

MAPPING INNOVATION SUPPORT PROGRAMMES FOR MICRO, SMALL AND MEDIUM ENTERPRISE DEVELOPMENT: FINDINGS FROM NEPAL

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JUNE
2023

This work was carried out with the aid of a grant (#109840-002) from the International Development Research Centre, Ottawa, Canada.



Suggested citation: Singh, D., and Kharel, P. 2023. *Mapping Innovation Support Programmes for Micro, Small and Medium Enterprise Development: Findings from Nepal*. Kathmandu: South Asia Watch on Trade, Economics and Environment (SAWTEE).

Views expressed are those of the authors.

This work was carried out with the aid of a grant (#109840-002) from the International Development Research Centre, Ottawa, Canada.

Acknowledgements

This report is based on a study done by South Asia Watch on Trade, Economics and Environment (SAWTEE) with the aid of a grant (#109840-002) from the International Development Research Centre (IDRC), Ottawa, Canada. The principal investigator was Dr. Paras Kharel, Executive Director, SAWTEE (paras.kharel@sawtee.org), and the co-principal investigator was Ms. Dikshya Singh, Programme Coordinator, SAWTEE (dikshya.singh@sawtee.org). Valuable comments were received from Mr. David O'Brien, of IDRC.

Research interns Mr. Anubhav Dhakal, Mr. Milan Acharya, Ms. Bini Dahal, Mr. Bipin Khadka, and Ms. Sukrita Karkee, and Research Officer Ms. Roopali Bista provided able research assistance. Mr. Shashi Bhattarai, Co-founder & Director, Knowledge Holding International Pvt. Ltd., provided vital support in facilitating interactions with stakeholders in Nepal's entrepreneurial ecosystem.

Abstract

Challenges facing micro, small and medium enterprises (MSMEs) have led to a proliferation of innovation support programmes in Nepal. This study examines the innovation support landscape in Nepal, describing existing policies and major innovation support programmes for MSMEs, presenting stakeholders' views on the same, examining the availability of credible empirical evidence on the effectiveness of these policies and programmes, and identifying whether and to what extent they take into account equity, diversity and inclusion considerations. The study has a special focus on the support available to growth-oriented startups and export promotion.

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1. Background

Nepal's economic landscape is populated with micro, small and medium-sized enterprises. With more than 95 percent of the business enterprises in Nepal categorized as micro, small and medium enterprises¹, these small businesses play a vital role in Nepal's economy. In a country where there are about only 1,100 large industrial enterprises, providing direct employment to about 150,000 people, smaller firms drive the economy.² SMEs are estimated to contribute 22 percent to the gross domestic product (GDP) and employ around 1.7 million people.³ Hence, SMEs not only play a vital role in keeping the economy going but also contribute to creating decent jobs, reducing poverty and overall national productivity.

Small enterprises are considered to be crucial in increasing an economy's productive potential, reducing inequality and sharing the benefits of globalization and technological progress.⁴ Small businesses help countries adapt to newer technologies, becoming the vehicle for major transformations and seizing new opportunities.⁵ Since these small firms promote inclusive and sustainable economic growth, are the source of decent employment and reduce inequalities, contribute to sustainable industrialization and promote innovation, micro and small enterprises are one of the major vehicles towards achieving the 2030 Agenda for Sustainable Development.⁶

The factors considered to put micro and small enterprises at an advantage in comparison to larger firms are their agility towards change and ability to adopt innovation as there is relatively less resistance to change. At the same time, innovation is not an easy feat for smaller firms that are constrained due to limited access to finance and technology.⁷ Especially in countries like Nepal where the financing arena is dominated by collateral-backed loans, access to finance for small businesses remains elusive. Besides constraints related to finance, small businesses may lack the capacity in terms of technical and entrepreneurial skills to identify and implement innovations. Similarly, for small businesses introducing innovation activities by deviating from their business-as-usual stance is full of risk and they may not have

¹ CBS. 2020. National Economic Census 2018, National Report. Kathmandu: Central Bureau of Statistics, GoN.

² CBS. 2020. National Economic Census 2018, National Report. Kathmandu: Central Bureau of Statistics, GoN.

³ NRB. 2019. SMEs Financing in Nepal. Kathmandu: Nepal Rastra Bank.

⁴ OECD. 2018. Fostering greater SME participation in a globally integrated economy.

<https://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Plenary-Session-3.pdf>

⁵ OECD. 2018. Fostering greater SME participation in a globally integrated economy.

<https://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Plenary-Session-3.pdf>

⁶ Policy Brief: The Role of Micro-Small and Medium Enterprises in Achieving SDGs.

https://sustainabledevelopment.un.org/content/documents/18349policy_brief_27_04_final.pdf

⁷ <https://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Parallel-Session-4.pdf>

enough resources to cushion against the fallout if the innovation goes bad. Hence, they may be wary of investing in innovation.

In a nutshell, small businesses require a lot of support and handholding not only to survive but to become thriving decent job-creating enterprises. Innovation is one of the key components that could catalyze such a growth spurt. It is equally true that not all businesses survive or grow, but all businesses should get access to fair opportunities. Like all small businesses, Nepali micro and small enterprises also face challenges created by information asymmetry, dearth of skills, lack of access to basic production and processing technology, ineffective branding, inadequate digital payment networks and limited e-commerce footprint. These are constraining the ability of such firms, including women-led ones, to export, expand exports and diversify products and markets.⁸ Although innovation is generally understood as the invention of new products or technology closely related to a scientific and technological breakthrough, that is only one dimension. Innovation in businesses is equally about changing production techniques, implementing new product designs, branding, etc., which are mostly driven by the firm's ability to create, seek and manage new ideas. However, small businesses face constraints in terms of sourcing innovative ideas or have limited capacity—in terms of finance, human resources, etc.—to implement those innovations. Moreover, as posited by Cirera and Maloney (2017) innovation in developing countries often is restricted by weak firm capabilities and government capabilities to foster and implement innovative practices and technologies.⁹

Helping businesses adopt innovation is one such area where small enterprises could use support from the government and other non-government entities. Moreover, such support can also be used as a tool to make the economic and entrepreneurial space more inclusive. The marginalization of certain groups based on their gender and caste has contributed to deep inequalities in society. This inequality manifests in unequal economic opportunities as social and political exclusion limits access to resources for marginalized groups. Economic policies have started to recognize that neutral policies for poverty alleviation or economic development without addressing the issue of an unequal society do not yield rapid results. Such support programmes could be good policy vehicles to implement equality, diversity and inclusion (EDI) so that those belonging to marginalized groups—as entrepreneurs, workers or

⁸ Kharel, P., and Dahal, K. 2021. Small and medium-sized enterprises in Nepal: Examining constraints on exporting. In S. Urata (ed.), *Enhancing SME participation in global value chains: Determinants, challenges, and policy recommendations*, pp. 367-97. Tokyo: Asian Development Bank Institute.

⁹ Cirera, Xavier and Maloney, William F. 2017. *The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up*. Washington, D.C.: The World Bank.

consumers—can be provided direct and indirect support. Innovation support programmes can actually spur economic growth and development, too, by making the economic sphere more inclusive and accessible.

While Nepal does not have a separate policy for micro, small and medium enterprises, different policies and programmes¹⁰ are in place that aspire to augment the competitiveness of these firms and enhance their market access. The Industrial Policy and the subsequent legislation strive for the creation of a better industrial ecosystem by enhancing managerial capacity and creativity, generating and sharing knowledge, developing skills, adopting appropriate technology, and instituting investment/development funds, among others. Government projects, such as the Micro Enterprise Development for Poverty Alleviation, have been preparing district entrepreneurship development plans; developing industrial clusters; establishing product development centres; providing assistance for the use of collective marks; promoting SME products; and establishing incubation centres. Other government initiatives include attracting youth and women through business incubation centres, making loans accessible to women entrepreneurs and marginalized communities, creating a women entrepreneurship fund, and provision of other concessions/facilities for women entrepreneurs.

Nepal is in need of structural transformation to create jobs on a massive scale with decent wages. Unfortunately, Nepal's productive capacity remains low and weak, and workers' remittances have become the mainstay of the economy.¹¹ A manifestation of the erosion of Nepal's productive capacity is the country's ever-widening trade deficit. A rapid depletion of foreign exchange reserves, which led the government and the central bank to enforce import restrictions (including a ban on select goods) during 2022, underlined the urgency to increase exports. Increasing exports, whether at the intensive margin or at the extensive margin, on a sustained basis entails innovation. SMEs have a significant presence in Nepal's export sector.¹²

¹⁰ The policies and programmes are discussed in the next chapter.

¹¹ Kharel, P. 2022. Fostering structural transformation in Nepal. Report submitted to ESCAP, Bangkok. https://www.unescap.org/sites/default/d8files/event-documents/ST_Nepal.pdf

¹² Kharel, P., and Dahal, K. 2021. Small and medium-sized enterprises in Nepal: Examining constraints on exporting. In S. Urata (ed.), Enhancing SME participation in global value chains: Determinants, challenges, and policy recommendations, pp. 367-97. Tokyo: Asian Development Bank Institute.

Objectives

Challenges facing MSMEs have led to a proliferation of innovation support programmes in Nepal. This study examines the innovation support landscape in Nepal, describing existing policies and major innovation support programmes for MSMEs, presenting stakeholders' views on the same, examining the availability of credible empirical evidence on the effectiveness of these policies and programmes, and identifying whether and to what extent they take into account equity, diversity and inclusion (EDI) considerations. The study has a special focus on the support available to growth-oriented startups and export promotion.

Methodology

The study used qualitative research methods—literature review (the innovation support programme literature, government policy and plan documents, existing studies on Nepal's SME landscape, publications related to entrepreneurship, etc.), key informant interviews and focused group discussions with key stakeholders (policymakers, entrepreneurs, business support services providers, etc.)

For the literature review, at first, materials related to innovation and SMEs were analyzed to understand the meaning of innovation and how it fits into the Nepali context. The existing literature on SMEs was also reviewed. In addition, a review of the government's industry- and enterprise-related policies and programmes was undertaken to understand how the government supports businesses, especially small businesses, in the adoption of innovative practices. Available statistics from the Central Bureau of Statistics and the Ministry of Industry, Commerce and Supplies were analyzed. Provincial governments' plans were also studied to understand the kind of support offered to small businesses. Additional literature review was undertaken to find out the types of support provided to startups and export-oriented studies. While analyzing any document, a focus was on getting an idea of how the support programmes tried to incorporate EDI components. The first round of literature review also enabled the research team to undertake a stakeholder mapping and thereby identify relevant stakeholders for interviews and focused group discussions.

Key informant interviews were undertaken with representatives of the Ministry of Industry, Commerce and Supplies, Micro, Cottage and Small Industries Promotion Board, Trade and Export Promotion Centre, representatives from private sector associations—e.g., Federation of Women Entrepreneurs' Associations of Nepal, Federation of Nepali Cottage and Small Industries, Confederation of Nepalese Industries, and relevant commodity associations. Similarly, more than 15 entrepreneurs—startup entrepreneurs and

seasoned ones—were interviewed. About five incubators and other business service providers were also consulted. The list of stakeholders is in Annex C.

Two roundtable discussions with stakeholders were undertaken. The one in September 2022 focused on exporters while the second one, undertaken in November 2022, also doubled as a validation workshop where preliminary findings of the study were discussed.

Structure of the report

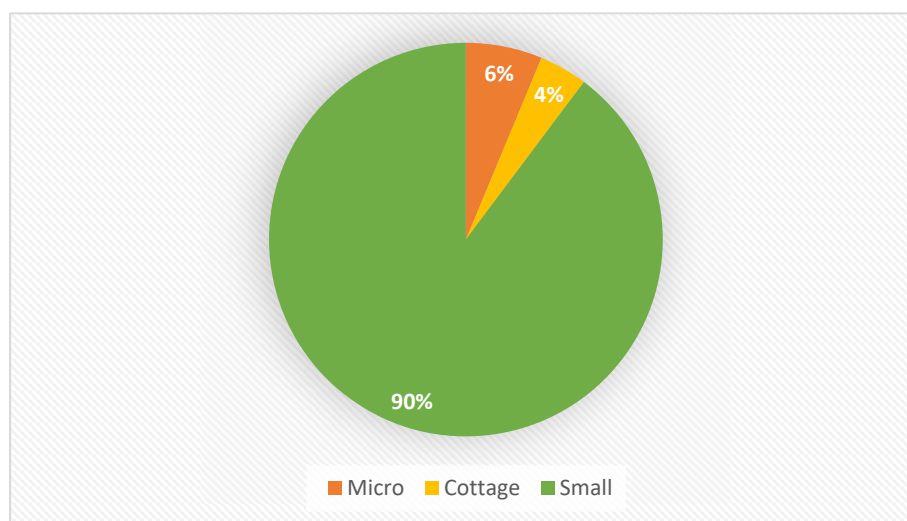
The report is divided into six chapters, including this introductory chapter. The second chapter presents an overview of innovation support policies and programmes in Nepal, discussing industrial and science and technology-related policies, and funds, programmes and projects that seek to support innovation in MSMEs in some ways. The third chapter looks into the state of business support services in Nepal that aim to support startups. The fourth chapter focuses on export support programmes. The fifth looks into equality, diversity and inclusion dimensions in support programmes, and the last chapter identifies gaps in the innovation support system and presents some concluding remarks.

2. Innovation support to small businesses

Small businesses in Nepal

In Nepal, reference to small businesses usually means micro, cottage and small enterprises (MCSEs) (see Box 2.1 for a formal definition of these enterprises). Medium ones could also be considered relatively large as these are firms that have fixed assets worth at least NPR 150 million. Microenterprises can be established with minimal investment. In Nepal, cottage enterprises are usually run from homes to produce products using traditional skills and machines. MCSEs can be analysed as a group since government agencies also consider them through a similar lens. In Nepal, about 94 percent of the registered entities fall under the small and medium categories.¹³ In addition, there are almost 500,000 firms registered at the then Department of Cottage and Small Industries and at the district-level offices of the Cottage and Small Industries Development Committee (see Annex Table A1).¹⁴ Of these, almost 90 percent are small (Figure 2.1). The micro and cottage enterprises use locally available resources and traditional skills with the hands-on involvement of the owners.

Figure 2.1: Micro, cottage and small enterprises in Nepal



Source: Authors' illustration based on data from DoI. 2021. *Micro, Cottage and Small Industries Statistics 2077/78*. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

¹³ "Small" and "medium" in this sentence is based on number of persons engaged. Data is from CBS.2021. National Economic Census 2018: Report No. 1-2 by Size of Persons Engaged. Kathmandu: Central Bureau of Statistics. <https://cbs.gov.np/wp-content/uploads/2019/09/Final-0-NEC2018-Final-Results-National-Report-No-For-Press.pdf>

¹⁴ DoI. 2021. *Micro, Cottage and Small Industries Statistics 2077/78*. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

As per Nepal's 2018 National Economic Census data, there are 923,000 establishments of which almost 98 percent are single entities (so independent businesses), 50 percent are registered, 30 percent are female owned and 55 percent are owned by young persons (aged below 40). On average, there are 3.5 persons (including the owner) employed per establishment.¹⁵

These figures also include the number of enterprises that are operating formally and are registered with different government entities. In Nepal, where almost half of the enterprises are operating informally—without registration—a clear picture of the entrepreneurial space cannot be obtained based solely on the examination of formal enterprises. Moreover, the prevalence of informal enterprises means that almost half of the enterprises in Nepal do not have any access to such innovation support since registration is the basic eligibility criterion for an enterprise to avail itself of any kind of support.

