potential in SMEs in Nepal

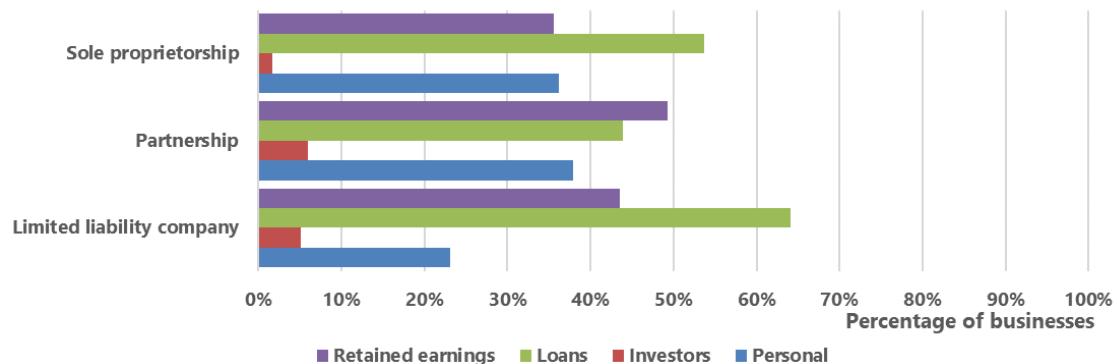
business. It is clear that most businesses are not thinking about approaching investors, either because they do not know how to find them or do not want to dilute their ownership.

**Figure 55: Financing expansion**



Financing preferences do not appear to vary much by the firm's legal status, as loans and retained earnings are the most likely instruments for securing future finance, whether for companies, partnerships or sole proprietors (Figure 56). Even though we might expect limited liability companies to make more use of equity investment, this does not appear to be the case. And only six per cent of partnerships expect to raise funds from investors. The widespread reliance on retained earnings to finance growth means that firm growth is likely to be slower than if they were willing to take on more debt.

**Figure 56: Finance for growth by legal status**



### 3.3.11 Resourcing growth

Nearly three quarters (72 per cent) of surveyed firms indicated plans to hire additional labour. This was the case across firms of different sizes – including the smallest (0-4 employees) – as well as across sectors. The number of anticipated new hires varies widely as a share of current employment, but the average ranges from 50 per cent for tourism sector firms to 80 per cent for agribusiness firms.<sup>9</sup> The median number of additional workers is around seven for manufacturing firms and around five for the other sectors. Aggregated across the entire sample of surveyed firms, the expected

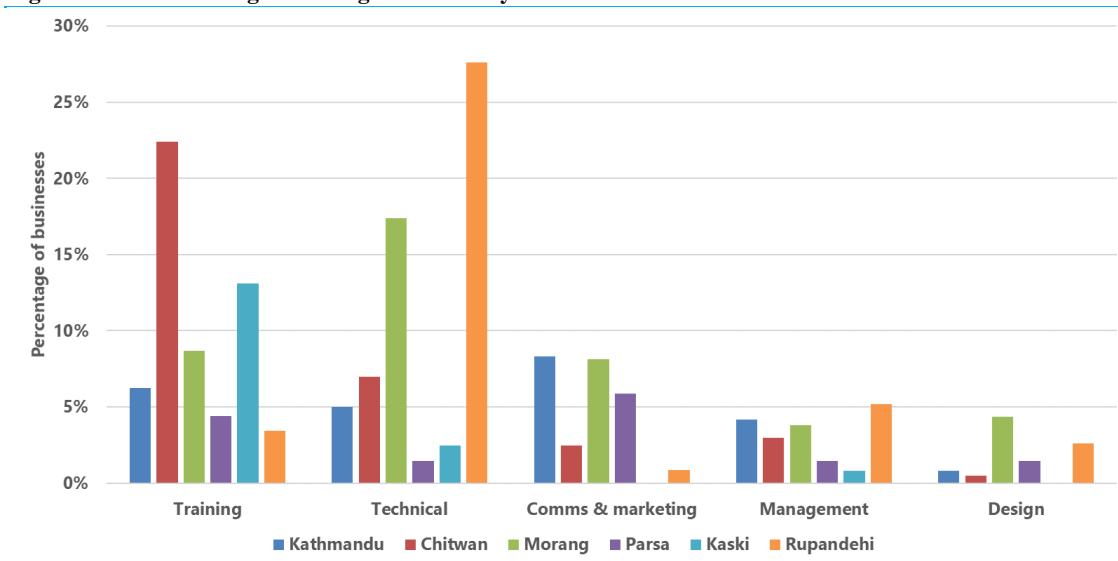
<sup>9</sup> These growth rates are commensurate with Louis Berger's estimate of 75 per cent over the next four years (2018b: 1).

new hires would generate 10,884 new jobs, equivalent to an average 80 per cent employment growth across the four sectors in our sample.

Still on the topic of growing their business, respondents were asked about the skills that they perceived were needed to grow and were currently missing in their workforce. The most common response was 'training', given by 11 per cent of respondents, followed by 'technical' given by 10 per cent, though most respondents did not elaborate so it is not clear what skills they are actually missing. Some were much more specific, saying graphics or design or garment machine operator. Communications and marketing was third with five per cent. Only two per cent mentioned management skills. On most categorisations, there is little to choose between each. Manufacturing has a higher need of people with technical skills; tourism has a lower need.

Agribusiness does not need much by way of communications. When we look at the figures by district (Figure 57), however, some difference emerge. Chitwan seems to have a particular need for trainers; Rupandehi has a particular need for people with technical skills.

**Figure 57: Skills missing in existing workforce by district**



### 3.4 Conclusion

The creation and expansion of businesses are important for boosting employment, creating wealth and generating tax revenue but, in Nepal, the density of SMEs is relatively low compared to many other countries. This suggests that there may be untapped opportunities to establish new firms to serve the Nepali market. Being a successful entrepreneur in this space requires, among other things, imagination and vision to identify unmet demand, knowledge of existing markets and the ins and outs of production, marketing and delivery and a willingness to take risk.

There appears to have been a rapid growth in the business population in recent years. Most businesses are located in Kathmandu, which has the largest number of consumers and the biggest supplier networks. This means that most job creation by SMEs is also concentrated in Kathmandu. The profile of our selected population of firms is similar to that reflected in the 2019 National Economic Census, but with a focus on (i) businesses employing between five and 99 workers, (ii) sectors important to Nepal's economic growth, and (iii) urban and rural districts determined to have the greatest potential to

create employment. Furthermore, our sample of businesses are predominantly in the formal sector.

The SME survey found a positive correlation between entrepreneurs' education level and firm performance in terms of firm size, investment level and revenue. A high proportion of SMEs in Nepal sell directly to consumers – although agribusiness and manufacturing firms also sell their products to other firms as intermediate inputs. Moreover, a majority of these customers, whether consumers or other firms, are not only domestic but also local. More than half of entrepreneurs in the sample are "necessity" entrepreneurs, while close to 40 per cent are "opportunity" entrepreneurs. Rural entrepreneurs are slightly more likely to be necessity entrepreneurs, but there are no other notable sectoral or regional trends associated with these categories, indicating considerable homogeneity. Whilst some businesses had high levels of revenue, on the whole, sales revenue was very low, when compared to the national minimum wage, even amongst opportunity entrepreneurs. This implies a low level of profitability which makes raising additional finance quite challenging.

Three-tenths of SMEs saw no increase in revenue in the last year, while four-tenths of SMEs reported positive revenue growth that was mostly ascribed to rising demand from existing customers or improvements in product quality. Very little was explained by firms entering new markets or introducing new products. Despite this modest performance, Nepalese firms are confident of their capacity to grow. But this optimism about the prospects for future SME growth is tempered by multiple challenges on the ground that entrepreneurs have not fully faced. Almost 90 per cent of respondents believe there is scope to grow their business, but the majority would rely on rising domestic demand rather than their own efforts to find new markets at home or abroad. Nepal's economic growth during the last decade has been robust but the population growth rate is slowing, due to changing demographics and high external migration. Taken together, domestic demand may expand only modestly, and thus is unlikely to deliver strong SME growth without proactive effort by firms. The local-market orientation of most SMEs also limits growth prospects. In addition to the observed focus on local customers, most firms' non-labour inputs are sourced domestically and only one in ten firms export. Nepal's relatively small market size, geographical challenges that limit connectivity and market integration, and the low average incomes of Nepali consumers together translate into only modest increases in domestic demand. This suggests that expansion plans may stall, including plans to hire additional labour.

Whereas many SMEs recognize the need to improve the quality of their products or services, their financial and skills capacity to make these improvements may be inadequate. Achieving the envisioned potential growth requires increased levels of working capital, as well as more highly skilled labour, whether through recruiting higher skills or upskilling current staff, all of which is costly for firms. Most respondents expect to finance future growth through retained earnings or greater investment of personal savings, but these channels typically yield limited resources and/or long delays that can undermine the viability of planned expansions. Many firms report difficulty in accessing credit, but about two-thirds of manufacturing and agribusiness firms expect to rely on debt financing, consistent with their existing access to loans. However, if additional loan finance will impact their gearing significantly, raising additional debt finance is likely to be challenging. Although firms in these sectors may be more credit worthy due to installed physical assets, their financing requirements are also high because of their

reliance on expensive capital equipment, without which their growth prospects are greatly reduced. Equity investment is severely underutilized, whether due to a lack of will or capacity by the borrowing firm, or a scarcity of potential investors. Whilst many businesses will find it difficult to secure equity investment, doing so would likely facilitate growth by avoiding the burden of loan repayment on a tight timescale.

## 4. The policy environment

### 4.1 Introduction

The Government's overarching policy objective is stated in the recent budget as rapid economic development with social justice (ICAN 2019). Private sector development has a role to play, and the budget includes a specific proposal to establish a challenge fund to provide seed capital to establish new businesses based on innovative propositions. This suggests that the Government of Nepal is keen to do more to support new and growing businesses.

The policy environment shapes the capacity of SMEs to launch, compete and grow their output and their workforce. With respect to trade policy, Nepal applies higher tariffs on the import of many intermediate and capital goods than other countries in the region, in many cases, motivated simply to raise revenue. This raises costs for firms.

The World Bank's recent Systematic Country Diagnostic for Nepal (World Bank 2018b) notes significant gaps in access to finance (40 per cent of firms report access to finance as a major constraint), especially for smaller firms, female-owned firms and geographically remote firms. Interest rates are capped, reducing the appetite of commercial lenders for risk, and collateral requirements can be as high as 400 per cent of loan value. Women entrepreneurs are further disadvantaged, since they do not have equal property rights, given that most banks still heavily rely on collateral (Louis Berger 2014). Firms that have rented land in industrial zones also find it particularly difficult to access finance due to insufficient collateral (GIZ, 2018). The World Bank (2018a) reports that banks are finding that tight availability of funds for lending are leading to a higher cost of capital. Together, this makes it hard for businesses to raise the finance that they need and tends to restrict funding to those who already own property. The central government introduced a number of initiatives to counteract this effect, such as the Women Entrepreneurship Development Fund, which provides collateral free loans at low interest rates, and the Micro-Enterprise Development Program (MEDEP) which was recently handed over to provincial governments for implementation (Trenkmann 2018).

In rural areas, the problems of access to finance have led to the development of a second financial ecosystem through cooperatives. There are 34,000 cooperatives in Nepal, providing financing opportunities for their members, typically very poor households. But cooperatives also charge high interest rates, and their loans are often used to finance household consumption. Moreover, cooperative funds have become a source of corruption, given their inadequate regulation. Remittances – which reached 32 per cent of GDP in 2017 – have also been a significant source to finance household consumption.

The World Bank (2018b) suggests that the environment is not conducive to FDI due to unclear policies. It provides complex procedures and inadequate investment facilitation as well as inadequate infrastructure and political instability. Further reasons for the slow FDI are "non-equity modes of investments...complicated policies on land acquisitions and the use of land as collateral by foreigners... the long negative sector list, exclusion of investors from Nepal's Stock Exchange... and the new labour law that demands a 50 per cent rise in minimum wages and social security to be paid" (GIZ, 2018:23). Yet, often, inward investors lead to the creation of local suppliers in their value chains, creating more jobs and generating more tax revenue.

Following the new constitution in 2015, a new federal structure that encourages the three layers of governments (national, provincial, and local) to work together, led to a lack of clarity on the roles at the different levels – particularly in relation to business registration. Registration of businesses with fixed assets worth at least NPR 100 million is with central government whereas below this it is with provincial governments and district offices of the Department of Cottage and Small Industries<sup>10</sup>. Trading businesses of all sizes, however, are still required to register with central government regardless of their location or area of operation in Nepal.

Furthermore, the introduction of a new Labour Act in 2017 to encourage the return of Nepali labour and to reduce the migration outflows of skilled labour, introduced significant burdens on small businesses. EPI

Anecdotal evidence indicates a number of problem areas:

- The bankruptcy law leads to directors being blacklisted;
- The Foreign Investment and Technology Transfer Act imposes a minimum investment of \$500,000 which constrains foreign investment in SMEs and makes repatriation of earnings difficult;
- The Electronic Transaction Act makes it hard to transfer funds out of Nepal;
- The Company Registration Act makes it hard to wind up a company;

There have been many attempts to review the enabling environment. The World Bank and World Economic Forum (WEF) undertake annual assessments. The ILO undertook a research exercise in 2018. GIZ undertook a broader ecosystem mapping assessment, also in 2018, which included an assessment of the business environment and investment climate. A brief overview is provided in appendix 7. These tell us that Nepal does not score highly as a place where it is easy to do business and does not appear to have prioritised improving the enabling environment, though that is now beginning to change. The ILO (2018) reports that businesses are most concerned about poor infrastructure, low market demand, inefficient dispute settlement and high cost of inputs. They report that people considering starting a business are deterred by financial risk, lack of people with relevant skills, lack of start-up information and limited access to finance. WEF (2017) reports broadly similar problems. The World Economic Forum's assessment of competitiveness (Schwab 2019) notes that Nepal scores low on innovation capability (scoring 29 out of 100) and quite low on adoption of ICT (scoring 39 out of 100).

Keen to improve, the GoN established in 2010 the Nepal Business Forum, funded by DANIDA through its UNNATI programme, as a public private dialogue mechanism to offer advice to government on ways to reform public policy to improve the environment for business. A High-Level Business Forum is chaired by the Prime Minister and is responsible for policy formulation. A steering committee, chaired by the Ministry for Industry, meets every two months. A private sector development committee, chaired by the GoN Chief Secretary, meets every two months and focuses on policy and implementation of recommendations from the working groups. A permanent management committee, chaired by the Industry Secretary, manages day to day operations. Working groups are set up as required, co-chaired by a Ministry Secretary

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<sup>10</sup> Though a new law, currently in Parliament, will require all businesses to register at the provincial level.

and business membership organisation presidents, to undertake work on specific themes or sectors.

It seems that programmes launched by donors are not always sustained and it is not clear whether these mechanisms are currently active. The Economic Policy Incubator (EPI), launched in 2016, is a programme jointly sponsored by the UK Department for International Development (DFID) and Nepal's Ministry of Finance. It is implemented by Palladium, in partnership with South Asia Watch on Trade, Economics & Environment (SAWTEE) and the Overseas Development Institute (ODI). EPI's main objective is to strengthen economic policies and policy processes, support a better regulatory environment and harness investment in order to create quality jobs and achieve higher and sustainable economic growth. This has, for example, set out ideas to simplify business registration (EPI 2017).

A list of legislation that might impact on businesses is provided in appendix 8.

#### **4.2 SME survey findings on the ease of doing business**

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The following assessment of the enabling environment is primarily based on the results from our SME survey and in-depth interviews. The SME survey asked a series of questions covering some 36 factors that might make it difficult to do business. Rather than asking respondents wholly open questions, or giving lists and asking respondents to rank, as many surveys do, we asked respondents – for each factor in turn – to state whether it was 'not a problem', was 'a small problem', was 'challenging' or was 'very challenging'. The answers were scored from zero for not a problem to three for very challenging and then averaged across the sample to give an overall score of 0-3 (results shown in Figure 58).

The full list of factors, and a comparison between rural and urban businesses (Figure 83), is shown in appendix 7. Whilst there are some considerable differences based on location – competition is seen as much greater in urban areas as is finding staff with management skills, late payment and political instability – there are very few gender-based differences (Figure 84). Men find late payment and finding highly skilled staff more difficult. The crucial difference is that women find it harder to access finance. In this chapter, we focus on the factors that score at least one, that is, they are regarded as being at least a small problem. Sixteen of the factors score at least one as shown in Figure 58 which shows differences by sector. However, only one comes close to scoring two – and that is competition. The tourism sector complains about this the most.

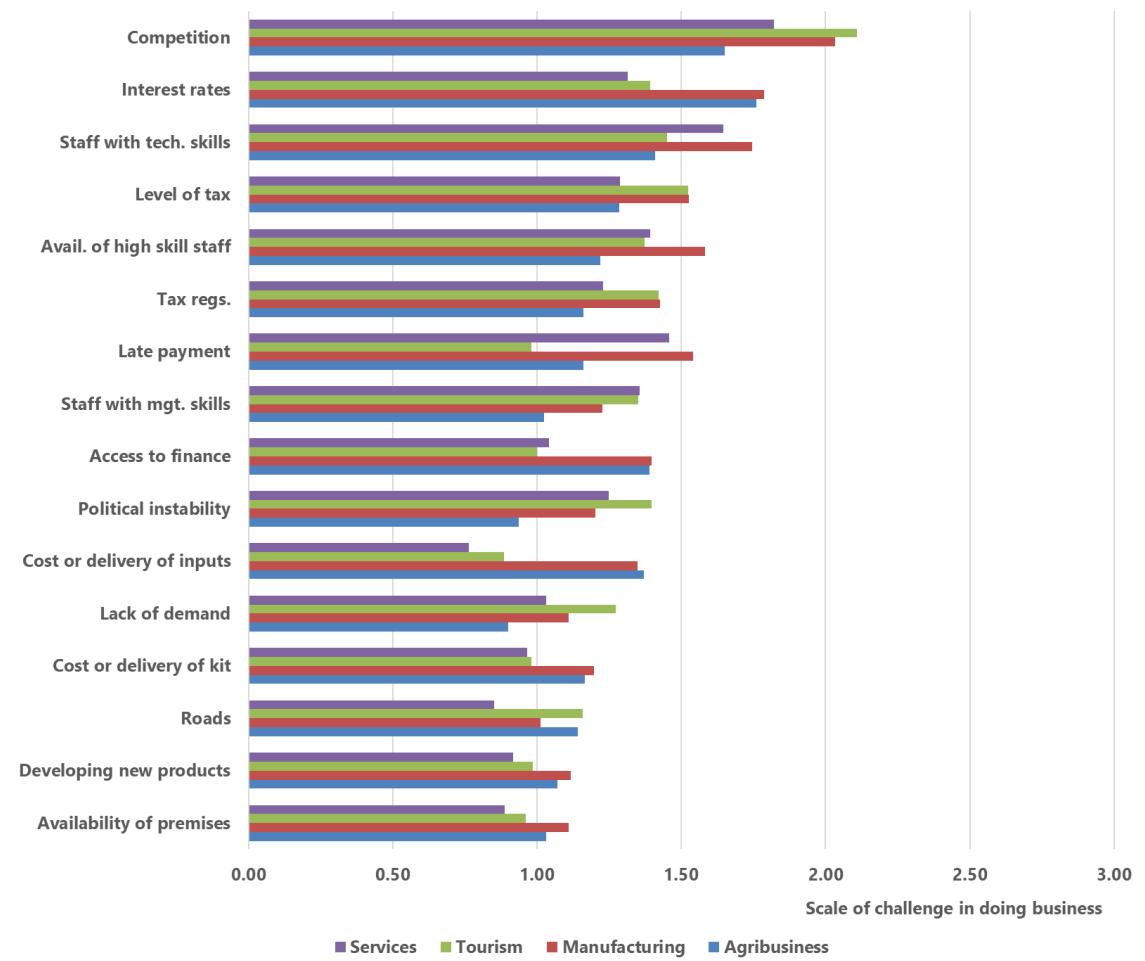
The survey findings yield an apparent contradiction on whether there is weak local market demand or whether local market demand is fuelling growth. Firms' perceptions about competition may provide a clue. Business is almost always going to face competition, so the only way to overcome this is for the business itself to become better at what it does, differentiating itself from its competitors. If competition is strong, and businesses have to work harder to differentiate themselves, then demand can be growing generally and yet some firms will not benefit from that growth. Given that Nepal's economy grew by seven per cent last year, we tend to believe that there is growth but that firms need to work hard to benefit from it.

Whilst access to finance is ranked ninth, interest rates are ranked second, with a score of more than 1.5. Manufacturing and agribusiness, with their higher reliance on debt finance, complain the most about interest rates. Availability of highly skilled staff also seems to be problematic, consistent with the findings of both WEF and ILO. This is

confirmed through interviews with businesses who report that even when they make the effort to train staff, the staff then seek higher paid employment abroad. Indeed, one entrepreneur reported that he works on the basis of spending a year doing training, hopes to get two years of good work from new young staff, and then expects them to leave. The in-depth interviews confirmed that the problem of retaining staff is widespread. Whilst the survey responses suggested that the use of foreign labour is low, the in-depth interviews suggested that businesses recruit from India for the highest skilled labour. These coping mechanisms raise the cost of doing business, however.

Other factors such as level of tax, tax regulations, and late payment are somewhat problematic and should be addressed before they become worse.

**Figure 58: Top factors that challenge business by sector**

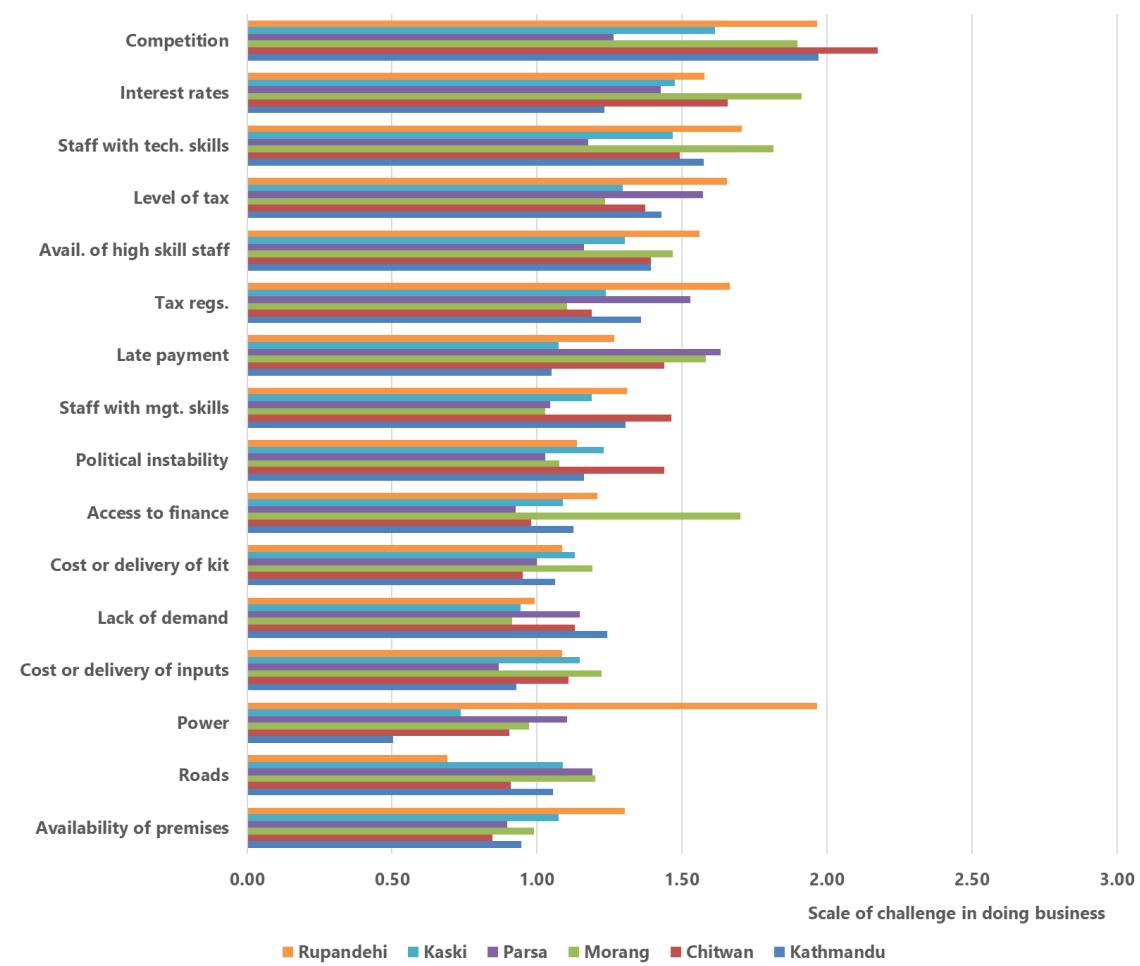


If we look at the results by district (Figure 59), we see that the overall profile is more or less the same. Competition is a challenge in all districts, but some districts face other challenges in particular. For example, power is a challenge in Rupandehi. Access to finance is a challenge in Morang and, businesses in Morang also see interest rates and recruiting staff with technical skills as challenging. Given that interest rates are relatively low (at 11 per cent, as we will see later in Figure 73) with inflation of around six per cent (ICAN 2019), and given that businesses report similar rates of interest across all six districts, this suggests that there may be a different problem. For small businesses, the binding constraint may be the cash flow impact of repaying capital and interest

## Understanding job growth potential in SMEs in Nepal

together over a short time scale, rather than the actual cost of the money. This may be a question for future research.

**Figure 59: Top factors that challenge business by district**



The recent institutional changes following the new federal structure have made it harder for the government to improve the enabling environment. The Small & Cottage Development Committee used to coordinate government policy for new and small business but much of the responsibility has been devolved to the province level with the introduction of the federal structure. The Department of Industry does, however, still have a women's entrepreneurship programme. As in many other countries, civil servants regularly move between departments, taking their knowledge and expertise that often results in poor institutional memory. An example of where this has proven problematic is the Business Incubation Centre set up by the Department of Industry in 2006, but which is now a low priority for the current administration. Indeed, the Department explains that the concept of incubation is not well understood, which makes it difficult to offer appropriate support programmes to new and growing businesses. The Department is now planning to work more closely with provincial level governments.

