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Labour Laws, the Business Environment and Growth of Micro and Small Enterprises

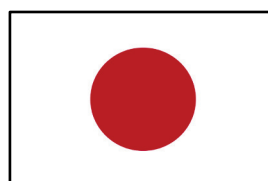


Labour Laws, the Business Environment and Growth of Micro and Small Enterprises

Nepal- Country Report



Norad



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Programme

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Foreword

Enterprises, in particular micro- and small enterprises or MSEs, are considered the growth engine for creating productive jobs. They play a crucial role in enabling countries achieve the goal of decent work for all. However, enterprises often face significant obstacles in the forms of red tape and lack of access to financing and markets. These challenges are among the contributing reasons why entrepreneurs decide to operate in the informal economy.

The International Labour Organization (ILO) has identified the informal economy as representing a significant obstacle to achieving decent work for all. Entrepreneurs who operate in the informal economy are less productive and unlikely to achieve the full growth potential of their enterprise. Furthermore, workers employed in informal enterprises generally receive lower salaries and enjoy fewer, if any, benefits that formal economy workers do. Enterprises operating in the informal economy, at times, also contribute to unfair competition by avoiding taxation and the costs associated with compliance with labour laws and other regulations. Facilitating the formalization of enterprises and workers is a key priority guiding the work of the ILO.

This study was conducted to support the ongoing policy dialogue in Nepal on strategies to support the formalization of the informal economy. While informal economy issues affect entrepreneurs and workers alike, this study focuses on the enterprise side of informality. It is a part of a series of four country studies commissioned by the ILO to research the impact of labour laws and the cost of regularization on entrepreneurs' decisions to formalize their businesses. The countries covered by this research are India, Nepal, Bangladesh, and Sri Lanka. In Nepal, the research has focused on four sectors: agro processing, carpet and garments, tourism, and information technology. The first part of the study was completed in 2007. The second part of the study, which was completed in 2011, included a large-scale survey of some 409 enterprises. While informal economy issues affect both entrepreneurs and workers alike, the study has focused on the enterprise side of informality.

Professor Pushkar Bajracharya and Rajendra Prasad Shrestha are the lead authors of the study. Professor T.S. Papola of the Institute for Studies in Industrial Development, New Delhi, has provided comments and was responsible for guiding the four country studies. The surveys were carried out by Keshav Bdr. Karmacharya (team leader), Shib Nandan Shah and Anil Sharma. Mridusmita Bodoloi (consultant) analysed and incorporated the additional data. Additional comments were received from Jose Assalino (Country Director), Nita Neupane (Programme Officer) and Anita Manandhar, ILO Nepal. Hideki Kagohashi (Senior Enterprise Specialist) of the ILO's Decent Work Team for South Asia has been responsible for conceptualizing and overseeing the research. Thomas Kring (Chief Technical Advisor, 'Way Out of Informality' project) oversaw and managed the finalization of the study.

This study was made possible with support from the Norwegian Agency for Development Cooperation, and with additional support from the Japanese government provided under the "Way Out Of Informality: Facilitating Formalization of Informal Economy in South Asia" sub-regional project.

Tine Staermose
Director
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Executive summary

This study is based on a survey of micro- and small enterprises (MSEs) in Nepal and provides a better understanding of the legal and regulatory factors that can aid or inhibit growth, quality of jobs and employment creation in MSEs in Nepal. It is a part of the four country studies carried out in South Asia, covering Bangladesh, India and Sri Lanka as well. These countries broadly share the same approach towards the application of labour and labour-related laws in MSEs: generic or partial exemptions for enterprises below certain threshold sizes. The core questions of the research are as follows: (a) whether these exemption thresholds, of both labour as well as other business regulations, are associated with certain types of avoidance behaviour of firms and, if so, to what degree; (b) whether regulations without such exemptions are also associated with certain types of avoidance behaviour and, if so, to what degree; (c) what are the important variables that affect such behaviour (e.g. inspection coverage); and (d) whether these findings support the perception-based rating of factors that affect the growth of MSEs.