BOX 2.1: Nepal government definition of MCSEs

The Industrial Enterprise Act 2076 (2020) defines a micro-enterprise as an enterprise where the entrepreneur himself/herself is involved in the operation and management of the enterprise. The fixed capital does not exceed two million rupees, excluding house and land, while the maximum number of workers is nine, including the entrepreneur. The annual turnover is less than ten million rupees. The capacity of electric energy and fuel to be consumed by the engine, equipment or machine used or of any other oil engine used, if any, is 20 KW or less. A cottage enterprise is an enterprise based on traditional skills and technology. It is labour-oriented and based on specific skills or local raw materials and local technology, arts and culture. The capacity of electric energy to be consumed by the engine, equipment or machine used, if any, is up to 50 KW. A small enterprise is an enterprise with a fixed capital not exceeding 150 million rupees, other than a micro enterprise and a cottage enterprise.

Innovation support

Any activities that support renewal, change or creation of more effective processes, products and/or ways of doing things mean innovation.¹⁶ Innovation does not always require scientific breakthroughs. At the

¹⁵ Irwin, D., and Ibrahim, N. 2020. Market Study to Understand Job Growth Potential in SMEs in Nepal. Jobs Working Paper, No. 46, World Bank, Washington, D.C.

¹⁶ Cirera, Xavier, and Maloney, William F. 2017. The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up. Washington, D.C.: The World Bank.

firm level, introducing a new software that helps manage inventories better or installing a piece of new machinery or even adopting a new branding strategy can be an activity resulting in innovation. Innovation is defined as the introduction of new products, technologies, business processes and ideas in the market, as well as the invention of new ideas. Schumpeterian innovation theory distinguishes between five types of innovation—a new product, a new method of production, a new market, a new source of supply of raw materials and the carrying out of a new organization or any industry.¹⁷ At the firm level, innovation leads to better productivity, which could be in the forms of better revenue, sales and profit, and higher wages which when compounded could lead to higher economic growth. Besides the financial gains, innovation could lead to a better living standard and overall improved human development, as demonstrated by welfare gains resulting from improved healthcare facilities.¹⁸ (See Box 2.2 for a detailed definition of innovation.)

Expecting Nepal’s MSMEs to experience or adopt a scientific breakthrough is difficult to imagine when nearly half of firms in Nepal are operating without registration. Moreover, small businesses in Nepal even have a hard time maintaining proper bookkeeping or human resource management and lack even information on markets. In such a situation, helping firms adopt good practices, and enhance managerial skills to search, identify and adapt new processes and practices would also support firm innovation. The World Bank Innovation Report proposes the idea of the “capabilities escalator” where firms advance from basic production capabilities to the ability to adopt and adapt technologies and then invent.¹⁹ In the absence of production capabilities, attempting to push scientific and technological innovation could only yield ‘frustrating’ results. Hence, the science and technological frontiers are supposed to be complemented by other factors of production such as better managerial capital, human resources, and improved business environment so that the production capabilities of the firms in the country can sustain better technological advancement. As the report puts it, even if a government offers grants to firms to undertake research and development activities (as developed countries do), scarce human capital and poor links within the private sector and weak firm capabilities could mean managers not implementing the innovation, and poor financial markets could limit the financing for the implementation of the innovation.

¹⁷ Kaya, Perihan Hazel. 2015. Joseph A. Schumpeter's perspective on innovation. *International Journal of Economics, Commerce and Management*, Vol. III, Issue 8. <https://ijecm.co.uk/wp-content/uploads/2015/08/383.pdf>

¹⁸ Cirera, Xavier, and Maloney, William F. 2017. *The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up*. Washington, D.C.: The World Bank

¹⁹ Cirera, Xavier, and Maloney, William F. 2017. *The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up*. Washington, D.C.: The World Bank.

Governments can support innovations at the firm level by financing research and development (which is found to have positive impacts on productivity)²⁰, providing subsidies or matching grants for the purchase of equipment or imparting trainings (for many developing countries purchase of machinery is the main source of knowledge acquisition in the vein of learning by doing), empowering managerial capabilities, facilitating access to finance, or supporting marketing activities, etc.²¹ To guide firms towards better innovation outcomes, resulting in improved employment and wage outcomes, requires governments to have a sound innovation support policy. Smaller firms do not have a sufficient financial cushion and skilled human resources, struggle with existing red tapes and lack linkages and managerial prowess to gamble on untested ideas. Thus, they require more support from the government and other agencies to be nudged towards adopting innovation.

There is a trove of well-documented literature that advocates government funding for innovation support for firms—directed or passive support. Public funding for innovation support is invoked to correct the different types of market failure that a firm faces while implementing innovative ideas, such as market failure related to knowledge as a non-rival good, asymmetry of information and the intangible nature of the assets accumulated.²² Since knowledge could be used by many and competitors can also emulate the innovation without investing in the development of the idea into marketable technology, entrepreneurs hesitate to invest in innovation. Similarly, information asymmetry between the firm and the external financiers concerning the success of the innovative attempt also leads to under-investment in innovation. These factors necessitate government investment in innovation in the forms of subsidies, matching grants to purchase or install new machinery, thematic funding, loan guarantee programmes, business advisory services, entrepreneurship training, etc.²³ Besides these directed support programmes, some passive

²⁰ Albis, Nadia, Raquel Marín, Erika Sánchez, Hernando Bayona-Rodríguez, and Juan Manuel García. 2021. "The impacts of public support for innovation on firm productivity and on private investment in R&D in manufacturing and services in Colombia". *Innovation and Development*, DOI: 10.1080/2157930X.2021.1996312 and Crespi, Gustavo, Lucas Figal Garone, Alessandro Maffioli and Ernesto Stein. 2020. "Public support to R&D, productivity, and spillover effects: Firm-level evidence from Chile". *World Development*, Volume 130. <https://doi.org/10.1016/j.worlddev.2020.104948>

²¹ Cirera, Xavier, and Maloney, William F. 2017. *The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up*. Washington, D.C.: The World Bank.

²² Benavente, José, Crespi, Gustavo, and Maffioli, Alessandro. 2007. *Public Support to Firm-Level Innovation: An Evaluation of the FONTEC Program*. Inter-American Development Bank, Office of Evaluation and Oversight (OVE), OVE Working Papers.

²³ Cirera, Xavier, and Maloney, William F. 2017. *The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up*. Washington, D.C.: The World Bank.

forms of support are provided to firms such as tax incentives, improving infrastructure, strengthening marketing and supply chain, and incentivizing exports, among others.

Constrained by limited technological prowess, Nepali firms in general (even the big ones) have limited space to implement innovations. Yet, some bigger firms have information, financial and managerial resources that allow them to invest in innovative ideas. For example, one of the largest yarn manufacturers of Nepal—Reliance Spinning Mills—is experimenting with creating fabrics incorporating Himalayan Nettle (known as *allo* locally) yarn and has developed the capacity to mass produce that mixed fabric. At the same time, small artisanal entrepreneurs who make a variety of items such as fabrics and bags from the fabric spun painstakingly by hand have not been able to innovate much in terms of providing varieties in design for textile, thereby limiting their reach in the market. The absence of effective mechanisms to support micro and cottage enterprises in exploring different types of machines, designing catalogues, financing the purchase of those machines, and helping them with marketing has left these entrepreneurs selling limited items to a limited clientele.

This section examines the existing support—directed and/or passive²⁴—made available by various government and non-governmental agencies for MSMEs, which could help them venture into innovating products or processes. Directed support programmes have inclusion criteria, requiring eligible firms or individuals to opt in or apply for a service or incentive. Passive support programmes, on the other hand, tend to apply to the entire MSME sector and do not require an MSME or individual to opt in. For example, targeted programmes for women entrepreneurs such as subsidized loans are directed innovation while provision of business facilitation services is passive innovation. We focus on policies and programmes that support innovation among MSMEs in the form of business support services, subsidized credits, grants to purchase machinery, programmes offering training, etc. Since the next two sections will examine the start-up landscape in Nepal and the support available to enhance exports, this section will investigate the support landscape for MSMEs overall. We will briefly explore existing policies for small businesses; science, technology and innovation (STI) policies; and annual and periodic government plans; and then delve deeper into major programmes offered by government and non-government organizations aimed at innovation support targeted at MSMEs. Besides these government-operated programmes, there are many development agency-sponsored projects that are working to provide support to MSMEs in Nepal.

²⁴ See, for examples of directed and passive support, <https://www.idrc.ca/en/evidence-innovation-equity-diversity-inclusion-and-impact-analyses-innovation-support-programs>.

We examine National Science, Technology and Innovation Policy (2019), Industrial Policy (2010), Industrial Enterprise Act (2020), support measures available for MSMEs, government funds for enterprise development, subsidized loans to small enterprises, and various micro enterprise development programmes implemented by the government. Likewise, some insights are provided into the kind of innovation support offered by non-government organizations to empower small businesses in Nepal.

Box 2.2: Defining Innovation

Innovation is an integral part of the value addition process in any firm. It has a significant impact on a firm's performance²⁵ through contributions to optimizing productivity, efficiency and increasing market share, thus giving the product a competitive edge in the market. Since these processes encompass a complex system of functions in the firm, the outcomes of which may not be apparent, innovation often receives "fuzzy"²⁶ definitions.

Schumpeter (1934) viewed new products, new sources of supply, new methods of production, and the exploitation of markets as different types of innovation.²⁷ Drucker's (1985) definition of innovation comprised of the process of equipping either new and improved capabilities, or increased utility.²⁸ The Oslo Manual, published by the Organization for Economic Co-operation and Development (OECD) and Eurostat, provides internationally recognized definitions and methodologies for the measurement of innovation statistics. The manual describes the term "innovation" as referring to either a process or an outcome depending on the context, where the innovation is "*a new or improved product or process (or combination thereof) that differs*

²⁵ Gurhan Gunday et al. 2011. Effects of Innovation Types on Firm Performance, International Journal of Production Economics 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.

²⁶ OECD/Eurostat, *Oslo Manual 2018: Guidelines for Collecting, Reporting and Using Data on Innovation*, 4th ed., *The Measurement of Scientific, Technological and Innovation Activities* (Paris/Eurostat, Luxembourg: OECD Publishing, 2018). <https://doi.org/10.1787/9789264304604-en>

²⁷ Joseph A. Schumpeter, *The Theory of Economic Development. An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle* (Cambridge: Harvard University Press, 1934). (As cited in Gurhan Gunday et al., 2011, Effects of Innovation Types on Firm Performance, International Journal of Production Economics 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

²⁸ Peter F. Drucker, *Innovation and Entrepreneurship* (Oxford: Butterworth-Heinemann, 1985). (As cited in Gurhan Gunday et al., 2011, Effects of Innovation Types on Firm Performance, International Journal of Production Economics 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

significantly from the unit's previous products or processes and that has been made available to potential users (product) or brought into use by the unit (process)".²⁹

The Third edition of the manual distinguished innovation into four categories: product innovation, process innovation, marketing innovation and organizational innovation.³⁰ Product innovation involves a new or significantly improved good or service in terms of characteristics or intended use. The product could have, for instance, better technical specifications, durability, software, materials, affordability, or user friendliness. However, product innovation alone does not ensure the success of the product in the market. It is argued that a strong interaction is needed both within the firm, as well as between the firm and its suppliers and customers.³¹

Process innovation involves a new or significantly improved method of production or delivery, for instance, an improved technique that decreases the cost of production. Similarly, organizational innovation involves a new organizational method in terms of workplace organization, business practices, or external relations. Such practices impact firm performance, for instance, by improving labour productivity through workplace satisfaction or reducing cost of supplies and transaction costs. The final category, marketing innovation, involves a new marketing method that significantly changes product design/packaging, placement, promotion, or pricing that increase sales by creating new markets or meeting consumer needs.

To address the ambiguity of "significant" changes, and to reduce the complexity of previous definitions, the fourth edition of the Oslo Manual distinguished innovation into two types: product innovation and business process innovation. Simply put, product innovation includes goods and services that are new or improved, and significantly different from the firm's previous goods or services, and are introduced in the market for intended users. Business process innovation entails business processes that are new or improved, and significantly different from the firm's previous processes, and that have been implemented by the firm in its operations. These business processes

²⁹ OECD/Eurostat, *Oslo Manual 2018: Guidelines for Collecting, Reporting and Using Data on Innovation*, 4th ed., *The Measurement of Scientific, Technological and Innovation Activities* (Paris/Eurostat, Luxembourg: OECD Publishing, 2018). <https://doi.org/10.1787/9789264304604-en>

³⁰ OECD/Eurostat, *Oslo Manual 2005: Guidelines for Collecting, Reporting and Using Data on Innovation*, 3rd ed., *The Measurement of Scientific, Technological and Innovation Activities* (Paris/Eurostat, Luxembourg: OECD Publishing, 2005).

³¹ E. Payzin, G. Ulusoy, A. R. Kaylan, and B. Akova, "New product development capabilities of the Turkish electronics industry," *Innovation in Technology Management. The Key to Global Leadership. PICMET '97, 1997*, pp. 481-, doi: 10.1109/PICMET.1997.653468. (As cited in Gurhan Gunday et al., 2011, Effects of Innovation Types on Firm Performance, *International Journal of Production Economics* 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

relate to the various functions of a firm, such as production of goods and services, distribution and logistics, marketing and sales, information and communication systems, administration and management, product and business process development.

In a 2011 study (in accordance with definitions in the Oslo Manual 3rd edition), it was found that the four types of innovations create synergies of improvement in firm performance. For instance, higher levels of organizational innovation resulted in higher levels of process innovation. Similarly, positive relationships were found between a) organizational innovation and marketing innovation, b) process innovation and product innovation, and c) marketing innovation and product innovation. Such improvements in innovative performance lead to improvements in market performance, production performance, and financial performance, all of which also had positive relationships among each other. The study observed that innovative firms have higher market shares, exports and total sales, and that all four types of innovation play a significant positive role in achieving these outcomes.

Other studies have found similar results emphasizing the various innovation types, for instance, organizational innovations improving total sales over technological innovations³², marketing innovations improving total sales³³, and improved management techniques leading to sustainable levels of higher firm performance.³⁴ The studies reiterate that innovation is a vast system of processes and outcomes, each fulfilling particular roles in the firm to optimize its performance.

Box 2.3 provides an overview of the innovation performance in Nepal using global indicators, among others.

³²Yeh-Yun Lin, C., and Yi-Ching Chen, M. 2007. "Does innovation lead to performance? An empirical study of SMEs in Taiwan", *Management Research News*, Vol. 30 No. 2, pp. 115-132. <https://doi.org/10.1108/01409170710722955> (As cited in Gurhan Gunday et al., 2011, *Effects of Innovation Types on Firm Performance*, *International Journal of Production Economics* 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

³³Johne, A., and Davies, R. 2000. "Innovation in medium-sized insurance companies: how marketing adds value", *International Journal of Bank Marketing*, Vol. 18 No. 1, pp. 6-14. <https://doi.org/10.1108/02652320010315316>. (As cited in Gurhan Gunday et al., 2011, *Effects of Innovation Types on Firm Performance*, *International Journal of Production Economics* 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

³⁴Han, J. K., Kim, N., and Srivastava, R. K. 1998. Market Orientation and Organizational Performance: Is Innovation a Missing Link? *Journal of Marketing*, 62(4), 30–45. <https://doi.org/10.1177/002224299806200403>. (As cited in Gurhan Gunday et al., 2011, *Effects of Innovation Types on Firm Performance*, *International Journal of Production Economics* 133 (2). <https://doi.org/10.1016/j.ijpe.2011.05.014>.)