Recent reforms by government have nevertheless helped the current environment, including the streamlining of company registration, and new tax incentives designed to encourage entrepreneurship. There are also plans for improved dialogue with the private sector.

#### 4.3 Key points from in-depth interviews

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Businesses are keen to expand but feel constrained. Respondents confirmed that profitability is low. On the other hand, there are some examples of high levels of growth, with one survey respondent reporting growth of 300 per cent last year (confirmed in a subsequent telephone conversation). There is a perception that the government does not encourage entrepreneurship and that people who start a business have to do everything for themselves. The media is regarded as generally unhelpful to business – one respondent said that “I see them being commen and we are perceived as the bad image in society”. Other respondents were more positive about the media, with one, for example, saying “media has been presenting us in a positive and favourable light”.

Many businesses complained about too many regulations and excessive tax, though failed then to be precise about the specific problems that they wished to see addressed.

Businesses indicate that there is a lack of clarity in policies relating to e-commerce. They also complain that it is difficult to understand the procedures for export and import and further complain about charges related to imports and exports which are higher for SMEs than for larger businesses.

Some respondents reported challenges caused by the Labour Act of 2017 which, inter alia, requires labourers to work for a fixed period of time and which is challenging for some businesses especially those with high labour turnover. Other respondents, however, said that this law was not a problem since they already offer decent remuneration and incentives to attract labour and perceive that the new law will not have further implications for their business.

The requirement for all employees now to have a permanent account number (PAN) seems to be exercising some businesses, who say that many employees do not even have a citizenship number. Businesses also complain that labour regulations that may be appropriate in urban areas are less appropriate in rural areas. It seems, however, that it continues to be relatively easy to take on staff on temporary contracts so businesses rely on that more than on recruiting salaried staff. As the government tightens the labour legislation, we were told by interviewees that there will be a move towards sub-contracting – which raises costs and makes quality control harder but retains flexibility needed when sales are volatile or seasonal in nature. However, even when businesses do offer salaried employment, it seems that retaining staff is challenging.

Businesses would like to see reforms to regulations covering business to provide more motivation including the need for fewer licences and “permissions” – one business reported the need for licences from 10 guilds. Acquiring the licences is not specifically problematic or costly but it takes considerable time. It appears that some businesses are not aware of which regulations or licensing regimes apply to their business and, indeed, some remain informal so as to avoid the necessity. There is a perception that most regulations are not enforced, so many entrepreneurs take the view that they do not need to bother. Businesses would like lower, and fairer, levels of taxation.

Managers at a senior level are predominantly male.

#### 4.4 Regulatory constraints

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The survey could only look generally at the areas where businesses feel that there may be challenges; most businesses interviewed in depth gave a limited explanation of the challenges. Some broader views on regulatory challenges emerged, however, from discussions with business support organisations, from other interviews with businesses and from the validation workshop as well as through a detailed review of legislative requirements undertaken by Antarprerana.

Our overall conclusion is that legislation and regulation does indeed slow the growth of business, though we also note that the half of businesses that are informal are not constrained except in so far as they cannot raise bank loans specifically because they are not registered. Businesses interviewed in-depth told us that they complied with all the regulatory requirements, and indeed, given that most were in the formal sector, that is perhaps not surprising. Some told us that regulation was not a constraint but more said that it was time consuming

The Industrial Enterprise Act offers a bewildering array of tax rebate incentives for different industries and sometimes for different size of businesses. Whilst this is understandable, it also distorts the market. It means that businesses that are not so favoured have to pay more in tax than they otherwise would to provide the subsidies to the favoured businesses. Often thresholds are a barrier to growth as firms try hard to remain below the threshold in order to keep benefitting from the subsidy; in Nepal, it seems that most thresholds are designed so that firms have to exceed them to secure the subsidy. This should encourage growth but some are so large, in practice they are unlikely to make much difference. There are considerable income tax incentives for micro-enterprises and for enterprises owned by women which do not seem to be widely known. There may be merit in publicising the incentives more widely to encourage people to think about starting but also to encourage informal businesses to formalise and thus open the route to bank loans.

It is not clear why sole proprietors and partnerships need to reregister periodically. Whilst not especially onerous, it would make more sense for there to be a presumption that, once registered, they are in business until they deregister. The place of registration for sole proprietors – Department of Commerce, Department of Cottage and Rural Industries or Department of Industry – is likely to be confusing. It would make more sense, both to simplify the process for entrepreneurs and also to enable the government to have access more quickly to accurate data – to have a single registration office.

The high threshold required by the Foreign Investment & Technology Transfer Act is causing some companies and especially the venture capital funds to fret, though it is not clear yet whether this has reduced the amount of inward investment. It is also not clear however what the government hopes to achieve through having a high threshold so reducing the threshold would send a message that government is listening to business.

Making it easier to wind up a business in cases of insolvency and allowing entrepreneurs who have failed the chance to try again, as long as they have not engaged in fraud, would give entrepreneurs the chance to learn from their mistakes. Evidence from the US suggests that these people do rather better the second time around.

The Labour Act of 2017 came in for much criticism, largely because there was a perception that it would make it much harder to fire staff, and there was an expectation that businesses would seek to get round this by sub-contracting rather than by taking on new staff directly. The new legislation is not so different to the old legislation, though some worker rights have been strengthened. However, the key change is that the previous legislation did not apply to firms employing fewer than 10 people and the new legislation applies to all firms. This is therefore a big change and with added bureaucracy. For firms employing 10 or more there is a requirement to set up a collective bargaining committee. Whilst this may make sense, it also creates a hurdle for businesses that may prefer not to cross it and this could certainly lead to more sub-contracting. In general, it is better not to have thresholds based on number of employees or on revenue since firms always see these as reasons not to grow beyond a certain size.

In addition, businesses hiring foreign employees face difficulties since the new law mandates that such employment requires formal approval from the Department of Labour. This has been a big challenge for businesses sourcing employees from India (especially in light manufacturing) as they now face more obligations towards foreign employees including, for example, the need to deposit 30 per cent of social security obligations up front when sourcing labour from India.

Until March, there was no legislation that covered the creation or management of venture capital funds. The funds seem generally to welcome the new legislation as they now feel 'institutionalised' though it seems that there are still some areas where further clarity is needed.

The federal government has passed responsibility for small firms to the provinces but the boundaries are not clear and much of national legislation inevitably impacts on small businesses. There is therefore a need to be clearer about boundaries and about how the federal government and provincial governments should work together to ensure that policy and legislation is coherent.

#### **4.5 Conclusion**

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The policy environment, whilst not especially conducive to business, is fairly stable and fairly predictable. Businesses face multiple licensing requirements and other regulatory requirements all of which impose a time penalty, if not always a high cost penalty. It seems that most businesses have either learnt to navigate the system or have identified that there are few penalties for remaining informal and ignoring all the requirements. Indeed, that may well explain the very high level of informal businesses. Nepal does not score especially well in international league tables but businesses, on the whole, are able to get on with their business. However, it is clear that businesses need to be helped to understand the nature of competition and how they can differentiate their business more effectively. This may include targeting customers more narrowly as well as looking at new markets, especially internationally. There are regulations that could be eased and which would alleviate some of the problems. For example, it has recently become harder to attract foreign direct investment. There is a lack of clarity on which level of government is responsible for small firms policy and indeed a lack of coherence with some aspects of policy transferring to provincial or local government whilst other aspects are retained at the federal level. A recent change in employment regulation is likely to encourage business to make more use of sub-contracting, rather than directly

## **Understanding job growth potential in SMEs in Nepal**

employing workers on formal contracts; this may or may not raise firms' costs, but it will certainly make quality control harder, at a time when businesses are striving to improve their product quality in order to win more business.

More could be done to help businesses that wish to import new technologies, especially in relation to the high level of tariffs.

There is a clear need for better skills in the workforce to fulfil businesses' needs. Government has a role to play in this regard, but businesses tend to blame the government when they cannot find skilled labour, even though firms could do more to ensure that their staff receive the training that they need (either through direct provision or perhaps through working in partnership with vocational training institutes).

Given the government's interest and willingness to improve the ease of doing business, business associations need to make clear the reforms that will make a difference and lobby the government accordingly. This also requires adequate space for genuine interaction between private sector associations and government.

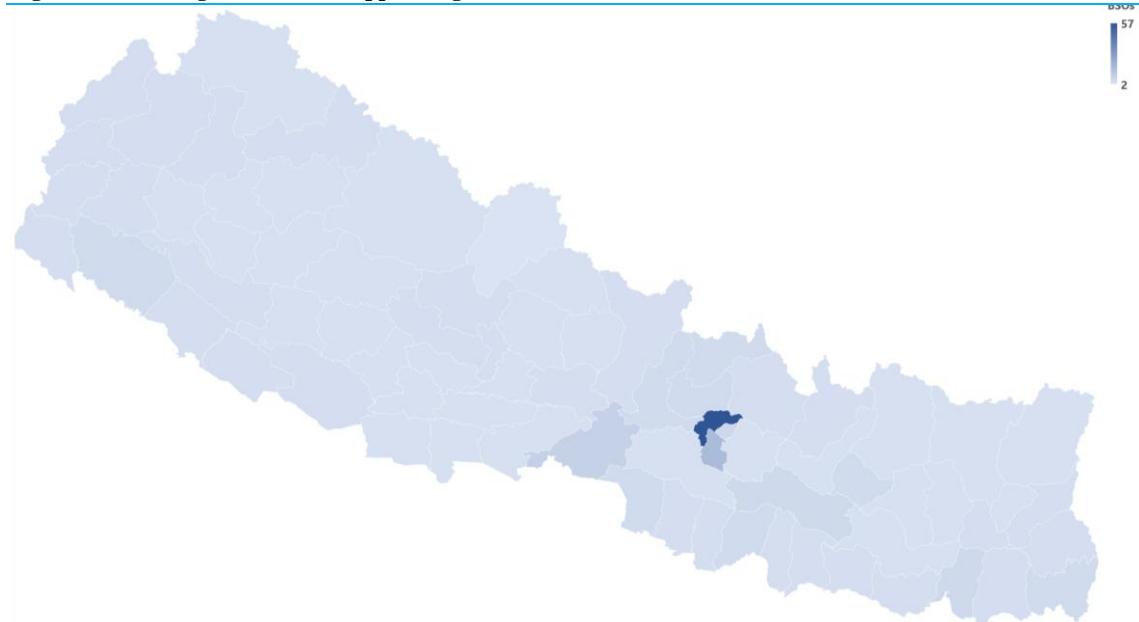
There were mixed views on the media. However, if the government is serious about promoting the importance of entrepreneurship and wishes to encourage more people to think about starting in business, then it could do more to encourage positive coverage of entrepreneurs and the difference that they are making to the country's economy.

## 5. The SME support ecosystem

### 5.1 Snapshot of business support services and their effectiveness

We identified some 76 local or national organisations that provide one or more business support services, including investor finance (other than loans). In this chapter, we describe the organisations, programmes and projects (including donor funded programmes) to provide a flavour of the non-financial support available. A list of business support organisations is provided in appendix 9 together with a short description of many of the organisations and their business support activities, though it is not intended to be a comprehensive list. Most organisations only serve Kathmandu and its immediate surroundings but there is fairly even coverage over the rest of the country (Figure 60).

**Figure 60: Coverage of business support organisations**



**Table 5: Business supporters and others consulted**

Type of organisation	Identified	Interviewed	At validation workshop
Business support organisation	35	7	8
For profit consultancy <sup>11</sup>	7	0	0
Investor	11	4	4
Business membership organisation	6	1	2
Innovation supporter	5	0	1
Educational establishment	7	2	1
Trainer	1	0	0
Donor initiative	4	2	1
	76	16	17

We have defined each of the organisations supporting business according to their main activity, though in practice many organisations could fall into more than one category.

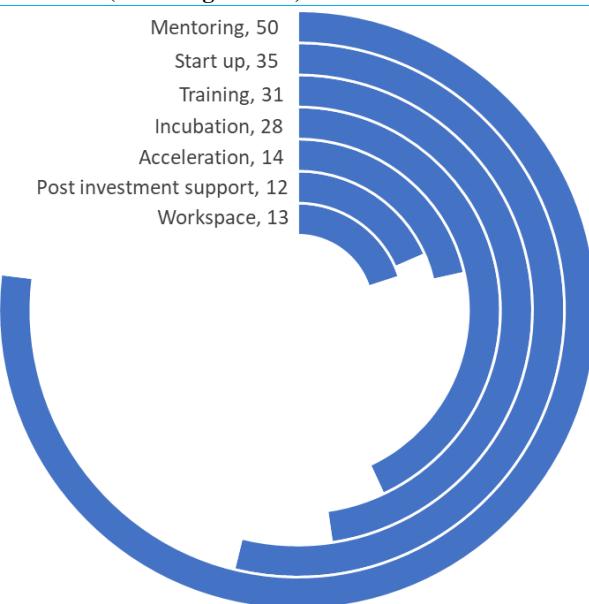
<sup>11</sup> Note that the list includes Antarprerana but we have omitted them from the interviewed and workshop participants.

## **Understanding job growth potential in SMEs in Nepal**

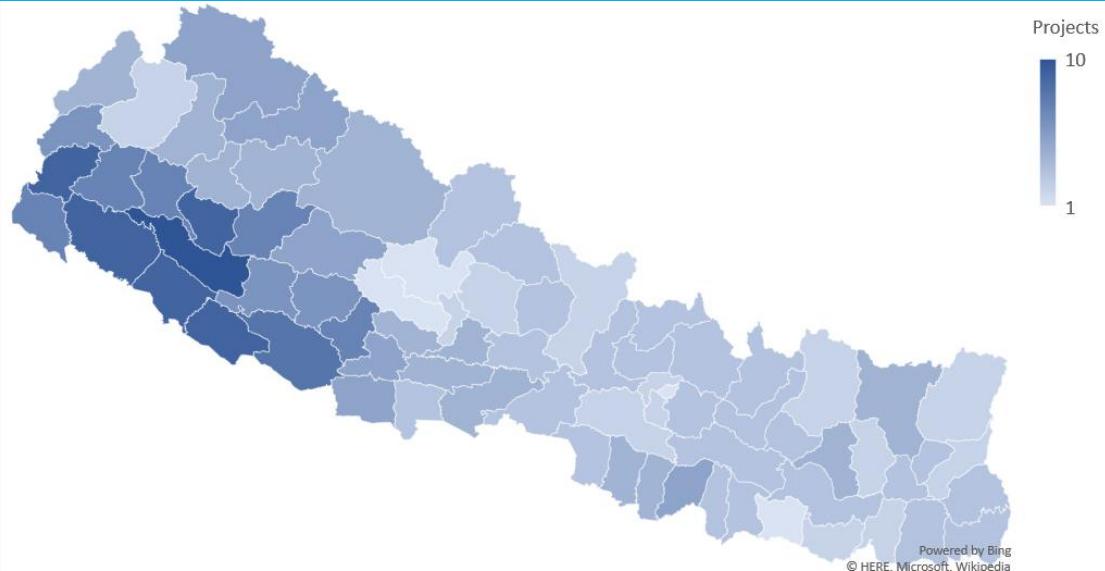
Of the 76 organisations that we identified, we interviewed 16. In addition, we interviewed four banks and two trade associations that do not offer business services. Some 17 of these organisations (which included some but not all of those interviewed) participated in the validation workshop. Note that we have not assessed the quality of the advice available. We have talked to a small number of businesses about their experience in seeking and exploiting business support and snapshots are included in example boxes.

Business support organisations provide a wide range of services as shown in Figure 61, though in many cases there is considerable overlap so an organisation may offer mentoring, training, workspace and grants, for example. In many countries, the term 'incubation' implies the provision of workspace alongside other support; in Nepal, several organisations have simply renamed their business support as incubation, perhaps because they offer a more systematised approach, but do not provide workspace. Some projects and programmes are government-sponsored such as the Micro-Enterprise Development Program (MEDEP), though from the entrepreneur's point of view, the nature of the organisation and its funding are immaterial.

**Figure 61: Business support services (excluding finance)**



In addition to the many business support organisations, there is a large number of donor-funded enterprise- and farmer-support projects, though not all work in the districts of focus for this study. Many, though not all, of the projects are undertaken in partnership with Government of Nepal ministries, including the Ministries of Industry, Agriculture Development, Tourism, Federal Affairs and others. Sometimes donor funded projects work through existing networks but sometimes the projects lead to the creation of new business support organisations in parallel to the existing business support network. Whilst most projects are geographically limited, there is some overlap. The greatest number are in the west of the country (Figure 62).

**Figure 62: Donor funded projects**

Some programmes have succeeded at scale. For example, the Ministry of Industry's Micro-Enterprise Development Programme and later Micro-Enterprise Development for Poverty Alleviation has supported the creation of 142,000 businesses and supported many thousands more to grow, but this level of scale is unusual. The Rural Enterprises and Remittances Project has plans to support 60,000 businesses and create 90,000 jobs. Many organisations and programmes support a relatively small number of clients and some require that businesses have already made some progress before offering any support. The Nepal Agri Business Innovation Centre (NABIC), for example, supports businesses that have sales revenue of at least \$100,000 and an expectation that they can grow at 30 per cent per annum. Last year, they attracted 284 clients and are

currently supporting 79. NABIC has received seed funding towards the cost of its establishment and first 18 months of operations from the World Bank's InfoDev programme via the Project for Agricultural Commercialisation and Trade (PACT) initiated by the Ministry of Agricultural Development. Nepal Communitere (NC) offers workspace, access to a MakerSpace and an incubation programme. Last year, they recruited eight new clients, of whom three started a business; they have 16 workspace units of which 14 are occupied. Some of the business and trade associations offer business support programmes, or at least mentoring and advice, as do a number of universities and colleges. A small number of commercial organisations also target new and growing businesses. Some advisers, such as Antarprerana, are willing to give pro bono support, but can only do so for one or two clients in a year.

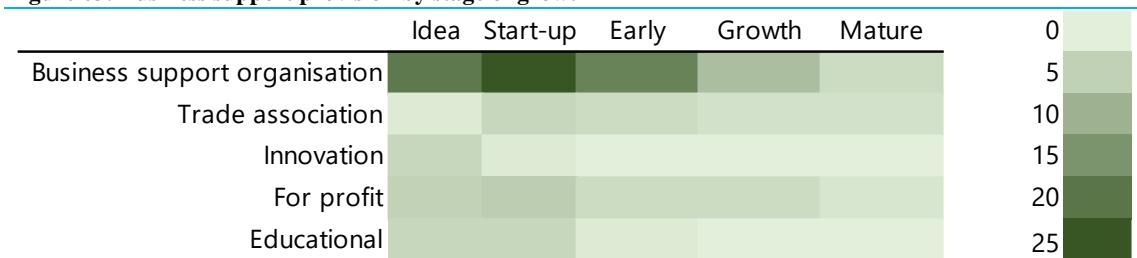
#### **Box 1: R&D Innovative Solution Pvt Ltd**

R & D Innovative Solution aims to empower rural farmers, especially women, through providing information and training programs. It supports a network of 15,000 farmers and more than 300 agro-entrepreneurs. The major challenges are the mindset of farmers, guided predominately by pre-conceived notions that they know it all and that all support should be free, and lack of qualified skilled workers. The company has received support, over several years, from Rockstart Impact (in business shaping and pitching), SPRING Accelerator (in learning and implementing human centred design), Antarprerana (business partnership), Connect to Grow (digital platform development & enhancement), Safal Partners (day-to-day business operation & scale up planning), Oxfam (scaling up and opening the way to a subsidised bank loan), Horticulture Innovation Lab, UC Davis (extension of low cost post-harvest loss management technologies) and M&S (local partnership & networking). The result is that R&D is growing strongly.

Figure 63 gives an indication of the provision of business advice and guidance by stage of

business development, though does not reflect the numbers of business supported. There is a high level of support for start-up but rather less advice and guidance for established businesses. It is not clear, however, if this reflects the lack of demand. Most support is provided by dedicated business support organisations.

**Figure 63: Business support provision by stage of growth**



Many of these programmes do a great job of supporting people to start and to grow but they are operating at a scale that is so low that it will never make a significant difference to the level of start-ups in Nepal. This is exacerbated by the low level of funding available towards to the cost of business support, especially general advice as opposed to more specialist incubation or acceleration projects. People who have not yet started and indeed even entrepreneurs in the early stages of growing a business are unlikely to have the funds available to spend on business advice –this is a challenge all over the world – so extra support is needed if there is a real desire to make a difference. Nepal Communitere observes, as we have, that there are many programme duplications, with many organisations doing the same thing, rather than perhaps mastering one particular offering and improving cross-referral.

#### **Box 2: Alpine Coffee Estate Pvt Ltd**

Following four years of continuous research, Alpine Coffee Estate launched its first product in 2012. The business benefitted from technical support from PUM Netherlands consultants and Home Swiss Contact and, in 2014, secured investment from a Dutch investor, renaming its first product Katman'Du Coffee. It is now successfully selling coffee and exporting beans to various countries, providing training on coffee farming and preparation, operating barista classes and helping small coffee entrepreneurs to establish their businesses. It set up a retail outlet to sell coffee earlier this year. It has set up six contract cafés in existing restaurants and plans to open its own café soon. However, the challenge is to continue to grow and expand. Alpine Coffee says that it is important to be patient and to avoid repeating old mistakes.

Nepal Communitere also points to challenges faced by people wanting to start in business including asserting that entrepreneurs are not professional and lack time management skills and suggesting that entrepreneurs lack the documentation needed to establish companies.

It is quite clear, however, as can be seen from the examples in Box 1 and Box 2, that businesses that can find advice can do very well as a result though not every business can be as successful as R&D Innovation has been in sourcing advice and support. There is a danger, also, that programmes, especially donor funded programmes, seek potential clients via the networks that do exist, and thus end up all supporting the same businesses.

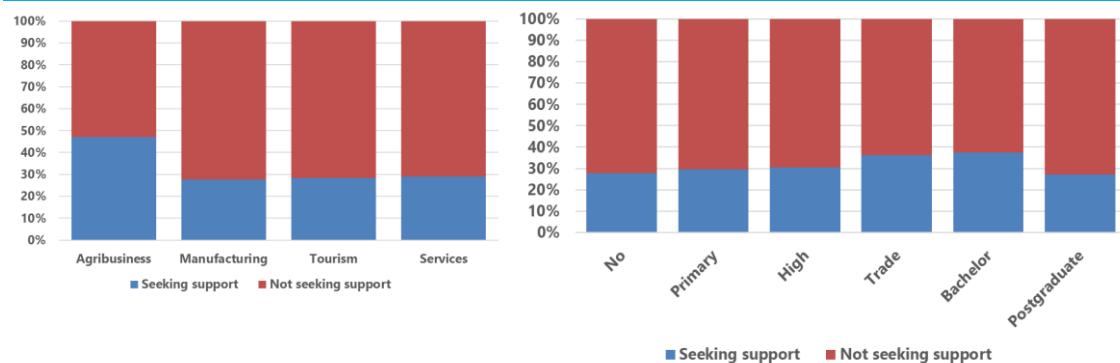
#### **5.2 Seeking advice**

Ensuring that advice and guidance is available is only part of the story. Businesses need to be willing to take advice and then to be able to find good quality advice. Across our sample of firms, just 32 per cent had received advice. In most cases they did not take it from a formal business support organisation but instead from informal sources that

include family, friends, government officials, other businesses, self-study (through internet for example) or a trade association.

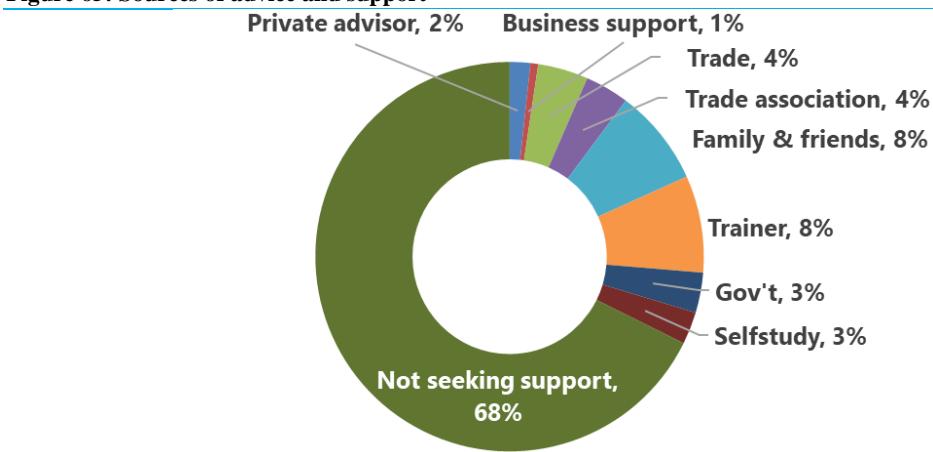
Size or age of business, or gender of principal does not seem to make a difference to the propensity to seek advice. Agribusiness is more likely to seek advice than other sectors. One might expect more educated entrepreneurs to be more likely to seek advice on the basis that they are more likely to know what they do not know, and be less embarrassed to admit that they do not know. In fact, it is entrepreneurs with a trade qualification or a first degree who are more likely to seek advice (Figure 64).

**Figure 64: Propensity to seek advice and support**



Businesses seek advice from a range of sources though almost never from business support organisations. However, training, at least according to the descriptions given by respondents, is predominantly vocational or trade training. 'Trade' describes the situation where the business asks another business in their own line of business or else an appropriate professional such as their auditor. Just 16 of the sample population (2 per cent) sought advice from a private adviser and six (1 per cent) sought advice from a business support organisation.