The study first reviewed and prioritized those laws and regulations from labour and other regulatory issues that are perceived to have high probability of becoming growth traps (e.g. incentivizing businesses to stay smaller than the set threshold or remain unregistered). Nepal's labour laws are applicable to enterprises with ten or more employees, except universally applicable provisions like minimum wages, prohibition of child labour, and protection of children and women, and a few provisions on crèches, rest rooms, and health and medical personnel and facilities that apply to enterprises with 50, 400 and 1,000 or more workers. The labour regulations that apply to enterprises with ten or more employees which have a high probability of creating growth traps are contribution to provident fund, payment of gratuity, compensation for injury or death, and annual paid leave. Despite having the same threshold level, the Trade Union Act of 1993 allows enterprises employing less than ten workers to join a union formed in other enterprises, making the Act practically applicable to all sizes of businesses. Besides labour regulations, income tax and value added tax (VAT) in Nepal also have exemption thresholds in terms of annual earnings/turnover. Besides the original assumption of firms staying below the threshold level, several other avoidance strategies were presumed and the survey questionnaire was designed to capture them.

The survey collected data from a sample of 409 enterprises with between five to 70 employees, covering four sectors (agro processing, carpet and garments, tourism, and information technology [IT]). Given the importance of ten employees as the threshold, the survey stratified them into those employing less than ten workers and those employing ten or more workers. It asked the owner/manager of these businesses about their knowledge of, and actual compliance with, each of the labour and business regulations perceived important in Nepal, then asked for the transaction cost of compliance and, if applicable, reasons for non-compliance. For the legal requirements linked to thresholds, the survey had a different set of questions for those below the threshold level and those above it in order to precisely identify avoidance and non-compliance behaviour and the reasons behind it. The questionnaire also captured information on registration, licensing, precise knowledge of the obligations and penalties of the labour regulations as well as the frequency of inspection, and access to incentives and informal payments.

Given below are the highlights of the survey's findings:

- The survey showed the presence of the *"staying below the threshold level"* strategy in some of the enterprises in Nepal. However, such practices were found to be marginal. One tourism business admitted avoiding contributing to the employees' provident fund (EPF); less than one

per cent of MSEs admitted they avoided paying income tax; two per cent of MSEs from IT and tourism admitted they avoided VAT payment; one per cent of businesses with 5–9 employees admitted avoiding paying compensation for injury/death; and two per cent of enterprises with 5–9 employees admitted avoiding giving annual paid leave. Besides, some of the six units with 5–9 employees with parallel units may have intentionally pursued “*creating parallel units*” as a way of “staying below the threshold level”. Among the 21 per cent of surveyed MSEs not registered under any of the eight popular types of registration/licenses, some of the reasons given indicated that they were intentionally “*remaining unregistered*” to avoid compliance with concerned regulations. For instance, 24 per cent of MSEs without tax registration (PAN/VAT) gave the reason as lack of enforcement of legal obligation.

- Non-compliance with legal obligations because MSEs are “*simply uninformed*” seemed an important scenario for some regulations in Nepal; for example, with environmental regulations (29 per cent of those not complying), minimum wage (51 per cent of all the MSEs surveyed) and trade union formation (56 per cent of all).
- “*Avoidance by choice*” was observed, to some extent, as avoidance behaviour though only a smaller proportion of MSEs seemed to adopt such practices. Since business registration is legally required, some of the reasons given to explain non-registration would be considered as avoidance by choice. Likewise, some of the reasons for not complying with environmental regulations, minimum wage, gratuity, income tax, and VAT indicate the existence of this strategy. The typical reasons were: “It is legally required, but not enforced”, “Unnecessarily complicated/do not see the benefits”, “Too costly” and “Takes too much time”.
- “*Making informal payments*” was a major avoidance strategy in Nepal and this was identified using the “have heard of” question. Around 21 per cent of respondents heard of informal payments being made with regard to environmental regulations, 31 per cent on minimum wage, 15 per cent on EPF, 13 per cent on gratuity, 33 per cent on income tax, 28 per cent on VAT, 40 per cent on compensation for injury/death, and 19 per cent on annual paid leave. A substantially small percentage of MSEs who had heard of this system had made such informal payments with regard to environmental regulations (2 per cent), minimum wage (11 per cent), EPF (2 per cent), gratuity (2 per cent), income tax (13 per cent), VAT (7 per cent), compensation for injury/death (four per cent), and annual paid leave (3 per cent).
- The survey data seemed to indicate the phenomenon of “*casualization of labour*” in Nepal to a relatively smaller degree. While only seven per cent of the paid workforce were reported as casual/temporary workers, the majority being full-time employees, 80 per cent of businesses from the carpet/garment industry were paid wages on a piece-rate basis. In each of the other three sectors, more than 85 per cent of workers were paid on a monthly basis.
- Sector-wise, the garment sector consistently scored the lowest on knowledge, both on cost of compliance and penalties. On the higher side was the IT sector with awareness about almost all the knowledge questions. This sector variation appears to be associated with the degree of coverage given by the inspectors. The percentage of establishments visited by the inspectors during the 12 months prior to the survey was highest in agro processing (62 per cent), followed by the IT sector (53 per cent), tourism sector (45 per cent), and carpet/garment sector (31 per cent).
- Transaction costs, as reported by those who complied, did not appear extraordinarily high. While some registrations, on average, take a couple of days, the majority of environmental examinations were completed within a week or two. However, it must be noted that the initial registration of business is a combined process of several registrations and environmental