BOX 2.3: Innovation performance in Nepal

Like any other least developed country, Nepal struggles with limited productive capacity, narrow production and export bases, and low investment flows. Lack of concerted efforts to establish a national innovation system means Nepal lags behind in innovation—be it science, technology and innovation (STI)-related or managerial. Judging from the index of global competitiveness computed by the World Economic Forum in 2019, Nepal’s innovation ecosystem is very poor, along with other pillars of competitiveness. It ranked 112th out of 141 economies in terms of innovation capability³⁵ and ranked 98th out of 141 economies in another pillar of innovation ecosystem—business dynamism.³⁶ In terms of entrepreneurial culture, one of the two sub-pillars of business dynamism, Nepal ranked 103rd out of 141 economies. Likewise, Nepal ranks poorly at 11th among 132 countries on the Global Innovation Index calculated by the World Intellectual Property Organization (WIPO).³⁷ Nepal’s rank has slipped from 95th in 2021 to 11th in 2022. Among the seven pillars of the Innovation Index, Nepal has performed well in business sophistication and market sophistication parameters. Nepal ranks lowest among countries in Central and Southern Asia.³⁸ These figures signal that Nepal is faring better in terms of adopting non-scientific innovations than STI-related hard innovations. The poor state of Nepal’s STI could also be understood from the country’s poor track record in terms of patent registration. Nepal reregistered only 92 patents between 2007 and 2016 while receiving 265 patent applications.³⁹ In FY 2020/21, government registered only three patents.⁴⁰

³⁵ Innovation capability takes into account the following variables: interaction and diversity (diversity of workforce, state of cluster development, international co-inventions, and multi-stakeholder collaboration), research and development (scientific publications, patent applications, R&D expenditures, research institutions’ prominence), and commercialization (buyer sophistication, trademark applications).

³⁶ Business dynamism takes into account the following variables: administrative requirements (cost of starting a business, time to start a business, insolvency recovery rate, insolvency regulatory framework) and entrepreneurial culture (attitude towards entrepreneurial culture, willingness to delegate authority, growth of innovative companies, companies embracing disruptive ideas).

³⁷ https://www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2021/GII_2021_results.pdf

³⁸ <https://www.globalinnovationindex.org/analysis-economy>

³⁹ Bhujju, Dinesh, Adhikari, Rameshwar, Subba-Chhetri, Nalini, and Khadka, Dipak. 2021. Nepal Science and Technology Report 2021. Lalitpur, Nepal: Resources Himalaya Foundation.

⁴⁰ MoICS. 2022. Yearly Progress Report of Fiscal Year 2077/2078 [in Nepali]. Kathmandu: Ministry of Industry, Commerce and Supplies, Government of Nepal. <https://tinyurl.com/mu2fzmm6>

Innovation support for MCSEs in policies and programmes

While there is no separate policy for small businesses, the government prioritizes the development of MSMEs in various policies. Particularly important is Industrial Policy (2010), which has several provisions that aim to strengthen small enterprises (micro, cottage and small enterprises to be precise). Subsequent Industrial Enterprises Acts have also followed suit in announcing support measures for small businesses. Nepal government's annual expenditure plans—budget speeches—also introduce support measures for small businesses and incentivize gender and social inclusion in economic activities. There are some programmes focused specifically on enhancing the capacities of micro, cottage and small enterprises in the form of subsidized loans, micro enterprise development, supporting skill training, technology transfer, marketing through collective trademarks, etc. Similarly, there is the National Science, Technology and Innovation Policy (2019) which focuses on hard innovation, but it does not address any MCSE-related issues in innovation adoption.

National Science, Technology and Innovation Policy (2019)

Nepal's federal Ministry of Education, Science and Technology formulated the National Science, Technology and Innovation Policy in 2019. This policy replaced the 2005 version, and aims at increasing investment in scientific research to retain scientific talent in Nepal to contribute towards achieving the overall national goal of "Prosperous Nepal, Happy Nepali". Although this policy appreciates the need and importance of institutionalizing a robust scientific ecosystem and the role of the government therein, prioritizing establishment of industry and STI linkages to boost economic growth and development is not emphasized in the document. The policy has identified the disconnect between academia and enterprises and the absence of linkages between technology development and entrepreneurship.

The policy envisions STI contributing to development through diversification and modernization of agriculture and industrial infrastructure. The policy also recognizes the need to adopt new and emerging technologies to develop production-oriented entrepreneurship. The policy emphasizes the importance of attracting investment for innovation-oriented scientific research. To achieve these goals, one of the strategies identified is to develop cooperation and partnership between academic institutes, research institutes and industrial enterprises. The policy has identified 'growth of the industrial production and productivity' as the number one priority.

Despite the plan to create linkages between STI and industrial institutions, the policy does not address the ways that this objective could be met—at the policy as well as implementation levels. Moreover, the STI Policy has been criticized for failing to deliver the planned policies into action⁴¹, given the lack of research and innovation system in Nepal. The policy does not address issues related to limited funds for research and adoption of innovative technologies. And there is no prescription to create linkages between research institutions and the private sector in STI activities.

Industrial legislation

The Industrial Policy (2010) has provisions pertinent to enhancing innovation in MSMEs. The most relevant provisions include the promotion of industrial entrepreneurship through the use of the latest technology and the development of human resources and managerial capacity. It has special provisions for the development of micro, cottage and small enterprises, which could spur innovation. Moreover, it also has an explicit EDI component as it includes special provisions such as attracting youths and women through business incubation centres, making loans accessible to women entrepreneurs, creation of women entrepreneurship fund, and other concessions and facilities for women entrepreneurs.

The Industrial Policy (2010) proposes using the ‘Micro, Cottage and Small Industries Development Fund’ for developing micro, cottage and small enterprises and enhancing their competitiveness and market access. Recognizing the local nature of the small businesses, the policy also provides for empowering districts administrations for supporting small businesses. The major provisions related to supporting micro, cottage and small businesses are related to creating institutional structures and infrastructures, and legal provisions to develop micro, cottage and small enterprises. The policy envisions developing industrial clusters to make business development services available. Business development services are referred to as skill development training, production management, access to capital, and marketing services. Product development centres have been envisioned to establish product-specific industrial clusters to develop micro, cottage and small enterprises. The policy mentions the need to provide loans to women entrepreneurs engaged in MCSEs in an easy manner.

The Industrial Policy has addressed branding and intellectual property rights (IPRs)-related issues for MSMEs, with provisions for assistance and promotion in relation to the use of collective marks to promote

⁴¹ Poudel, R. C. 2021. Implementation of National Science Technology and Innovation Policy 2019: Assessment of Challenges in Government Organizations of Nepal. Nepal Journal of Science and Technology, 20(2), 85–102. <https://doi.org/10.3126/njst.v20i2.45779>

products of micro, cottage and small enterprises, and protection of IPRs. The policy recommends developing technology hubs for MSMEs. Likewise, it recommends granting customs duty exemption for imports of technologically advanced machinery by MSMEs. Recognizing the need for business incubation for small businesses, the policy also recommends the government to collaborate with private sector umbrella organizations such as the Federation of Nepali Cottage and Small Industries, the Federation of Nepalese Chambers of Commerce and Industries, and the National Micro Entrepreneurs' Group.

In addition to providing business support to MSMEs, the Industrial Policy has also recognized the need to support businesses in adopting new technologies: it recommends concessions and facilities for assisting industrial research and development. Similarly, the policy also has laid stress on enhancing "managerial capacity, creativity and promotion of knowledge and skills and adoption of appropriate technology". Annex Tables A2 and A3 provides a list of provisions related to MSMEs and innovation in the Industrial Policy.

In an attempt to operationalize the Industrial Policy, subsequent versions of the Industrial Enterprise Act (including the latest one of 2020) made a provision to exempt customs duty on the purchase of machinery by MSMEs. To encourage women's participation in entrepreneurship and to encourage formalization, women entrepreneurs were to be provided with certain exemptions in registration fees. The Industrial Enterprise Act has announced a 35 percent exemption on the registration fee for women-owned enterprises and a 20 percent exemption on the registration fee for any industrial property for firms registered solely under women entrepreneurs' ownership.

The Industrial Enterprise Act 2020 mentions that micro enterprises will be tax exempt, but micro entrepreneurs point out that the implementation of this provision has been lax. The jurisdiction on tax-related exemption falls under the Ministry of Finance that announces tax changes in the annual budget statement and the accompanying new Finance Act for each fiscal year (beginning in mid-July every year). The budget for FY2020-21 (the same year when the new Industrial Enterprise Act came into operation) had announced a seven-year tax exemption for micro enterprises in response to the impact of the COVID-19 pandemic and the subsequent lockdowns across the country. The exemption is extended by three more years (that is, 10 years) for micro enterprises owned by women. This is just an example of legislative mismatch between different government policies and entities that creates problems in implementation.

Support to MSMEs

Besides the provisions announced in the Industrial Policy and the Industrial Enterprise Act and the exemptions offered to micro, cottage and small enterprises, the Government of Nepal's Micro, Cottage and Small Enterprises Promotion Board explicitly works for the development of the MSMEs in Nepal. One of the major activities of the Board is to provide short-term skill training opportunities in order to enhance entrepreneurship and increase employment. According to the Micro, Cottage and Small Industries Promotion Training Programme Working Procedure 2018, the trainings are targeted at financially poor people, Dalits, ethnic and indigenous people, women and people from other marginalized communities, but anyone can apply for the trainings. They provide entrepreneurship development training, basic skill development training, and advanced training, among others. The trainings are outsourced to accredited training institutes at the local and provincial levels while the course content is based on the Government of Nepal's Council for Technical Education and Vocational Training (CTEVT).⁴² The programme has provided training to more than 182,000 individuals since its inception in 1994.⁴³ This is one of the major government programmes to have helped in creating a force of self-employed people and entrepreneurs. A study undertaken on women entrepreneurship in Nepal showed that a large number of women entrepreneurs trace their origins back to one of these skill trainings.⁴⁴ The Board also operates Women Entrepreneurship Development Fund targeted at women micro entrepreneurs.

Nepal became a federal country following the promulgation of the new constitution in 2015. The transition to federalism disrupted the works of the government authority concerned with micro, cottage and small industries. Earlier, the Department of Cottage and Small Industries under the Ministry of Industry, Commerce and Supplies was responsible for the implementation of different programmes for small enterprises and operated its funds through its different offices and committees across Nepal. However, following the federal restructuring, micro, cottage and small enterprises fell under the jurisdiction of provincial governments while some activities—mostly related to supporting small enterprises—were shared with local governments. The confusion created in the initial years left the whole service delivery in a disarray. Provincial and local governments have just become attuned to programmes and projects meant to support MSMEs. For example, many municipal governments have themselves

⁴² CTEVT, established in 1989, is the national autonomous apex body of technical education and vocational training in Nepal.

⁴³ Information available at <http://ctevt.org.np/>.

⁴⁴ CUTS-Centre for International Trade, Economics and Environment. 2019. Gender Dimensions of Trade Facilitation: Evidence from Nepal. CUTS CITEE Policy Brief No. 3. Retrieved from <https://cuts-citee.org/pdf/policy-brief-gender-dimensions-of-trade-facilitation-evidence-from-nepal.pdf>

developed funds to support micro enterprises and tied up their works with the federal government's Micro Enterprises Development for Poverty Alleviation Program (MEDPA).

Recognizing the gaps in entrepreneurial capabilities, the Government of Nepal has established the Industrial Enterprise Development Institute. Established in 1996, the Institute offers trainings to potential and existing entrepreneurs. The Institute also partners with other non-government organizations, development partners and start-ups. The institute is functioning as a training provider, offering courses on enterprise development. The Ministry of Industry, Commerce and Supplies is working on merging it with the National Productivity and Economic Development Center.⁴⁵ The Ministry had undertaken a feasibility study for that two years ago, but there had been no implementation in that regard.

Besides the Micro, Cottage and Small Industries Development Board (MCSIPB)'s enterprise development training, the then Department of Cottage and Small Industries also operated a business incubation programme that provided mentorship to select businesses based on their proposals and growth prospects. The selected entrepreneurs were provided counselling on financial management, marketing and accounting; provided technical trainings and access to laboratories; and were helped to join and form business networks, among others. Between 2006 and 2020, the centre trained and graduated 20 such start-up businesses. Among them are commercially successful ones such as Shivakoti Bags and The Himalayan Rabbit Farm.⁴⁶ However, the programme is not operational since 2019.

Recently, the Government of Nepal introduced different provisions to promote technology adoption by micro and cottage enterprises. The Technology Transfer Programme 2022 targets enterprises seeking to upgrade traditional practices with modern technologies that will complement and enhance their existing skills. According to the working procedure of the programme, the Board can provide 50 types of machines to entrepreneurs based on their proposals and need assessments. The entrepreneurs need to deposit 10 percent of the cost of the technology as a deposit with the Board. Similarly, the Board has also announced similar technology support to enterprises working in turmeric processing, apiary, and processing of Himalayan nettle (allo), sheep and butter nut (churi) to promote commercialization of these products in which a large number of rural microenterprises are engaged.⁴⁷ The MCSIPB started to accept applications

⁴⁵ MoICS. 2022. Yearly Progress Report of Fiscal Year 2077/2078 [in Nepali]. Kathmandu: Ministry of Industry, Commerce and Supplies, Government of Nepal. <https://tinyurl.com/mu2fzzm6>

⁴⁶ DoI. 2021. Micro, Cottage and Small Industries Statistics 2077/78. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

⁴⁷ DoI. 2021. Micro, Cottage and Small Industries Statistics 2077/78. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

for such technology purchase from September 2022 for the first batch.⁴⁸ A similar programme is offered by Bagmati Province’s Ministry of Industry as well. Annex B provides details about provincial governments’ support for enterprise development.

Government funds for enterprise development

The Government of Nepal has established multiple funds to promote entrepreneurship and technology adoption that provide either matching grants or subsidized loans to entrepreneurs that apply for the support with a sound proposal and plan.

However, in practice, these funds have not been able to propel innovation—be it adoption of new technology or new process—as envisioned in the Industrial Policy. For example, the Technology Development Fund under the aegis of the Ministry of Industry is envisioned to help firms in upgrading their existing technology through matching grants or subsidized credit through financial institution; research appropriate technology transfer and make this information available in the public domain; and provide support in registering patents, among others. However, this Fund has remained almost defunct for nearly a decade. The Fund has not been able to mobilize the seed fund of NPR 10 million despite having the Directives and Procedural Guidelines for fund operation. Although another fund—the Micro, Cottage and Small Industries Development Fund—has fared better, in operation since fiscal year 2005/06, the purse is too small to support considerable upgrading for industries. As per the latest available data, which is for fiscal year 2074-75, the average annual grant amount under this Fund is NPR192,000.⁴⁹

The Women Entrepreneurship Development Fund has seen relatively more success. The Fund was established by the Industrial Policy 2010. It has been providing collateral-free loans of up to NPR 500,000 at a six percent interest rate for a period of three years, to women entrepreneurs of micro, cottage, and small enterprises. This loan is different from the subsidized interest loan provided by banks to women entrepreneurs. The Ministry of Industry implements this programme through Rastriya Banijya Bank Ltd., a public sector bank. Such loans are provided to registered enterprises that have been in operation for at least two years, on the recommendation of umbrella organizations—Federation of Nepalese Chambers of Commerce and Industries, Federation of Nepali Cottage and Small Industries, Federation of Women Entrepreneurs’ Associations of Nepal, and National Micro Entrepreneurs’ Federation Nepal. As per the

⁴⁸ Notice issues by MCSIPB regarding the matter [in Nepali] <https://www.mcshipc.gov.np/wp-content/uploads/technology-trasfer-notice1.pdf>

⁴⁹ DoI. 2021. Micro, Cottage and Small Industries Statistics 2077/78. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

latest available data, the average loan amount received by micro women entrepreneurs under the programme is NPR 162,064.⁵⁰ This loan scheme will run till the end of the fiscal year 2022-23.

Considering all the different funds and their lack of effectiveness, the Ministry of Industry had proposed to bring all of them together and create a fund of funds, which would provide support to micro, cottage and small enterprises, and women-owned enterprises, among others.⁵¹ The proposal was approved by the federal cabinet in December 2021. However, the fund is yet to come into existence. Unified guidelines will provide clear directions in terms of modalities to mobilize and execute all these funds to make them effective and efficient.