**Figure 65: Sources of advice and support**

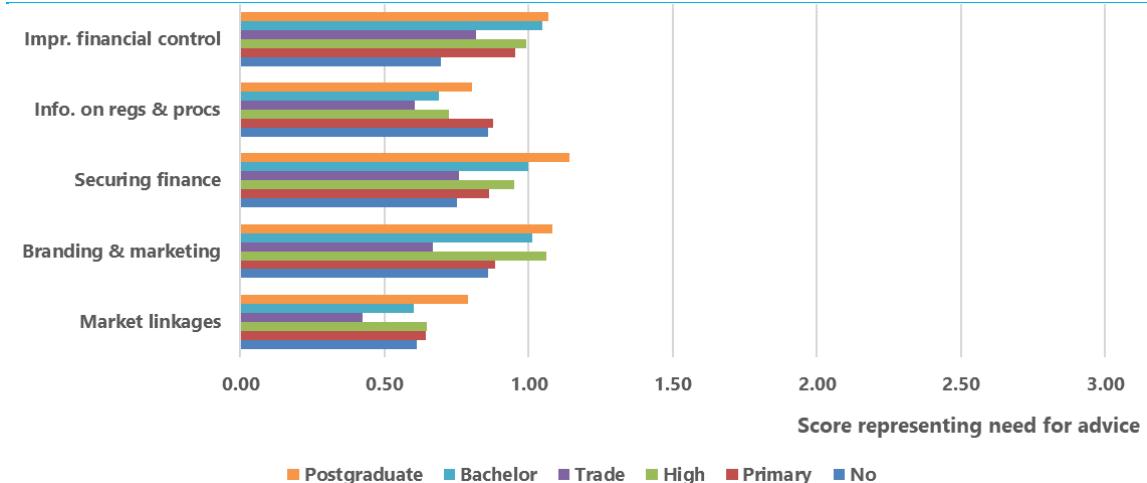


It is positive that as many as 32 per cent of respondents seek advice. In many cases, they have a very specific need or simply require some (vocational) training. It is not clear whether the advice sought from family and friends is general or specific, but either way, the advice may be unreliable if provided by informal sources with limited information or experience. It seems that no more than three per cent of businesses seek formal advice from a private adviser or business support organisation.

## Understanding job growth potential in SMEs in Nepal

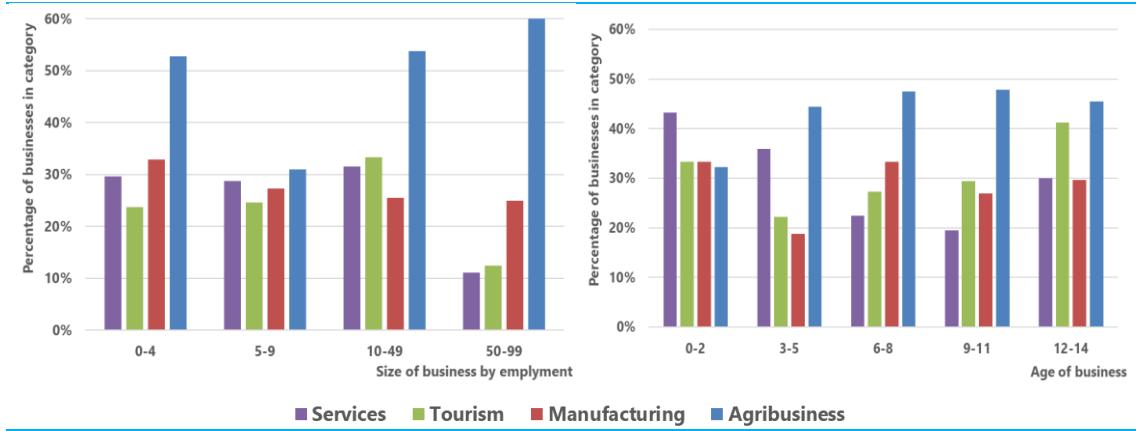
This low take-up of business support services lies in contrast to firms' acknowledgment of their need for advice. Within our survey, nine in ten respondents believed advice to be 'somewhat necessary' for improving financial control (93 per cent), branding & marketing (93 per cent) and securing finance (91 per cent). And for most aspects of running a business, owners with higher levels of education were more likely than those with less education to acknowledge the need for advice (Figure 66).

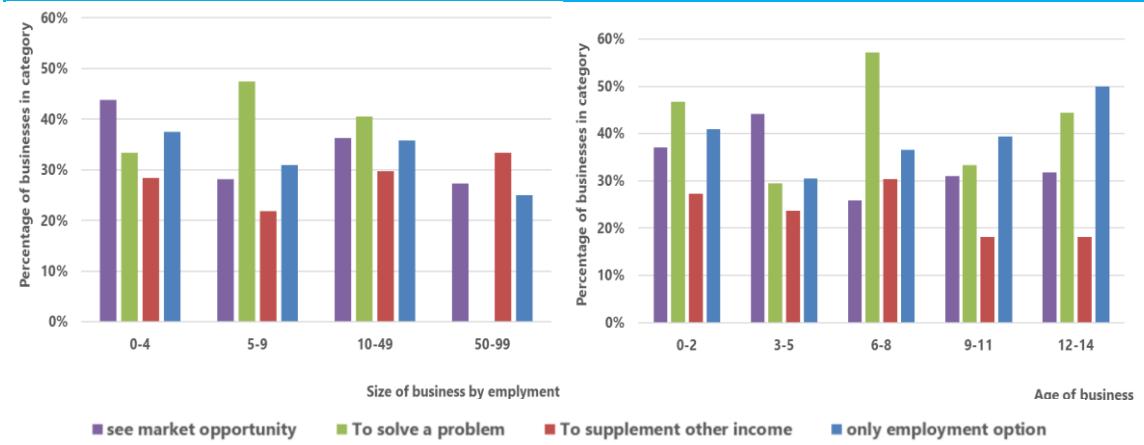
**Figure 66: Desire for advice by educational attainment**



If we look at the desire for advice by sector (Figure 67) we see that agribusiness is the one asking most for advice – for businesses of all sizes and across most age groups. If we look by reason to start, we see that it is those who see a market opportunity or a problem to solve who are most looking for advice, at least in the early stages of growing their business. This then tails off as the business grow. But age of businesses seems to make little difference, with those wanting to solve a problem the most likely to seek advice, even when their business appears to have become quite established.

**Figure 67: Desire for advice by sector**



**Figure 68: Desire for advice by reason to start**

There is also an interesting contradiction between the answer to this question and the earlier question about the skills that the business felt it lacked. There is a desire to improve financial control yet only one per cent of businesses thought that they needed accounting skills; there is a desire to improve branding and marketing yet just five per cent of businesses said that they lacked these skills.

### 5.3 Key points from in-depth interviews

Whilst businesses said that they received support from Chambers of Commerce and other business associations, it is apparent from the narrative responses in the survey and from the in-depth interviews that it is limited mainly to vocational skills training. They do not appear to offer training related to business operations and management.

Businesses even questioned whether business advice and support was available, with one saying for example “there’s no such support” and another asking for more training and mentorship. Several said that they received no support, though were not always clear whether this was because they had not looked.

In fact, it seemed that most of the interviewed firms were unaware of the existence of business support organisations, confirming the conclusions from the survey.

A main finding emerging from the in-depth interview discussions was the commonly-held view that large numbers of people aspire to become entrepreneurs, and need a decent level of general business advice – on topics such as marketing, financial control and business planning – to make it happen.

There are, therefore, essentially three major challenges:

BSOs are still a new concept in Nepali society where businesses are run in traditional ways, largely without seeking advice and support. In any event, there is a negligible presence of the BSOs outside Kathmandu. On the whole, BSOs do not widely promote the availability of business support because they do not have the resources to offer support to more than a handful of businesses. And businesses, especially start-ups, are reluctant or unable to pay for the service.

The second challenge, already alluded to, is that BSOs have very limited resources and so can only support a very small number of clients. Those that are funded to support larger numbers of businesses offer a weaker service.

### Box 3: Himalayan Accessories

When a colleague of Arabinda Subedi met with a road accident, he realised how painful and risky this could be, and wondered how hazards and risks could be minimised through more effective safety clothes and gear. Arabinda and Jayanta Bhatta, with a background in the garment industry, thus launched Himalayan Accessories, to offer high-end safety clothes for people engaged in motorcycling, outdoor sports, tunnel building, hydropower dam construction, fire-fighting and construction. Major challenges are finding skilled staff, financial support, meeting regulations and adopting new technologies. To some extent, the support from business service providers like Antarprerana helped to address the challenges; V-Chitra Advertising provided pro bono promotional consultancy. SAFAL Partners has provided angel finance. The business was one of 15 finalists in the 'Creative Business Cup Nepal' business competition and is about to launch its first products into the marketplace.

to a perception that accessing advice is difficult; whilst that may be true in five of the six districts studied here, it is clearly not the case in Kathmandu.

Nepal has a large number of business support organisations, but too many offer very specific services, such as incubation and acceleration for a small number of clients, rather than providing good-quality general business advice. And existing support services are heavily weighted toward start-ups or early stage micro entrepreneurs rather than existing firms. These shortcomings could be ameliorated through better networking and cross-referral within the business support ecosystem, and through promotional campaigns about business service offerings. Because most business support organisations work with only a small number of clients, their impact on the SME population as a whole is likely to be small.

The "success story" case studies<sup>12</sup> imply that effective advice can make a considerable difference to firm performance. Whilst there are too few case studies to draw general conclusions, it does appear that businesses that seek support from multiple sources tend to be more successful – though it may be that more successful businesses tend to seek advice from wherever they can find it – and, moreover, that businesses that seek advice tend to find it easier to raise finance. This should not be surprising as funders are more likely to support a business that has received advice and been referred by an adviser whom they know and trust. It is not clear to what extent business support organisations work together in referring clients to each other. There may also be an issue that organisations with new programmes use their existing networks to find potential businesses to support, because they want to ensure that their programme is a success and the shortest route to achieve that is by working with businesses that have already demonstrated some success.

Thirdly, businesses need a wide range of support dependent on their stage of development, including mentoring, training, strategy development, financial packaging, marketing etc. Business support organisations are not individually funded adequately to cover all these skills, yet the level of networking and cross-referral is limited. Business support organisations would themselves benefit from good mentoring and effective staff development. However, this needs to go hand in hand with the provision of sufficient resource to be able to support a significant number of businesses.

### 5.4 Conclusion

Businesses seem to recognise that they need advice<sup>12</sup>, but most are not currently seeking advice from organisations that are likely to provide good guidance. This may be partly due

<sup>12</sup> It is possible that survey respondents were simply saying to the enumerators that they wanted advice because they perceived that was the 'right' answer.

<sup>13</sup> It is important to acknowledge that the cases studied for this assessment were chosen from amongst businesses that have been successful.

What is clear is that business support organisations need more resources, and then need to promote themselves more effectively to SMEs, and that businesses need to be proactive in seeking appropriate advice both as a way of taking steps to make their business more effective and as a way of unlocking additional capital.

In order to raise both awareness and access, Nepal needs a more cohesive – and we would suggest collaborative – business support network to promote the existence of business support offerings and extol the benefits that accrue to those businesses that take up such advice. We acknowledge that there are resource limitations that constrain widespread take-up. It is also important to note that not all advice is good advice; therefore, an accreditation system of service providers would help avoid the potentially negative consequence of poor advice on firm performance. There may be merit in experimenting with different ways of offering advice, for example, through factsheets<sup>14</sup> and YouTube videos.

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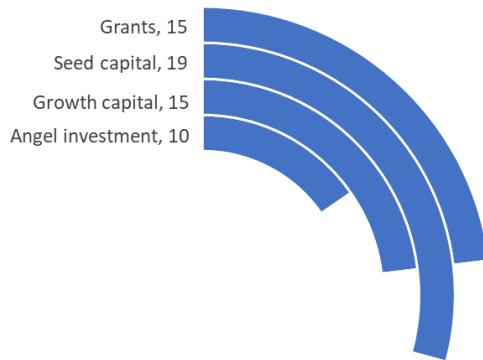
<sup>14</sup> For an example of the sort of information that can be provided, see <https://cobra.cobwebinfo.com/>

## 6. Finance & investment

### 6.1 Sources of finance

In this chapter, we examine the sources, types (loan and non-loan) and levels of financial support provided to Nepal's SMEs. A large number of organisations provide non-loan finance – such as through grants, seed capital, growth capital or angel investors<sup>15</sup> (Figure 69), but the numbers belie the fact that only a small number of businesses actually receive this support.

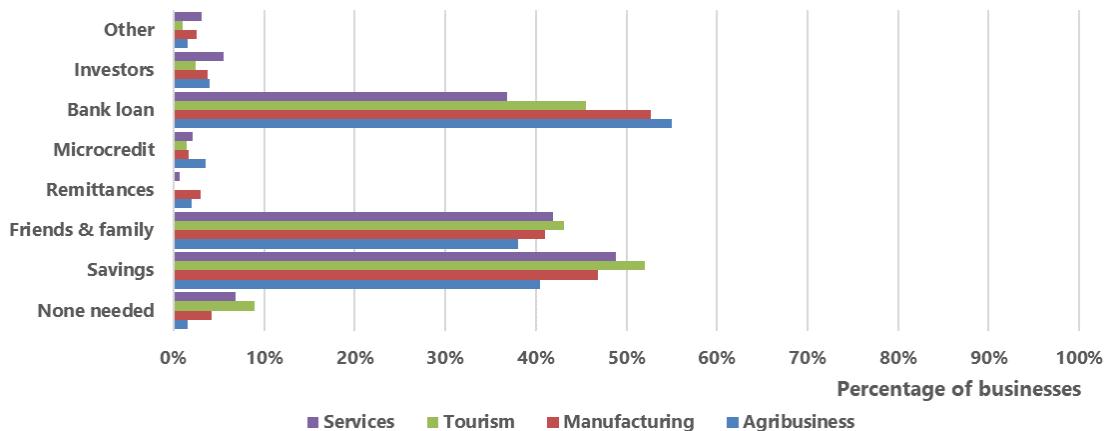
**Figure 69: Providers of investment capital**



The findings of our SME survey indicate that firms rely on multiple sources of finance rather than a single source. When asked to identify the main sources of start-up finance, most firms relied heavily on some combination of personal savings, family and friends and bank loans. Direct investors, micro-credit and remittances played a very small role among our sample of non-micro firms. There is little variation between sectors, although bank loans are slightly more prevalent amongst agri-business and manufacturing firms, while service sector and tourism firms rely relatively more on their own savings and on friends and family. As shown in Figure 70, in which the x-axis shows the percentage of businesses in the sample taking each form of finance<sup>16</sup>, some 47 per cent of all surveyed businesses use bank loans, 47 per cent use their own savings, and 41 per cent borrow from friends and family. Note that just five per cent of respondents did not require any start-up finance.

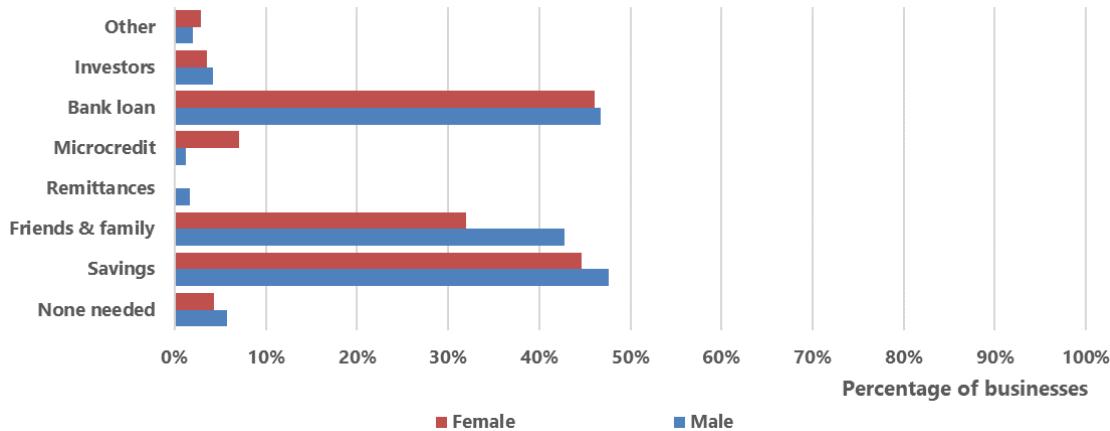
<sup>15</sup> Seed capital is externally provided start-up capital, which may come from family or from angels or even from venture capital funds with an eye to the future. It may be available pre-revenue, though that is unusual if provided by an angel or a fund. As a business grows it will need more capital. If the business seeks equity, this may initially come from angels – high net worth individuals willing to take a risk in exchange for part of the business. As the business continues to grow, it is likely to see larger levels of equity investment, usually from a venture capital fund. This often provides an opportunity for the initial investors to sell and recover their investment.

<sup>16</sup> Note that because businesses are able to choose multiple options, the shares do not add to 100 per cent.

**Figure 70: Sources of start-up finance by sector**

(Note that respondents could select more than one source of finance)

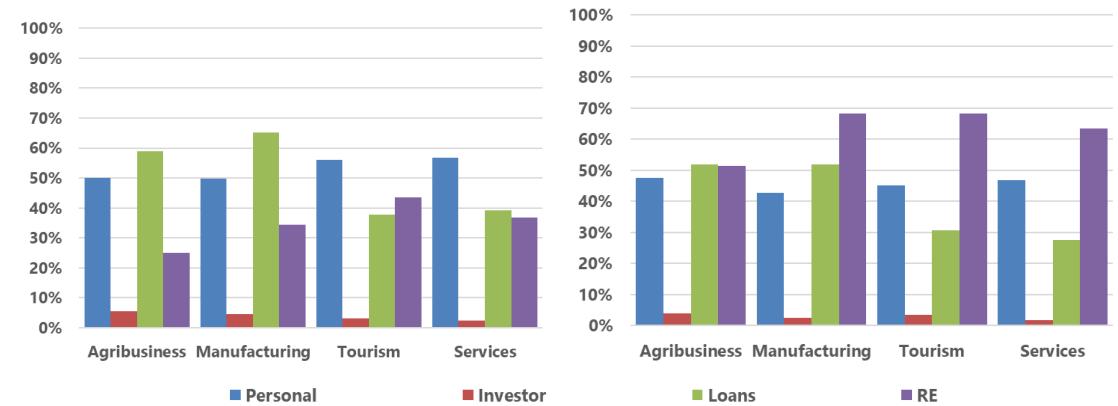
Some gender differences emerge in the types of financing used, although the gaps are modest. As one might expect, women rely less on personal savings than men, due to credit access constraints and the fact that they have lower personal savings, but it is interesting that women have much lower reliance on friends and family (Figure 71). Women make much more use of micro-credit, implying that they start smaller businesses and have few other options.

**Figure 71: Sources of start-up finance by gender**

Once businesses move beyond the start-up phase, they have the possibility to utilise retained earnings to fund their business operations and new investments. With respect to capital expenditure, the two largest financing sources continue to be personal savings and bank loans (Figure 72). Once again, services and tourism mostly rely on personal savings, followed by retained earnings. With respect to financing working capital, a different pattern emerges. Namely, most sectors rely on retained earnings, although manufacturing and agribusiness still utilise bank finance.

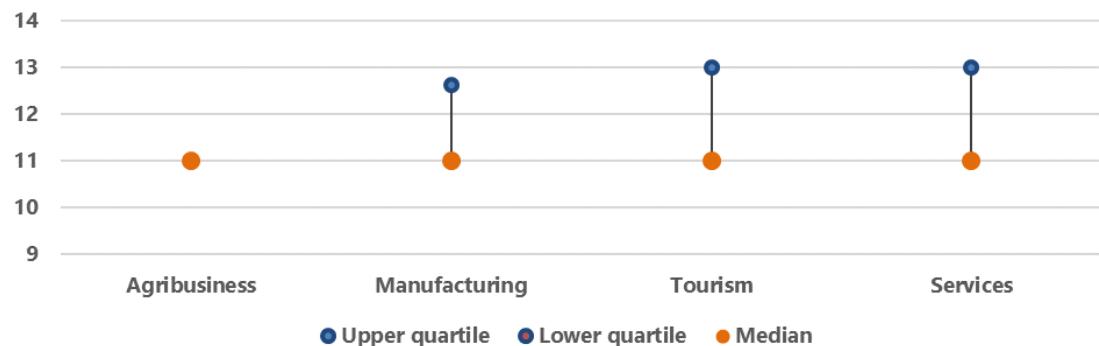
## Understanding job growth potential in SMEs in Nepal

**Figure 72: Sources of current finance for capital equipment and for working capital**



There is little variation in the cost of capital across firms, consistent with fact that interest rates are widely capped. Figure 73 shows medians and quartiles across each sector, where there is only minor variation in the top quartile. Given the base rate is currently 9.7 per cent, a cost of capital averaging 11 per cent seems quite reasonable.

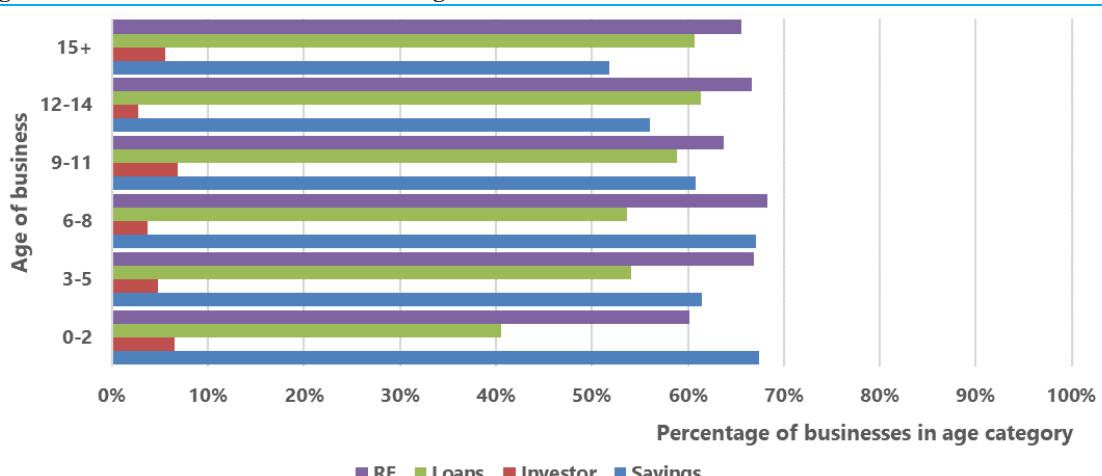
**Figure 73: Cost of capital**



NB, in all cases, lower quartile equals the median; in one case, the upper quartile equals the median.

We might expect that, as businesses age, they become less reliant on debt finance or savings and more reliant on retained earnings, but this is not the case in Nepal (Figure 74). In fact, the high reliance on retained earnings persists as firms age (but does not increase), and older firms make increasing use of loans. SMEs' use of equity investment is very low for businesses of all ages.

**Figure 74: Sources of finance as businesses age**



NB, firms could select more than one; this combines capital equipment & working capital requirements

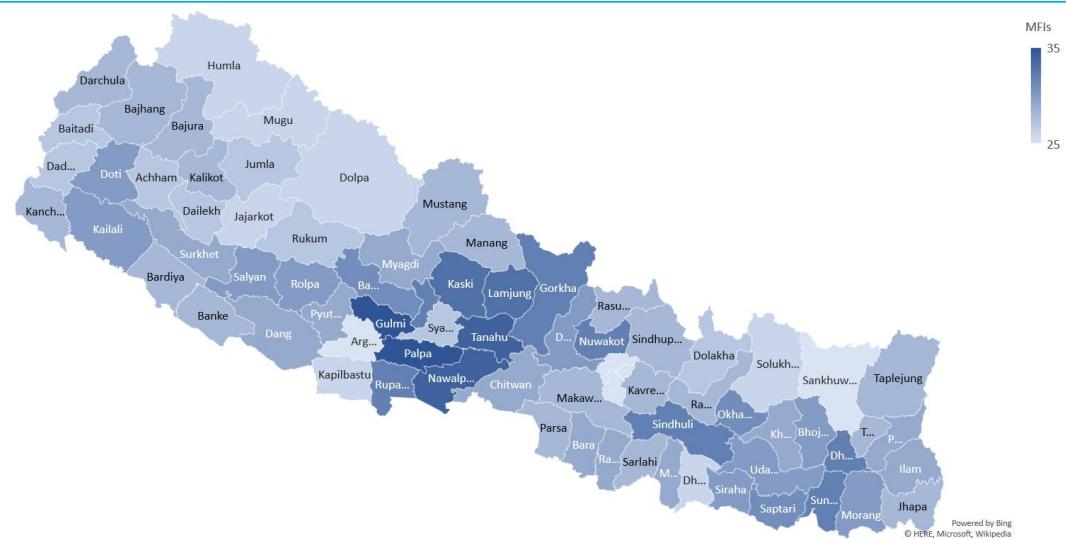
## 6.2 Non-commercial funds

The Government of Nepal, similar to governments elsewhere, recognizes its potential role in subsidizing credit to private agents in order to stimulate new firm entry and growth, which are key to generating employment and fostering dynamic economic production. Subsidized credit can be structured to support specific objectives such as priority sectors or firm sizes, start-ups, or existing firms with high growth potential. Rural and women-targeted micro-finance schemes are examples of subsidized credit.

It is perhaps surprising that microfinance is used so little by SMEs in Nepal despite their high coverage levels across the country (Figure 75). Almost certainly this is because their maximum loan size is too low for most businesses, especially once firms start to grow. The list of banks and financial institutions licensed by the NRB includes 54 micro-finance institutions (MFIs). In addition, several organisations specifically support new and growing businesses with grants and loans, though their reach and scope are limited.

MFIs, NGOs, savings and credit cooperatives (SCC) and the Agriculture Development Bank (ADB) can secure long-term loans of up to NPR3,500,000 at an interest rate equivalent to the refinancing facility rate fixed by Nepal Rastra Bank. In turn, they can provide long-term loans to eligible individuals at an interest rate not more than four points higher.

**Figure 75: Distribution of micro-finance institutions**



Source: derived from NRB (2017)

The discussion that follows describes the main non-commercial lenders supporting SMEs in Nepal today.

Practical Action has launched the Access to Capital for Rural Enterprise (ACRE) impact fund to invest in growth businesses requiring investment in the range \$150,000-\$1.5million. Three investments have been made so far.

The Youth & Small Entrepreneur Self-Employment Fund (YSEF) is operated under the auspices of the Ministry of Cooperatives and Poverty Alleviation as a challenge fund to create employment. The fund aims to provide unemployed youths with subsidised loans to start small businesses. Any unemployed individual aged 18-50 years is eligible for a loan and can receive up to NPR 200,000 (US\$1,800). Through its *Namuna* scheme, a group of up to 20 people working across a common value chain (say four businesses

of five people each pursuing a different link in the chain) can receive up to NPR4,000,000 (US\$35,000). Loans are made available through a partner BFI or cooperative. Loans charge 10 per cent interest for agri-based ventures and 12 per cent for other sectors and are repayable over 36 months after a 6-month capital repayment holiday. After successful repayment, the entrepreneur receives a rebate equal to 60 per cent of the interest paid. The BFIs pay 5 per cent and loans are insured by the YSEF. To date, YSEF has supported 63,000 young people, half male, half female.