clearance, and hence could take several months to complete. There were a few cases of environmental clearance that took several months.

- The perception-based rating did not demonstrate consistent patterns vis-à-vis compliance/avoidance behaviour identified above.

Finally, this report discusses the results and its contribution to the policy dialogue on the legal and regulatory framework. The aim is to seek a good balance between the protection of workers and the incentives to growth and employment generation in the context of the emerging regulation debate.

List of abbreviations

ADB	Asian Development Bank
CBS	Central Bureau of Statistics
CSIDB	Cottage and Small Industries Development Board
DCSI	Department of Cottage and Small Industries
DFID	Department for International Development
DFTQC	Department of Food Technology and Quality Control
ECC	Environmental Clearance Certificate
EIA	Environmental Impact Assessment
EPF	Employees' Provident Fund
FNCCI	Federation of Nepalese Chambers of Commerce & Industry
GD P	Gross domestic product
IEE	Initial Environmental Evaluation
ILC	International Labour Conference
ILO	International Labour Organization
NGO	Non-governmental organization
MSME	Micro-, small and medium enterprises
PAN	Permanent Account Number
PCC	Pollution Control Certificate
PPS	Probability Proportional to Size
PSU	Primary sampling unit
VAT	Value added tax
VDC	Village development committee
WTO	World Trade Organization

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Chapter 1: Introduction

1.1 Context and background

Despite the significant progress made by humanity in the last century, the world continues to suffer from a plethora of problems including, among others, the persistence of large-scale poverty and the unequal distribution of wealth, resources and power which has caused further divisions in societies and promoted conflict, dissent and deprivation. Over a billion people suffer from utter hunger and deprivation. A large segment of additional populace suffers from widespread deprivation caused by exclusion, poor representation and marginalization. Most efforts so far, including those made by donors, despite some visible change, have been insufficient to bring about meaningful change in the livelihood and empowerment status of people. Thus, the existence of a billion-plus strong populace as poor and deprived, even in the twenty-first century, is a stigma that humanity must bear.

The only way out is to address the problem by creating sustainable, equitable and decent gainful employment opportunities, particularly by including and addressing the needs of the deprived, poverty-stricken and excluded population. Among the many approaches to attaining this goal is enterprise development according to the market and the needs of the people. It is one of the foremost strategies not only generally advocated, but also one with visible and genuine impact and ability to transform the livelihood and quality of life of many. The 2007 International Labour Conference (ILC) provides a coherent and comprehensive approach to enterprise development. This approach defines the components of an enabling environment, a list of enterprise-level sustainable and socially responsible practices, and the roles of governments, social partners and the International Labour Organisation. The objective is to promote sustainable enterprises in a manner that aligns enterprise growth with sustainable development objectives and creates productive employment and decent work. The approach recognizes that the creation and growth or transformation of enterprises on a sustainable basis combine the legitimate quest for profit (one of the key drivers of economic growth) with the need for development that respects human dignity, environmental sustainability and decent work. Various studies in Nepal, viz. ILO (2004), Bajracharya (2007), Bajracharya and Shrestha (2008), Bajracharya and Shrestha (2009), further show that micro-enterprises contribute notably to economic growth, particularly to improve the livelihoods of poor and vulnerable people. While it is recognized that MSEs can grow in other ways (e.g. turnover, profit, productivity), the principal concern is how new employment opportunities can be created through the expansion of MSEs. However, this does not dismiss the importance of improving job quality in MSEs.