Subsidized loans

Enhancing access to formal finance is one of the major support programmes offered to small businesses and groups that are usually excluded from conventional banking. Since Nepali financial institutions are collateral based—that is borrowers need to pledge immovable property to receive loans—access to finance through banks has emerged as one of the major constraints for small businesses, more so when they are owned by women or Dalits. To deal with such exclusion and enhance access to finance for these groups, Nepal Rastra Bank (NRB), the central bank, in 2020 introduced 10 types of project-based loans (except in the case of agriculture loans higher than NPR 1 million and loans to the textile industry) that are to be disbursed by banks and financial institutions (Table 2.1).⁵² The Government of Nepal, through NRB, subsidizes the interest rates and insurance premiums for such loans. For example, under the Women Entrepreneurship Loans, if banks lend at 12 percent per annum interest rate, the NRB will cover 6 percent so that the entrepreneurs will have to pay only 6 percent. For most types of loans under the scheme, NRB covers 5 percent interest as subsidy while for agriculture loans the subsidized amount is only 2 percent. The upper limit for loans is based on the category of loans. For example, under Women Entrepreneurship Loans, loans of up to NPR 1 million can be offered based on personal guarantee while loans higher than NPR 1 million and of up to NPR 1.5 million can be issued against a group guarantee. It is to be noted that these loans are not necessarily targeted at small businesses. Indeed, to what extent these loans are going

⁵⁰ DoI. 2021. Micro, Cottage and Small Industries Statistics 2077/78. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

⁵¹ Based on personal communication with a Ministry of Industry, Commerce and Supplies official.

⁵² Nepal Rastra Bank published Guidelines for Concessional Loans [in Nepali] shorturl.at/bejt8

to small businesses and whether they are being cornered by businesses whose access to finance is not constrained are questions that feature in policy discussions, including in media reports.⁵³

Table 2.1: Interest subsidized concessional loan

S.N.	Types of Loan	Number of borrowers			Outstanding Loan Amount (NPR million)		
		2020	2021	2022	2020	2021	2022
		Mid-Jul	Mid-Jul	Mid-July	Mid-Jul	Mid-Jul	Mid-July
1	Commercial Agriculture and Livestock Loan**	24,763	46,057	60,545	54,114.1	106,978.4	139,234.1
2	Educated Youth Self-employment Loan	65	140	157	35.2	63.7	76.1
3	Project Loan for Youth-Returnee Migrant Workers	221	839	952	151.7	598.0	564.2
4	Women Entrepreneur Loan	6,682	55,551	84,001	4,353.5	50,984.4	70,996.1
5	Dalit Community Business Development Loan	351	965	1,097	185.3	572.9	582.3
6	Higher, Technical and Professional Education Loan	84	111	148	20.0	25.3	36.5

⁵³ Arthik News. 2021. “अनुदानको सहूलियतपूर्ण कर्जा सबैभन्दा बढी महिला उद्यमीले प्राप्त गरे [Women received the subsidized loans the most]”. *Arthik News* September 26, 2021. <https://arthiknews.com/news/42555>.
Prasain, Krishana. 2022. “Number of women borrowers soars after pandemic”. *The Kathmandu Post*, February 11, 2022. <https://tkpo.st/3GCotDW>

7	Housing Loan for Earthquake Victim	221	231	208	54.7	49.4	32.3
8	Loan to Textile industries	61	210	255	648.5	2,162.5	2,358.5
9	Loan for training by CTEVT-approved institutions	-	2	2	-	0.4	0.3
10	Youth Self-employment Loan	-	3	28	-	1.1	8.9
Total		32,448	104,109	147,393	59,563.0	161,436.2	213,889.3

Source: Nepal Rastra Bank.

Note: Loan extended under "Unified Procedure (second amendment) for Interest Subsidy on Concessional Loan, 2076". ** Without collateral = Rs. 2,328.18 million and with collateral Rs. 136,905.9 Million as of Mid-July 2022.

In response to the economic disruption in the wake of the COVID-19 pandemic, Nepal government utilized this scheme (along with Business Continuity Loan and Refinancing schemes) to support small business that were affected by the pandemic. Loans for commercial agriculture and the textile industry are aimed at larger enterprises as well; the ceiling for these loans is as high as NPR 50 million while the limit for other loans is as low as NPR 200,000. The women entrepreneurship loan of up to NPR 1.5 million has performed quite well in terms of uptake. A third of the total amount of loans disbursed under the subsidized loan scheme is channeled to women entrepreneurs. Although this reflects increasing entrepreneurial spirit among women, it is partly also due to the regulatory push to financial institutions. In 2021, the central bank announced that all commercial banks are required to provide a minimum of 500 subsidized loans or issue at least 10 loans per branch while development banks are required to float a minimum of 200 such loans or at least 5 loans per branch and finance companies need to provide a minimum of 100 such loans. This regulation has helped increase the volume of women borrowers, as evident in Table 2.1. This programme is useful for many entrepreneurs to access finance. However, many entrepreneurs complain that the amount provided is not sufficient if they really want to expand their plant and production. Women

entrepreneurs express concern about the possible misuse of concessional loans, stating that men may be taking these loans by using women as fronts and loans are not always being used for their stated purposes.⁵⁴

Programmes helping micro, small and cottage enterprises

In order to support livelihood and income generation, Government of Nepal has different programmes that specifically work to develop entrepreneurship. A major programme in this regard has been Micro Enterprise Development Programme which is now functioning as Micro-Enterprise Development for Poverty Alleviation. Similarly, programmes such as Prime Minister Agriculture Modernization Program, Nepal Livestock Sector Innovation Project and Rural Enterprise and Economic Development Project also work on supporting commercialization of agriculture, providing support to existing businesses.

Micro-Enterprise Development for Poverty Alleviation (MEDPA)⁵⁵

MEDPA is one of the most extensive programmes of the Government of Nepal aimed at supporting enterprise development as a means of poverty alleviation. MEDPA is the sequel to Micro Enterprise Development Program (MEDEP) that was operated by the Government of Nepal with the financial and technical support of the United Nations Development Programme (UNDP) from 1998 to 2018, in four phases. The programme was aimed at poverty reduction and employment generation through entrepreneurship development targeting marginalized individuals living below the poverty line, particularly in rural and inaccessible areas. Since 2018, the programme has been continuing as MEDPA and fully implemented by the Government of Nepal in collaboration with subnational governments. The programme follows the Micro Enterprise Development (MED) model developed by MEDEP across the three tiers of government—federal, provincial and local. At the central level, the implementation and coordination of MEDPA is done by the Industry and Investment Promotion Division under the Ministry of Industry, Commerce and Supplies (MoICS). At present, MEDPA has extended to all 753 local governments with an allocation of NPR 2.26 billion.⁵⁶ It has also received financial and technical support from international organizations such as UNDP and the Australian Government's Department of Foreign Affairs

⁵⁴ These views were expressed by women entrepreneurs in a roundtable discussion at the Federation of Nepalese Women Entrepreneurs' Association of Nepal held on 21 April 2023. A Ministry of Finance official revealed that the NRB, the central bank, is undertaking an independent evaluation of the concessional loan programme.

⁵⁵ Based on the information sourced from <https://medpa.moics.gov.np>

⁵⁶ Information available at <https://medpa.moics.gov.np/Home/About?infold=11>.

and Trade (DFAT), the Australian Government's International Development Agency (AUS AID) and the Government of Canada's International Development Agency (CIDA).

The programme provides support to micro enterprises in accessing markets, identifying market opportunities, and developing marketing strategies. Likewise, support is also provided in adopting appropriate technologies and improving production processes to increase efficiency and competitiveness. Similarly, the programme also offers support to beneficiaries in accessing financing. It targets poor and marginalized people, including women, Dalits, ethnic minorities, and people living in rural areas.

The programme prioritizes the most disadvantaged groups such as single women, persons with disabilities and minorities like Dalit and indigenous/janajati populations. The target group is to comprise at least 70 percent women (including single women), 30 percent Dalit, 40 percent Indigenous/Janajati, 40 percent Madhesi, and 60 percent youths (16-40 years).⁵⁷ According to official records, by generating employment at the local level by mobilizing local resources, the programme has created 172,514 micro-entrepreneurs since 1998 (76 percent women, 25 percent Dalit, 39 percent Janajati).⁵⁸ According to official figures, from 1998 to 2018, 142,593 micro-entrepreneurs were created, out of which 37,304 graduated, 29,417 became resilient, and 1,317 converted their micro enterprises to small or medium enterprises. The project is estimated to have created 231,746 jobs.⁵⁹ The UNDP and other funding partners have undertaken independent impact assessments of the different phases of the MEDEP project. A 2010 impact assessment, carried out by an independent team, reported that 80 percent of MEDEP enterprises continue to do business.⁶⁰ Another assessment, based on interviews, surveys and group discussions, found that 7.53 percent of the enterprises under MEDEP were 'resilient' and 33.77 percent of the enterprises had the 'potential to be resilient' while the remaining 58.70 percent were considered to be 'non-resilient'.⁶¹

⁵⁷ MoICS. 2018. Micro-Enterprise Development for Poverty Alleviation: A Brief Introduction. https://medpa.moics.gov.np/Home/Download?fileLocation=/Content/Uploads/DownloadPublications/673a6f733a9849db906746620b393f0d_MEDPA%20Brief%20Introduction%20Booklet.pdf

⁵⁸ MoICS. 2018. Micro-Enterprise Development for Poverty Alleviation: A Brief Introduction. https://medpa.moics.gov.np/Home/Download?fileLocation=/Content/Uploads/DownloadPublications/673a6f733a9849db906746620b393f0d_MEDPA%20Brief%20Introduction%20Booklet.pdf

⁵⁹ Information available at <https://medpa.moics.gov.np/Home/About?infol=11>.

⁶⁰ MEDEP. 2014. "Assessment of Effectiveness of MEDEP's Support to Make Micro Entrepreneurs More Resilient through Job Creation and Livelihoods Improved", In Micro Enterprise Development in Nepal: Potentials, Achievements and Impacts. Micro Enterprise Development Programme. https://medpa.moics.gov.np/Home/Download?fileLocation=/Content/Uploads/DownloadPublications/e65fad8a4ff54bed8cb628d688d69fae_Micro%20Entrepreneur%20Development%20in%20Nepal%20%20MEDEP%20Impact%20Study%20report%202014.pdf

⁶¹ MEDEP. 2014. "Assessment of Effectiveness of MEDEP's Support to Make Micro Entrepreneurs More Resilient through Job Creation and Livelihoods Improved", In Micro Enterprise Development in Nepal: Potentials, Achievements and Impacts. Micro Enterprise Development Programme.

One of the last publicly available evaluation reports of MEDPA dated 2016 points out that MEDEP's business survival rate as of 2015 is more than 99 percent.⁶²

Other projects

Nepal government and donor agencies also run other programmes mostly targeted at helping small businesses. Most of them support businesses in accessing finance, help them in business development, provide them support in the purchase of machinery, etc. Government programmes tend to be concentrate in agriculture commercialization, and thereby provide support to agribusinesses. Programmes such as the Prime Minister Agricultural Modernization Programme and the Nepal Livestock Sector Innovation Project are major programmes that aim at leveraging the dependence on agriculture of livelihoods in Nepal to enhance income and living standards of a large number of people. Although a large part of these projects is related to helping farmers adopt better technologies and inputs for increased production, all of these programmes take account of marketing and facilitate agri-businesses through different types of support.

The Prime Minister Agricultural Modernization Programme is a decadal programme started in FY2016/17 aimed at modernizing and commercializing agriculture to increase production and productivity.⁶³ This programme is targeted at developing sustainable agriculture value chains for food and nutrition security. In addition, one of the objectives of the programme is to enhance value addition to exportable agriculture goods. There are four sub-divisions of the programme: small business agriculture production centre (pocket) development program, commercial agriculture production centre (block) development programme, commercial agriculture production and processing centre (zone) development programme, comprehensive commercial agriculture production and industrial centre (super zone) development programme. Throughout the project period, the minimum number of pockets would have reached 15,000 pockets across Nepal. The programme is targeted at farmers but activities aimed at commercialization of agriculture by helping them set up amenities such as warehouse and cold storage units also support agribusinesses. Similarly, the project also provides subsidy for the purchase of machines for harvesting, post-harvest activities and processing of agriculture products.

https://medpa.moics.gov.np/Home/Download?fileLocation=/Content/Uploads/DownloadPublications/e65fad8a4ff54bed8cb628d688d69fae_Micro%20Entrepreneur%20Development%20in%20Nepal%20%20MEDEP%20Impact%20Study%20report%202014.pdf

⁶² Development Consultancy Center. 2016. Micro-Enterprise Development Programme (MEDEP) –PHASE IV: Mid Term Evaluation. <https://www.dfat.gov.au/sites/default/files/nepal-micro-enterprise-development-programme-medep-mid-term-evaluation-report.pdf>

⁶³ PMAMP. 2022. Annual Program 2020/21. [shorturl.at/blz46](https://pmamp.gov.np) and <https://pmamp.gov.np>

Nepal Livestock Sector Innovation Project⁶⁴, implemented by the Ministry of Agriculture and Livestock Development (MoALD) with credit support from the World Bank, aims to improve the living standards of small farmers and entrepreneurs, and increase the productivity of and develop the value chain of animal products based on select animal products (milk, meat, pashmina). The estimated primary beneficiaries of the project are 200,000 livestock producers, at least 45 percent females, from all 28 districts of its current operation. Furthermore, 500 small and medium agro-enterprises are projected to be beneficiaries of production and post-production value chain support. Livestock farmers, producers' organizations and agro-business entrepreneurs are the potential primary beneficiaries. According to the latest implementation status report (March 2023), through interventions such as capacity building, improved shed management and feed, herd improvement vaccination, the project was able to significantly increase the percentage of average milk production per cow/buffalo by 130.15. Similarly, carcass weight for goats is 8.4 percent which is a 42 percent achievement over the end of project target. The project has reached out to 35,140 farmers who are adopting climate-smart agricultural technology provided by the project. Of these, 51.18 percent are women. Similarly, 174,290 farmers have been reached with agricultural assets or services, of which 49 percent are women farmers.⁶⁵

Rural Enterprise and Economic Development Project (REED)⁶⁶ is another project implemented by the MoALD, aimed at the progressive improvement of rural enterprises. For this, REED has identified four regional corridors in Dhankuta, Mahottari, Rupendehi and Dadeldhura. Through these economic corridors, it seeks to strengthen market linkages among smallholder producers in the value chains of agricultural commodities. It intends to create and strengthen the environment that is favourable for enterprise development. The project provides economic and technical support for the establishment of value chain-related infrastructures in public-private partnership (PPP) model; start-up businesses; and the establishment and upgrading of demand-driven market centres. The project is under operation in 171 local levels and 35 districts along 4 economic corridors.

Evaluation of support programmes

The programmes aimed at supporting small business, either run by the government or by development partners on their own or with support of the government, are quite prominent in Nepal. Although

⁶⁴ Based on the information sourced from nlsip.gov.np

⁶⁵ Information available at <https://projects.worldbank.org/en/projects-operations/document-detail/P156797?type=projects>

⁶⁶ Based on the information sourced from <https://reed.moald.gov.np/>

monitoring and evaluation are built into the programmes, it does not appear that impact evaluation considerations have been designed into the projects. For example, among 19 such programme interventions, only six seem to have undertaken evaluations (only these projects’ evaluations were readily available in the public domain). Even among these, only a few use quantitative methods that consider the counterfactual—what would have been the situation of the beneficiaries if the project was not in operation. These are presented in the Table 2.2 below.