The Rural Self-Reliance Fund (RSRF) is a state-owned wholesale lender set up by GoN, in partnership with the Nepal Rastra Bank, to make it easier for entrepreneurs to access finance. It has total capital of NPR443 million. It provides wholesale credit to MFIs, savings and credit cooperatives and NGOs at 8 per cent interest. The on-lending institutions can charge their borrowers up to 14 per cent interest. Individuals can borrow up to NPR90,000 (US\$800) and groups can borrow up to NPR150,000 (US\$1,300).

### **6.3 Commercial lenders and investors**

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Commercial banks do lend to SMEs, though many SMEs struggle to meet creditworthiness criteria related to collateral requirements and struggle to afford interest and other charges. To address this market failure, the GoN has attempted to direct bank lending to specified priority sectors which include agriculture and tourism, and to SMEs generally. Banks are supposed to allocate 25 per cent of their lending to businesses in priority sectors (Antarprerana 2018). Low levels of capital assets – notably land ownership – make it hard for businesses to qualify for loans; it is especially difficult for women who generally do not hold property titles. Furthermore, banks will not lend to any business that is not formally registered. Banks exhibit a low appetite for risk (Antarprerana 2018: 12), consistent with their business model to lend depositors' savings while guaranteeing a small return on deposits. As a result, banks lend very little to SMEs and commonly fail to reach their lending targets.

Kamana Development Bank states that it offers loans based on innovation, experience of the entrepreneur and the availability of collateral. They observe, however, that there is very little innovation, with most start-ups being 'me too' ideas (that is, simply copying what others are already doing, rather than innovating and doing it better). This leads to significant cost competition and makes it harder for businesses to continue to innovate since they have fewer spare resources and it may reduce their sustainability. Kamana Development Bank also asserts that most entrepreneurs have inadequate knowledge or experience and that most borrowers hope to have their loans written off rather than having to repay. They are now talking about setting up their own SME counselling service.

In many countries, the problem of collateral is overcome through a government-sponsored credit guarantee scheme. Whilst Nepal has such a scheme, banks report that it is extremely difficult to recover lost funds and, indeed, at least one bank, SBI, has stopped using it. SBI is also piloting a programme, with donor support, to lend based on cashflow rather than on balance sheet (that is, based on expected sales and profitability rather than on assets).

Because Nepal's SMEs in general continue to struggle to access and afford bank credit, despite existing initiatives to mitigate these challenges, there is scope for banks and business support organisations to work more closely together through direct

collaboration that exploits their complementary missions. Businesses that have received good advice and training are likely to present a lower risk to banks, which could then be reflected in lower collateral requirements and/or lower interest rates.

With respect to non-bank investment, there is a small number of non-bank commercial and impact investors that target support at emerging businesses. Divakaran *et al.* (2018) report that there are just four local investment firms that offer private equity or venture capital: BO<sub>2</sub>, Dolma, One to Watch and True North Associates. These four had collective funds of \$48m in 2017. There is, as yet, little track record on which to judge their performance. They are all hampered to some extent by Nepalese legislation which makes investing quite hard. It is not surprising therefore that the bulk of the funds' capital has been provided by development finance institutions, including IFC and DFID. One to Watch aims for an IRR of 15 per cent at the deal level; the other three target an IRR of at least 20 per cent.

BO<sub>2</sub> is part of IFC's Global SME Ventures initiative. It invests in any sector but businesses need to have a track record. Investments are in the range US\$100,000-500,000, and the fund has made seven investments in Nepal. The Dolma Impact Fund, a private equity and impact fund, has raised \$26m from international investors. It invests in the range of US\$500,000-US\$4million and has so far invested in five businesses. The minimum revenue threshold to qualify for consideration is \$500,000.

One to Watch is a subsidiary of One to Watch BV, a Dutch impact investor, which offers investment, preferably as equity, across the SME growth spectrum. They support around 10 businesses each year. Since their launch, they have supported 50 businesses and believe that 49 are still in business. They have made 15 direct financial investments totalling €5m to-date, all of which continue to perform. They have not yet exited any investments though expect to exit two very shortly. They focus on agriculture, agri-processing, infrastructure, healthcare and education, and their direct investments have spanned agriculture, solar energy, waste management, ICT, construction and textiles. Some 86 per cent of their operating expenses are provided by donors.

True North Associates aims to invest in growth businesses, with sums of US\$100,000-500,000. It has raised US\$5 million from local investors, and has made three investments since their launch in 2014.

We have identified three more funds. Jaguar Investments, another investment group supporting SMEs in Nepal, works with a small number of clients each year and has invested in just three firms since their launch in 2013. Safal Partners, a recently launched investor group, offers seed and angel investment to firms facing mid-sized

finance gaps, in recognition of the fact that many businesses do not need large sums of money, perhaps up to US\$200,000. They have recruited 20 investors to their pool, but ask each for sums as low as US\$2,000, reducing individual exposure. They have invested in three business to date. iCapital, another investor active in this space, has invested across eight sectors including hydro, IT and trading. Based on their experience, iCapital observes that (i) many business support organisations providing incubation services do not really understand

#### **Box 4: Fine Feed Pvt Ltd**

Fine Feed processes animal feed. It employs 30, mostly highly skilled, staff. It sees considerable opportunity to grow, utilising improved cold storage, automated processors and additional staff. However, despite its experience and expertise, it is still constrained – by inability to source all raw materials locally and challenges in importing additional raw materials, exchange rate fluctuations, cost of quality testing, and difficulty, even for an established business, in raising loan finance.

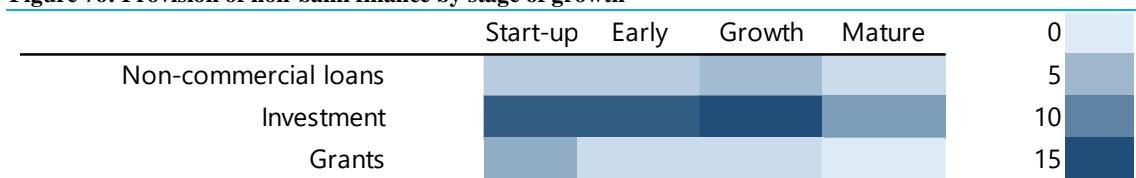
incubation; (ii) many firms struggle to recruit skilled staff, because the best potential candidates tend to work elsewhere such as Delhi; and (iii) regulation is burdensome for small firms –even registering a company name.

Until recently, the concept of equity investment has not been recognised in Nepal's legislation. Whereas on the one hand this created flexibility for investors, on the other hand, it provided no protection. Moreover, it conveyed a lack of understanding by government about the role of angel and other investors. As noted in the policy chapter, the industry generally seems happy with the recently approved legislation.

#### **6.4 Summary of provision**

Figure 76 shows the number of organisations (other than banks and institutions offering straightforward commercial lending) purporting to provide finance to new and growing business, though does not reflect actual take-up of financing by firms. Whilst the graphic suggests a disproportionate focus on growth businesses, in reality, existing investment funds each work with a very small number of clients. Without considerable expansion of support to more firms, the impact at the market-level will be modest.

**Figure 76: Provision of non-bank finance by stage of growth**



Note: Non-commercial loans exclude loans from banks, but includes credit from savings cooperatives, microfinance institutions and business finance institutions.

In a recent article in the *Kathmandu Post*, Shah (2019) stressed the need for a greater variety in types of funding, including greater use of equity and grant finance. But making more finance available will not, by itself, enable more businesses to emerge and grow. However, he also stresses the need for a greater variety of funding to be made available, including greater use of equity and grant. Shah also notes the need for access to knowledge, advice and guidance specifically geared to the firm's stage of growth.

#### **6.5 Key points from in-depth interviews**

Most of the businesses with which in-depth interviews were conducted for this study had secured loan finance from a bank, though did not always take it up. In one instance, a business avoided the lengthy bank procedures by 'shopping' the loan offer to a savings cooperative which then provided a comparable loan. This type of coping strategy is helpful to the firm seeking credit, in particular by expediting access to funds, but it undermines the efforts and time invested by banks to carry out due diligence. Moreover, it does not help those businesses that need much greater levels of credit. One business, for example, reported that it need to raise investment funds of US\$9 million over five years and anticipated that this would need to come from the banks as loans – but further reported that they have been waiting for months for agreement to a small scale working capital loan – so had no confidence that they could ever raise the investment that they needed, despite being a successful business.

Interviewed firms were not broadly aware of financial institutions or credit sources other than banks, such as venture capital or private equity. And very few were aware of the possibility of raising investment from foreign investors.

## 6.6 Conclusion

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Taking the survey data results together with insights from firm interviews, the experiences of a wide variety of BSOs, and the perceptions of different types of investors active in the SME sector, it is unclear whether there is sufficient liquidity, particularly in the banking sector. Nearly half of surveyed firms have bank loans to cover at least part of their financing needs, despite challenges in meeting qualifying criteria and expensive commercial terms. What is clear, however, is that businesses would prefer to avoid bank loans if possible, due to high interest rates and other requirements such as arrangement fees, renewal fees, due diligence fees and long processing delays.

SMEs in particular require more flexibility and agility than the financial system is currently providing. A growing number of equity funds are starting to channel equity finance to creditworthy SMEs, but these incipient efforts are limited in scope. As such, they are not yet investing in sufficient numbers of firms to make a sizeable impact at the market level. Firms rely on personal savings, informal loans from family and friends, and retained earnings to finance start-up and operations, but make very little use of equity-based financing and other types of formal credit (including an underutilization of bank finance for working capital). This low take-up could be due to the fact that firms are not well-informed about options. Or it could be that most firms are simply not up to the mark, whether in terms of profitability and growth potential, or in terms of their internal capacity requirements that imply a high level of post-investment support that investors perceive as risky or are unwilling to provide.

SMEs are constrained by the current limitations of the credit market. There are several potential entry points for improving the situation, however. There is scope for banks and business support organisations to collaborate on identifying and referring creditworthy clients and upgrading firms' capacity to increase their viability potential and thus their attractiveness to creditors. Banks would be able to increase their lending portfolio to SMEs, channelling more financing to the firms that need it to expand their operations. This type of partnering approach between banks and business support organisations could be tested in a pilot to measure the effectiveness of BSOs in signalling creditworthiness.

Similarly, there is scope for investment funds and business support organisations to work more closely together. One solution for encouraging more equity investment is for BSOs to refer clients to investment funds. Investment funds, in turn, would quickly assess the quality of various business support organisations and would only work with those that refer investment-worthy propositions. In several examples where this collaboration happened, businesses were able to secure finance and grow successfully.

Achieving impactful collaboration across credit and service providers may require the business support network to market itself more effectively to both banks and potential investors. Better exploiting the complementary objectives of BSOs, banks and investors could generate a virtuous circle of investment and advisory collaboration that expands the market through both increased provision of support to SMEs and wider access to support by a larger number of SMEs, helping to build a vibrant SME sector.

Firms, themselves, need to be better informed in order to make the financing choices that best suit their specific needs. There is a need to educate entrepreneurs not only

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about sources of finance, but also which sources to use to fund different aspects of the business (e.g., overdrafts for working capital; loans or leasing to finance fixed assets).

Whilst access to finance is clearly important, especially for upgrading product quality and competitiveness that will enable SMEs to grow, the SME survey results suggest that firms' greatest current need is to reach more customers. Given the many challenges involved in starting and growing a firm and competing in tight markets, firms need finance as well as other complementary support. For instance, firms need to be able to market their products effectively. They also need the skills to manage operational challenges, inputs and labour, especially as the business grows. Shah (2019) argues that access to specialised knowledge is an additional factor essential to SME growth, and needs to be accompanied by an enabling policy environment (which requires better harmonisation). All of these are aspects where business support organisations could play a more proactive role in enhancing the SME ecosystem.

## 7. Validation workshop

As noted above, a validation workshop was held to share the research findings and discuss the preliminary conclusions with a wide set of stakeholders. Participants were asked specific questions (described in appendix 6) though could comment as they saw fit. A complete summary of observations and comments is in the appendix. The key comments were:

- Competition is high but innovation is low with successful businesses being quickly copied. Agribusiness and manufacturing additionally face considerable competition from imports. Businesses focus on the domestic market because they cannot compete internationally often constrained by Nepali regulations. Some products, such as coffee, however, see strong international demand.
- There should be better links between organisations supporting SMEs, including investors, banks and advisers. However, there is still a challenge in that businesses are unwilling to pay for advice.
- There needs to be more information about the SME support services that are available.
- Too many busy advisers lack genuine business experience.
- Banks could offer business advice alongside loans to reduce risk.
- Raising finance is challenging with banks overly reliant on collateralised lending, making it hard for women to borrow from the banks, and limited access to equity based investment
- Business associations could do more to offer business advice and support and more to encourage business linkages.
- Recruitment and retention of staff is problematic exacerbated by an aspiration of young people to work abroad.
- There should be an overarching federal policy framework that defines the scope of province and local level policy reach thus allowing provinces and local government to adopt policies to facilitate SME start-up and growth.
- The FDI threshold should be reduced.

The comments largely reflected our assessment – though participants were often much firmer in their belief that action was needed. One participant made the point that there are many such studies and many such workshops but a lack of action to address the challenges.

MolCS concluded by stressing the government recognises the need to do more to support entrepreneurs with the aspiration to grow and is currently aiming to ensure that there is a favourable environment for them.

## 8. Our assessment

SMEs the world over face challenges that constrain their ability to compete and grow. These stem from the start-up stage in which entrepreneurs need to identify a gap in the market and create the infrastructure to produce the product or service to fill that gap. This involves product design, procuring inputs, recruiting staff, complying with regulations, financing initial production, finding customers, etc. The challenges faced by SMEs in Nepal mirror these same challenges. However, there are particular problems in raising finance, especially for women, and in recruiting skilled labour. An obvious retort is that businesses could do more themselves to train staff but Nepal has a much higher level of outward migration than most other countries.

The group of businesses that seems to be most ambitious to grow and is making the most headway is the one where the entrepreneurs are trying to solve a particular problem. They create more jobs, are more likely to seek advice, are less fazed by the competition, are more focused on growth through introducing new products and improving quality, and more likely to be selling internationally, so this should be the priority group for additional support if any is available.

The government is working to create a favourable environment for entrepreneurs and recognises that this requires regular discourse with firms and with business associations to identify constraints and engage in policy reform. Areas of recent progress include the Labour Act 2017 (even though most firms do not yet recognise that and there is scope to support businesses to recognise the advantages). Other areas that are important for future discussion include protection of intellectual property, (since Parliament is currently advancing legislation on this topic) which will help those businesses that are creative and innovative, as well as consideration of the threshold specified in the Foreign Investment and technology Transfer Act, simplification of licensing requirements and simplification of the rules for starting a firm. One issue that has arisen is caused by devolution. Specifically, there appears to be a need to develop an overarching policy framework at the federal level that defines the scope of province and local level policy reach. Then, provinces and local governments will find it easier to set out policies to facilitate local SMEs to operate, access finance and grow in a way that addresses local realities and priorities and is consistent with the broader framework.

There are several areas where SMEs in Nepal seem to face particular struggles. Many entrepreneurs launch copycat firms that produce similar products to their competitor's and yet complain about the high level of competition. The paradox is that many firms are optimistic about their future growth, but expect to rely on increased market demand to deliver this growth, rather than taking steps to differentiate their own product, upgrade its quality and/or seek new markets. Another striking pattern that emerges is a pervasive inward focus by SMEs, both with respect to where they source their inputs and where they sell their outputs. But Nepal's relatively small domestic market will ultimately limit firms' scope to expand.

In line with national development objectives and the need to absorb young jobseekers into productive work, there is a desire to encourage more people to start and grow a business. The Government – and many donor programmes – seem focused on facilitating start-ups and micro-entrepreneurs as a way to reduce poverty, but SMEs create more jobs because they are larger by definition, but also because they have more productive capacity and thus generate higher per capita earnings. And their

better quality jobs have larger spillovers to household incomes and aggregate demand, making larger contributions to economic growth and sustainable poverty alleviation. SMEs are not well-served by existing micro-finance or subsidized credit programs.

Encouragingly, there is a high proportion of businesses that believe they have the potential to grow and are actively seeking to create new jobs. This is true of both opportunity entrepreneurs and necessity entrepreneurs. However, almost all firms saying that they expect to grow state a need to recruit staff, often with specialist skills, and it seems that there are not people easily available with the necessary skills, hence the recruitment of foreigners for specialist tasks (though the numbers are fairly low). However, there is a contradiction between (i) firms' expectations to add a significant number of new employees, and (ii) firms' limited resources due to a reliance on retained earnings and savings to fund that anticipated growth. SMEs need support – whether from government or donors or private investors or business support organizations – to access more suitable methods of finance that provide them the flexibility to invest and expand. This might mean accessing larger levels of credit or equity financing in order reach a more competitive or profitable scale of production.

Whereas there does not appear to be a shortage of finance in Nepal, businesses cannot always access it. This may be because entrepreneurs are not able to convince investors that they have an idea for a product or service that customers will want to buy, or because they balk at the level of interest, or because they have insufficient collateral. Beyond bank credit, equity investment is used in only a limited way. Investors, including impact investors, are supporting a very small number of businesses each year and, even then, find that firms' capacity remains inadequate and requires continued support.

Business support organizations have a role to play, both in improving SMEs' performance and increasing their creditworthiness. This study documents an extensive network of organizations that provide a range of business support services to SMEs. The over-arching impression is that there is a plethora of small business support projects, many of which are working with a relatively small number of people but lack a guiding strategy to support enterprise development, job creation and improved livelihoods. There are nevertheless at least a handful of organisations that appear to be providing effective support and are working at a scale appropriate to the challenge.

How can BSOs have a bigger impact? One interesting pattern that emerges from the survey relates to the willingness of SMEs to seek advice. Even though a third of firms reported seeking advice in the past, most was from informal sources rather than BSOs. This may be a failure of marketing – many firms are unaware of the existence of BSOs and what they offer. Other entrepreneurs who are aware of BSOs may be unwilling or unable to pay for the advice. We make no assessment of the quality of advice and guidance on offer, but we infer that more effort is needed to increase both the number and quality of advisers available to SMEs. Current services seem disproportionately weighted toward start-ups or those in the very early stages of development.

There is scope for business support organisations to play a stronger networking role, including through direct collaboration with banks and/or investment firms to connect creditworthy firms with the financing they need. Collaborating effectively may, in a first stage, require BSOs to promote their services to potential SME clients as well as to banks and investment funds. Whilst networking does not require additional resources, being able to take on additional clients on referral from banks and investment firms will clearly need to be resourced. Firms, themselves, need to be better informed in order to

make the financing choices that best suit their specific needs. A majority of entrepreneurs do not fully understand the various types and optimal uses of different financing instruments to fund different aspects of their business (e.g., overdrafts for working capital; loans to finance fixed assets).

It is important to be mindful of the possibility that donor-supported interventions can inadvertently distort markets or market signals. Some donor initiatives engage directly in business advisory and support functions as a by-product of the main poverty reduction focus of a project, but end up duplicating efforts by creating their own business support network, rather than working with existing organisations (this may have been a rational choice if existing service quality was poor). The resulting inflow of donor resources could however lead to excessive enthusiasm for starting businesses even when fundamental viability criteria are not met. And after firm entry, other distortions can arise from program design components (e.g., project beneficiaries may focus on buying machines or fixed assets to meet grant criteria rather than what may be best for the business).

While the survey results suggest that many businesses take a passive stance to future business development, hoping that new customers will materialize but seeing no need to adjust their business processes or production mode, there are, of course, many success stories where firms have actively marketed their products or innovated, and grew as a result. These firms utilise technology, not only for back-office operations but also in processing. They create good quality jobs for qualified people. Many seek to hire skilled labour. Some develop innovative solutions including through developing apps to reduce coordination or information failures, thereby contributing to better quality products or services. These firms have a vision and want to invest in it. They are not looking for hand-outs, but are constrained and would find it easier to grow if these constraints could be mitigated.

Specific areas where government can help SMEs navigate these challenges relate to the availability of skilled workers and the relevance of their skills, for example, by laying the foundations in education curricula. Firms' inward orientation – both in terms of sourcing production inputs and targeting final consumers – limits their capacity to grow; similarly their reliance on domestic capital may restrict their options. It would be useful for government to review the impact of the recently raised foreign investment threshold and consider lowering it to facilitate credit access to firms so that they can add domestic value and create local jobs. Government can play a regulatory role to ensure the provision of quality business support services through a network of accredited providers. SMEs would also benefit from more efficient and flexible credit options that can meet their changing needs as they progress from start-ups to growth-firms and into maturity; government should consider how to facilitate this SME segment of the market. There is a need for more innovative and creative firms that can diversify local product offerings and increase product sophistication, enabling them to compete more effectively and provide better products to the Nepali market and external markets. Government needs to facilitate innovation through human capital interventions (e.g., curriculum reform) as well as targeting programs to encourage innovative approaches and stimulate increased entry of creative entrepreneurs.

Firms themselves can do more to help improve the business environment by communicating with their business associations about the reforms that could make a difference. And business associations need to maintain a productive dialogue with

government policymakers and regulators to lobby for reforms. Government can encourage this process – for example through ensuring that the fora for dialogue are effective and additionally through offering alternative channels through which businesses can raise issues of concern, both indirectly through trade associations (which can then aggregate concerns) and directly (for example through a website).

The government's recent initiative to conduct a national economic census will be highly useful for deriving both national and granular trends, and identifying statistically significant challenges and/or areas of concern. This new information will provide an evidence base for future policy decisions. This current, much more targeted research can complement the firm census with further evidence and reflections on the factors motivating entrepreneurs' decisions and SME performance. Neither the census nor our SME survey can provide detailed insight into SME performance over time, as neither captures starts or closures. However, in many countries, there are academics who are especially keen to research both the performance of SMEs (starts, closures, etc) and the factors that support or constrain SMEs. There is some of that research being undertaken in Nepal, for example by Samriddhi Foundation, but arguably insufficient.

## 9. Suggestions for action

We offer a number of suggestions, although some may need more detailed consideration or research before they can be considered formal recommendations.

### 9.1 Policy

- Policy makers would benefit from more information about the SME ecosystem. A good approach would be to create an SME observatory (that is, a dedicated research service that monitors and reports on SME performance and challenges), but we anticipate that there are insufficient resources, so instead propose that it would be appropriate to explore with universities, Samriddhi Foundation and others whether there is interest in doing more to review the small business landscape – success rates, closure rates, reasons for closure, lessons from success, factors impeding the growth of SMEs – that might help to inform policy makers on a consistent, long-term basis.
- Adopt a mission statement, across government, containing three or four simple principles that stress the importance of private sector firms to the economy and to encourage Ministries to think carefully about the potential implications of their decisions on the private sector, especially SMEs (as for example the UK government did in 2001, with the Small Firms Service drafting the principles and the Prime Minister promoting them). This could also provide a framework for devolved government.
- Develop an overarching SME policy framework at the federal level that defines the scope of province and local level policy reach. This will help provinces and local governments to set policies to facilitate local SMEs.
- Publicise more effectively the existence of public-private dialogue mechanisms and encourage businesses to contribute through their business associations. Consider setting up a web-based mechanism to allow businesses to communicate directly with government.
- In light of the negative reaction of private sector firms and BSOs to the increase of the foreign investment threshold to US\$500,000, Government should assess the potentially negative impact and revisit the threshold.
- Review the tariffs on imported technologies where the technology is likely to have a job creating impact.
- It is unlikely that government will be able to discourage people from wanting to spend time working abroad, but government could encourage people to return by making it easier for them to identify employment opportunities in Nepal and by offering short term tax breaks to people returning to work.

### 9.2 Business support

- Whilst it is likely that all businesses will benefit from good advice and guidance, the ones who are seeking it the most, and who are most likely to create jobs and invest more as a result are those entrepreneurs who have started in business to solve a problem, though extending support to all opportunity entrepreneurs may be sensible since the boundary between solving a problem and spotting an opportunity is blurred.
- Create an online portal to provide guidance on regulatory compliance, tax compliance, sources of finance, sources of business advice and guidance,

information on skills development, access to basic tools and techniques such as book-keeping and perhaps a range of 'business information factsheets'.

- There is a need to encourage prospective entrepreneurs to be more creative and innovative. Business support organisations are experimenting with FabLabs but more could be done, for example, in secondary schools and at universities to encourage creative thinking. Education for enterprise, at the secondary level, at universities and elsewhere, should not be offered in isolation but in tandem with other programmes that tend to result in people starting in business, such as software and information technology, tourism, catering, fashion design and three-dimensional design. There has already been some experimentation with business plan competitions or design competitions to stimulate innovation and we suggest that this not only continues but is expanded.
- Provide access to information that would allow businesses to see what is being imported and then consider whether comparable products could be produced in country. This could be achieved through setting up a product identification centre and/ or making the information available via a portal. This could go further with medium and large firms being asked to state (within limits of confidentiality) what products and services that they buy and that could potentially be sourced locally.<sup>17</sup> Medium and large firms could also be asked to run workshops in which they explain what they are looking for in their suppliers so that smaller firms are better able to understand what they have to do to satisfy the procurement requirements and standards of such firms.
- Encourage businesses to take more responsibility for the training of their staff by setting up a fund which can contribute to the cost of delivering such training.
- Develop management development programmes that can be delivered through local chambers of commerce and other business associations.
- Establish informal mentoring programmes, and create entrepreneur networks through which entrepreneurs can share experiences and knowledge and foster connections.
- Support business support organisations (with funding, skills development and accreditation) to offer a broader range of services, and encourage them to target businesses with growth potential.
- Encourage business support organisations to market their services more widely: to potential client firms, to banks and to investment firms.

### **9.3 Business finance**

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- Pilot and market a programme in which one or more business support organisation partners with a bank to provide loan finance to growing businesses. The BSO would need to demonstrate that it can provide quality advice and guidance, including in the areas of preparing detailed financial forecasts and marketing; the bank would need to undertake to provide loans on terms better than businesses that do not receive such support. The BSO would need at least some financial support to cover its costs, though the client could be expected to contribute; it may be appropriate to provide a small fund to ameliorate the risk being taken by the bank. The programme would need to be carefully monitored and evaluated over a period of at least three years, and ideally five.

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<sup>17</sup> Shell UK was a pioneer of such programmes in 1970s and 1980s.

