



# Analysis of the business environment in Least Developed Countries

## Nepal

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# Nepal

Region  
South Asia

Population  
30 500 000

Demographic growth  
1,71%

Average income (2022)  
664 USD

Human Development Index:

**While Nepal improved its ranking from 144th to 143rd position, the Human Development Index (HDI) value has marginally declined from 0.604 to 0.602 due to continued turbulence caused by the Covid-19 pandemic.**

## Economic overview

*Nepal is landlocked, with a total area of 147,516 sq. kilometres and an estimated population of around 30 million. Nepal shares borders with India towards the East, West and South, while its mountains border with China in the North. Nepal's economy is predominantly based on agriculture, contributing to 24.3 per cent of GDP and almost 64.4 per cent of employment. The industrial sector, comprising manufacturing, construction, mining and quarrying, electricity generation, gas and water, accounts for 13.79 per cent of GDP<sup>1</sup> and 15.10 per cent of total employment. The services sector accounts for 60.2 per cent of the GDP and 20.50 per cent of total employment.*

Nepal is currently experiencing a large youth population, accounting for more than 40 per cent of the total population. It has yet to leverage this group to drive forward its economic development fully. **The country has failed to absorb its young talent pool of about 500,000 workers entering the labour force every year, with approximately 1,700 young people leaving the country daily according to official figures.**

A major human development challenge is the gap in equal access to digital infrastructure and technical know-how since most of Nepal's population (79.42 per cent) reside in rural parts with limited or no access. Nepal has made some progress in upgrading its infrastructure networks to facilitate the growth of its digital economy. The access to electricity rate stood at 90 per cent of the total population as of mid-March in 2019/20. Similarly, Nepal has made significant progress in its high broadband density rate, which increased to 84.09 per cent in mid-March (2019/20). **This rapid increase in broadband density rate can be attributed to the role of the government in applying the Public-Private Partnership (PPP) model for project implementation.**



## Challenges faced by the private sector

- **Skill mismatch:** The absence of a system to assess labour market demands and skill requirements for Nepali workers causes a mismatch between skills available and business skill requirements. Businesses bear the cost of constantly recruiting and retraining new staff, especially with young people choosing to seek jobs overseas.
- **Low human capital and lack of skilled workforce:** Nepal's adult literacy rate was 57 per

<sup>1</sup> Gov-UK: Overseas Business Risk: Nepal. 2021

cent as of 2018. Despite having a high primary net enrolment rate (93.4 per cent), the rate for secondary education (grade 9-12) remains low, with an enrolment rate of only 47.6 per cent. This could be attributed to the fact that students from poorer households tend to look for work to escape multidimensional poverty. Another reason is the lack of proper school facilities in rural areas. Those who drop out have low access to decent job opportunities and lack skills and capacities in technical work.

- The agricultural sector faces challenges such as low availability of resources and materials to increase agricultural productivity and inadequate infrastructure systems such as warehouses, cold storage, agricultural markets, irrigation facilities, and road access networks. The agricultural sector in Nepal needs formalisation and digitisation, as 97 per cent of those working in the agricultural sector are doing so informally.



The country has failed to absorb its young talent pool of about 500,000 workers entering the labour force every year, with approximately 1,500 young people leaving the country searching for foreign employment.

- A hindrance to manufacturing sector growth is the limited number of operating Special Economic Zones. Among the 14 areas identified as Special Economic Zones, only Bhairahwa Special Economic Zone is in operation.
- The agricultural sector lacks adequate distribution of technological capacity, impeding its modernisation and industrialisation transition. As a result, agricultural goods are being imported to Nepal. Rice made up 2.8 per cent, and vegetables amounted to 1.1 per cent of the total share of imports in 2019/20.
- The yields in agricultural outputs are low, caused by challenges of supply and generation

of improved seeds, fertilisers, utilisation of new techniques and climate change<sup>2</sup>.

- The main barriers faced by the industrial sector are the government's relaxed policies towards importers and an open border policy with India, lack of incentives and programmes aimed at attracting national and international investors to create goods and services with a comparative and competitive advantage, high tariff rates on raw materials, semi-processed goods and spare parts, and poor coordination among government agencies and investors have impacted the quality of Nepal's industrial policies.

- **Access to credit and financing:** Micro, small and medium enterprises (MSMEs) are fundamental aspects of Nepal's economy but lack access to finance. Almost 60 per cent of SMEs do not have access to capital, and only 16 per cent of SMEs' investment is done through bank financing. Due to gaps in information and a lack of access to long-term bank loans or equity, ensuring investment and growth has been challenging. These challenges eventually increase the cost of production, making local products less competitive in the market.

- **Large informal economy: More than 70 per cent of the economically active population in Nepal is engaged in the informal economy, and more than 49 per cent of total businesses are unregistered.** Micro and small enterprises operate their businesses informally because of excessive bureaucracy, redundant and opaque government procedures, cumbersome post-registration compliances and corruption. Entrepreneurs face many hurdles, one being that the cost and time for business registration are relatively high. Workers in the informal sector are often marginalised from government actions or policies due to inadequate data to plan programmes effectively. They lack social protection and are exploited as the government cannot regulate the sector. One of the biggest challenges for the country remains integrating informal workers into the formal economy.