Table 2.2: Availability of evaluation of past programmes

Project	Project results	Evaluation report publicly available	Evaluation method
Micro Enterprise Development Program (MEDEP). 1998-2018	MEDEP and its follow up, MEDPA (operated by the government of Nepal) have created 131,000 micro enterprises and 231,000 additional employment in the country by July 2018. Considering the positive impact of the project initiatives, Government of Nepal took the full ownership of the project since 2018 and implementing as a part of its enterprise development and poverty alleviation strategy.	MEDEP (now MEDPA) has been one of the largest such projects in Nepal. Since the inception there have been evaluation studies undertaken on the overall project as well as on specific geographies or value chain-specific activities. The reports are available in the MEDPA’s website (link) or in the UNDP Digital Library.	Available reports on the project’s website and the UNDP’s digital library indicate a large number of studies have been conducted based on primary consultations and comparing baseline data with the overall secondary data available. Only one evaluation study tried to

			compare control and treatment groups.
USAID/Nepal's Knowledge-Based Integrated Sustainable Agriculture and Nutrition (KISAN) Project. 2012-2017	According to the project document, the project assisted 100,000 subsistence smallholder farmers in 4,300 groups to graduate to more commercial agriculture by improving on-farm production and facilitating market development. The project focused on building the capacities of private sector and community-based service providers to improve the supply of quality inputs, credit, and other services such as land preparation and equipment rental. In parallel, the project facilitated market linkages to improve farmers' access to service providers and buyers.	Evaluation was undertaken at the end of the project and the report is available online. (Link)	The review was based on documents provided by USAID as well as secondary data sources and the team conducted field work in eight districts as well as in Kathmandu, completing 32 Focus Group Discussions (FGDs) with farmer beneficiaries and over 100 key informant interviews (KIIs) with beneficiary leaders, value chain actors, implementing

			partners and other stakeholders.
High Value Agriculture Project in Hill and Mountain Areas (HVAP) 2011-2018	The results of the Evaluation report show that HVAP was successful in increasing income in its target group. Specifically, households in the treatment group earned 37 percent more annual income driven mainly by increases in crop income and livestock income of 50 percent and 93 percent.	Available on the IFAD website and evaluation is also published as a research article. (Link)	The impact assessment compared the control and treatment group using propensity score matching method.
SAHAJ Nepal Agricultural Market Development Programme: Phase I 2016-2020	According to the programme's official website, its activities boosted on-farm productivity and increased the marketing potential of agricultural products. Sahaj Phase 1 partnered with over 75 private sector and 10 public sector actors through around 50 interventions. It covered over 50 districts of Nepal, including 12 of the 14 districts in Province 1. The programme created 1,800 new jobs, and increased farm-	The information available is from the programme's website (link here). A qualitative evaluation of the project has been undertaken, which examines if the programme's theory of change held up in practice and what has been the programme's value-added for the private sector (link here). The qualitative evaluation provides recommendations for Phase II of the programme.	Qualitative approach based on extensive interviews.

	income of 45,800 households.		
Samarth-Nepal Market Development Programme (Samarth-NMDP) (2012—2018)	The evaluation found that the programme achieved its targets relating to reach and gender, but had disappointing results in improving farmer incomes.	The evaluation looked into suitability of Making Markets Work for the Poor (M4P) approach in the Nepali context. The evaluation found that M4P approach was suitable in Nepal but there are several caveats (link here).	The impact evaluation is theory-based evaluation design, framed by contribution analysis and drawing on a mix of methods.
Trade Promotion Programme in Nepal (2013—2017)	The programme's website points out that the project contributed to the enhanced export potential of select priority products as listed in the Nepal Trade Integration Strategy 2010. Similarly, 81 percent of the companies supported by the programme reported increased international demand for their products, compared to just 49 percent in 2013. Also,	The available information is a one-pager on the GIZ website (link here).	No information about the methodology.

	the programme helped bring about policy reforms, too.		
Business Incubation Programme, GoN 2006—2020	The programme ‘graduated’ 20 businesses from all over Nepal that covered different types of enterprises. However, there is no publicly available document with details on how these firms are doing in the post-incubation period. The programme has been discontinued following the restructuring of Department of Cottage and Small Industries.	There does not seem to be any evaluation of the programme.	

3. Business support services

The previous chapter focused on government-led initiatives and programmes that aim to support business development and innovation implementation. This section examines the private sector support available to small business, notably startups, mostly in the area of business development.

In order for small businesses to become thriving growth-oriented enterprises, they require various forms of support. Not all businesses can become growth-oriented enterprises as they require growth vision and a plan to scale up. Not all of enterprises in countries like Nepal start out by seeing an opportunity but out of necessity to make a livelihood.⁶⁷ But there are a few that have started business as a choice, having envisioned their business ventures as a means to solve certain problems or to bridge the gap between supply and demand or create a new demand for entirely novel products or services. That is why such enterprises are the ones that identify and implement innovation—be it introducing a new product, incorporating a new technology, or finding new ways of doing traditional jobs. The global digital boom and the rise of platforms and ecommerce have provided opportunities for startups worldwide and Nepal has also not remained untouched with many such ecommerce and service platforms emerging and disrupting existing traditional businesses. Yet, a lack of proper support programmed to help innovative firms has prevented many promising startups from reaching their potential, according to stakeholders working in Nepal’s entrepreneurial space.

Nepal government had started drafting a Startup Policy in 2017 to create a legal framework that would provide clear guidance regarding the definition of startups and how public and private sector entities could contribute in supporting these enterprises. However, the Policy is yet to be approved as of April 2023. Instead, government released the Start-Up Enterprise Loan Fund 2023– The 2017 draft of the Policy had set out to define startups so that they could be distinguished from other micro, cottage and small enterprises. Despite the lack of a formal startup policy, the government has been cognizant of the importance of startups and their financing needs. The release of Working Procedure on Start-Up Enterprise Loan Fund 2023 has defined what constitutes startups in Nepal.⁶⁸ According to the document, to be a startup a firm should have a paid-up capital of less than NPR 5 million and a fixed capital not exceeding NPR 20 million. Further, the gross annual income of the firm should not exceed NPR 5 million

⁶⁷ United Nations Conference on Trade and Development. 2018. The Least Developed Countries Report 2018: Entrepreneurship for Structural Transformation – Beyond Business as Usual. https://unctad.org/system/files/official-document/ldcr2018overview_en.pdf

⁶⁸ Start-Up Enterprise Loan Fund 2023, <https://doind.gov.np/detail/170>

and the firm should not have more than 10 fulltime employees. The firm should aim to address issues that will solve some problems faced by consumers through the use of information technology or creative ideas. The firm has to invest at least 5 percent of its annual expenses on product development, market development and research and development. Likewise, the intellectual property of the firm should either be patentable or eligible to be patented.

Besides innovative ideas, promising young businesses require capital, mentorship, and induction into business networks so that startups can survive beyond the initial few years. Although there is no exact definition of startups, the oft-repeated definition is that “a start-up is a temporary organisation designed to search for a repeatable and scalable business model.”⁶⁹ Before the release of Working Procedure on Start-Up Enterprise Loan Fund 2023, there was no definitive definition of startups in Nepal. However, disruptive and innovative business that demonstrate certain growth potential were recognized as startups even if they operated in traditional work areas. For example, Delish Dairies made a splash in Nepal’s dairy market by marketing its Greek yoghurt instead of relying on the traditional dairy product portfolio. Similarly, Upaya Cargo has broken into the traditional cargo business by offering digital solutions. This section explores the challenged faced by growth-oriented, opportunity-based enterprises that could fit into the most common definition of startups.

Business support for startups

Along with the increase in the number of startups, complementary business support service providers that facilitate startups have also grown. The startup ecosystem in Nepal consists of entrepreneurs, their companies, support organizations, funding entities, legal and regulatory environment, research and knowledge institutions and networks between them. A World Bank study has identified 76 local or national organizations providing business development services (mentoring startup, training, incubation, acceleration, post-investment support, and workspace) in Nepal.⁷⁰ In addition, donor-funded enterprise and farmer support projects, sometimes in partnership with the government, also offer business support. According to a report by Nepal Economic Forum, there are more than 400 companies that have participated in startup incubation and acceleration programmes offered by various business incubation service providers (this does not include the services offered by programmes such as MEDEP or MEDPA).⁷¹

⁶⁹ <https://steveblank.com/2010/01/25/whats-a-startup-first-principles/>

⁷⁰ Irwin, David, and Nada Ibrahim. 2020. Market Study to Understand Job Growth Potential in SMEs in Nepal. Jobs Working Paper, No. 46. Washington, D.C.: The World Bank.

⁷¹ Nepal Economic Forum. 2019. Mapping of Nepal’s Evolving Startup Ecosystem. Kathmandu: Nepal Economic Forum.

Among these about 45 companies have received equity investments. These programmes offer access to working space, mentorship, and peer-to-peer learning. Since startups are young companies usually run by first-time entrepreneurs, they lack understanding about simple regulatory compliances and accounting practices. Therefore, such programmes also offer them mentorship in developing an accounting system, regulatory compliance, networking with experts, logistical and supply chain management, among other things. The aim of these support services is to scale up startup firms into high-growth, high-employment and high revenue-generating enterprises. Such services mostly intend to generate enough growth potential in the enterprises so that they could attract private equity investment for the scale-up.

Some of the agribusiness incubators specialize in developing value chains or entire sectors, and provide market access to small-scale farmers, like the Rural Enterprise Acceleration Program (REAP) by Daayitwa. Incubators are often created to provide solutions to a specific issue, but some business incubation programmes provide seed capital to those entrepreneurs who are trying to develop new business vertices, ready to pivot, iterate and adopt innovative business models. Similarly, to support commercialization of Nepal's agri-sector business, the National Agriculture Incubation Center (NABIC), one of the first agri-based business incubation centres in the country, has been helping startups and SMEs based in the agricultural sector since 2018. NEXT Venture Corporation and FasterCapital have been helping the expansion of startups through various programmes and platforms aiming to encourage growth-driven firms and help entrepreneurs thrive by providing entrepreneurial education, mentorship and market exposure, and giving a platform where entrepreneurs can gain new valuable networks. FasterCapital, precisely, invests in business ideas and assists with product innovation. In addition, there are some challenge funds operated by development agencies to support.

Challenging scenario

Stakeholders in the Nepali entrepreneurial ecosystem consulted while conducting this study are of the view that the Nepali startup ecosystem could perform better. Since these privately run businesses do not disclose their financials to the public, it is quite difficult to assess whether they are doing well or not. The startups that have been in operation for a relatively long period of time and have expanded their business are mostly digital-based such as Foodmandu (a food delivery app) that has utilized the first mover advantage when there were no such food delivery apps operational in Nepal. However, not all such startup models are successful. For example, the ride hailing app Tootle started its operations in 2015 and was beginning to create a market for itself, but a similar app Pathao was launched in 2018. Since venture capital-backed Pathao had deep pockets, it was able to offer its services at a lower price, attracting

Tootle's customers while offering a better share to riders. This resulted in Tootle being almost at the verge of shutting down. Another issue is that the startup space is mostly dominated by digital enterprises heavily banking on the expansive reach of the information technology. According to entrepreneurs, IT-based services do not require large investment and the fixed costs are usually limited to human resources. But a heavy reliance on digital-only services has left a vacuum in the manufacturing-related enterprise space. This section draws upon the findings from key informant interviews and roundtables undertaken for the study (see Annex C for the list of stakeholders consulted).

Ill-prepared entrepreneurs

Business support providers such as incubators and even private equity investors point out that most of the small businesses are ill prepared.⁷² The ones that are presented as startups are also now aware about the technicalities regarding running a business. The startups may have an idea that could be innovative but to transform that innovative idea into a commercially scalable business requires different skills: managing human resource and supply chain, marketing, accounting, among others. Business service providers point out that most of the startups need mentoring in these aspects, too. However, these startups seek funding from investors without having these basic business operations in place. Business incubation service providers point out that entrepreneurs need to be prepared and perceptive about the advice they get and also be proactive themselves about seeking information that could help their businesses.

Missing link between researchers and private sector

In recent years, academia-supported innovation and incubation centres have grown in Nepal. Business schools support business incubation centres but they have mostly been limited to academic exercises and have not been able to create much impact in terms of creating viable businesses, as concluded by stakeholders in a roundtable discussion. Similarly, some engineering and technical schools have their own innovation centres. For example, Kathmandu University has Nepal Technology Innovation Centre and the Institute of Engineering has Enterprise Innovation and Incubation Centre. Although both the Centres have seen some successful businesses (for example, latter helped create the app Hamro Patro, which started as a basic calendar app and now has become a go-to app for a host of information, including news, in Nepal), the linkages with the private sector and corporates that could use the technology that they are

⁷² This was reflected in the discussions undertaken at the roundtable discussion on "Overcoming Barriers to Growth Entrepreneurs" held on 29 November 2022 in Kathmandu.

developing are weak. There was not much attempt on the part of the Centres as well as from the private sector to explore avenues of partnerships. However, there are attempts at connecting the research with the market too. For example, the Nepal Technology Innovation Centre has, however, signed an MoU with the state-owned Agriculture Development Bank Ltd. The bank has agreed to finance the purchase of any farming machinery for farmers, provided the use of the machines is commercially viable.

Lack of support for non-finance issues

Entrepreneurs consulted for this study point out that most of the business support service providers' main concern is to make enterprises viable for raising capital while other aspects essential to run businesses are not given much attention. For example, some startups in the food processing business point out that no mentoring or support is provided in terms of dealing with challenges related to supply chain management. Likewise, another set of startups that sell their products through various retail and wholesale channels identifies the lack of support with regard to recovering stuck payments and managing logistics as major issues plaguing firms that deal in goods. Business incubation programmes do not address these issues, leaving entrepreneurs unprepared to face real-life difficulties.

Lack of institutional mechanism

Amidst all the development and progress happening in the startup landscape, there is an absence of an institutional mechanism that could guide the startup ecosystem. In the absence of a startup policy and SME policy, these small promising businesses are treated with the same regulatory oversight as the large established ones. These businesses require considerable handholding given their constraints emanating from lack of finance and expertise and limited access to information networks. The current government policy to support micro enterprises is more linked to poverty alleviation (through programmes such as MEDPA) targeted at necessity entrepreneurs. The new Startup Policy is expected to bring clarity to many aspects. The government had been announcing different programmes to support startups (see Table 3.1) but implementation is weak. For example, the one-billion-rupee Challenge Fund for startups announced by the government received 699 applications from interested startups in 2018. Even after the working procedure clarified ambiguities about project selection, the government changed the type of support from grants to subsidized loans. Eventually, the Challenge Fund's amount was halved and was turned into a business continuity fund for businesses affected by the Covid-19 pandemic.⁷³

⁷³ Prasain, Krishana. 2022. "Start-ups wait for promised funding that never comes". *The Kathmandu Post*, May 16, 2023. <https://tkpo.st/3wCvQbB>

Until 2019, Nepal was without a regulation on private equity and venture capital funds. On the insistence of private equity companies, the Securities Board of Nepal—the capital market regulator—promulgated the Specialized Investment Fund Regulation 2019 in March 2019. The objective of the regulation is to promote alternate investment vehicles such as private equity funds, venture capital funds and hedge funds. The minimum fund size has been set at NPR 150 million to get permission to function as an equity fund, a venture capital fund or a hedge fund. The regulation specifies that the fund manager should maintain a minimum stake of two percent of the fund size and a paid-up capital of NPR 20 million. The minimum investment set for a limited partner is NPR 5 million; this restricts investment to large investors. The minimum investment has been set to protect small retail investors who are not familiar with complex financial instruments.