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- Encourage lending by providing funding to non-bank financial intermediaries for on-lending to SMEs, specifically to fill the gap between what is available from micro-finance and cooperatives and the realistic threshold to borrow from a bank.
- Whilst we do not advocate the use of grants or other incentives specifically to encourage people to start in business – as people then tend to start for the wrong reasons and do not survive – we do see merit in there being more encouragement for people to consider starting a business. This can start at school and be continued at university, as will happen for example in the proposed new enterprise development programme at Pokhara University. There may be merit, however, in exploring ways to give businesses a helping hand, for example with short tax holidays whilst they become established.

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## Appendix 2: Research approach and methods

As noted in the introduction, there are three focus areas to our research: the SME sector; the policy environment in which SMEs operate and the various government agencies that shape it; and business advice and support organisations (which includes providers of finance and a wide range of donor funded initiatives as well as some government programmes).

### A2.1 Small and medium enterprises survey

The key source of data was a survey of small and medium enterprises<sup>18</sup>. The World Bank was keen to focus the survey on small and medium enterprises, based on a broad definition, so effectively any business employing at least five people. We reviewed the data available at the time (before the census data was published) and selected four sectors active across three districts and prepared a sampling frame.

Our selection of the sectors was based on a combination of various layers of analysis. We used data from other complementary sources such as the Office of Company Registrar (OCR) to gain an insight into the concentration of companies but also analysed value multipliers and labour intensity and productivity using data from the Central Bureau of Statistics and the Department of Industry.

Using online data from OCR, we examined the concentration of companies within four broad sectors (agriculture and related industries, manufacturing, tourism and related services, and other services) across 20 districts in Nepal. Although OCR data does not allow us to differentiate between size of SMEs, this gave us the top seven districts with the highest numbers of companies within our selected sectors. From this we selected the top three taking into account geographic coverage of the survey.

Next we examined the importance of the selected sectors within the three districts of focus. Using data from OCR which includes the last three years of registration, we classified suitable Nepal Standard Industrial Classification (NSIC) codes into the selected sectors to show how the importance of sectors differed between the districts. We then considered growth of the different sectors in each district to understand the trajectory of potential growth in the future. For this, we used time series data available from OCR from 2009 to 2016.

To calculate value multipliers, to give an idea of the magnitude of spill-over effects associated with each sector, we used the 'Supply and Use' tables available for 2005 and 2011 in the National Accounts section of the Central Bureau of Statistics website. The Use table, which looks at industry inputs in different NSIC sectors, allows an inference of the direct and indirect inputs in terms of gross value added for each sector. Direct inputs are intuitive for each industry and indirect inputs are calculated as the difference between direct inputs and total value added. The value multiplier for each NSIC code was calculated as the value of total inputs relative to direct inputs. The data available could only be used to indicate which sectors would lead to the most spill-over effects rather than identify the employment multipliers as planned.

We then calculated the labour intensity and productivity of manufacturing business across the 20 districts used for the concentration analysis. The data required was only available in the Manufacturing Census 2011/12 – hence the analysis was restricted to manufacturing although we made a distinction between agri-processing and other manufacturing. We calculated labour intensity through the labour-fixed asset ratio and the labour intensity of production. These were examined to give an indication of the number of people that would need to be engaged to support additional increases in production in a way that is efficient for capital investment and productivity. To calculate labour productivity – due again to lack of available data – we resorted to information from the same manufacturing census for the different districts – again differentiating between agri-processing and other manufacturing business.

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<sup>18</sup> The Central Bureau of Statistics undertook a national economic census during 2018 (GoN 2019). We had hoped that we might have been able to access their business contact data, which could have provided a starting point for our research. In the end, that was not possible and we put together our own sampling frame.

Through data from the Department of Industry (DOI) we looked at the relative labour intensity of SMEs across the sectors and districts of interest. Despite using a very small sample where a number of sectors within districts were missing and where we could only calculate the labour-capital stock ratio, it allowed us to establish whether the most concentrated sectors in each district are also the most labour intensive. To analyse the strength of the relationship between employment and capital we considered the correlation between 'people engaged' and 'fixed assets'. Our findings in Table 6 and Table 7 below show that the correlation for agri-processing businesses within the sample was much lower than that for 'other manufacturing' businesses, with correlations of 0.34 and 0.8 respectively – suggesting that omitted variables and external factors could be driving the relationship for agri-business.

**Table 6: Agri-processing correlations and significance**

	People engaged	Fixed assets	Value added	Pr >  t	Lower bound (95%)	Upper bound (95%)
People engaged	1.00	0.34	0.57			
Fixed assets		1.00	0.71			
Value added			1.00			
Source	Value	Standard error	t			
Intercept	-402144.995	366863.596	-1.096	0.288	-1176159.523	371869.534
Number engaged	-165.147	270.190	-0.611	0.549	-735.198	404.904
fixed assets	1.489	0.172	8.647	< 0.0001	1.125	1.852

**Table 7: Other manufacturing correlations and significance**

	People engaged	Fixed assets	Value added	Pr >  t	Lower bound (95%)	Upper bound (95%)
People engaged	1.00	0.80	0.75			
Fixed assets		1.00	0.96			
Value added		0.80	0.75			
Source	Value	Standard error	t			
Intercept	-149093.842	589448.249	-0.253	0.803	-1392720.940	1094533.255
Number engaged	161.392	67.749	2.382	0.029	18.453	304.331
fixed assets	0.346	0.092	3.739	0.002	0.151	0.541

We thus determined three districts (Chitwan, Kaski and Kathmandu) and four sectors (agri-processing (which is mostly food processing but does include some businesses that are more agricultural in nature), manufacture, tourism (including hospitality) and other services (which covers a range including technology and software but also some businesses that are more retail in nature). However, the World Bank later asked if the survey could be extended to cover rural businesses and a further three districts. The final sample frame is shown in Table 1. We aimed to over-survey by 10 per cent to allow for incomplete and unreliable responses, giving a final target of just under 1,000.

The work to do the survey was split so that Antarprerana took responsibility for identifying businesses that fitted the firm-size and sector profile, FACTS took responsibility for undertaking the initial survey, Antarprerana then undertook follow up interviews, and David Irwin undertook the analysis. Some surveys work on the basis that enumerators simply walk from door to door, on a pre-determined route, in specified areas. We did discuss this as a possible method, but FACTS' experience has been that it is important to compile a strong database of verified companies before starting a survey.

We encountered considerable difficulty, however, in identifying businesses that fitted the profile and then in persuading businesses to engage. We aimed to identify potential respondents from the company record database provided by the Office of the Company Registrar (which mostly had e-mail addresses, but not telephone numbers), from commercially sourced business databases, from lists of members sourced from appropriate trade associations, from

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government agencies, from business support programmes and from respondents to earlier surveys.

Sourcing data from Morang, Parsa was Rupandehi especially challenging:

- Local government bodies, following reform of Nepal's federal system, do not have the old files of SMEs. There is limited digitization, meaning that Antarprerana had to rely on hard copies of SME data when sourcing data from organizations such as Federation of Nepalese Cottage and Small Industries (FNCSI) and Federation of Nepalese Chamber of Commerce and Industries (FNCCI). Receiving hard copies of data from outside Kathmandu delayed the process of data verification.
- Even with a list of more than 80 federations and associations, it was difficult to reach out to the key person as either their website had out of date information, or their phone did not work, or the staff refused to cooperate.
- Most officials from both government and private sector associations were hard to convince. Some were sceptical about the research and thus unwilling to help; others wondered what they would get in return (with one official asking for payment).
- In the agriculture sector, in particular, most SMEs are not legally registered so finding them through government bodies was not possible. Even when business were identified, often they employed fewer than five people.
- In the more industrialised districts, it was difficult to meet the required numbers of SMEs in the agriculture and tourism sectors.

Once a list of businesses was prepared, it was necessary to verify the data, so that the enumerators did not visit businesses and then be turned away:

- As noted, the dataset of businesses from OCR did not include phone numbers. Finding the companies online was not easy. Online directories such as nepalyp and yellowpages often had out of date phone numbers, exacerbated by recent road expansion activities which has resulted in the phone numbers in most of the areas being changed. This made verification difficult, even in Kathmandu city.
- Many of the entrepreneurs outside Kathmandu were found to be travelling, so even with correct phone numbers, it was difficult and time consuming to make contact.
- Businesses were not persuaded by Antarprerana saying that they were doing research for the World Bank. A typical response was "*we always received calls from World Bank for survey and all, but nothing happens eventually. You just waste our time and we get nothing in return. You are the one who will get money. But we get nothing*"
- Political tensions in Morang have resulted in people getting call from strangers asking for donations. This affected the verification as people were not answering their phones.

### **A2.2 The fieldwork**

Undertaking the survey interviews was also more challenging than anticipated:

Developing the questionnaire and agreeing with the World Bank took several iterations and discussions, recognising that there is a trade-off between asking every possible question and the goodwill of the business being interviewed. Once agreed, FACTS translated the questionnaire into Nepali.

The focus group discussions were helpful, especially the first as it provided insights for the choice of language and options to answer closed questions. The questions were first discussed in the English language and later translated to Nepali. Further changes took place after each FGD and before the subsequent one, so that the process of finalising the questions was iterative. After finalisation, the questions were uploaded into Droid Survey software for pretesting. Some 18 surveys were undertaken, all in Kathmandu but covering all four sectors, to check the sequence and understanding of questions by respondents. Minor amendments were made after pretesting.

Enumerators were all selected on the basis of experience. Moreover, most enumerators were residents of their assigned districts which made it easier for them to communicate with respondents. The enumerator induction for Kathmandu was conducted on 30 May, followed by inductions in Chitwan on 31 May and in Morang on 2 June.

FACTS communicated with all enumerators on a daily basis inquiring about survey completion and data collection status, as well as difficulties in the administration of the questionnaire through Viber chats and video calls.

As Antarprerana compiled the list of prospective interviewees, FACTS simultaneously started making appointments. Surveying in three districts – Kathmandu, Chitwan and Morang – started on 2 June, 3 June and 4 June, respectively. Initially, surveying went well but as it progressed, problems began to arise. By the time FACTS called, however, some had changed their minds about participating whilst others had become unreachable. Even when FACTS was able to make appointments, a large number then postponed, often at the last minute, or cancelled, sometimes only when the enumerator had arrived to undertake the survey. This not only caused delay but also meant that enumerators who had been recruited for a specified number of days then departed requiring new enumerators to be recruited and trained. Some enumerators were forced to leave for personal reasons. Surveying carried on well into July. However, many businesses were by then reluctant to participate because of audit and financial closure at the end of the fiscal year (16 July on the western calendar), though indicated that they would be willing to participate later in the year (and indeed some were later approached again). The heavy rainfall in early July caused considerable flooding (including of the house of FACTS survey manager) and landslides adding to communication difficulties.

Enumerator induction for the second phase of the survey – for Parsa, Kaski and Rupandehi – were held on 19 June, 21 June and 24 June respectively and surveying started on 26 June, 28 June and 1 July respectively, also running into the challenge of the end of the fiscal year. In the rural areas, enumerators needed to travel as much as 50 km to conduct one survey.

The survey was conducted entirely using the Droid Survey app on a tablet. Data was later downloaded in SPSS format. This raw file was shared with IMC for further processing. The feedback and details to change the unrealistic data were shared by David and which was later cross verified by FACTS. Corrections were made after consultation with the respondents.

Whilst we defined target sample numbers for sector and district, we did not define target employment bands (beyond the broad target of 5-99) and we did not define target gender ownership, though stated a desire to ensure that we had a proportion in the sample at least equal to the apparent proportion of women entrepreneurs quoted by Louis Berger (2014) as 13 per cent and by World Bank (2013) as 12 per cent. We now know from the national economic census (GoN 2019) that the proportion of women-owned firms is closer to 30 per cent. We were unable to achieve this proportion in our sample. The ILO (2018), in a recent survey, found that registered female ownership of businesses was intended primarily for tax relief and that their meaningful participation in business and decision-making authority was low. They too explained that it was challenging to find an adequate number of women respondents for their survey. Our follow-up, in-depth interviews confirmed the view that many businesses are registered in the name of a woman specifically to secure government subsidies.

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The number of usable responses achieved is shown in Table 2. We succeeded in surveying more than this number but some responses had to be discarded, because they were in the wrong district, or were in the wrong sector, or too many of the answers gave cause to believe that the respondent was not being as accurate as possible.

A comparison of responses compared to our target is shown in Table 3. In most cases, we came close to or exceeded the target, though we had some difficulty in reaching the target in Parsa.

The survey was not expected to be statistically representative, which would have been difficult in advance of the publication of the national economic census results; rather, its objective was to allow an in-depth analysis of a sample of SMEs large enough to infer patterns across our parameters of interest: firm size, specified sectors, gender of ownership and rurality.

The questionnaire is shown in appendix 3. As there are a large number of questions it was written as far as possible to use closed questions. The intention was then to follow up around 60 of the respondents with a more in-depth, semi-structured interview, to look further at some of the underlying issues and to seek more insight. We found, however, that most businesses were reluctant to participate as they said they do not have time to spare for a second interview. Indeed, they were generally irritated when we asked them for their time for the follow up interview. As a result, we experimented with a focus group discussion format in Chitwan, which attracted three participants. In addition, we were able to undertake 23 in-depth interviews, with three or four interviews in each of the six districts (Table 4). Four (two in Kaski and one in each of Parsa and Rupandehi) were in rural locations.

### Appendix 3: Defining small and medium enterprises

There is no general agreement on definitions of micro, small and medium enterprises.

The Government of Nepal (GoN), according to its Industrial Enterprise Act, 2016, uses fixed assets, and not employees. A micro-enterprise is one with fixed assets of less than NPR500,000, a small enterprise has fixed assets of NPR500,000-NPR100m, a medium enterprise has fixed assets of NPR100m-NPR250m and a large business has fixed assets of more than NPR250m. However, the legislation additionally defines a micro-enterprise as one employing fewer than 10 people. It also defines a cottage industry as one that uses traditional techniques and machines of less than 10 kilowatts. Not all business counts as industry, however, and the Industrial Enterprise Act only relates to industries.

The European Union (EU) and Organisation for Economic Development and Cooperation (OECD) both define a micro-enterprise as one employing fewer than 10 people, a small enterprise as one employing 10-49 people, a medium enterprise as one employing 50-249 people and a large enterprise as one employing 250 people or more. They also have a scale based on sales turnover and on net assets, but tend to use the employee bands for most purposes.

The World Bank, for its enterprise surveys, defines a small business as one employing 5-19 people, a medium enterprise as one employing 20-99 people and a large business employing 100 or more people.

Using levels of investment is problematic since it raises questions about whether it is original investment or current book value; moreover, respondents are reluctant to share details and even if they are willing to share, it is likely that there is an element of guesswork; respondents are much more likely to share numbers of employees and to give an accurate response. In our sample of 934, some 883 (95 per cent) gave a figure for employment that was higher than zero whereas 804 (86 per cent) gave a figure for investment (though some of the figures looked suspiciously high or suspiciously low for the type of business or size by revenue).

Table 8 compares size of business by number of employees and by level of investment. Some 783 respondents answered both questions. On the basis of investment, 37 businesses are micro, 700 are small, 46 are medium and none are large. On the basis of salaried employment, using the WB definition, 239 are micro, 415 are small, 122 are medium and 7 are large. If we additionally include the temporary and seasonal staff for last year, then 151 are micro, 396 are small and 212 are medium.

**Table 8: Comparison of size by salaried employees and size by investment**

		Size of business by level of investment (NPR)				Total
		1-0.5m	0.5m-100m	100m-250m	>250m	
Size by number of employees	0-4	28	210	1	0	239
	5-9	8	216	6	0	230
	10-19	1	171	13	0	185
	20-49	0	87	20	0	107
	50-99	0	13	2	0	15
	100-199	0	2	4	0	6
	200+	0	1	0	0	1
		37	700	46	0	783

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In this report, we have used categories of 1-4, 5-9, 10-49, 50-99 on the basis that the reader can then determine the number of businesses using whichever definition they prefer.

#### **Appendix 4: Validation workshop conclusion**

Participants at the validation workshop were split across six tables. After the initial presentation, each table was asked to consider a different question as follows:

##### **Discussion 1**

- Do our findings reflect your perception of the main constraints restricting SME growth?
- What is necessary to address these constraints?
- What measures (policies and programmes) might government implement to address these constraints?
- How can the private sector itself address these constraints?

##### **Discussion 2**

- Businesses perceive high levels of competition as challenging.
- What are the possible causes creating this competition?
- Are businesses too focused on the domestic economy? Should they refocus? What limits their ambition?
- Local demand is growing but to what extent do cheap imports add to the competition?
- How can Nepali businesses differentiate their products and services?

##### **Discussion 3**

- There appears to be a mismatch between the demand for finance and the availability of finance.
- Why is this? Do the terms for loans (including interest rates, arrangement fees, repayment periods, collateral, paperwork) deter SMEs? Is there a lack of investment finance? Do financiers perceive propositions to be too risky?
- What can be done to address this issue? Are there ways to mitigate lending/ investment risks? Is there a need for policy reform? Would additional approaches make a difference?

##### **Discussion 4**

- There appears to be a mismatch between the demand for business advice and its availability.
- What are the reasons for this mismatch?
- What prevents SMEs from seeking advice on a commercial basis? Is there a market failure here?
- What approaches could be adopted to address this apparent lack of availability?
- Is there a role for government?

##### **Discussion 5**

- Businesses say that recruiting skilled staff and upskilling existing staff are both challenges.
- How can these issues be addressed?
- Is there scope for closer collaboration between SMEs and those who provide training?
- What is necessary to ensure that business owners recognise the importance of staff development?
- What should SMEs do to encourage staff to stay with them?

##### **Discussion 6**

- Is there a need for an overarching SME development policy? What should that policy cover? Would this lead to greater coherence in the way that SMEs are encouraged and supported?

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The key observations from the discussion groups were:

- Recruiting and retaining skilled people is a major challenge; SMEs then invest resources in training the new hires who, once they become competent, join a competitor or fly abroad.
- High-interest rates, and high hurdles to secure loans, are a major impediment to growth. To overcome the hurdles, SMEs rely on cooperative loans with even higher rates of interest.
- Raising money through IPOs is generally not possible.
- The banks should provide business support services along with the loans so that the business success is ensured and their loan is secured.
- The banks should invest more in productive sectors.
- The high floor for Foreign Direct Investment announced by the government recently is a major setback in SME development in Nepal. It has caused a lot of harm and it should be lowered.
- The provincial governments should be given more power to adopt policies offering incentives for SMEs. For example, recently the Province 2 government announced tax exemption and free land for businesses to attract more investment. But the policy conflicted with the provisions of the federal government.
- Private sector business associations such as FNCCI and CNI should provide business development services to SMEs.
- They should also act as a networking platform between suppliers and buyers so that SMEs can have better access to the market.
- There should be a more rigorous exchange of information between the stakeholders.
- One of the participants from the government mentioned that there is a huge shortage of skilled human resource in specific sectors. For e.g. Kathmandu Metropolitan City faced a lack of skilled people to deal with the manholes and fibre cables. Such needs to be identified and human resources should be developed accordingly. The government should come up with a policy provision along this line.
- SMEs and other actors may be able to make changes on the individual or local level but to achieve an overall game-changing shift, policy-level change is required. The government needs to look at it.
- The government needs to have its things in order before inviting international investors to invest here in Nepal.
- There is a high level of duplication of successful businesses in Nepal. An innovative idea, if successful, is copied and imitated by countless other businesses. Majority of those businesses do not sustain in the long run.
- Competition, per se, is not a problem but unhealthy and unfair competition is. Healthy competition is always good for businesses.
- Import of cheaper and subsidized goods from India and other countries is threatening the survival of Nepali SMEs.
- The competition, however, is of a different kind for different sectors. Agriculture and manufacturing-related businesses are suffering from competition from imported goods whereas the tourism sector faces a lot of domestic competition.
- Unable to compete at the international level, a lot of businesses are focusing on the local economy.
- One of the reasons why Nepali businesses are not being able to think globally or be more ambitious is due to the existing laws and policies (e.g. capital account control) that prevent Nepali businesses from investing abroad.
- Some Nepali businesses, however, especially the ones in the Information Technology sector are wholly export-focused.
- Whatever few products Nepal is exporting, there is a huge demand for these products in the international market. For e.g. Nepali coffee. Nepali businesses should, however, focus on packaging and supply chain management if they want to scale up their exports.

- We should also refocus on products that are home to Nepal such as local cuisines, local herbs, etc.
- Leveraging their products and utilizing the prestige and appreciation Nepal has across the world can be a way for Nepali businesses to differentiate their products and services.
- Brain drain is another major impediment to the growth of business in Nepal. The number one aspiration of young people in Nepal, especially the educated ones, is to go abroad. Therefore, Nepal lacks the middle-level managers. We have either people working at entry-level and menial jobs or passionate entrepreneurs.
- Similarly, lack of access to newer technologies, lack of schemes to help SMEs, lack of skilled human resources are acting as barriers to growth.
- For banks, getting a genuine customer is difficult, genuine in the sense those who have their records in order, paperwork in order, documentation and so forth.
- Our banks still rely on collateral-based loans. There is no equity-based financing. Since women do not hold properties, they are unable to access loans from the banks and financial institutions.
- The Government recently brought a new Industrial Enterprises Act. But the act has no mention of angel investors and angel investment neither the provisions about the different investment modalities. New types of investment modalities like angel investment are very important for SMEs in Nepal.
- The interest of banks and financial institutions is too high for SMEs.
- The SMEs also seem to lack vision. Most of them are focused on survival.
- Government (MEDPA) and other business service providers are now collaborating to assist the SMEs.
- Some banks like Mega Bank has carried out financial literacy training programs for the SMEs but they were not very effective. It is suggested that the investors who are looking to invest in SMEs also provide them with financial literacy knowledge.
- We should promote angel investors so that they can bring more investors.
- The high floor of Foreign Direct Investment is hampering the growth of SMEs.
- Most of the advisors providing advice to SMEs are from academic field and lack real-life experience in the business.
- There is also a lack of people (advisors) with experience in a similar business sector.
- There is a need to create a linkage between all the organizations working to support SMEs. We have to link with all of the different groups that are providing financing to the SMEs whether they are Angel Investment, Seed Investment, banks, even donors because one of the things that some of these business support organizations do is they support early-stage entrepreneurs that are still looking to validate their business models, need resources for research and development, feasibility study.
- One thing everyone is looking for is scalability. There is a need to develop and create quality programs for helping scale up but it should be done in collaboration with other related organizations.
- The other thing government can do is provide real estate, identify skills which we can then upscale, coach, mentor and provide TOTs in different provincial areas and basically create a larger network which is not just Kathmandu based but is a network that then supports each other nationally.
- We can build the capacity of all these business support organizations in different provinces. They can then link investors to different provinces and also entrepreneurs, business coaches, and mentors to all these different provinces. The government can help them by informing the businesses who come to register at the Company Registrar's Office or the Tax Office about all the business support service providers.
- One major challenge to overcome, however, is that the SMEs are unwilling to pay for such services.

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- It seems that a lot of skilled staffs or anybody studying undergraduate level or graduate, they all come with the mindset of already leaving the country which has been the major problem for not only SMEs but all types of businesses.
- On the other hand, in the upscaling part of existing staffs, there are already many businesses in Nepal that may have put a whole lot of priorities in training their employees, HR to become better. Some of the issues that they may face or dilemma they might face are that even after putting so much resource into HR, they might just leave in six months and go and work for other companies. So all the effort and energies provided to the human resources may actually end up benefitting some other company.
- For collaboration between SMEs and training providers, there must be a matching centre and also information dissemination so that the need for training can be highlighted over there. There must be a good recognition of the SMEs for staff development.
- Unless and until there is no staff development, there is a problem for the enhancement of SMEs. SMEs should have a good career path, there must be a good relationship with the employer and also the employee must have a sense of ownership. Maybe the SMEs should give equity to their employees.
- There is a need to develop a federal overarching policy framework that defines the scope of province and local level policy reach, and under this and consistent with this framework, provinces and local governments can set policies to facilitate local SMEs to operate/access finance/grow.
- The province-level policies should include areas such as tax policy, investment incentives, loans/access to finance, government-provided rent-free space for BSO services for SMEs, oriented to local needs but governed by the national framework. These would require strong oversight by the federal level and a clear accountability framework. [We need to be careful about recommending tax breaks, given the lack of fiscal capacity/policy setting/implementation at the moment as Nepal adapts to the federalization model.]
- The government perceives a lack of regulation for angel and other investment companies, and conveyed a lack of understanding of the role of angel investors. Therefore, there is a need to clarify: the respective roles of early investors vs later-stage investors in the cycle of an SME; how the existing regulatory framework already accommodates angel investors, venture capitalists, FDI, individual investors, and investment companies; and where the gaps in the market are (start-up/working capital/pre-bankable, etc). [The SME market study will do this, and this will shape the recommendations.]
- The government conveyed a lack of appreciation of the difference between micro-entrepreneurs who are benefitting from small government start-up financial support and MSMEs who already employ workers and have a track record of performance but struggle to grow and therefore need help (not necessarily financial help). The government already has programs of hand-holding for micro-entrepreneurs/start-ups, with plans to sub-contract these hand-holding efforts to BSOs. Government therefore recognizes the need for hand-holding for some groups of poor/vulnerable entrepreneurs...but without understanding the need by SMEs for similar albeit differentiated assistance.
- The government needs a more strategic policy for enabling firms across the range of MSMEs (all sizes, but could focus on micro and small) that is not reliant on banking institutions who are inherently unwilling/unable to take on the associated risks.
- The government is not convinced that the high FDI threshold (~\$500K) dissuades investment, since government is lobbied by those wanting a higher threshold.
- MoIICS and MoF Finance need to communicate with each other to understand better the implications of their respective policies (FDI threshold inter alia).
- Request from banks for Government to work on a country investment rating, without which borrowers face very high interest rates and foreign investors are loathe to come in.
- There is a need for SME centres at the provincial level or at least a facilitating agency such as FNCCI, due to currently poor national coverage of services to support SMEs.