In the International Labour Organization's (ILO's) seven-country study on the role of policies and laws on MSE employment, Reinecke and White (2004) found that while governments in some countries have created mechanisms that exempt MSEs from full compliance with the labour law, this "not only leaves workers unprotected, it creates growth traps for enterprises close to the maximum threshold for the exemption". This finding is consistent with other research which found that exemptions of this kind may also undermine the incentives for MSEs to upgrade their production and to produce for more demanding markets. While the ILO study found that most MSE employers it surveyed did not identify labour laws and regulations as a principal growth constraint, general exemptions appeared to reinforce a view that MSEs should be treated differently. Thus, the regulatory system can promote or hinder MSE growth, as can various kinds of non-regulatory instruments. General exemptions of MSEs from labour laws and regulations, say Reinecke and White (2004), leave many workers unprotected and have a negative impact on job quality. Exemptions create a growth trap by providing incentives for enterprises close to the exemption threshold size to either stop hiring workers or to hire informally.

The present study is specifically concerned with how size-based exemptions in labour influence the behaviour of MSE employers. Thus, this study is specifically concerned with the prevalence of growth traps, as defined by the existence of size-based thresholds that were designed to support the promotion of MSEs. Additionally, there is also an interest in determining the extent to which other regulatory barriers may inhibit enterprise growth. Results from previous studies highlight the role of business licensing procedures in inhibiting growth, as well as the role of incentive and subsidy schemes in promoting growth. This includes the role of taxation and the practice of exempting MSEs from taxation. This research recognizes that there are likely to be barriers to the growth of MSE employment that are beyond regulation. These may include concerns regarding poor, inadequate or costly infrastructure, access to finance, access to markets, the requirement to begin paying taxes, and many others. While there is a wide range of existing research on this topic in the countries and states under study, this survey endeavours to ascertain how MSE owners–managers perceive these constraints and consider them to be barriers to growth. Finally, this study is concerned with the ways in which MSE managers–employers respond to the regulatory regime in which they operate by avoiding compliance, and the impact this has on employment growth. It is understood that many MSEs, in particular those at the smaller end of the size spectrum, will apply avoidance strategies in order to evade compliance with labour laws and other regulatory instruments. This study endeavours to identify these practices in order to better understand how labour and business regulations influence the behaviour of business owners and managers.

To contextualize the Nepalese scenario, Nepal, despite engaging in planned development that to some extent transformed the traditional agrarian economy to a modern economy, has not been able to attain desired development in multifarious aspects resulting in the persistence of poverty, deprivation and high underemployment. In addition, the development has not been inclusive, fuelling the feeling of discrimination and creating socio-political problems. The problem has mainly emanated from the absence of coordinated policies, exacerbated by poor implementation. In this perspective, Nepal has suffered in the quagmire of slow and unequal development. In an era when neighbouring countries are galloping ahead with unprecedented growth levels, Nepal, sadly, is losing momentum and opportunities. Nepal still faces rampant poverty, regional imbalance, a deepening social divide, and numerous political, social, economic, and cultural problems. These problems are not only manifest in the daily lives of the people, but have led to violent conflicts and have given rise to other forms of movement, resistance, aggression, and civil disobedience. The issues are further manifested in the continuity of large-scale poverty that is estimated to exceed seven million people, in the large-scale migration of youth to foreign countries in search of jobs due to less than satisfactory employment generation, in the increasing gaps between the haves and the have-nots, and in the country losing its competitive edge and momentum. The growth, averaging around 4.4 percent during the last two decades, is affected by continued high population growth rate and unequal distribution of wealth. No doubt, efforts have been made to launch a large number of programmes and activities to improve the situation but they have not yet yielded the desired result.

From the beginning of the 1990s, Nepal intensified its economic reforms with the aim of higher growth and employment. After accession to the World Trade Organization (WTO) in 2004, the country has also pursued more open and liberalized policies to fulfil WTO commitments. Today, Nepal stands as one of the most liberalized countries in the South Asian region (Khanal, 2006). The major areas covered by the reforms included, among others, trade, industry, foreign exchange, capital markets, the financial sector, and interest rates. There is also a continued attempt at labour policy reform, notwithstanding the fact that this has been one of the most contentious issues.