So far, eight such funds have received licence from SEBON.⁷⁴ Almost all the funds were awarded a licence after July 2022 although the regulation came into effect in 2019. Among these, two are equity investment companies while the rest are merchant banking subsidiaries of established banks. Since this regulation restricts individual foreign investors from participating in local private equity/venture capital funds (but multilateral and bilateral agencies are allowed), foreign investment companies need to follow the usual foreign direct investment regulations to make investment in such funds. Foreign direct investment needs to be approved by different government agencies depending on the sectors they are investing in. Likewise, in the case of startups, entrepreneurs have a difficult time getting their businesses valued. Startup valuation is not strictly based on the assets of the companies but mostly based on projections of the company's future earnings. If Nepali firms are expected to receive investment from foreign investors based on their future prospects, the entrepreneurs are required to pay taxes based on those valuations to get approval. Such unrealistic regulations discourage FDI in startups. However, cognizant of these issues, the government is attempting to reform the regulations. Earlier, the minimum floor for FDI in Nepal was NPR 50 million but the government recently changed it to NPR 20 million to support funding to startups where foreign investors are not willing to commit a large sum. Private equity funds point out that until the regulation clarifies about the exit options for foreign investors, Nepali companies will have a difficult time attracting investment from foreign private equity or venture funds.

⁷⁴ Securities Board of Nepal. 2022. Press release on license for specialized fund managers [in Nepali]. shorturl.at/abeQR

Table 3.1: Provisions announced in government budget speeches to support startups

Fiscal Year	Announced provisions	Implementation
FY 2022-23	Concessional credit is to be provided by establishing a Challenge Fund to encourage businesses run by young entrepreneurs and returnee migrant workers.	Directives to provide loans to start ups came into operation
	A business incubation centre will be operated in Hetauda Industrial Area as well as in each province to expand knowledge-based business in partnership with the private sector.	Not implemented
FY 2021-22	For encouraging startup business, facility of seed capital loan of up to NPR 2.5 million, at an interest rate of 1%, will be provided to young entrepreneurs by keeping the project itself as collateral.	Not implemented
	For attracting foreign investments in startup businesses, a simplified policy shall be introduced.	Reduced minimum investment requirement from NPR 50 million to NPR 20 million

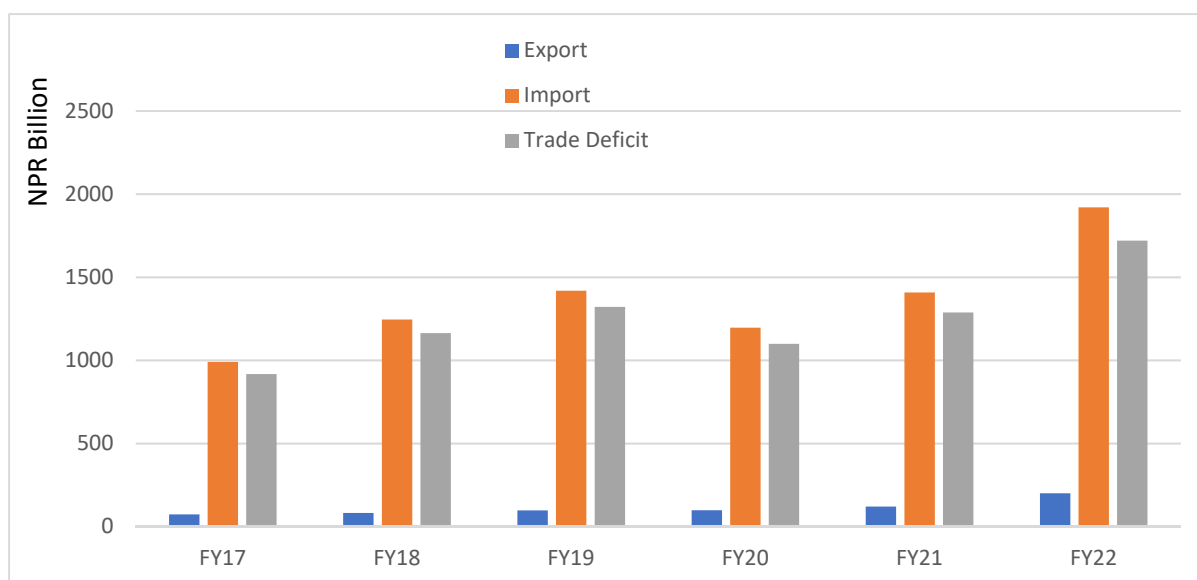
	<p>A Challenge Fund of NPR 1 billion has been established for encouraging startup businesses.</p>	<p>Not implemented</p>
	<p>100% tax concession is provided to startup businesses, from the date of transaction to up to 5 years from operation.</p>	<p>No definition of start-up</p>
<p>FY 2020-21</p>	<p>A budget of NPR 500 million allocated for providing loans at 2% interest for funding initial capital to encourage startup businesses with innovative ideas and utilizing opportunities due to the Covid-19 pandemic.</p>	<p>Not implemented</p>

4. Support to overcome export barriers

In its plans and policies over the years, Nepal government has emphasized exports. Global empirical evidence suggests that programmes that support small businesses in export and innovation have a positive impact on exports.⁷⁵ The support for export promotion could come in the form of helping small firms get connected with buyers in the international market, market their products through collective branding and marketing, improve product quality and meet destination-market standards. It could also be in the form of direct cash subsidy to exporters. Nepal government also provides such support considering the need to improve Nepal's export performance in the context of an ever-widening trade deficit.

Nepal's trade deficit is as high as the annual expenditure of the government at NPR 1.79 trillion in 2022. In the fiscal year 2021/22, Nepal imported goods worth approximately NPR 1.92 trillion and exported goods worth NPR 200.03 billion approximately. On average, Nepal's total merchandise imports have been approximately 13.48 times greater than Nepal's total merchandise exports (Figure 4.1).

Figure 4.1: Trends in Nepal's merchandise trade value



Source: Department of Customs, Government of Nepal

⁷⁵ Piza et al. 2016. The Impact of Business Support Services for Small and Medium Enterprises on Firm Performance in Low- and Middle-Income Countries: A Systematic Review. *Campbell Systematic Reviews* 2016:1, DOI: 10.4073/csr.2016.1

Only a few enterprises export. According to a study that used data from the World Bank Enterprise Survey 2013, of the total manufactured exports from Nepal, small firms have a 3.2 percent share.⁷⁶ However, these small firms engaged in export are mostly exporting items such as handicrafts products, such as pashmina, carpets and felt products, and agriculture products like tea, ginger and large cardamom, which have a lot of backward linkages and provide livelihood to thousands of farming households. For example, tea is one such sector. Covering about 3 percent of total export income, tea is an important export commodity for Nepal.⁷⁷ There are about 14,000 tea plantation units, including both individual farmers and large tea estates.⁷⁸ Similarly, about four fifths of tea farming units are small holders—cultivation farm is less than 1 hectare.⁷⁹ Nearly 15 percent of the total farms are operated by women while 75 percent of the labour used in the sector is contributed by women, who are overwhelmingly employed as seasonal workers. The tea sector in Nepal is estimated to provide direct employment to 70,000 individuals and have considerable socio-economical backward linkages.⁸⁰ Tea has consistently featured as a priority export sector in government plans, policies, strategies and programmes. It has also received considerable support via foreign aid projects.

Support to export capacity building

Since agricultural products are among the major items in Nepal's export basket and hold tremendous export potential, a large number of export support programmes are in a way designed to help farmers. For example, the Unnati project, which was funded by a Danish development agency and implemented by different agencies and ran for five years till 2018, worked to strengthen applied research on farmers' production issues, improve production practices for productivity and quality, improve the supply of quality inputs and support value addition and market diversification. Hence, the project supported not only farmers in the commercialization of their products but also the processors of agricultural produce. In Ilam, in east Nepal, the project has helped tea processors implement mechanized tea processing for small units resulting in enhanced capacity of these processors. Similarly, the World Bank's Project for Agriculture Commercialization and Trade worked on enhancing the capacity of the farmers and also worked on

⁷⁶ Kharel, P., and Dahal, K. 2021. Small and medium-sized enterprises in Nepal: Examining constraints on exporting. In S. Urata (ed.), *Enhancing SME participation in global value chains: Determinants, challenges, and policy recommendations*, pp. 367-97. Tokyo: Asian Development Bank Institute.

⁷⁷ Department of Customs. 2022. Annual Report 2078-79. Kathmandu: Department of Customs.

⁷⁸ MoICS and ITC. 2018. *Nepal National Sector Export Strategy: Tea*. Kathmandu: Ministry of Industry, Commerce and Supplies and Geneva: International Trade Centre. https://moics.gov.np/public/uploads/shares/strategy/Tea_1546150222_compressed.pdf

⁷⁹ Information available from Nepal Tea and Coffee Development Board.

⁸⁰ Information available from Nepal Tea and Coffee Development Board.

enhancing the efficiency and efficacy of sanitary and phytosanitary (SPS) services so that existing barriers to agricultural and food trade could be removed. Likewise, the Enhanced Integrated Framework (EIF), the aid for trade body of the World Trade Organization, has worked on improving the SPS-related capacity of actors in the ginger value chain in Nepal.

There are numerous such projects⁸¹ that have been working to enhance export capacity through providing training on improved farming practices, and helping farmers in getting mechanized, accessing improved processing technology and improving their product quality, among others. Anecdotal accounts suggest that these programmes have been useful for exporters and farmers.⁸² However, the availability of funds from development partners and the government, albeit small, has left processors and exporters waiting for the grants to implement any form of innovation. For example, herb processors in Nepal can get a good price for essential oils extracted from herbs than from exporting raw herbs. However, they are waiting for government or foreign aid programmes to fund their purchase of processing machines. Many export enterprises complain that export capacity enhancement programmes only offer trainings, which enhance soft skills, while their pressing need is hardware support. On the other hand, some projects that provide hardware support, such as grants to purchase machinery, are criticised for contributing to the expansion of processing facilities without considering there not being enough raw materials for the plants to run at full capacity.⁸³

Promoting products

MCSEs have limited resources and they lack resources to market their products in the international market. Since marketing is crucial to create a footprint, especially in the international market, where Nepali products have to compete with products from other countries, having a collective mark or a certification mark assures the quality and the uniqueness of the product to the buyers.

Besides the obvious advantage in marketing, certification marks, which ensure that certain standards and conditions are met by the product, also work as a quality assurance mark. Hence, certification marks also

⁸¹ Trade Promotion Programme (TPP) (2013-2017); Nepal Economic, Agriculture and Trade (NEAT) Program; Nepal's Increased Sustainable Tea Exports Project (Nov. 2020- Jun. 2023); Nepal Enhanced Capacities for Trade and Development (NECTRADE) (2010-2017); Nepal Trade and Private Sector Development (TPSD) programme (2015-2018), among others.

⁸² Based on discussions in a roundtable discussion held on 28 September 2022. <https://sawtee.org/featured-events/pathways-to-enhance-exports-through-innovation-.html>

⁸³ Based on discussions in a roundtable discussion held on 28 September 2022. <https://sawtee.org/featured-events/pathways-to-enhance-exports-through-innovation-.html>

ensure that downstream suppliers—farmers and collectors in the case of Nepali tea—will also adhere to certain standards, leading to improved and consistent quality of tea exported from Nepal. This, in turn, could fetch a better price. Hence, a certification mark also confers additional downstream benefits on the stakeholders in the supply chain—most of them seasonal workers. Moreover, certification marks also help create linkages among the different actors in the supply chain so that a traceability system could be established. Similarly, a certification mark also aims at addressing issues related to limited capacity among tea producers that result in faulty packaging, among other problems, and contribute to inconsistent quality of Nepali tea.

So far, Nepal has registered collective trademark for six products—tea (Nepal Tea: Quality from the Himalayas), coffee (Nepal Coffee), large cardamom (Everest Big Cardamom), Pashmina (Chyangra Pashmina) and medicinal and aromatic plants (Nepal Herb). Similarly, work is going on for registering collective trademarks for products such as jute, carpet and some food products. A host of export promotion strategies emphasize utilizing certification marks as a tool for export promotion as well as quality management: e.g., Nepal Trade Integration Strategy (NTIS); Agriculture Development Strategy; Nepal Tea Sector Strategy. However, there has been no evaluation of the effectiveness of such support measures.

The certification mark of Chyangra Pashmina—which ensures that the Pashmina is prepared from special mountain goats called chyangra—did not boost the export of Pashmina products from Nepal.⁸⁴ Since the certification mark could be used by products made from chyangra wool only, there were not many takers.

The case of tea is a little bit different as the certification mark users need to ensure that the seven stakeholders involved in the tea supply chain comply with the regulations while in the case of Pashmina, only the manufacturer has to comply. The about two dozen tea exporters that have obtained the mark are already doing well in export markets. The smaller ones that are actually struggling to make a mark in the international market have not obtained the marks. Since obtaining a collective mark for tea require all the actors in the supply chain—producers, collectors, packagers and exporters—to follow a code of conduct, not all exporters are eligible to receive the mark. Tea producers who have obtained the mark point out that not many tea producers and exporters are aware about the value of the collective mark in the marketing of their products in export markets.

⁸⁴ Based on discussions in a roundtable discussion held on 28 September 2022 in Kathmandu. <https://sawtee.org/featured-events/pathways-to-enhance-exports-through-innovation-.html>

Cash incentives for exports

One of the flagship export support programmes of the government is the cash incentive for export programme. It offers exporters cash subsidies ranging from 4 percent to 8 percent of the value of export transactions for a select group of products, depending on the rate of value addition. The Ministry of Industry, Commerce and Supplies has identified 36 exportable products for the cash incentive scheme.⁸⁵ The amount of cash incentives provided to exporters has grown steadily over the years as the coverage of the programme has expanded (Table 4.1).

Table 4.1: Amount paid to exporters as cash incentive

	Cash incentive to exporters (NPR in million)
2016/17	290.34
2017/18	211.38
2018/19	351.86
2019/20	856.92
2020/21	1,400.31
2021/22	1,428.50

Source: Different editions of annual reports of the Office of the Auditor General, Nepal.

⁸⁵ The latest update was dated October 2022. As per the ministry, incentives of up to five percent will be provided to 18 goods that include processed tea, processed coffee, handicrafts and wooden crafts, leather goods, handmade papers and related products, processed herbs and oil products, precious stones and jewelry, finished goods made of Himalayan nettle (allo), and mineral water. Goods such as turmeric, vegetables, flowers, processed honey, cardamom and ginger and related products are also eligible to receive the cash incentive, provided these products are exported to countries other than India. Goods receiving a five percent incentive should have at least a 50 percent value addition inside the country. Likewise, 18 items have been listed for a three percent cash incentive. These include textiles, readymade garments, carpets and woollen products, pashmina products sold under the brand of collective trade mark logo of 'Chyangra Pashmina,' gold and silver jewelry, semi-processed leather, drugs, felt items, copper utensils and yarn made out in polyester, viscose, acrylic and cotton.

World Bank carried out an impact assessment of the programme based on the data for the years 2011 through 2014.⁸⁶ The study, using econometric techniques, compared firms that received export cash incentives with those that did not and attempted to address selection/endogeneity issues by using a rich set of fixed effects. It found no significant impact of the cash incentive scheme on firm-level export values, prices, quantities, or their growth rate. However, the study found a small positive effect on the number of eligible products exported to countries other than India and the number of destination markets reached among firms that received the subsidy. The study had taken place before the regulations were revised to make exports to India eligible for the cash incentive. There have not been other rigorous assessments of this scheme.

Although the export cash incentive is among the major export incentives offered by the government and the procedure for its implementation has been simplified over time, not many small exporters are able to access this support. They cite bureaucratic hassles that discourage them. According to the work procedure, the cash incentive will be transferred to the bank accounts of exporter once all the paperwork is finished by the exporter. However, the process of getting their enterprises certified by the Department of Industry and then having to submit all the documents repeatedly lengthen the duration of procedure. Most MCSEs do not have enough human resources to spare to go to these places repeatedly to receive the incentive. On the other hand, big enterprises that can afford to have dedicated staff for this type of works have successfully availed themselves of the export subsidy scheme. Hence, exporters have begun to demand that the government revisit the cash incentive programme and use the funds for other forms of support—be it subsidizing technology acquisition or even subsidizing export loans so that their cost of production is reduced.⁸⁷

5. Inclusion in innovation support programmes

Small businesses—MCSEs—provide income and employment opportunities to a large number of people. In Nepal’s agrarian economy plagued by seasonal unemployment and underemployment, local businesses provide diversified sources of employment. Such entrepreneurial ventures also provide income

⁸⁶ Defever, Fabrice Fernand, Reyes, Jose Daniel, Riano, Alejandro, and Varela, Gonzalo J. 2017. All these worlds are yours, except India: the effectiveness of export subsidies in Nepal. Policy Research working paper, No. WPS 8009. Washington, D.C: The World Bank Group.