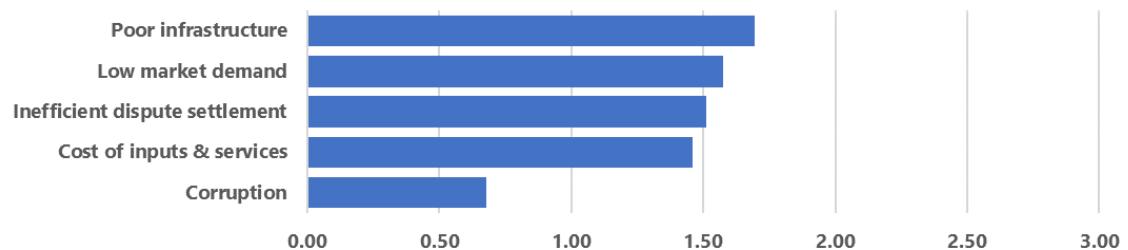
- There is a widespread lack of information about the types of services available, service providers, existing government and bank programs of support (including training, financial literacy trainings by banks). Government could support better knowledge dissemination through promotional/public information campaigns, specific efforts embedded in local government offices (pamphlets, other outreach in conjunction with other local government office activities), and/or dedicated knowledge centres at the municipality level or regional knowledge centres with a digital connectivity component.
- Provincial and local governments need to consider local priorities not limited to priority sectors (e.g., tourism, agriculture, and trade, which are too broad) but also through spatial considerations and cross-sector complementarity. Provincial/local government efforts should focus on promoting local networks and creating market linkages in order to increase the size of the local market.
- Access to finance is one major challenge, especially low levels of working capital that is immediately available. Banks are not prepared to provide this type of financing, due to high risks and high administrative burdens. There is a need for an insurance mechanism to incentivize financial institutions to provide this type of financing quickly. The SME policy should have some kind of provision to address this.
- There is a need to develop a framework for remittance and other funds so that they can be used for investment.

#### Appendix 5: Factors that may affect the ease of doing business

There is considerable information available from other sources to describe the enabling environment and the key challenges facing SMEs in Nepal. This appendix summarises results from a recent ILO study, the World Bank's Doing Business analysis and the World Economic Forum. It concludes with more detailed analysis from our survey.

An ILO (2018) survey of 622 firms asked respondents to rank their top three challenges. Poor infrastructure topped the list, followed closely by low market demand, which is notable, given that our sample population both ascribes recent growth to increased market demand and expects future growth also to depend on increasing local market demand (Figure 77).

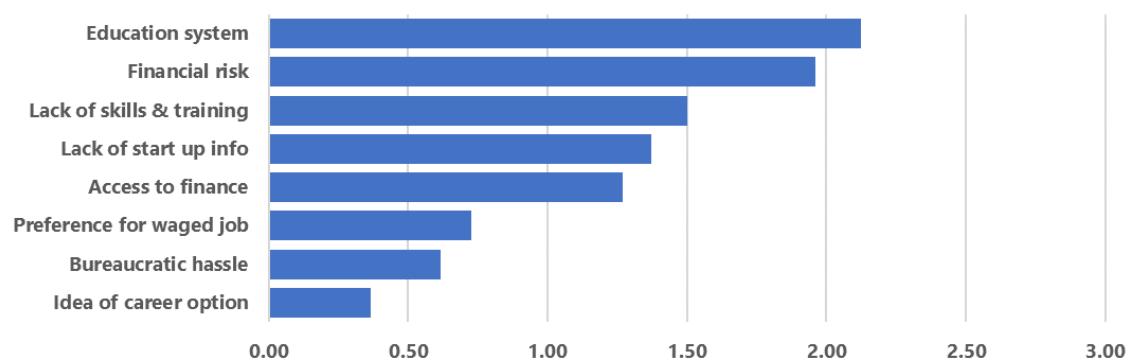
**Figure 77: Perception of factors affecting business**



Source: ILO (2018)

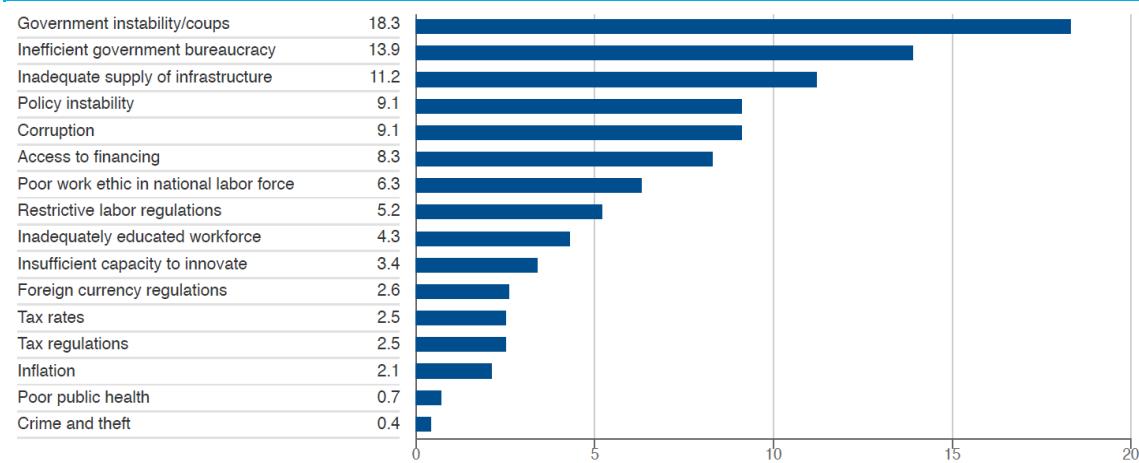
The ILO study also asked respondents about the factors perceived to prevent or deter people from starting in business. The results (Figure 78) indicate that skills and training and access to finance are important, as is the lack of start-up information. The latter suggests low penetration of business advisory services, whether public or private.

**Figure 78: Factor perceived to deter starting in business**



Source: ILO (2018)

The World Economic Forum ask businesses about the factors that they perceive make it difficult to do business, essentially a combination of the questions asked by ILO, though with subtly different results. For WEF (Figure 79), government instability scores worst, though this survey was undertaken before the current government was elected. However, it is likely that the other problems are still problematic, notably inefficient government bureaucracy, inadequate infrastructure, corruption and access to finance.

**Figure 79: Most problematic factors for doing business**

Source: World Economic Forum, Executive Opinion Survey 2017

Corruption scores quite highly in the WEF survey yet was much lower in both the ILO survey and our survey. The ILO (2018) survey does suggest that firms question the government's commitment to reducing corruption, but more than two-thirds of firms were optimistic that the federal structure would be helpful to growth. Respondents felt that trade unions were politicised and did not adequately represent the concerns of employees.

The WEF's Global Competitiveness Index ranks Nepal at 108 out of 141 countries surveyed. Figure 80 shows Nepal's scores on 12 indicators. This is revealing in relation to the enabling environment, where Nepal scores low in three of the four indicators, and the innovation ecosystem where Nepal scores badly on innovation capability.

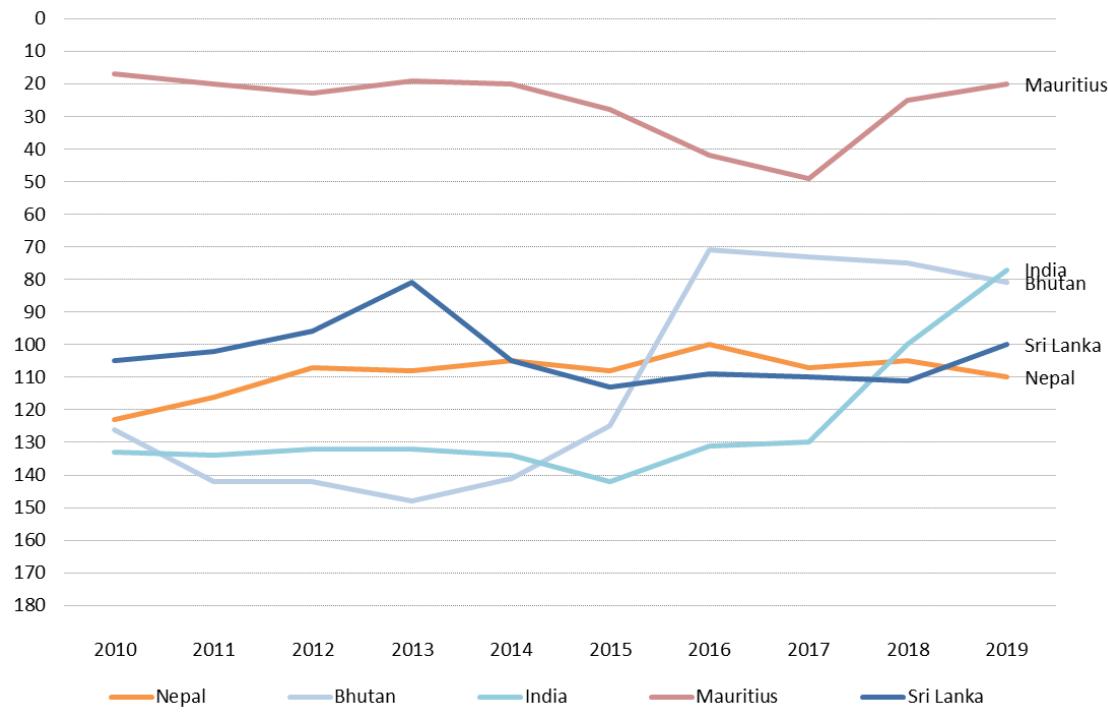
**Figure 80: Assessment of competitiveness**

Source: Schwab (2019)

It is, therefore, not surprising that Nepal ranks poorly in the World Bank's Doing Business league table. Its rank improved from 122 in DB2010 to 110 in DB2019, but its neighbours including India and Bhutan performed much better (Figure 81).

## Understanding job growth potential in SMEs in Nepal

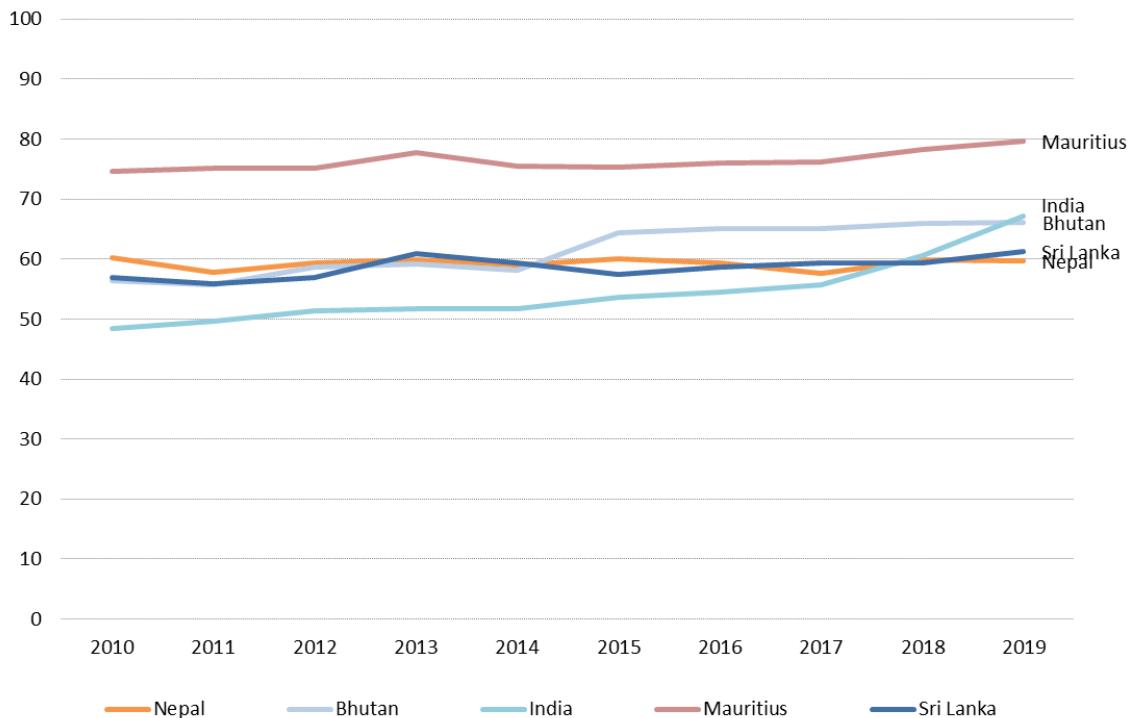
**Figure 81: Doing Business rankings**



Source: World Bank Doing Business reports (DB2010-DB2019)

The World Bank's distance to the frontier score gives an indication of how each country performs compared to the best performer. Here, too, Nepal showed only modest improvement, lagging key neighbours (Figure 82).

**Figure 82: Distance to Frontier**



Source: World Bank Doing Business reports (DB2010-DB2019)

Trenkmann (2018), in her report for GIZ, identified several issues:

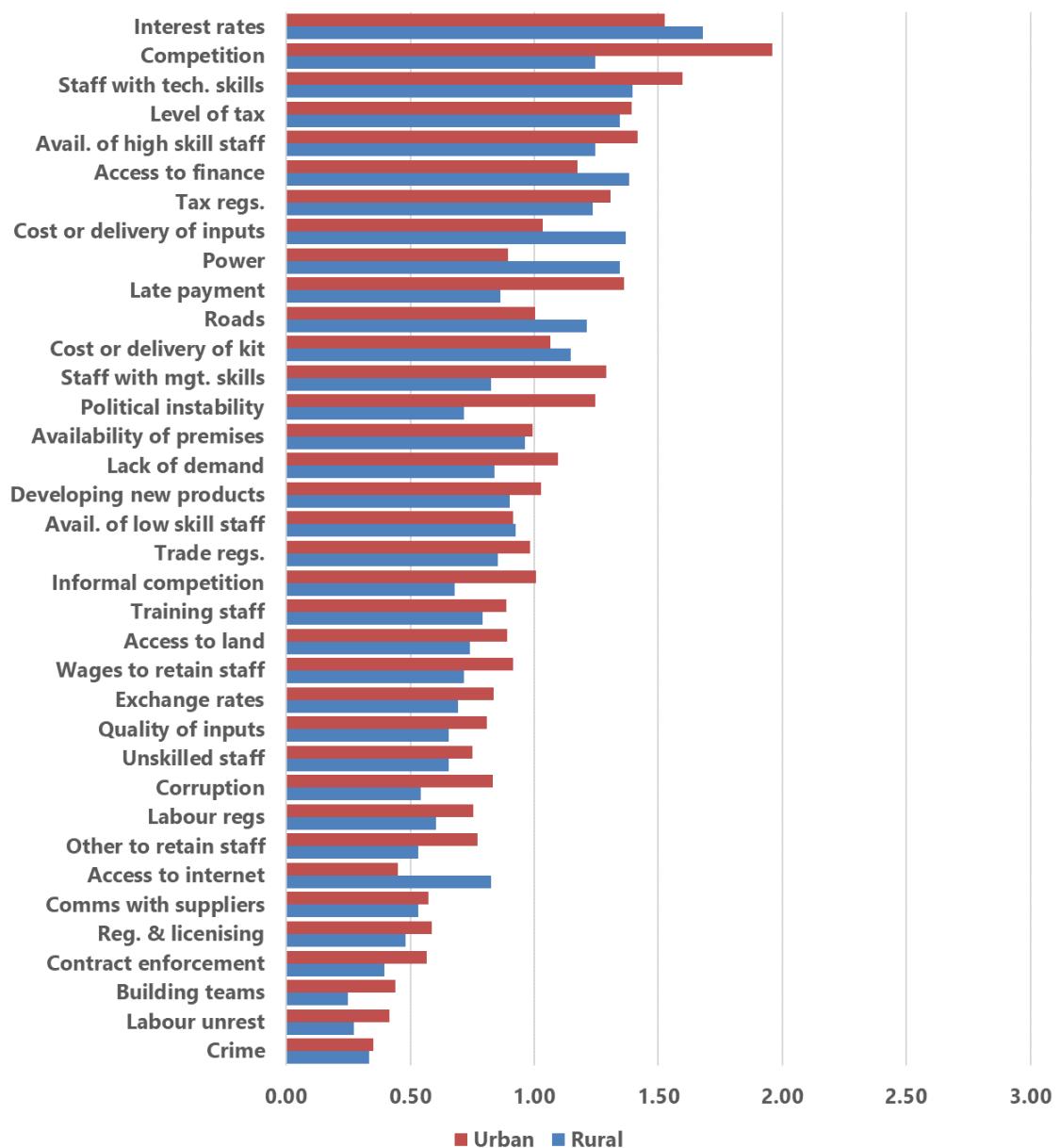
- The federal system implemented in 2015 is characterised by a strong centre, relatively weak provinces and a lack of clarity regarding responsibility and authority in different levels of government.
- Foreign direct investment is low, attributed to sector restrictions and challenges in doing business.
- Infrastructure, especially roads and air connections, need to be improved.
- The open border with India is perceived as being more advantageous to India allowing it to export cheap products into Nepal.
- Access to finance is one of the biggest challenges.
- Corruption in Nepal is widespread and political.
- The land market is highly inefficient due to poorly developed land market institutions and regulations.
- Limited job opportunities have contributed to a high migration of Nepalis to other countries.
- Public private dialogue is ad hoc.
- Policy making is top down and hierarchical in nature.
- Businesses tend not to be innovative and lack the creativity and knowledge to pursue opportunities in emerging sectors such as IT. The education system lacks tools and techniques to teach students creative and abstract thinking.
- Businesses do not have access to the full range of support services needed to grow and invest.
- Women entrepreneurs are rare to find due to cultural constraints.
- The media rarely present success stories of entrepreneurs

As part of our survey, we asked respondents to score 36 factors which might affect their ease of doing business. Respondents stated whether each factor was 'not a problem', was 'a small problem', was 'challenging' or was 'very challenging'. The answers were scored from zero for not a problem to three for very challenging and then averaged across the sample to give an overall score of 0-3. Figure 83 shows the full list of factors split according to whether the respondent is in an urban or rural location. Interest rates, competition and finding staff with technical skills are the most problematic factors. Competition and late payment by customers are seen as much more of an issue in urban locations. Power is much more of an issue in rural locations as is the cost of delivery of inputs. Finding staff with management skills is more of an issue in urban areas (though this may reflect the fact that the larger businesses also tend to be in urban areas). Access to internet is more problematic in rural areas.

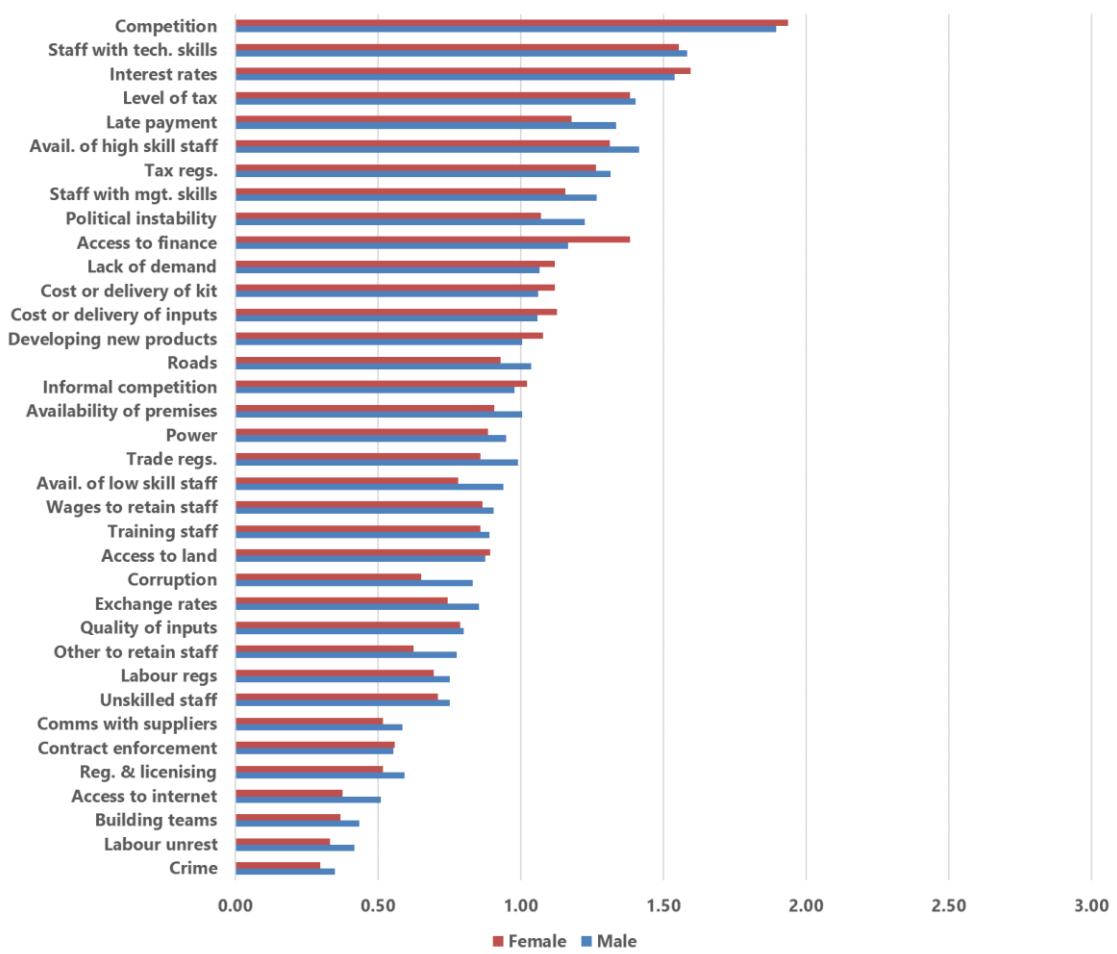
It is interesting to compare these results with those from ILO, WEF and GIZ. There is a high level of agreement, except perhaps on corruption which is seen as being relatively unimportant in our survey.

## Understanding job growth potential in SMEs in Nepal

**Figure 83: Factors impacting business in Nepal by urban/ rural split**



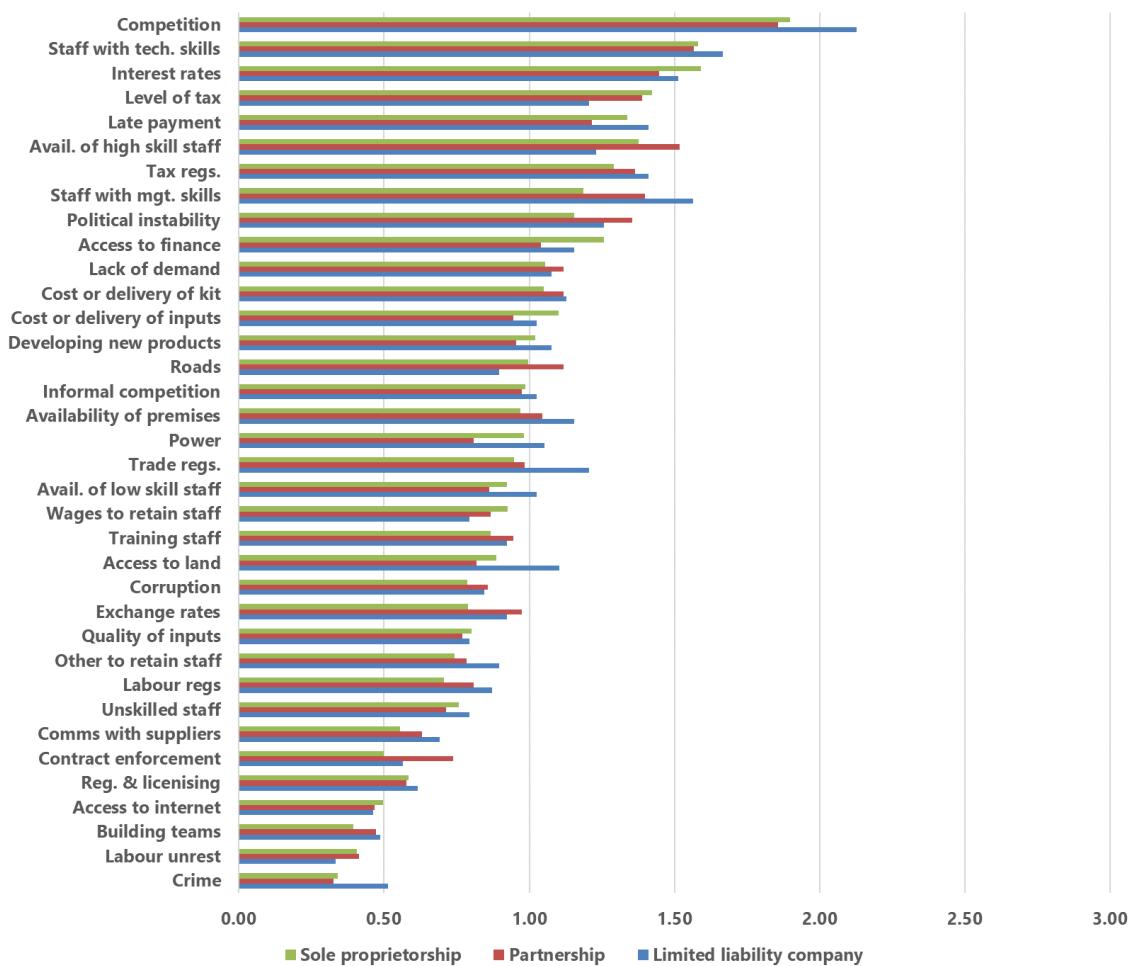
When we look at differences by gender of the entrepreneur, we see that the main factor that is harder for women is access to finance, though women are more likely to face difficulty with lack of demand, cost or delivery of equipment and cost or delivery of inputs. In most cases, it seems, men face more difficulty with each of the factors.

**Figure 84: Factors impacting business by gender of principal owner**

It seems that limited companies struggle with each of the factors more than sole proprietors or partnerships (Figure 85). One should be careful reading too much into this since companies are a relatively small proportion of our total sample. However, the results are consistent across all factors. This may be worthy of further research.