In order to alleviate poverty, the primary task required is to generate gainful employment opportunities. However, the situation of employment generation in the country is bleak as among the

estimated 400,000–450,000 new entrants in the market, over 300,000 migrate abroad for jobs. This number reached a phenomenal 354,750 in 2010 and yet there is a reported unemployment of 2.9 percent and underemployment of 31.8 percent. This means that due to poverty many cannot remain jobless and have to accept part-time, underpaid or inferior jobs, which explains the persistence of higher underemployment. One serious concern is that the unemployment rate is highest among the youth implying that when they enter the job market the chances that they may not get a job are the highest. This does not augur well for the nation. The continuation of traditional agricultural practices, though notable shifts towards commercialization are also noticed, but not through the year is another explanation for higher level of underemployment. The need to continue promoting employment in other countries is clear from the above fact otherwise the mismatch between job creation and labour supply will generate a catastrophic situation. In order to move away from this contradictory situation efforts including enterprise development will have to be intensified within the country to generate a sustainable basis of development in an inclusive and all-encompassing way. While promoting enterprise development, any anomalies on the policy and legal front need to be addressed so that sensible employment generation and growth can be realized.

1.2 Objective

The objective of this study is to contribute to policy and legal reforms that enhance the growth of MSEs in South Asia. Through dialogue with ILO constituents and other stakeholders, this project will identify areas where the policy and legal framework, particularly the policies and laws that regulate labour in MSEs, can be improved or simplified in order to increase enterprise performance and job quality in the region.

In achieving the above development objective, three specific objectives are pursued:

1. Assessment of the extent of influence of labour-related laws and their administration on the growth of MSEs.
2. An agreed set of policy formulation and implementation mechanisms, particularly in relation to improvement in drafting and administering labour laws, applying either nationally or, as is feasible, to specific regions or sectors.
3. Strengthen policy-making and social-dialogue mechanisms for improved enterprise performance and compliance with labour laws.

1.3 Research questions

This study tries to answer the following research questions:

1. What influence do national and state labour laws have on the growth of MSEs?
2. What elements of the business environment, other than national and state labour laws, hinder the growth of enterprises?
3. Are there additional non-regulatory barriers to the growth of MSEs?
4. To what degree does each factor contribute to the perceived growth trap provided there are multiple factors?

1.4 Limitations

This study had to be conducted keeping in mind the following limitations:

- There is a paucity of data and information which creates difficulties in presenting and analysing the situation, both exhaustive and adequately.
- The survey had to be conducted without segmenting the selected sectors in a representative manner, though efforts have been made to ensure representativeness in totality for all four sectors.
- The response rate of 84 per cent in the survey is taken as satisfactory.

Chapter 2: Overview of labour laws, business regulations and MSEs

2.1 Background

There is a growing realization that without a suitable labour and business environment, industries cannot flourish. This is more so in the case of micro- and small enterprises (MSEs). Many studies carried out in these areas, however, indicate that complex labour laws and compliance requirements hinder the growth of MSEs. There is increasing evidence of a labour law–MSEs growth trap situation leading to undermining of ongoing reforms aimed at inclusive growth and sustainable industrial development.

A research study reveals that 18 countries (including some Asian and Latin American countries) have adopted specific MSE laws, separate from labour standards, hiring and firing, paid vacations, working hours and social security including administrative procedures (ILO, 2006). In some countries, labour legislation exempts MSEs from certain specific sections of the general statute, for example, requirements to establish occupational safety and health safeguards. These exemptions leave workers unprotected thus implying the risk of “growth traps”, whereby enterprises would stop growing (or disguise their growth by remaining/turning informal) in order to avoid passing the threshold level. There is, however, no conclusive evidence so far in these pertinent issues. A recent study on the German legislation of protection against dismissal finds only weak statistical evidence for the threshold effect. Nonetheless, exclusions give incentives to enterprises above the threshold level to split up into multiple units and this can result in unfair competition between enterprises within and outside the scope of the law. On the other hand, parallel labour law regimes with lower labour standards keep MSEs segregated from the mainstream economy, thereby reducing the opportunity to integrate with supply chains in addition to creating problems of discrimination, growth traps and even promoting unhealthy practices.