<sup>2</sup> Paudel, R. C. & Acharya, C. P. (2020). Financial Development and Economic Growth: Evidence from Nepal. NRB Economic Review, 32(1), 15-36

- **Climate change:** Nepal's increasing urbanisation at an annual rate of 3.09 per cent, deforestation and poor waste disposal practices have adverse impacts on the local weather patterns, potentially aggravating the local effects of climate change. For example, melting glaciers can damage livelihoods and affect the tourism industry.



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- Current policy frameworks fall short of providing an environment conducive to the growth of technology-based start-up ecosystems and innovative enterprises, as there are no concrete policy positions on financing and incubation in shaping the digital and knowledge economy sectors. Proper institutional arrangements are yet to be in place to spearhead the Digital Nepal initiative. Concrete investment proposals supporting each of the 80 activities listed in DNI are yet to be formulated for the framework to be wholly implementable<sup>3</sup>.
- The Labour Act enacted in August 2017 has added to the costs of doing business as many SMEs are struggling to meet the requirements of the new Social Security Fund introduced in 2018<sup>4</sup>.
- **Covid global pandemic:** The temporal closure of business for about five to six months led to entrepreneurs struggling to pay bills, rent and the welfare of employees.

## Private sector policy recommendations

- In partnership with the private sector, the government should develop a system to

assess the labour market demands and skill requirements for the Nepali youth population. This will help develop an informed human development strategy involving targeted education policies.

- Initiative should be embarked upon to improve digital literacy among young people. This will create opportunities for digital entrepreneurship among young people. The Ministry of Education should also invest in ICT resources and facilities that enable easy learning for students in primary, secondary and tertiary institutions<sup>5</sup>.

- Develop policies that create a favourable environment for cooperation and partnership in ICT among public and private sectors, civil society, and between all stakeholders at local, national, regional, and international levels.

- Promote joint venture initiatives for local entrepreneurs with international private investors to provide public ICT goods and services to catalyse the sector's growth.

- To help develop ICT business incubators and promote start-up projects in close coordination with the private sector by creating a supportive eco-system and accessible financing.

- Government should adopt policies that encourage private sector investment, moving the country away from over-reliance on mobile networks towards promoting investments in robust, high-capacity, fibre-optic-based fixed broadband networks. Such investment is needed to build 'future-proof' connectivity infrastructure that can cope with an ever-increasing demand for quality connection and bandwidth.

- The implementation of the key objectives of the Digital Nepal Framework

- Government should offer private agricultural investors the chance to contribute through

<sup>3</sup> Bhattarai M. K. (2021). Information and Communication Technology Scenario of Nepal: Assessing Policy Environment and Challenges. Nepal Public Policy Review, 1, 201-211

<sup>4</sup> International Trade Administration (ITA) Nepal - Country Commercial Guide. Published 2021

<sup>5</sup> Dhital, H. (2018). Opportunities and challenges to use ICT in government school education of Nepal. International Journal of Innovative Research in Computer and Communication Engineering, 6(4), 3215-3220.

projects like Nepal Seed and Fertilizer Project (NSAF). The private sector contribution would ensure enough seeds and fertilisers are frequently supplied to small-scale farmers in the country. The government should encourage farmers through incentives to leverage the biological diversity of Nepal to farm high-value crops and diversify crop production.

- Nepal is a landlocked country with limited road networks; airplanes are a convenient way of transporting cargo, agricultural produce, and high-value products. Government should consider public-private partnerships in the management and operation of existing airports, which also presents opportunities for the expansion of non-aeronautical services (such as airport taxis, duty-free shops, parking management, eateries, and recreational and hospitality facilities).



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- Boosting import substitution and quality of exports through strengthening the competitiveness of export-oriented industries and industries that can meet local demands will also build the country's self-reliance.

- Nepal must increase and strengthen private sector engagement in various avenues such as strategic planning, policy, investment, and execution. This will be critical in providing access to more significant resource and knowledge pools, ensuring efficient allocation of limited resources, and leveraging innovation to ensure quality and successful delivery of government initiatives.

- The government should pursue the digitalisation of customs procedures and initiation of one door tax payment system. This will involve the implementation of hassle-free and easy documentation procedures through the integration of various agencies into an electronic system, improved coordination of joint physical inspections at borders, initiation of electronic submission of documents, the establishment of testing labs in border areas with proper facilities, upgradation of dry port infrastructures, construction of parking infrastructure at each ICDs<sup>7</sup>.

- Government should engage the private sector in developing policies aimed at encouraging entrepreneurship among young people, making access to easy finance, insurance and technology a component of its decent work framework

- It is recommendable that the Ministry of tourism work towards integrating tourism drives towards attracting international sporting events (e.g. Hiking and biking) and festivals.

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<sup>7</sup> FNCC, 2021. National Economic Transformation 2030, Private Sector for Prosperity and Growth.



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