<https://openknowledge.worldbank.org/bitstream/handle/10986/26350/WPS8009.pdf?sequence=1&isAllowed=y>

⁸⁷ Based on discussions in a roundtable discussion held on 28 September 2022 in Kathmandu. <https://sawtee.org/featured-events/pathways-to-enhance-exports-through-innovation-.html>

opportunities to marginalized groups that face barriers to entry to job markets due to various reasons—insufficient time, discrimination, etc. For example, women entrepreneurs have pointed out that the flexibility offered by operating a business is one of the factors enabling them to participate in income-earning activities as they are also able to undertake their care duties at home. Traditional jobs that require workers to be present at work hours every day would not have allowed that. Likewise, for historically marginalized groups that face implicit and explicit discriminations, self-employment offers an opportunity to overcome barriers to getting jobs. However, for these groups, the entrepreneurial space is also difficult to navigate due to the existing discriminatory socio-political landscape that manifests in unequal access to resources required to succeed in any business. Unequal access to educational opportunities, limited access to finance, and exclusion from business networks, among others, mean that businesses operated by marginalized groups need more support and handholding to make up for the generational exclusion that they have been going through.

Since entrepreneurial success depends on various factors—such as ideas, execution of the idea into viable products and services, marketing, networking, finances, etc.—a helping hand in any of these areas is quite useful for the sustainability and growth of especially small businesses, which are resource constrained. In addition to helping businesses undertake activities to introduce innovative practices, such support can also be used as an instrument to make the entrepreneurial spaces more inclusive. Promoting equality, diversity and inclusion through the implementation of such support programmes provides much-needed leg-up towards a sustainable and thriving business, which, in turn, expands economic activities and creates employment opportunities.

The Constitution of Nepal 2015 guarantees that the state will not discriminate against people based on their origin, religion, race, caste, tribe, sex, economic condition, language, region, or ideology. This has been reflected in the successive development plans of the government that devised various strategy measures and programmes to promote social inclusion. The Fourteenth Three-Year Plan (2016/17–2018/19) emphasized gender equality, social inclusion, and mainstreaming as key cross-cutting approaches. Likewise, the Fifteenth Five-Year Plan (2019/20–2023/24) aims to end all kinds of discrimination, poverty and inequality by improving structures and systems to develop the capacity of individuals and groups to access resources and opportunities. Almost all of the policy documents are cognizant of the need to ensure that women, the poor, Dalits, Adivasi Janajatis, Madhesis, Muslims, people with disabilities and members of other historically excluded groups are active participants in the formulation, implementation, monitoring and evaluation of the plans, policies and programmes that

affect them.⁸⁸ Programmes and projects implemented by non-governmental organizations and civil society organizations aim to be inclusive and their outcomes are expected to help marginalized communities.

Some of the support programmes aimed at helping small businesses, discussed earlier in this report, do have some components reflecting EDI considerations and speak to some gender, equity and social inclusion (GESI) concerns. For example, the Micro Enterprise Development for Poverty Alleviation (MEDPA) project aims to ensure the following composition among its beneficiaries: women 70 percent, Dalits 30 percent, Indigenous people/Janjatis 40 percent, Madhesis 40 percent, and youths' 60 percent. Likewise, there are some programmes targeted exclusively at women such as the Women Entrepreneurship Development Fund and the Women Entrepreneurship Facilitation Centres.

However, there is a dearth of studies rigorously assessing the impact of the programmes—be it the overall impact or the impact on specific groups targeted as part of EDI considerations. To understand the actual impact of the programmes in helping small business owners in the longevity and growth of their enterprises, more rigorous impact evaluations that go beyond regular monitoring and evaluation would be helpful to distill policy lessons.

Inclusion in industrial policy

Industrial Policy 2010 speaks to some of the disparities persistent in Nepal's socio-economic landscape by announcing the need to support small businesses and women-owned businesses. It has made representation of women entrepreneurs from indigenous communities and marginalized groups mandatory in the decision-making level for formulating industrial and enterprise policies. The issue of access to finance for women-owned small businesses is aimed to be addressed through micro loans. The Industrial Enterprise Act 2020 has a provision to prioritize women entrepreneurs if they want to establish enterprises in an industrial area. In addition, the Act also says that women exporters, when they apply for the export loans, should be prioritized by financial institutions.

⁸⁸ Gurung, Yogendra B., Pradhan, Meeta S., and Shakya, Dhanendra V. 2020. "State of social inclusion in Nepal: Caste, ethnicity and gender. Evidence from Nepal social inclusion survey 2018". Kirtipur: Central Department of Anthropology, Tribhuvan University. http://anthropologytu.edu.np/wp-content/uploads/2021/07/STATE-OF-SOCIAL-INCLUSION-IN-NEPAL_CASTE-ETHNICITY-AND-GENDER.pdf

Micro entrepreneurship for inclusion

The Industrial Enterprise Act has granted tax-free status for the micro enterprises. However, tax exemption can only be executed by the Finance Act, which grants 100 percent income tax exemption for micro enterprises for 7 years after registration, while women-owned micro enterprises are exempted from income tax for 10 years. According to data from the Internal Revenue Department, there are about 400,000 women-owned micro enterprises registered at the IRD.⁸⁹ Although exempted from income tax, they still need to pay a presumptive tax of about NPR 2500. The IRD records show that 47 percent of the registered enterprises have not even filed the presumptive tax as of FY2021/22.

The subsidized interest rate programme offered through banks and financial institutions has categories of loans for educated youths and loans for Dalit-run enterprises. The skill development training offered by Micro, Cottage and Small Industry Promotion Centre targets the poor, the Dalit, members of indigenous communities, women, members of the Madhesi community and minority groups, persons with disabilities, martyrs' family members, victims of conflicts, unemployed and semi-employed people listed at the local government's Employment Information Center, returnee migrant workers, among others. Similarly, the Micro, Cottage and Small Industry Promotion Board's Technical Assistance and Technology Transfer Programme Operation Working Procedure, 2022 that provides matching grants to purchase technology (machinery), covering fifty different items, is targeted at groups such as the poor, women, indigenous people, Dalits, unemployed people and residents of remote areas. Furthermore, entrepreneurs using locally available raw materials and traditional skills are also part of the target groups.

Provincial and local-level programmes are more pronounced in the support offered to make economic spaces more inclusive (see Annex B for details). Many of these programmes are skill development training programmes aimed at creating skilled human resources ready for self-employment. Province 1 has training programmes aimed at commercializing community-based traditional skills and professions, particularly focusing on the Dalit community by providing free-of-charge training in tailoring, running a beauty parlor, motorcycle repair, among others. Bagmati Province supports skill development trainings related to making handicrafts, other traditional skills, and forest- and agro-based industry, especially targeting Dalit, minorities, women and impoverished communities. Gandaki province, is working on promoting handicraft-based cottage enterprises based on the traditional knowledge and skills of Kumal, Dalit and other communities. Karnali Province has a Chief Ministerial Livelihood Programme aimed at

⁸⁹ This information was shared by a former Ministry of Finance official at a roundtable organized by Federation of Women Entrepreneurs' Association of Nepal on 25 April 2023 in Kathmandu.

minorities and marginalized communities, as well as a Chief Ministerial Dalit Income Generation Programme for the development and empowerment of the Dalit community.

Gender focus

Programmes that have concrete provisions on inclusion are usually directed towards women entrepreneurship development. Most of the programmes with inclusion as an objective include women as one of the targeted beneficiary groups. The successful among the subsidized loans schemes in terms of uptake are the ones centered on women. An example is the Women Entrepreneurship Development Fund, which provides collateral-free loans of up to NPR 500,000 at a six per cent interest rate for a period of three years through Rastra Banijya Bank, a government-owned commercial bank. Similarly, among the different categories of interest rate subsidized loans, women entrepreneurship loans are the ones flying off the shelves (Table 2.1). One of the reasons for the success of this loan programme, as mentioned earlier, is the mandatory nature of the loan disbursement. Besides these loan programmes, there are Women Entrepreneurship Facilitation Centres run by the federal government's Ministry of Women, Children and Senior Citizens in association with local governments that provide business facilitation support to women. The programme aims to make women economically independent by, for example, helping them with information access, counselling them on utilizing their skills, and helping them with market promotion and access to finance and technology. The facilitation centre is envisioned to provide information on the availability of raw materials, help coordinate testing, labelling and packaging services, provide information on the facilities provided to women entrepreneurs, provide training on accounting and marketing, etc.

Annex Tables A3 and A4 list some provisions in Nepal's Industrial Policy and Industrial Enterprise Act that are targeted at women entrepreneurs.

There are numerous other support programmes offered at the provincial and local levels targeted at women entrepreneurs. For example, Bagmati Province has been working for creating self-employment for women through skill training.

6. Concluding remarks

At a glance, there are many innovation support programmes in operation for small businesses in Nepal. However, it appears that the scale and kind of support currently available do not meet the needs of the enterprises. While necessary to understand the effectiveness of the support available to firms, there is a dearth of Nepal-specific evidence on the type of interventions and supports that work best as per the need of the enterprises they are meant to support.

Government and/or non-government entities that provide support need to evaluate the effectiveness of their interventions. There are projects such as MEDPA that has done a significant amount of work in poverty alleviation and income generation by supporting thousands of households. However, the number of businesses that have graduated to larger businesses—from micro to small—is less than one percent.⁹⁰ Hence, based on stakeholder consultations done for this study, it can be inferred that while such projects could be useful in poverty alleviation, their role in enterprise development is limited. Other similar programmes offered by the Micro, Cottage and Small Industries Promotion Board are also limited to supporting grassroots-level enterprises. Missing are more specialized support policies directed towards small enterprises that could graduate into medium-sized enterprises with a little push. These enterprises are the ones that can adopt innovative solutions. At present, local bodies and provincial governments are replicating similar programmes based on little or no evidence. The decisions to scale up or expand programmes should be based on the evidence of how useful the programmes have been to targeted beneficiaries.

Most innovation support programmes initiated by the government—whether in the form of provision of grants or subsidized loans for entrepreneurs; business incubation centres; or collective certification marks for exportable products—do not appear to be properly evaluated, considering the dearth of evaluation reports. Provincial governments have introduced programmes similar to those offered by the federal government (for example, Bagmati Province also offers a subsidized loan scheme similar to a federal government programme). Moreover, publicly available documents do not credibly show whether similar programmes in previous years had been successful in meeting their objectives or not. Projects run with foreign aid that support business enterprises tend to have a monitoring and evaluation component based on the underlying theory of change. Usually, these projects undergo monitoring and evaluation but their rigorous impact evaluations, comparing outcomes of treatment and control/comparison groups, rarely

⁹⁰ Based on the information available at <https://medpa.moics.gov.np/Home/About?infold=1020>

happen. If rigorous impact evaluations have taken place, the results are mostly not in the public domain. Only a few programmes such as the High Value Agriculture Project⁹¹ have impact evaluations built into their design. In the absence of impact evaluation, the extent of success of the projects cannot be gauged reliably. The same is true with regard to evaluating the impact of the EDI components of these programmes.

Moreover, in the absence of evaluation of a project, a decision to expand or replicate the project solely based on the subjective perceptions of the project's success is risky. For example, the subsidized loan scheme offered to women entrepreneurs through banks and financial institutions is a seemingly successful support programme to provide finance to women-owned businesses. There are anecdotes of the loans being obtained by "surrogate" entrepreneurs (referring to men taking loans in the name of their female household members). However, there is no proof of how frequent such incidents are. At the same time, there are voices advocating for an increased ceiling for the loans from the current NPR 1.5 million, deeming the cap to be insufficient. Since the current average outstanding loan amount is NPR 700,000, it needs to be examined if increasing the amount is worthwhile or whether focus should be on expanding the coverage. Provincial governments have also started to roll out similar subsidized loan programmes (e.g., Lumbini and Bagmati Provinces) without testing the efficacy of such programmes run by the federal government. Similarly, Bagmati Province has also launched the Technology Transfer Programme that is similar to the federal government's.

In the innovation landscape of Nepal, the academic and commercial spaces are disconnected. Although science and technology academic institutions have research and innovation centres, they are disconnected with the businesses that could use their outputs commercially.

The private sector in Nepal also fails to seek out innovative solutions to their problems. For example, the private sector or private sector umbrella organization could seek help from existing engineering institutions and other research facilities to develop customized machines that could make the spinning of *allo* fibre easier, or provide alternative solutions to the firewood drying of large cardamom. Cardamom

⁹¹ High Value Agriculture Project in Hill and Mountain Areas (HVAP) was a joint endeavor of the Government of Nepal (GoN) and the International Fund for Agricultural Development (IFAD), executed by the Ministry of Agricultural Development (MoAD). The overall goal of the project was the reduction of poverty and vulnerability of women and men in hill and mountain areas of the Mid and Far Western Development Region by integrating the rural poor, especially women and marginal groups, in high-value agriculture and Non-Timber Forestry Products (NTFPs)/Medicinal and Aromatic Plants (MAPs) value chains and markets.

and products made from *allo* fibre have high export potential. There are many areas of interventions where innovation—R&D related—could be a game changer in increasing the productivity of enterprises.

This partly comes down to the absence of a national innovation system in Nepal which would create linkages between people, enterprises and institutions. Since innovation is the result of a complex set of relationships among actors in the system, which includes enterprises, universities and government research institutes, innovation cannot be expected to take place from the attempt of any one of these entities alone. Inventions are happening in the laboratories but they may not be commercialized due to the absence of linkages with the private sector. In Nepal, the Institute of Engineering undertakes large exhibitions showcasing product prototypes. They have remained an academic exercise rather than an effective trade expo as not many private sector players are found to be taking up the inventions on display, as pointed by academics and product developers that have participated in the expos.⁹²

It is necessary to develop a national innovation system that captures both entrepreneurial and STI aspects. Existing policies prepared by agencies in their own silos may not be able to provide the required direction to the entire innovation system. For example, the Ministry of Education prepared the STI Policy but it is disconnected with the business support policies prepared by the Ministry of Industry. Similarly, when the Ministry of Industry prepares the technology transfer guidelines for small businesses but does not link entrepreneurs with potential sources of innovative technology, the programme may not bring the best outcome.

⁹² This issue came up repeatedly during the panel discussions held at the First National Innovation Conference in Nepal organized by The Nepal Academy of Science and Technology (NAST), the Robotics Association of Nepal (RAN), and NAXA in 24 January 2023. <https://innovationnepal.nast.gov.np/conference>

Annex A

Table A1: Number of micro, cottage and small enterprises registered in Nepal and their class of industry

Class of Industry	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	Total (since 1994)
Production based	5,718	4,544	4,961	6,463	7,725	8,402	5,895	9,679	145,395
Energy	13	14	80	33	17	18	1	7	1,455
Agri and Forestry	3,800	4,380	7,660	9,282	12,256	17,687	22,097	48,852	134,711
Mining	3,006	1,988	3,155	4,207	4,135	4,969	1	3	39,333
Tourism	4	2	59	82	40	3	4,997	5,693	11,964
Service	9,504	6,404	8,170	11,327	11,717	20,899	14,879	18,218	176,008
Construction	84	322	232	620	1,089	557	903	886	13,455
IT	-	-	-	25	164	94	81	48	412
Total	22,129	17,654	24,317	32,039	37,143	52,629	48,854	83,386	522,733

Source: DoI. 2021. Micro, Cottage and Small Industries Statistics 2077/78. Kathmandu: Department of Industry, Ministry of Industry, Commerce and Supplies.