Country experiences indicate that exemptions of rules and regulations do not help to derive definite benefits on the job creation capabilities of MSEs. Differences in social security coverage also have not resulted in employment creation or formalization (ILO, 2005). Hence, the question remains whether exemption from certain provisions in labour law or simplification of compliance requirements would be a better option for balancing between the need for protecting workers’ rights and enhancing the enterprise’s performance. Exemption or low levels of coverage of labour and labour-related laws are an important part of the problem of the decent work deficit in MSEs as they are related directly to shortcomings in levels of income (minimum wages), social protection (affiliation to social security schemes) and job security (employment contracts). Formal work contracts are less common than in enterprises of larger size and infringements of labour law and basic occupational safety and health regulations are frequent (Gasparini, 2002). Studies have also tried to examine likely labour law–growth trap tendencies in the enterprises. After examining various provisions of labour law and likely ramifications, Joshi concluded that once the MSEs cross the threshold of exemption, they are legally responsible to comply with various laws, thus creating a sort of “growth trap” beyond which they are not able to transfer into the formal economy (Joshi, 2004).

2.2 Labour laws in Nepal in the context of MSE growth

Multifarious laws and regulations govern the labour sector in the country, adding to the complexity of compliance not only for enterprises but also with regard to enforcement. The Government of Nepal has so far passed 264 Acts and 282 Rules under labour-related laws. The principal Acts and Rules affecting MSEs include Labour Act 1992; Trade Union Act 1992; Foreign Employment Act 1986; Children’s Act 1992; Local Self-Governance Act (LSGA) 1999; Defection Act 1997; Labour Court Rules 1996; Labour Rules 1993; Bonus Act 1974; Bonus Rules 1982; and Essential Services Act 1957.

In 1992, both the Labour Act and Trade Union Act were enacted in Nepal in the course of pursuing liberalization policies. The key feature of the Trade Union Act is the right to associations and collective bargaining. The Labour Court Regulation Act 1995 and the establishment of the labour court are the outcome of the Labour Act 1992. The Labour Act concentrates on the organized sector. The three interesting features of labour law are: (a) the lack of a single labour code; (b) various pieces of legislation applying to enterprises of various sizes; and (c) workers in enterprises with less than ten workers receiving almost no protection. Except universally applicable provisions like minimum wages, prohibition of child labour, and protection of children and women, the laws are applicable to enterprises with ten or more employees only. The major provisions in the Labour Act include defining minimum wages, working hours, working conditions, and protection of children and women. The Labour Act has defined various facilities including leave, gratuity and provident fund, and protection from injuries and accidents and the requisite compensation for them.

- The Trade Union Act 1993 (2049) is guided by the Interim Constitution 2007 (under the freedom of association) which has made a provision ensuring personal freedom and freedom of association. Under Article 30(2), every worker enjoys the right to form, and be associated with, a trade union and to engage in collective bargaining. Similarly, under section three of the Act, the workers of industrial establishments can form establishment-level trade unions for the protection of workers' rights and welfare. This Act has prescribed the requirement of at least ten workers/employees for the registration of a trade union at the level of an enterprise. Workers from MSEs with less than ten employees may join unions formed in other enterprises. This is considered a high growth trap as the union is considered to apply pressure for the implementation of labour laws and also pressurizes in favour of workers. The violation of this law leads to a penalty of up to 10,000 Nepalese rupees (NPR). The compliance cost of having trade union representation involves making available the space in the enterprise for the union. The number of trade unions is increasing over a period of time. There were 172 trade unions in 2001, which increased to 1,125 in 2006 and then came down to 566 in 2008, with an increase in the number of inspections.
- The minimum wage is governed by the Labour Act, 2048 (1992), S. 21 SS. 1-6 by the Labour (first Amendment) Act, 2054, 28 Jan 1998, published in Nepal Gazette part 58, no. 3423/8/65. The minimum wage varies from NPR4,650 to NPR4,950,¹ depending on level of skill. Workers are available at less than the minimum wage rate in the market due to the persistence of unemployment and underemployment, and consequently the minimum wage constitutes a high compliance cost. The non-compliance cost is specified as triple that of the wage rate.
- The annual increment is governed by the Labour Act 1992, by the first Amendment 1998, S. 21(a). The annual increment should be at least equivalent to half a day's salary per annum. The non-compliance cost is triple the amount of the due to be paid. This is considered to be a medium growth trap. The increment is not considered to be significant.
- The regulations on annual paid leave in Nepal apply to businesses with ten or more workers and all enterprises inside industrial estates.
- The provisions regarding paid annual leave are in the Labour Act 1992, S. 16 and S. 40 and Labour Rules 1993 S. 16, Rule 29, Rule 31, Rule 30, Rule 32, Rule 33. The employer must provide the following: 52 weekly leaves; 13 public holidays; 15 sick leaves (half pay); home leave (one day for every 20 days worked) to be accumulated for 60 days; 13 days mourning leave; and 30 days without pay special leave in a year, upto a maximum of six months for the entire service period. The provisions of leaves create a financial burden and also reduce