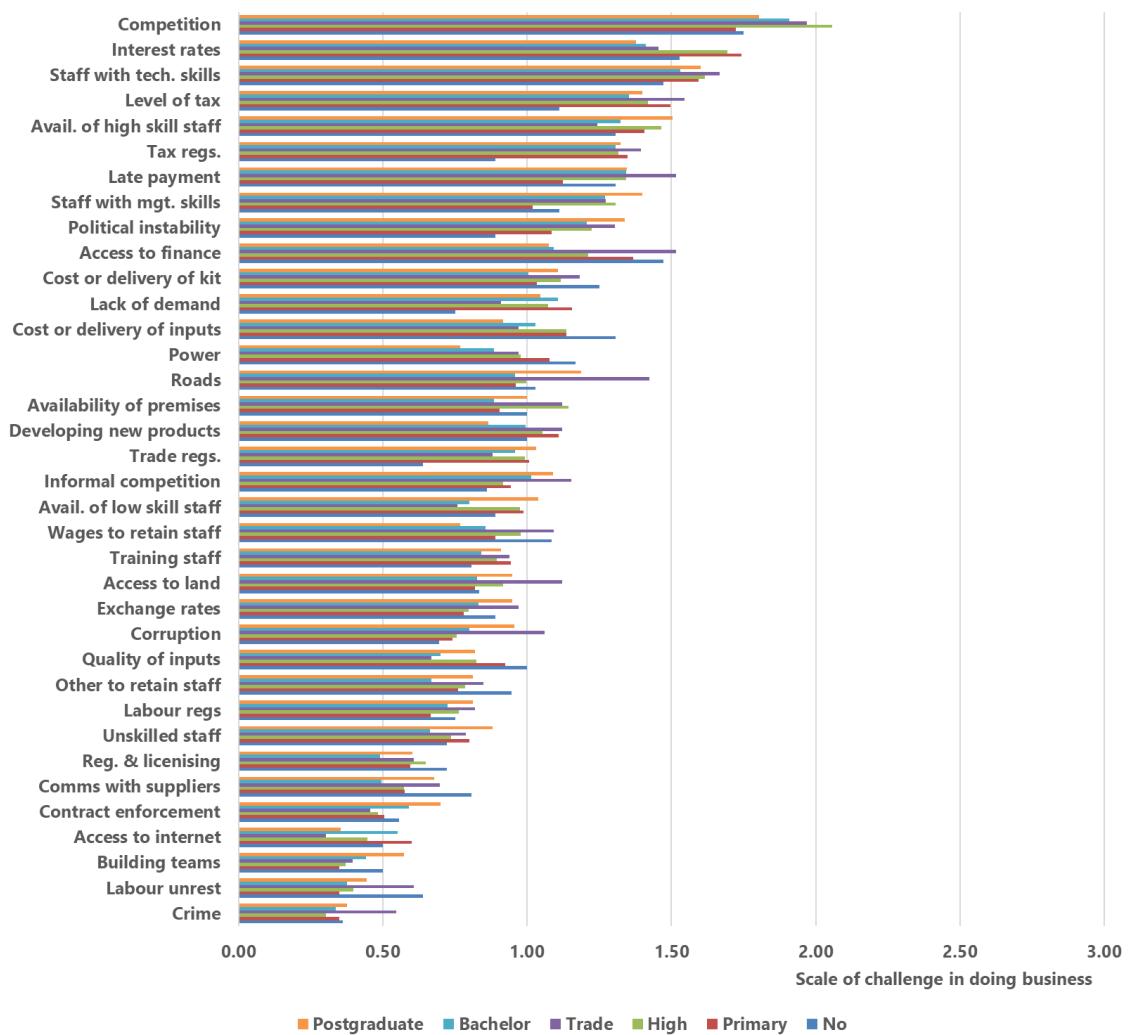
## Understanding job growth potential in SMEs in Nepal

**Figure 85: Factors impacting business by legal status**



There is little difference in the perception of the factors based on educational attainment. Principals with a high school education complain most about competition. Entrepreneurs with a trade qualification complain most about late payment, access to finance and roads. Entrepreneurs with an incomplete education also complain about access to finance.

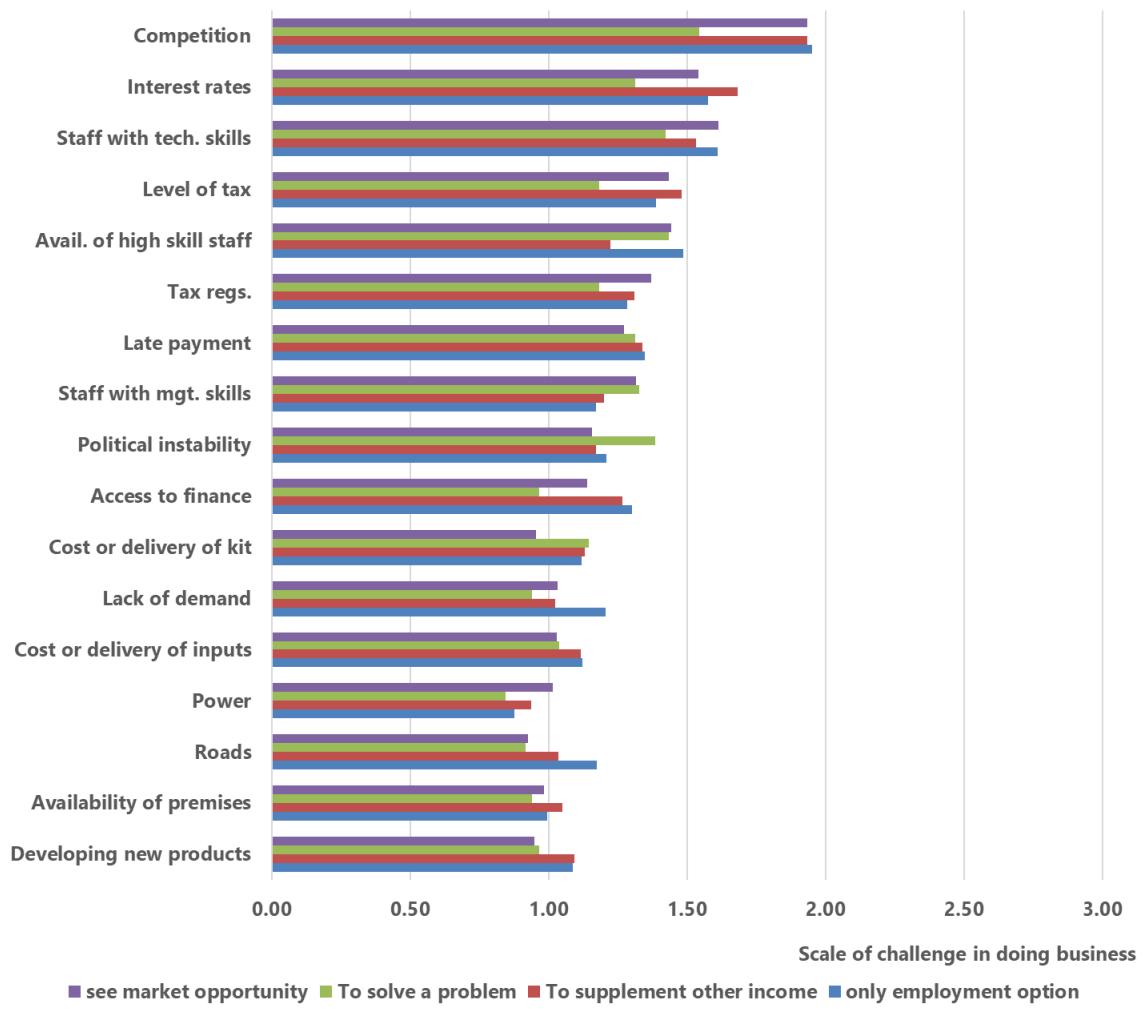
Figure 86: Factors impacting business by educational attainment of principal



There is not a great deal of difference between the factors that make business difficult when separated by reasons to start in business – except that those who started a business because it was the only employment option worry most about lack of demand (yet do not see that perhaps they need advice and support to address this challenge) and those who have started a business to solve a problem so worry least about competition, least about interest rates, least about tax. They worry the least about finding staff with technical skills though here the difference is rather less,

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**Figure 87: Factors impacting business by reason to start**



## **Appendix 6: Legislation impacting on business**

### **Industrial Enterprise Act, 2016**

Approval is required to all industries for their establishment, extension and diversification.

All industry should be registered online where the digital signature is applicable. The registration of minor and cottage industry may be within six months of the commencement of the operation. Operating or establishing without registering if found will be fined as per this Act. After submission of application if required need to conduct Environmental Impact Assessment (EIA) or Initial Environmental Examination (IEE).

The Act includes definitions of micro, small, medium and large based on fixed capital.

The manufacturing industry is entitled to receive a 20 per cent rebate in income tax. If established with more than a billion Nepalese rupees and provided annual direct employment of more than 500 people will be given exemption from income tax for a period of five years from the date of operation and addition of 50 per cent for another three years. Industry exporting their products also are entitled to receive exemption of 25 per cent in income tax on such income. ICT based industry is entitled to 50 per cent rebate on income tax. Both ICT and manufacturing industry who provides direct employment to more than 300 Nepali citizens is entitled to 15 per cent and if employ more than 1,200 Nepali citizens is entitled to a 25 per cent rebate on income tax. Furthermore, such industry gets 25 per cent additional rebate in income tax if half of the employees are women, dalits and differently abled persons.

Fruit-based brandy, cider and wine producing industry established in remote areas are entitled to receive 40 per cent rebate in income tax for a maximum of 10 years from the date of commencing operations. Other remaining industries established in any remote, undeveloped or underdeveloped areas are entitled to a rebate of 90 per cent, 80 per cent and 70 per cent respectively in income tax.

Energy-based industry generating, transmitting and distributing energy from water, solar, air and biomass by mid-April 2024 receive full rebate on income tax for ten years and 50 per cent additional for another five years. Excavation and exploration of petroleum or natural gas and fuel within mid-April 2019 are entitled to receive full rebate on income tax for seven years from the date of operation and 50 per cent rebate for additional three years.

Tourism based industry established with more than Rs.2 billion and other establishments such as hotels, resorts etc. outside municipality and sub municipality with more than Rs. 5 billion will be granted full rebate on income tax for a period of five years for the date of operation and additional 50 per cent for another three years period.

Industry based on tobacco, alcohol and Katha is not entitled to receive income tax facilities and concessions. However, there will be a deduction on some expenses related to employee and investments which helps to reduce environmental impact.

A multinational or foreign investment company can import new products produced by its mother company in another country to Nepal for the purpose of promotion and market development for a limited time period.

Any industry can import machinery, transformer, generator with a capacity of more than 10 KW and industrial tools in the lowest slab of customs duty.

Employee expenses and labour welfare related activities or long-term benefits will be deducted from taxable income.

Micro industries are entitled to free or any registration charges and fees and established before its promulgation will receive full income tax exemption for five years from the date of promulgation.

## **Understanding job growth potential in SMEs in Nepal**

Women ownership only enterprise is entitled to a 35 per cent discount on company registration and 20 per cent on industrial property registration. They are given priority to establish their business inside industrial zones and also are provided export loan if needed.

The government will provide security to all the industries and also provide seed capital to cooperative, micro-industry, cottage and small industry to establish industry in remote areas. If requested government will also facilitate in getting land necessary for industry, hold or lease necessary public owned property. It is mandatory to utilize allocated one per cent of annual profit towards corporate social responsibility where the requirement is applicable to medium and large industry and cottage and small industries having annual turnover of more than Rs.150 million. Failing to do so is liable to pay penalty of 0.75 per cent of its annual turnover.

Any industry can hire foreign nationals for a maximum period of seven years in a high-level position where there is a skill shortage and recommended by the Department of Industry and approved by the Department of Labour.

The Act has addressed 'no work no pay' provision to address illegal strikes where the act further restricted employees to carry illegal strikes and instead has made provisions to put their demands forward in a mutual agreement.

There are four ways legally to establish a business in Nepal:

Individuals can register under the **Private Firm Registration Act 1958**, which provides the firm with a trading name, and are generally known as sole proprietors. Sole proprietors do not have a separate legal personality and the liability of the proprietor is unlimited. Proprietorship firms are mostly used by individuals undertaking trading activities and professional service firms. Section 4 requires registration at the Department of Commerce for commerce related firms, at the Department of Cottage and Rural Industry for cottage and rural industry or at the Department of Industry for other firms. Firms need to reregister after five years.

Partnerships are registered under the **Partnership Act 1963**. They do not have a separate corporate personality and the liability of the partners is unlimited (it is not yet possible to register as a limited liability partnership in Nepal). Partnership firms are mostly used for trading activities and professional service firms. Businesses need to reregister annually.

Limited liability companies, including private limited companies, public limited companies and not for profit companies, are incorporated under the **Companies Act 2006**. They need just a single shareholder. A company has a separate legal personality and limited liability.

Cooperatives are registered under the **Co-operative Act 1992**. Like companies, cooperatives have a separate legal personality and members enjoy limited liability. A minimum of 25 members are required to form a co-operative.

## **Competition Promotion and Market Protection Act, 2007**

The Competition Promotion and Market Protection Act is provided to make legal provision for competition promotion and market protection.

Section 3 prohibits of anti-competitive practices, including any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or services which causes or likely to cause adverse effect on the competition in Nepal.

Section 4 prohibits any enterprise from abusing its dominant position with intent to control competition in the production and distribution of goods by that enterprise or through its affiliation.

Section 5 states that enterprises producing and distributing goods and services are prohibited from implementing restrictive trade practices.

### **Banking and Financial Institution Act, 2017**

The Banking and Financial Institution Act (BAFIA) provides reliable banking services, legal provisions, protects banking risks, protects the rights and interest of depositors and investors and promotes the national economy.

### **Foreign Investment and Technology Transfer Act (FITTA), 2019**

The Foreign Investment and Technology Transfer Act aims to improve the economy through mobilisation of the limited capital, human and the other natural resources by promoting foreign investment and technology transfer.

A foreign investor can invest through the purchase of share or property and transfer of technology in any permitted industry individually or jointly, or through joint investment with Nepalese citizen or company established in Nepal. There is no limit on threshold for foreign investment however some limits may be posed for investment in service industry and investment made through venture capital fund. The act has introduced new modes of foreign investment through lease financing in airlines, ship, machinery, construction equipment or similar types of equipment with a limit. Borrowing loan from foreign institution in foreign currency by issuing stock is permitted but needs to be authorized by any public company established in Nepal or organization authorized by Nepal Rastra Bank. The act prohibits nationalization of industry with foreign investment.

### **Insolvency Act 2006**

The sad truth about start-ups is that 9 out of 10 cease trading. Hence, there is a need for bankruptcy laws which are friendly to entrepreneurs to help them take risks. Nepal has a risk averse culture hence the insolvency laws only increase the cost of entrepreneurial failure. The current insolvency act has a slew of hurdles attached to it. Firstly, as per the directive of Nepal Rastra Bank any financially distressed or insolvent company will be automatically blacklisted if it applies to the court to initiate insolvency proceedings. Directors also will be blacklisted and restricted from taking further loans. Secondly, Nepal lacks specialised courts to hear cases of insolvency which means that it is a time-consuming and expensive process.

### **Income Tax Act**

The corporate tax rate under the act stands at 25 per cent for all business entities and portfolio companies. Unlike some other countries, there is no differential system with lower taxes for SMEs or tax breaks for priority sectors. However, the government has set a general tax rate of 20 per cent for manufacturing firms which may incentivise funds to invest in the sector. For foreign investors, tax treatment depends on the Double Taxation Avoidance Agreement between Nepal and the foreign investor's country of residence. In absence of DTAA, the foreign investor is subject to a tax rate of 25 per cent on gains.

### **Securities Act 2007**

The Securities Act mandates the Securities and Exchange Board of Nepal (SEBON) to regulate collective investment schemes which can include private equity and venture funds set up as companies or trusts as specified by SEBON. The current framework of collective investment schemes' key focus is on regulating open ended mutual funds and requires regulation to protect retail investors. PE/VC are closed funds and the act does not provide specific exemptions for such funds.

### **Foreign Exchange (Regulation) Act, 1962**

The Nepal Rastra Bank restricts PE/VC from providing capital in the form of debt because these funds are not licensed under the BAFIA Act. The Foreign Exchange (Regulation) Act empowers Nepal Rastra Bank to regulate foreign loans. Hence lending by foreign institutions is strictly regulated by the Nepal Rastra Bank (NRB) and allows foreign lending only in cases where domestic debt is unavailable and is subject to an interest rate cap of LIBOR +5.5 per cent.

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However, the Nepal Rastra Bank has permitted foreign loans to be availed from multilateral or regional financial institution such as IFC, ADB subject to NRB approval.

### **Specialized Investment Fund Regulation 2019**

The regulation was introduced in March 2019 to promote alternate investment such as private equity fund, venture capital fund and hedge funds. The minimum fund size has been set at NPR 15 crore to get permission to perform as equity fund, venture capital or hedge fund. The regulation specifies that the fund manager should maintain a minimum stake of two per cent of the fund size and paid up capital of NPR 2 crore. The minimum investment set for a limited partner is NPR 5 million which restricts investment to deep pocket investors. The minimum investment has been set to protect small retail investors who are not familiar with complex financial instruments. The investor lock-in period is one year which means that investors cannot exit from the fund for one year. The regulation focuses on bilateral and multilateral agencies and allows such institutions from participating in local PE/VC funds but restricts individual foreign investor from participating in local PE /VC funds. As a result, foreign PE funds may continue to use the FDI route to invest because regulation by SEBON would mean additional documentation and delays. Further, the regulation does not provide clarity on tax pass through status for the funds. The regulation is encouraging in terms of banks and financial institutions (BFIs), pension funds (CIT, PF), insurance companies being able to invest in PE/VC funds. This opens up opportunities to unlock domestic capital but regulators of BFIs, insurance companies need to make amendments to their existing policies to pave way for BFIs, insurance companies and pension funds to invest a certain percentage of their portfolio in PE/VC funds.

### **Monetary Policy (2019/20)**

The Monetary Policy for the Fiscal Year 2019/20 has been announced to facilitate targeted economic growth rate of 8.5 per cent with emphasis on the merger of commercial banks and microfinance institutions and also to facilitate agriculture and small and medium enterprises.

Inflation rate has targeted at 6 per cent for fiscal year down from 6.5 per cent in the previous year to maintain price stability. The central bank has projected limit of 18 per cent of the money to supply growth where, private sector credit growth is made to 21 per cent which is one per cent more than previous year and domestic credit growth at 24 per cent which is 1.5 per cent more than last fiscal year.

The bank rate (interest rate charged by the NRB to the domestic BFIs while lending money to the latter) is reduced to 6 per cent from existing 6.5 per cent. For up to Rs. 1 million, the interest rate of refinancing facility for SMEs will be reduced to 3 per cent while the BFIs can charge only 7 per cent interest from borrowers.

### **Labour Act 2017**

The Labour Act of 2017 applies to all firms employing people, whereas the previous act only applied to firms employing 10 or more people. The law requires that firms employing at least 10 people set up a collective bargaining committee and that firms with at least 20 constitute a safety and health committee. The old act required a secret ballot before a strike could be called; the new legislation simply allows workers to give notice to the employer. New rules govern outsourcing of work. Probation periods have been reduced to a maximum of six months. Statutory leave requirements are more generous. The new labour law does give more rights to workers but overall is not much more onerous than the law it replaced, except that it now applies to micro-businesses as well, which is a big change in a country where average employment is 3.5 people.

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- Labour Act 2017: see commentary at [https://www.nbsm.com.np/assets/kcfinder/upload/files/Nepal%20Labour%20Law.NBSM\(1\).pdf](https://www.nbsm.com.np/assets/kcfinder/upload/files/Nepal%20Labour%20Law.NBSM(1).pdf)

#### **Appendix 7: Business support organisations**

We have identified a large number of organisations, from the private sector, the not for profit sector and the government sector as well as investors and educational establishments who offer some sort of services to new and growing businesses (Table 9). Whereas some initiatives are specifically designed to encourage and stimulate entrepreneurship, other initiatives achieve this objective indirectly. An example of the latter is the Smart Urban Technology Challenge, an initiative of the Mayor of Kathmandu Metropolitan City. Whilst it is not designed to encourage people to start in business, it does aim both to stimulate Nepal's entrepreneurial spirit and to identify solutions to address the challenges of urban development. It focuses on supporting young people using modern technologies but additionally has offered participation in a range of workshops that would help anyone subsequently deciding to start in business. Whilst this is one of a very small handful of projects aiming to stimulate innovation, there is no shortage of projects to support people to start in business.

The Ministry of Industry, Commerce and Supplies (MoICS), through its 20 years old initiative, the Micro-Enterprise Development Program (MEDEP) and the subsequent institutionalisation of the MEDEP model another Government programme, the Micro-Enterprise Development for Poverty Alleviation (MEDPA), has supported the creation of business by more than 142,000 micro-entrepreneurs and scaled up thousands more. MoICS has promoted policy reforms to foster entrepreneurship development and to support existing entrepreneurs. MoICS has now expanded MEDPA to all 77 districts. Moreover, efforts are underway at the provincial and local government levels to promote entrepreneurship development at a wider scale. The products made by MEDPA-supported MSMEs are marketed through Saugat Griha Micro Enterprise Promotion<sup>19</sup>, an integral part of the marketing chain connecting micro-entrepreneurs to the general market. Saugat Griha is one of a few select retailers engaged to support micro-entrepreneurs through district level outlets (in various locations including Pokhara, Kapilvastu, Nawalparasi and Chitwan) and at the national level.

Elam is an informal sector enterprise development programme of Helvetas Nepal, originally started in 2003, which focuses on employment generation based on the promotion of local resource value chains and their value addition, particularly for disadvantaged women and men in Nepal working within local, mostly agricultural, value chains. It introduces new technologies. It works through business service providers in just nine districts, including Parsa. It provides access to finance through Business Finance Institutions.

The Poverty Alleviation Fund (PAF) also started in 2003 and works across some 58 districts, so more or less across the whole country. Its objective is to improve living conditions, livelihoods and empowerment among the rural poor. It provides capacity building and enterprise development support. It has a small grant scheme.

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<sup>19</sup> See <http://saugatgriha.com/>

**Table 9: Organisations supporting business**

Organisation	Start-up	Incubation	Acceleration	Mentoring	Training	Post-investment support	WorkSpace	Seed capital	Angel investment	Growth capital	Grants
Agro Enterprise Center (AEC)				Yes							planned
Antarprerna	Yes	Yes		Yes	yes		Yes	yes	YES		
Biruwa Advisors				Yes			yes				
Blinc venture	Yes	yes	yes	yes	yes	Yes	Yes	Network s	Yes		
Business Oxygen Pvt. Ltd.										yes	
Chitwan Chamber of Commerce and Industry	Yes	Yes	Yes	Yes	Yes			Network sharing	Yes	yes	
Clock B	Yes				Yes			Space sharing if required			
Daayitwa	Yes	Yes	Yes	Yes	yes		training	yes			yes
DOI - One Stop Service Centre	Yes										
Dolma Impact Fund										yes	yes
Employment Fund, HELVETAS	Yes			Yes	yes			Yes			
FNCCI - Federation of Nepalese Chambers of		Yes		Yes	yes						
FNCSC					yes						
FWEAN (Federation of Women Entrepreneurs'	Yes	Yes		Yes	yes			Yes	yes		
GIZ (Deutsche Gesellschaft für Internationale		Yes		Yes	yes						
Glocal	Yes			Yes							
Hiefer				Yes	Yes						
Himalaya Climate Initiative	Yes	Yes		Yes							
Hydroelectricity Investment and Development								Yes	Yes	yes	
iCapital						Yes				yes	
Idea Studio- KUSOM	Yes	Yes	Yes							yes	
Industrial Enterprise Development Institute (IEDI)	Yes					yes					
Invation Hub	Yes						yes				
Jaguar Investments Pvt. Ltd.	yes			Yes		Yes				yes	
Karkhana	Yes			Yes							
Kathmandu University Business Incubation		Yes		Yes	Yes						
KCM Business Incubation Centre	Yes	Yes		Yes	Yes		Yes				
King's College	Yes	Yes		Yes	Yes		Yes	yes			
Kwledge-based Integrated Sustainable							Yes			yes	
KU School of Arts		yes		yes	yes						
Locus IOE Incubation Centre		Yes									
Micro Enterprise Development for Poverty	Yes										
Mid Valley College		Yes									
M&S Next Venture Corp - Next Launchpad							yes				
National Inovation Center	Yes							Yes		yes	
Nepal agribusiness ination center (NABIC)	Yes	Yes	Yes	Yes				yes			
Nepal Communitere	Yes			Yes	Yes		Yes	yes	yes		yes
Nepal Engineers Association Business	Yes	Yes									
Nepal Entrepreneurs' Hub (NEHUB)	Yes			Yes							
Nepal Inovation Center		yes		Yes			yes			yes	
Nepal Inovation Lab (World Vision International)	Yes	Yes	Yes	Yes						yes	
Nepal School of Entrepreneurs (NSE)	Yes	Yes	Yes	Yes	Yes		Yes				
Nepalese Young Entrepreneurs' Forum	Yes			Yes			yes				
Next Venture Corp			Yes	Yes	yes		Yes	Yes	Yes	Yes	yes
NYEF (Nepal Youth Entrepreneurs Forum)	Yes			Yes	Yes						
One to Watch				Yes			Yes			yes	yes
Pioneer Law Associates						Yes					
Practical Action		Yes								yes	
Presidency College of Management	Yes		Yes	Yes		Yes		Network sharing		yes	
PUM Netherlands		Yes		Yes							
RAP3Connect		Yes		Yes				Yes		yes	
Robotic Association of Nepal			Yes	Yes	Yes						
SAFAL Partners				Yes			Yes	yes	Yes		yes
Samarth					Yes						
Samriddhi - Rural Enterprises and Remittances	Yes		Yes	Yes	yes	Yes		yes		yes	
Seed Investments							legal compliances				yes
Smart Urban Techlogy Challenge/KMC						yes					
Start Up Nepal	Yes										
Support Activities for Poor Producers of Nepal				Yes	yes		yes				
SPRING Accelerator											
Team Venture	Yes					Yes		yes	Yes	yes	
The Platform						yes		yes			
True rth Associates			Yes	Yes		Yes				yes	yes
Udyami Fellowship - Institute for Suitable											
Ujyalo Foundation	Yes	Yes	Yes	Yes		Yes		yes			
Ukaid Sakchyam Access to finance Programme											
UNCDF (UN Capital Development Fund)					yes	yes					
Uniglobe College	Yes	Yes		Yes				yes			
Unlimited Ventures	Yes	Yes	Yes	Yes				Yes	Yes		
Upaya					Yes	Yes					
Women Development Advocacy Centre - Rural	Yes			Yes							
Young Inovation Pvt. Ltd.					Yes	Yes					
Youth Inovation Lab	Yes			Yes				Yes through connection with investors			
Youth Self Employment Fund - MoF (GoN)					Yes					Yes	yes
Yunus Social Business	Yes	Yes	Yes	Yes		flexible		yes			
Yuwa	Yes			Yes	Yes		yes				

Inclusive Development of the Economy (INCLUDE) worked in six districts to ensure that selected actors from the public, private and cooperative sectors play an increasing role in promoting inclusive economic development. By April 2017, some 14,000 people had benefited from the programme. One in two of them managed to increase their income by more than EUR 200 per year. It set up business incubation centres, some of which are still working, but they are now struggling for lack of funding. INCLUDE has now supported Kailali CCI which is operating a 'one stop shop' service providing advice to new businesses as well as supporting member entrepreneurs with tax training, small business training and trade fairs.