SMEs in Industrial Policy, 2010

Special provisions for the development of micro, cottage and small enterprises.

- Proposes using 'Micro, Cottage and Small Industries Development Fund' for developing the micro, cottage and small industries and to enhance their competitiveness and market access.
- Envisions creating institutional structure, infrastructures and legal provisions to develop micro, cottage and small industries.
- Preparation of district entrepreneurship development plan.
- Development of industrial clusters to make business development services available. Business development service will include skills development training, production management, access to capital, and marketing services.
- Establishment of product development centres, product specific industrial clusters to develop micro, cottage, and small industries on the basis of 'one village one product' principle.
- Provision of grant for local bodies that take initiative to develop infrastructures for micro, cottage, and small industries villages.
- Provisions assistance and promotion for the use of collective mark to promote products of the micro, cottage, and small industries.
- Creation of integrated and competent institutional arrangement for the protection of intellectual property in micro, cottage, and small industries and proposes encouraging the use of intellectual property.
- Proposes special arrangements for production and market promotion of the products of micro, cottage, and small industries.
- Use of information technology, through establishment of technology hubs, for the development of micro, cottage, and small industries.

- Establishment of business incubation centres in collaboration with private sector organizations such as “Cottage and Small Industries Association, Federation of Nepalese Chamber of Commerce and Industries, National Micro Entrepreneurs Group”.

Innovation in Industrial Policy, 2010

- Promotion of industrial entrepreneurship by utilizing latest technology. [Objective 7.3]. Provisions concessions and facilities for assisting industrial research and development. [Strategy 10.17].
- Development of productive human resources and managerial capacity required for industrial development. [Objective 7.4].
- Augmenting competitive capacity through enhancing “managerial capacity, creativity and promotion of knowledge and skills and adoption of appropriate technology” (no EDI component). [Policy 8.2; Strategy 10.1].
- Capacity enhancement activities for development of industrial skills and entrepreneurships. [Policy 8.11].
- Envisions programs to assist in the area of technology, marketing, skills and research for industries based on “agriculture, non-timber forest products, animal husbandry, dairy industries, bird farming and industries based on fruits and herbs”.

Industrial Policy accords special priority to the targeted groups prescribed by the GoN with regard to the establishment and promotion of micro, cottage, and small industries. Similarly, the Policy had also taken into consideration that women-owned businesses require more attention, hence, provisions were introduced to support these businesses. Some of the more concrete provisions announced in the Industrial Policy and their implementation status are presented in the table below.

Table A3: Provisions in Industrial Policy and implementation status

Provision	Implementation status
Envisions special provisions to attract youth and women in micro, cottage and small industries through Business Incubation Centre.	Incubation centre was established but is not operational anymore due to restructuring of Department of Cottage and Small Industries
Making loans available to women entrepreneurs engaged in micro, cottage and small industries, in simple and easy manner.	Women Entrepreneurship Development Fund under the Department of Industry was established
Mandatory representation of women entrepreneurs of indigenous, marginalized groups in the decision-making level while formulating industry/business policies.	This is still lacking at places.
Group loans to be made available through banking and financial institutions to micro and small women entrepreneurs	Women Entrepreneurship Development Fund under the Department of Industry was established
Women will be prioritized while providing venture capital in establishing an industry	No such provision yet

<p>35 percent discount in the registration fee if the company is being registered in women's name.</p>	<p>Industrial Enterprise Act of 2016 and 2020 has this provision</p>
<p>Priority will be given to women entrepreneur if she wants to establish her industry in an industrial area.</p>	<p>Industrial Enterprise Act of 2016 and 2020 has this provision</p>
<p>To develop entrepreneurship and to empower women to become entrepreneurs, women entrepreneurs will be included in, trainings, seminars, conference, study visit teams regarding technology development.</p>	<p>There is no provision in any regulation, hence enforcement is lacking</p>
<p>Exhibitions organized by the government must have participation of women entrepreneurs.</p>	<p>There is no provision in any regulation, hence enforcement is lacking</p>
<p>Provision of export loan based on the financial situation of the enterprise to women entrepreneurs who export their products</p>	<p>There is no provision in any regulation, hence enforcement is lacking</p>
<p>20 percent discount on the registration of industrial property, patent, design and trademark for the enterprise registered solely registered in a woman's name.</p>	<p>Industrial Enterprise Act of 2016 and 2020 has this provision</p>

<p>A women entrepreneurship development fund will be set up for their entrepreneurial development</p>	<p>Women Entrepreneurship Development Fund established</p>
<p>Ensure gender equality in industrial promotion plans, programmes and budget implementation by making them gender friendly as well as by embedding gender analysis and assessment, gender audit and gender budget in the relate policies and programmes</p>	<p>No such provision yet</p>

Table A4: Provisions for women entrepreneurs in the Industrial Enterprise Act 2020

- If a company is registered solely under women entrepreneurs’ ownership, 35 percent discount will be provided in the registration fee of such an enterprise
 - If a company is registered solely under women entrepreneurs’ ownership, 20 percent discount will be provided in the registration fee of industrial property of such an enterprise
 - Priority will be given to women entrepreneur if she wants to establish her industry in an industrial area.
 - Provision of export loan based on the financial situation of the enterprise to women entrepreneurs who export their products.
- Additional provisions for micro enterprises**
- No registration fee will be charged for the registration of a micro enterprise
 - No income tax will be levied on micro enterprises.

Annex B: Province support for enterprise development

Besides the programmes offered by the federal government of Nepal, provincial governments have also introduced programmes to support entrepreneurship development. The study looked into the programmes announced between 2020/21 and 2022/23. The programmes are either providing matching grants, subsidized loans, technology transfer or skill training. This section provides examples of programmes offered in the provinces. Available documents barely mention the success of the programmes offered in the previous years. A lot of times, these plans are published in the plan document without much description of the implementation plan. Understanding the success of these programmes in meeting their targets and objectives would require an in-depth study. The Table B lists the programmes announced by provincial governments in the review period (note that not all the fiscal years saw the announcement of programmes related to entrepreneurship development or enterprise support).

Table B1 List of enterprise support programmes offered by Provinces

Province	Fiscal Year	Program Description	Targeted Beneficiaries
Koshi Province	2022/23	A campaign for development and expansion of Cottage and Small Industries based on local raw materials would be conducted.	Cottage and small industries based on local raw materials, traditional enterprises

Koshi Province	2022/23	One Village, One Industry (OVOP) program would be conducted, which has been adopted since 2006 as a Public Private Partnership between Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and Ministry of Agriculture and Cooperatives (MoAC) as a means for production capacity improvement through technology transfer.	Cottage and Small enterprises, especially those that employ traditional and cultural skills
Koshi Province	2022/23	Birat International Trade Expo was organized from December 15, 2022 to December 21, 2022. Recognizing investment opportunities in the province, business development of startups through incubators and improvement of logistic services for agri-businesses were among the agenda. The expo included B2B, B2C and B2G seminars. ^[1] This is the seventh expo of its kind. ^[2]	Agriculture, domestic and cottage industries
Koshi Province	2022/23	Establishment and operation of a Business Incubation Center in Morang	Not specified
Koshi Province	2022/23	Capacity building for small and medium industries, coordination with the central government and related sectors to create short-, medium- and long-term solutions for COVID-19-affected SMEs as well as big industries, and the facilitation of concessional loans through coordination with BFIs would be carried out.	SMEs and big industries

Koshi Province	2022/23	“Chief Minister’s Youth Entrepreneurship Program” in coordination with the local level and development partners would be conducted to provide direct benefits such as concessional loans and interest subsidies to target groups.	Youth unemployed due to COVID-19, entrepreneurs forced to shut down business or lacking personal investment, returnees from employment abroad, and extremely poor individuals
Koshi Province	2021/22	Legal and policy arrangements would be made for the standardization, branding, and marketing of domestic products in international markets.	Products that integrate traditional and cultural skills
Koshi Province	2021/22	Infrastructure construction support related to equipment for the processing and marketing of milk, meat and spices was provided to 8 entrepreneurs.	Entrepreneurs
Koshi Province	2021/22	A <i>Koseli Ghar</i> that would incorporate tourist spots for businesses in Jhapa, Sunsari and Morang would be operated.	Local entrepreneurs and enterprises
Koshi Province	2021/22	Micro-enterprise development programs were conducted where development and upgrading of MSMEs was carried out through the use of indigenous labor and local raw materials and resources. At the time of publishing, the programs had	MSMEs, women, Dalits, Janajatis, Madhesis, youth and other marginalized

		facilitated the development of 10,674 new micro-enterprises, and upgrading of 9,660 micro-enterprises.	groups and communities below the poverty line
Koshi Province	2021/22	Small and medium cold chambers and cold rooms were constructed in collaboration with the local level.	Agriculture markets, local inventories, private entrepreneurs
Koshi Province	2021/22	Support was provided to 3 cooperatives and 3 private entrepreneurs for the construction of dryers and storage houses for the processing and storage of agricultural produce like paddy and maize in order to ensure reasonable pricing for these products. Similarly, 4 agri produce banks were constructed for storage of produce purchased at the minimum support price set by the government.	Co-operatives and private entrepreneurs, farmers
Koshi Province	2021/22	Training for skill and entrepreneurship development, information flow, transfer of technology, facilitation of an industrial fair and facilitation of subsidized loans for the promotion of cottage and small industries.	Cottage and small industries, entrepreneurs

Madhesh Province	2022/23	Development of entrepreneurial and productive culture focusing on the value chain through the facilitation of relationships between micro and small enterprises with medium and large-scale industries. Chief Minister Skill Development and Employment program to produce labour for industries in coordination with the local level, private sector and NGOs.	MSMEs
Madhesh Province	2022/23	Technology transfer would be set in place to encourage entrepreneurs with fresh ideas and protect traditional skills of small industries.	Entrepreneurs
Bagmati Province	2022/23	Program for subsidized loan flow focusing on agricultural production and entrepreneurship development would be continued, in collaboration with BFIs.	Households with minimum income
Gandaki Province	2021/22	Training program would be conducted for employment and self-employment opportunity creation, through which skill, technology and business-related and skill-based training along with seed money would be provided.	Person with disabilities, deprived, Dalit community, Dalit females, marginalized women and gender and sexual minorities
Gandaki Province	2020/21	Technology transfer would be facilitated to encourage the operation of cottage and small industries (based on agriculture, fruits, herbs, handicraft and forest	SMEs, entrepreneurs

		products). The program was predicted to foster capital growth in 732 enterprises along with 1,464 individuals being provided employment directly.	
Gandaki Province	2022/23	The program 'Cottage and Small Enterprise Development Program' would be continued.	Communities with traditional skills and professions
Gandaki Province	2022/23	The technology transfer program for modernization of cottage and small enterprises was continued.	Cottage and small businesses
Gandaki Province	2021/22	Funds were allocated for the restructuring of cottage and small industry office into a Business Incubation Centre.	Entrepreneur
Gandaki Province	2021/22	Funds were allocated for the development of entrepreneurship and self-employment program.	Workers who lost their jobs during Covid-19
Gandaki Province	2021/22	Subsidies would be provided on loans for the promotion of business.	Traditional skill-based businesses

Gandaki Province	2021/22	Interest subsidy to be granted through Entrepreneur Development Fund for fulfilling the shortfall of capital needed to establish and operate MSMEs.	New entrepreneurs from deprived and marginalized communities
Gandaki Province	2021/22	Grants provided to rural startup enterprises.	Rural start-up enterprise
Lumbini Province	2022/23	The 'Micro, Cottage and Small Enterprise Development Fund' was established to subsidize interest on subsidized loan. The program intended to engage foreign employment returnees who lost their jobs due to COVID-19, helping them run their own business.	Foreign employment returnee
Lumbini Province	2022/23	Registration fee was waived on the establishment of MSMEs for the upcoming fiscal year. Registration fee on vehicle, whose ownership is with industry and is used for the transportation of industrial products, was waived.	MSMEs
Lumbini Province	2021/22	Transfer technology conducted for production of pearl and processing of Himalayan-nettle.	Micro, cottage and small industry

Lumbini Province	2021/22	Seed Capital to encourage Nepali paper, traditional domestic and small industries.	Small industries
Lumbini Province	2020/21	To promote domestic and agricultural production of cottage and small enterprises, support given for the operation of <i>Koseli Ghar</i> in major tourist destinations.	MSMEs
Lumbini Province	2020/21	The Chief Ministerial Livelihood Program and Chief Ministerial <i>Dalit</i> Income Generation Program were given continuation to uplift living standard of target group.	Minorities, marginalized, backward classes/communities and <i>Dalit</i> community
Lumbini Province	2020/21	Interest subsidy provided for the operation of small enterprise and agricultural and animal husbandry related activities.	Small enterprise and business and farmer engaged with local group and cooperative
Lumbini Province	2020/21	Micro, cottage and small enterprises provided with subsidy, subsidized loan and subsidy on interest with the objective of recovering the economy affected by Covid-19. Infrastructure and equipment development support provided to medium and large enterprises.	Micro, cottage, small, medium and large industry

Sudurpashchim Province	2022/23	Subsidy would be provided in cooperation with federal and provincial government, to operate forest-based industry.	Micro and small industry
Sudurpashchim Province	2020/21	Establishment of small and domestic industries are to be facilitated at each local level.	Local small and domestic industries

Source: Compiled from Annual Budget announcements of each Province available at their Ministry of Finance websites.

Annex C: Key informant interviews and the roundtable discussions

List of key informants

S.N.	Name	Organization	Stakeholder	Gender
1	Ram Kumar	Nepal Pashmina Industries Association	Private sector Association	M
2	Deepak Khanal	Nepal Tea and Coffee Development Board	Policymaker	M
3	Aasha Bhandari	Himalayan Tea Producers Co-operative Ltd. (HIMCOOP)	Private sector	F
4	Dilli Raj Baskota	Himalyan <i>Orthodox Tea</i> Producer's Organisation (HOTPA- <i>Nepal</i>)	Entrepreneur and private sector association	M
5	Tek Prasad Luitel	Ministry of Agriculture and Livestock Development	Policymaker	M
6	Radha Devi Sharma	Ministry of Agriculture and Livestock Development	Policymaker	F
7	Prem Luitel	Ministry of Industry, Commerce and Supplies	Policymaker	M
8	Shreya Upadhyay	SweetFix Nepal	Entrepreneur	F

9	Sudeep Bajracharya	Mandala Agrifresh	Entrepreneur and agriculture market system expert	M
10	Bhushan Shah	Nepal Agribusiness Incubation Centre	Business support provider	M
11	Shashi Bhattarai	Expert	Expert on business development	M
12	Anjana Rajbhandari	Ekadesma	Entrepreneur	F
13	Neeru Rayamajhi	Federation of Women Entrepreneurs Association of Nepal	Entrepreneur and private sector association	F
14	Mahalakshmi Shrestha	Beekeeping Shop	Entrepreneur	F
15	Gaurav Kandel	Shark Tank Nepal	Expert on business development	M
16	Nidhan Shrestha	True North Associates	Business support provider; venture capitalist	M

17	Nirnaya Bhatta	Confederation of Nepalese Industries	private sector association	M
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Roundtables and Focused Group Discussions

- Roundtable discussion on “Overcoming Barriers to Growth Entrepreneurs” held on 29 November 2022 ([link](#))
- Roundtable discussion on “Pathways to Enhance Exports through Innovation” held on 28 September 2022 ([link](#))
- Focused Group discussion held with women entrepreneurs at the sidelines of 6th International Women’s Trade Expo and Symposium 2022.



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