¹ Recent revision is NPR6,200.

production. The non-compliance cost of these provisions involves a penalty of up to NPR10,000 plus NPR100 per day for repeated violence. This is considered a high growth trap affecting the production and growth of MSEs. It not only affects smooth production but also increases administrative complications. These provisions are enforced if necessary by indulging in labour actions in the organized sector.

- Regarding the regulation on payment of gratuity, the Labour Act 1992, S. 39 and Labour Rules 1994 make a provision for gratuity. The amount of gratuity ranges from half a month's salary for each year of employment for those who have been employed for seven years to one month's salary for each year of completed service period for those employed in excess of 15 years' completed service period. The non-compliance cost involves a penalty that is triple the amount of the gratuity payable. This is considered a significant factor affecting the growth of MSEs.
- The employer must provide compensation such as: all treatment expenses as per recommendation of a government medical officer (in the event of injury at work); 100 per cent salary for treatment in hospital and 50 per cent salary for treatment at home subject to the limitation of one year (if the employee is unable to resume work immediately and is required to undergo treatment at a hospital or at his own home); five years of his/her remuneration (in the event of disability caused by injury at work); compensation of disability to be calculated on a proportionate basis by taking five years' remuneration for 100 per cent disability as the basis; and/or three years drawing salary as compensation (in the event of death as a result of accident at work) as per the Labour Act 1992, S. 38 and S. 39 and Labour Rules 1993, Rules 15–17.
- The welfare fund and 79 various compensation schemes for physical injuries and disabilities depending upon the type and severity of the problem are provisioned under the Labour Act 1992, S. 37 and S. 38 and Labour Rules 1994, Rule 15, Rule 16 and Rule 18. The compliance cost ranges from a minimum of four per cent of the three years' drawing salary, in case of damage to metacarpal (*Karam Asthi*), to 100 per cent of the same in the event of damage of major organs (such as loss of sight, loss of hearing, paralysis, loss of both hands, loss of both legs).

Table 2.1. Summary of the provisions of labour laws in Nepal

Area	Legal provision
Job security	Employee automatically becomes permanent after one year of service; can be dismissed only on misconduct; due process mandatory before dismissal.
Working hours	Maximum eight-hours standard working day and 48-hour week; one-and-half time payment for overtime; provision for rest breaks.
Wages	Minimum wage guarantee; annual increment provided.
Health and security	Maintain hygienic environment; provide protective accessories to workers; need to ensure safety of workers.
Trade union and collective bargaining	Right to associate into a trade union; right to engage in collective bargaining within the norms set by the labour law.
Protection for children and women	Prohibits employment of women and minors in hazardous work and outside normal working hours; prohibits sex discrimination.

Table 2.2. Provisions regarding facilities in labour laws

Facilities	Provision
Leaves	Annual leaves, sick leave.
Maternity	Paid leave for 52 days available for a maximum of two times during service period (45 days in tea estates).
Work injury	Full medical expenses under certification of a registered doctor plus paid leave in case of hospitalization but half-paid leave if not hospitalized. Access to welfare fund for worker.
Disability and invalidity arising due to work/ work accident	Details of quantum of disability and size of compensation provided in the regulation.
Sickness	Half-paid leave for 15 days; access to welfare fund for workers.
Work accident leading to permanent invalidity or death	Salary of three years given to the nearest family member plus priority in employment to one family member.
Retirement	Gratuity based on service years.
Retrenchment	Retrenchment benefit based on service years.
Old age	Provident fund (10 per cent of salary plus ten per cent contribution from management) available at the end of service with compound interest.