The High Value Agriculture Project (HVAP) supports specified agricultural value chains with vocational training. There is a value chain fund which can finance small scale infrastructure projects and a production inputs fund which effectively takes the place of contract farming advances. It works in six districts.

The Project for Agriculture Commercialisation and Trade (PACT) works across 25 districts including Chitwan, Parsa and Rupandehi. It supports smallholder farmers via farmer groups and cooperatives. It provides technical assistance and additionally provides value chain development grants.

The High Mountain Agribusiness and Livelihood Improvement (HIMALI) aims to increase the incomes of high mountain people working in selected value chains in 10 districts. It provides agribusiness assistance grants.

The Raising Incomes for Small & Medium Farmers Project (RISMFP) assists small and medium sized farmers to diversify into high value commodities. It works across nine districts. It provides technical assistance, especially for market linkages and value chain development, and has an agribusiness grant facility.

The Samarth-Nepal Market Development Programme (NMDP) aims to raise the incomes of smallholder farmers and small-scale entrepreneurs in 36 districts. It provides technical assistance, including market research, and financial support, mainly through grants (slightly surprising given that this is described as an M4P programme).

Knowledge-based Integrated Sustainable Agriculture & Nutrition (KISAN) worked in 20 districts to deliver sustainable growth in agriculture and offered technical assistance. A second programme, KISAN II, does much the same but has additionally introduced a partnership and innovation fund to test, pilot and scale innovative business models and technology solutions.

The Improved Seeds for Farmers Programme (ISFP) aims to develop the formal seed sector. Although not immediately obviously a farmer or enterprise support project, this programme does offer technical assistance to facilitate partnerships between farmers and the broader private sector and also aims to provide access to finance and manages its own Competitive Grant Scheme.

Inclusive Growth in Nepal (UNNATI), initially implemented by the Danish Embassy in Kathmandu and later by the United Nations Capital Development Fund (UNCDF), UNNATI is now implemented through a National Implementation Modality (NIM) in partnership with Nepal Rastra Bank (NRB). Its objective is the "promotion of sustainable inclusive growth that reduces poverty and raises living standards." UNNATI works in seven districts and provides technical assistance and additionally has a challenge fund, operating through business finance initiatives, to support entrepreneurs and others in

the agricultural sector (Antarprerana 2018). Some 159 projects have been approved and supported with matching grants. UNCDF facilitated and supported 57 successful projects to raise more investment at the end of 2018 (op. cit.).

Sakchyam Access to Finance for the Poor aims to leverage access to the financial sector to help MSMEs grow. It works across a large number of districts including Rupandehi. It targets BFIs and MFIs and manages the Sakchyam Challenge Fund.

The Slush Global Impact Accelerator was created by the Ministry for Foreign Affairs of Finland and other partners globally to support impact start-ups. A competition amongst 15 promising teams resulted in three being selected to participate in an accelerator programme. However, this programme does not appear to be running at the moment.

Rural Enterprises & Remittances Project (RERP), also referred to as Samriddhi, aims to promote and support rural MSMEs including farming, to promote self-employment and to support vocational training. It works in 16 districts including Morang. It intends to support 60,000 businesses and the creation of 90,000 jobs. It works through enterprise service centres and offers performance based matching grants.

Skills for Employment programme (SEP) is funded by UKaid and was launched in April 2019 focusing on ICT, tourism, commercial agriculture, construction (hydropower), light manufacturing sectors through market-led interventions that enable job creation, increase in incomes and migration optimisation. The programme harnesses the benefits of migration for Nepal's workforce and economic development by demonstrating cost-effective models to increase migrants' skills; lower financing and other costs of traveling abroad; and increase savings and investment of remittances. The project aims to assist 90,000 people to reach their potential through skill development whilst also enabling businesses to increase and improve productivity.

The Rural Access Programme (RAP) provides some enterprise support, focusing in improving the livelihoods of subsistence farmers. It partners with colleges to establish Future Entrepreneurs' Clubs and has partnered with KUSOM to offer rural business bootcamps and is additionally working with Idea Studio Nepal. Sustainable Action for Resilience and Food Security (SABAL) provides some support to strengthen agriculture value chains. Hariyo Ban supports small scale enterprise support focusing on forest dependent ultra-poor.

UNCDF has launched a challenge fund as a part of the global Financial Innovation Lab Initiative. The objective behind hosting this challenge is to support innovators and existing start-up companies ideate, innovate and implement technology driven solutions for smallholder farmers and the private sector companies serving them.

The Industrial Enterprise Development Institute (IEDI) grew out of a Ministry of Industry project undertaken in partnership with GIZ. It has established Business Development Centres in five districts. It offers research, training (including orientation programmes and bootcamps) and consultancy to aspiring and existing entrepreneurs. Entrepreneurs need a minimum capital of NPR2m and can access support for up to two years. They claim more than 50 per cent start their business after training.

As well as basic advice, there are a large number of organisations that claim to be incubators or accelerators, though the terms seem to be used quite loosely.

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Antarprerana (one of the partners in this research project) is a private firm which aims to support and strengthen the entrepreneurship ecosystem. It works through a three 'I' approach: incubation, investment and international linkage. It offers mentorship, coaching to entrepreneurs and runs incubation centres at Chambers, business associations and colleges.

Business Incubation Centre Kathmandu (BICK) was originally set up under the auspices of the Department of Cottage and Small Industries. It is still in existence but is not currently operational.

Business Incubation Project is a GoN programme intended to support growth-oriented businesses with advice, office space, equipment and market linkages. To date, they have only supported six businesses. It is not closed, but nor is it active

Daayitwa, a not for profit, offers a programme known as REAP: Rural Enterprise Acceleration Project. It works in the three districts of Palpa, Gulmi and Ramechap

Enterprise-Nepal Business Accelerator Program offers a 12-week business development programme which target growth businesses. It works in partnership with the Nepal Young Entrepreneurs' Forum and the University of Oklahoma. It works closely with True North Associates.

Himalayan Climate Initiative supports social enterprises and businesses that have a social impact through its Social Innovation and Business Incubation Hub

Idea Studio Nepal, a not-for-profit company, provides encouragement, resources, space, and networking for the entire life-cycle of a socially conscious business idea. The initiative encourages social innovators to come forward with reactive and innovative ideas that can address social issues faced by local communities.

Microsoft Innovation Centre's Unlimited Ventures Programme supports technology start-ups with a pre-accelerator programme, the Unlimited Impact Fund and international networking opportunities.

M&S NEXT Venture Corp supports entrepreneurs to start and grow a business. It provides entrepreneurial education, mentorship, market exposure, creative office space, shared resources, supportive community, valuable networks. It offers access to funding through NEXT Venture Fund, workspace through NEXT Venture Hub and further training through NEXT Venture School. Their four-month start-up accelerator program, NEXT Launchpad, helps businesses to grow. Whilst they say that they support start-ups, they also say that their target is businesses that have been in business for at least six months.

The Nepal AgriBusiness Innovation Centre (NABIC) focuses on the agri-processing sector offering business and technical training, networking, acceleration, workspace and access to finance mainly to businesses that have grown to revenue of at least \$100,000 and have the potential to grow at 30 per cent per annum. They attracted 284 new clients last year and are currently supporting 79. They estimate that they have reached out to 1,000 entrepreneurs in total. NABIC says that ideally its incubation programme would last three years, though due to funding constraints, it lasts for one year, and that its acceleration programme lasts from ten weeks to six months. An incubation programme of more than six months is almost certainly too long. It suggests either that the business was not ready to join it, though this would be surprising if they are already generating revenue, or that the programme could be designed to be more intensive.

NABIC confirms that a key issue is poor management skills of entrepreneurs – and categorises them mostly as necessity entrepreneurs. They see access to finance as a major problem. They have co-workspace for up to 12 clients though apparently none are let at present.

Founded in 2015, Nepal Communitere is a branch of Communitere International, an innovative non-profit organisation pioneering a model for sustainable disaster recovery. Nepal Communitere brings together Nepali innovators, entrepreneurs and creative change makers to further their ideas. Nepal Communitere provides a dynamic, collaborative space for innovation and entrepreneurship. The Nepal Communitere Resource Center and Innovation Hub enables early stage start-ups, entrepreneurs, innovators and their communities to work together to design creative solutions to the diverse challenges facing Nepal. They offer 'coworking' space, a Makerspace, a training lab and a (year-long) business incubation programme. Last year, they recruited eight new clients and supported three clients actually to start in business. They have 16 units of workspace, 14 of which are currently occupied. The rent is heavily subsidised.

Rockstart Impact, launched by the Dutch NGO, Rockstart. Rockstart launched in 2011 in Amsterdam as one of Europe's first start-up accelerators. Today, it supports start-ups in four sectors: energy, health, agrifood and emerging technologies. It provides access to capital, market, community and expertise by connecting start-ups to partners, investors, mentors and the wider Rockstart network. In Nepal, it is closely associated with One to Watch. Its main support is through a 100-day business programme.

Startups Nepal provides access to a community of start-ups, entrepreneurs, mentors, experts and business leaders. It organises bootcamps and networking events.

Ujjyal Foundation, a not for profit organisation, aims to empower communities through technology, innovation, social enterprise and gender inclusive leadership, collaboratively locally and globally. It runs an EmpowHer program for young women to promote their leadership in running social enterprises.

Entrepreneurs for Nepal is a loose network of entrepreneurs. It offers monthly networking events, known as Last Thursday, which feature renowned Nepalese entrepreneurs.

Institution for Suitable Action for Prosperity is a non-profit, non-governmental organisation which aims to improve the economic and social status of resource-poor people through skill enhancement, research, entrepreneurship, capacity building and infrastructure development utilising innovative, participatory and market-based approaches. It runs the Udyami Fellowship, an apprenticeship program and the Agro-Fundamental Workshop which supports small-scale entrepreneurs take a more commercial approach to their farming.

LOCUS IOE is a platform of engineering students from the Institute of Engineering. LOCUS provides opportunities to students to participate in various challenge-based competition and non-competitive events including exhibition, skill development program and interactions.

Nepal Entrepreneurs' Hub (NEHUB) offers start-up weekends, Spark Talk & Meet-ups, Spark Mentoring and occasional bootcamps. Women Development Advocacy Centre offers some business support, mainly training. Unlimited Ventures provides training for start-ups.

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Some of the trade and business associations also offer some support to new and growing businesses.

The Federation of Women Entrepreneurs' Association of Nepal (FWEAN) offers a range of services including mentoring, training, networking and business development.

The Federation of Nepalese Chambers of Commerce & Industry (FNCCI) is a federation of chambers and offers training to new and growing businesses. It hosts the Innovation Hub which provides library and creative space to support entrepreneurs and students aspiring to become entrepreneurs. Innovation Hub is a partnership between FNCCI with the US Embassy and Kathmandu. The Hub offers a wide range of resources for entrepreneurs including incubator desks, which give entrepreneurs workspace and access to a specialised library of books and computer resources.

Nepal Engineers' Association (NEA) has a Business Incubation Centre which targets engineering related start-ups and offers workspace, mentoring and networking. The Nepalese Young Entrepreneurs' Forum (NYEF) is primarily a trade association but additionally mentors young people to develop their ideas into viable businesses.

Several of the universities also offer support, usually to their students, to start in business.

Kathmandu University's Business Incubation Centre supports students and aspiring entrepreneurs to work through their ideas and start in business. It provides workspace as well as mentoring, business planning, marketing, networking and training. The University also has an Idea Studio within the School of Management (KUSOM) which seeks clients from round the country and provides business support including seed funding.

Kings College has two programmes – Centre for Innovation & Entrepreneurial Development and Yunus Social Business Centre – which support students and aspiring entrepreneurs to start in business offering a 15-week incubation programme, seed capital, workspace, mentoring, etc. The Yunus Social Business Centre offers an incubation programme specifically targeting social entrepreneurs. They prefer to work with businesses that have at least two years' experience of business. To date they have supported eight businesses.

The Nepal School of Entrepreneurship is a business and design school for leadership and entrepreneurship which offers short courses for entrepreneurs. The Presidency Business Incubation Centre, established by the Presidency College of Management Sciences, supports undergraduate and post graduate students who want to start a business. They offer training, mentoring, bootcamps and incubation programmes.

There are some for-profit organisations aiming to support business. For example, Biruwa Advisors offers business development services including mentoring, planning, legal support, training, market research, financial due diligence, investment facilitation and networking.

There are also a large number of projects that offer workspace to new and early stage businesses, including Adda, Bikalpa Art Center (a café and art gallery which also provides workspace), Clock B (an emerging promoter of innovation, supported by the Indian Embassy, which emphasises crafts), Haushala Creatives (which provides women with workspace and a supportive community to develop a project idea, start up or to

expand a business), Nepal Connection, Open Gov Hub, Pasa Yard, Platform.Inc, Ventures Café and Work around.

Founded in 2006, Samriddhi Foundation is an independent economic policy think tank that facilitates debate on market-based solutions for a free and prosperous Nepal. It believes that entrepreneurs are key to economic development and engages in fostering democracy and building an environment that is more conducive for economic growth. It works in three broad areas: research & publication, education & training and advocacy. It organizes an annual economic policy reform initiative, the *Nepal Economic Growth Agenda*, entrepreneurs networking events called *Last Thursday with an Entrepreneur* and a regular discussion forum on contemporary political economy, *Economy*. One of Samriddhi's award winning programs is a five-day residential workshop on economics and entrepreneurship, *Arthalya*, which has produced over 400 graduates over the past few years, of which more than two dozen have set up their own enterprise.

In addition, a number of organisations offer services solely on a commercial basis. These include:

- Biruwa Advisors, which offers business development services including mentoring, planning, legal support, training, market research, financial due diligence, investment facilitation and networking.
- Upaya, which offers services to business process related to public offices including registration, renewal and taxation.
- Job dynamics, a human resource support company, in collaboration with Antarprerana, has recently launched 'Founders Sahayog' with an objective to support early stage companies to address their human capital requirements.
- Pioneer Law, a law firm, supports firms secure foreign investment.
- Reanda Biz Serve offers consultancy, advice and guidance in finance, legal and IT.

### Appendix 8: Statistical analysis

The results of the survey were analysed for reliability, correlation and regression using SPSS and separately using xlstat (an add-in package for excel).

In SPSS, revenue was selected as the dependent variable with employees working days, number of employees, investment, age of principal, gender of principal, educational attainment of principal and level of exports as the explanatory variables. Two variables, gender and export, are dummy variables while other five variables are continuous. The dependent variable, revenue, is also continuous variables. Outliers were removed by eliminating the uppermost and lowermost 2.5 per cent of responses. The continuous variables were converted into Z-scores. Table 10 presents the findings of the correlation analysis. Except two variables, number of staff working days and number of employees, the independent variables show a significant and positive correlation with revenue.

**Table 10: Correlation matrix**

		Number of Staff working days (X1)	Number of employees (X2)	Investment(X3)	Principal owner's age(X4)	Principal owner's education level(X5)	Export (X6)	Principal owner's gender (X7)
Revenue	Pearson Correlation	.012	.019	.111**	.117**	.110**	.107**	.079*
	Sig. (2-tailed)	.753	.609	.004	.001	.003	.004	.032
	N	735	736	663	738	745	745	745

\*\*. Correlation is significant at the 0.01 level (2-tailed)  
\*. Correlation is significant at the 0.05 level (2-tailed)

To measure the effect of the independent variables, a regression analysis was undertaken. The relationship of these variables is expressed in regression model

$$\text{Growth in revenue} = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7$$

The findings are presented in the next three tables. The findings of ANOVA indicate that the regression model expressed in the equation is statistically significant and that the regression model is statistically significant at 5% level of significance with p-value of 0.000

**Table 11: ANOVA**

	Sum of Squares	df	Mean Square	F	Sig.
Regression	44083008274999.9	7	6297572610714.3	6.475	.000 <sup>b</sup>
Residual	619583394974213.0	637	972658390854.3		
Total	663666403249213.0	644			

a. Dependent Variable: Revenue

The findings of R-square suggest that around 6.6 % of the variation of revenue is explained by these seven independent variables. Thus, there is very medium level effect of these independent variables on the dependent variable, revenue.

**Table 12: Model summary**

R	R Square	Adjusted R Square	Std. Error of the Estimate
.258 <sup>a</sup>	.066	.056	986234.45025

The findings of the regression analysis show that the model is significant as a whole, but some of the variables of the model are not statistically significant. Three variables, number of staff working days, number of employees and gender of the owner are not significant explanatory variables of the revenue while other four variables, investment, age, education and level of export are statistically significant explanations of revenue.

The standardized regression coefficient of variable investment is 0.120, that is, this variable has a positive effect on revenue: higher investment is associated with higher revenue. An increase in one standard deviation in investment results in an increase of 0.12 in the standard deviation in revenue. The findings presented in the coefficient table show that the regression coefficient of investment is statistically significant with standard error (50987.1) and p-value of  $0.008 < \alpha = 0.05$ . Similar results are observed in other three variables, viz. age, education and level of export.

**Table 13: Regression coefficients**

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	113177.5	98786.2		1.146	.252
Number of Staff working days (X1)	103844.7	120836.0	.059	.859	.390
Number of employees (X2)	-150512.4	132112.1	-.085	-1.139	.255
Investment(X3)	135225.2	50987.1	.120	2.652	.008
Principal owner's age(X4)	153869.5	44086.1	.141	3.490	.001
Principal owner's education level(X5)	146220.7	41648.9	.144	3.511	.000
Export (X6)	487789.3	133066.7	.144	3.666	.000
Principal owner's gender (X7)	140473.3	106911.8	.051	1.314	.189
a. Dependent Variable: Revenue					

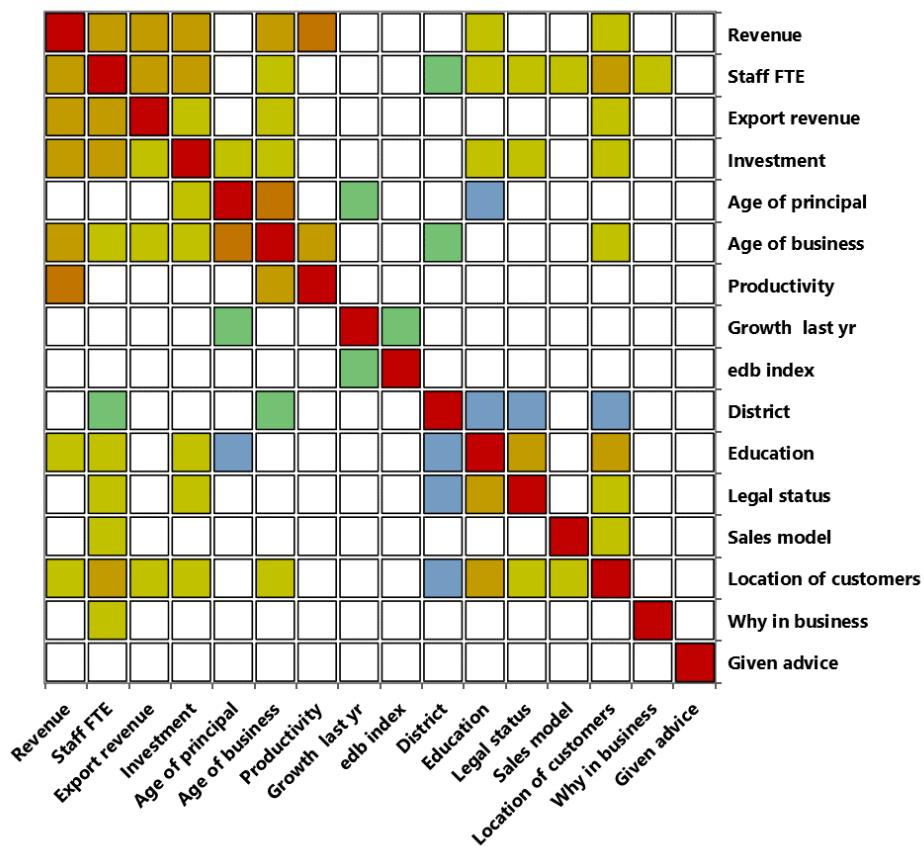
Since this initial analysis only explained a small level of the variation, further tests were undertaken (in xlstat). Revenue was still regarded as the independent variable. The quantitative explanatory variables tested were staff FTE, export revenue, investment, age of principal, age of business, productivity (though this is calculated from revenue and staff FTE so is not really independent), level of growth last year and the business's own assessment of the ease of doing business (taking an average across all of the factors). Qualitative explanatory variables covered district, level of educational attainment, legal status, sales model (ie, business to consumer, business to business or business to government), location of customers (ie, local, national or international), why in business (reduced to two options of opportunity or necessity) and whether received advice.

All records with missing data were ignored, giving 635 usable observations. There were no correlations (apart from with productivity) higher than 0.36 (for export revenue), though investment was close at 0.35. Cronbach's alpha evaluates internal consistency

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and is generally considered acceptable when it is greater than 0.7. In this case it was just 0.44. The correlation map (Figure 88) shows the correlations – the redder the colour, the stronger the correlation – and suggest weak correlations between revenue and each of staff FTE, export revenue, level of investment, age of business, and very weak correlations with education of the principal and location of customers.

Figure 88: Correlation map

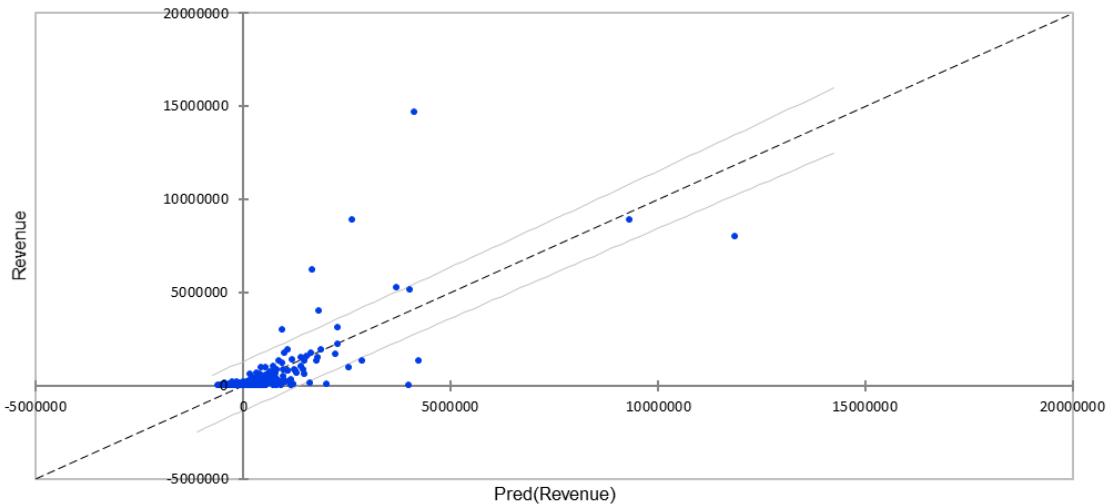


A regression analysis, based on 742 observations, gave a probability corresponding to the F value lower than 0.0001, meaning that we are taking a risk lower than 0.01 per cent in assuming that there is no effect of the explanatory variables.  $R^2$  is 0.58 which, whilst still below the desired level of 0.7, is quite close. Xlstat concludes that the variables explain 58 per cent of the variability of the dependent variable, revenue. Based on type III sum of squares, it suggests that the following variables bring significant information to explain the variability: staff FTE, export revenue, level of investment, ease of doing business index, district, sector, education of principal, sales model, location of customers, reason to start in business and whether received advice. It seems that educational attainment was the variable considered the most influential – though as noted in the narrative, this is an association rather than a causation.

**Table 14: Type III sum of squares analysis (revenue)**

Source	DF	Sum of squares	Mean squares	F	Pr > F
Staff FTE	1	7221915906880.000	7221915906880.000	15.923	< 0.0001
Export revenue	1	16536812314390.100	16536812314390.100	36.461	< 0.0001
Investment	1	173750258993776.000	173750258993776.000	383.093	< 0.0001
Age of principal	0	0.000			
Age of business	0	0.000			
Productivity	0	0.000			
Growth last yr	1	886883361094.375	886883361094.375	1.955	0.163
edb index	1	10396581055195.100	10396581055195.100	22.923	< 0.0001
District	2	109693049714283.000	54846524857141.300	120.928	< 0.0001
Sector	1	87821210145534.400	87821210145534.400	193.632	< 0.0001
Education	4	724888742115450.000	181222185528863.000	399.567	< 0.0001
Legal status	1	7162604452.375	7162604452.375	0.016	0.900
Sales model	2	76166614299684.000	38083307149842.000	83.968	< 0.0001
Location of customers	1	8285697559358.250	8285697559358.250	18.269	< 0.0001
Why in business	1	27703970242114.000	27703970242114.000	61.083	< 0.0001
Given advice	1	3066251674244.370	3066251674244.370	6.761	0.010

Figure 89 compares the predicted revenue, based on this model, and the actual revenue and, as can be seen, the fit is quite good.

**Figure 89: Predicted revenue versus revenue**

The responses were then adjusted the data to remove outliers, done by calculating the fifth and 95<sup>th</sup> centile and removing all results with revenue outside that range. We also reduced the variables that it appeared from the first xlstat test had no impact on the dependent variable. This reduced the number of usable observations to 705. The probability corresponding to the F value was again lower than 0.0001. Based on this reduced data, xlstat concluded that 37 per cent of the variability is explained by the nine explanatory variables.

The following variables bring significant information to explain the variability: investment, age of principal, age of business, legal status, sales model and location of customers. This time, xlstat reported that investment was the most influential variable. It is unlikely that investment per se is the driver of revenue, but is a proxy, perhaps for ambition and scale of business requiring greater levels of investment, but also probably means that businesses that have higher levels of investment are more competitive.

One factor that we could not take into account, since we did not attempt to measure it, was the skill level of the existing workforce. It is highly likely that this would make a

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contribution to productivity and to sales revenue not least because many businesses told us that the level of skills was too low and that, if they were to grow, they needed more people with greater skill, through training their existing workforce and through recruiting people with more developed skills.

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