There are four thresholds for enterprises in Nepal according to the Labour Act 1992 (figure 2.1).

Figure 2.1. Threshold structure of enterprises in Nepal

4th threshold	<u>Labour Act 1992 (2048) and Rules 1994 (2050)</u> <ul style="list-style-type: none"> • Establish health centre 	A health centre be established with the provision of one doctor and an assistant with medicines and first-aid material (Rule 27)
3rd threshold	<u>Labour Act 1992 (2048) and Rules 1994 (2050)</u>	A provision of one trained medical assistant be made (Rule 27)
2nd threshold	<u>Labour Act 1992 (2048) and Rules 1994 (2050)</u> <ul style="list-style-type: none"> • Provision of crèches (S.42) • Provision of rest room (S. 43) • To employ an auxiliary health care worker (Rule 27) 	
1st threshold	<u>Labour Act 1992 (2048) and Rules 1994 (2050)</u> <ul style="list-style-type: none"> • Home leave, mourning leave, special leave, and maternity leave • Welfare measures (including compensations) (S. 37–44) • Code of conduct (S. 50–53) • Quarter facilities (S. 45 and 435 (b)) • Provident fund (S. 39 and Rule 26) • Disputes settlement mechanism: wages (S. 25 and S. 26); dispute regarding misconduct (S. 59 and S. 60); individual and collective dispute (S. 73 and S. 74); and collective bargaining (S.79) <u>Bonus Act 1974 (2030)</u> <ul style="list-style-type: none"> • 10 per cent of net profit to be paid as bonus (S. 5–7) <u>Trade Union Act 1993 (2049 BS)</u> <ul style="list-style-type: none"> • Right to form a trade union and must have a minimum of ten members (S. 3–5) 	<p>One day leave for every 20 days' work accumulative to 60 days; 30 days' special leave for one service year without pay; and two times 52 days' maternity leave with full pay during the whole service period</p> <p>Creation of welfare fund and 79 various compensation schemes for physical injuries and disablement.</p> <p>Provision of punishment in terms of warning, stop annual increment, suspension and dismissal from service. Make a provision of fund for quarter by allocating five per cent of the total profit every year.</p> <p>Employer should make a provision for provident fund for permanent employees.</p> <p>Provision of dispute settlement regarding wages, individual and collective bargaining.</p> <p>The worker who has worked for half the year should also get a bonus. The amount of the bonus should not exceed six-month's salary.</p> <p>Employees have the right to form a trade union with ten and more employees.</p>

<p><u>Labour Act 1992 (2048) and Rules 1994 (2050)</u></p> <ul style="list-style-type: none">• Issue of appointment letter (S. 4)• Working hours and overtime (S. 16 and S. 19)• Public holidays and sick leave with half Pay: s. 40 and Rules• Payment of minimum wage (S. 21 and S. 21(a))• Health and safety (S. 27–S. 32)• Accidental Insurance (only in travel and trekking) (S. 48(c)) <p><u>Child labour (Prohibition and Regulation) Act, 2000</u></p> <ul style="list-style-type: none">• Prohibited to employ a child below the age of 14 (S. 3(1))• Children (ages 14–16) not to be employed in hazardous work(S. 3(2))• Prohibited to employ a child of ages 14–16 against his/her will (S. 4)• Working hours (S. 9(d))• Employer is liable to pay equal pay for equal work (S. 10) <p><u>Industrial Enterprises Act 1992 (2049)</u></p> <ul style="list-style-type: none">• Facilities, e.g. sales tax, excise and concession, to be accorded to cottage industries, and in case of fruit-based production industry such facilities to be accorded in stipulated districts (S. 15) <p><u>Prohibition of bonded and forced labour 2002 (2058 B.S)</u></p> <ul style="list-style-type: none">• Prohibited to employ as bonded labour (S. 4)• Government may fix minimum wage for agricultural labour (S. 13)	<p>Conditions of employment to be followed by all sizes of enterprises.</p> <p>Compulsory issue of appointment letter with the completion of 240 days of service.</p> <p>The stipulated working hour per day is eight hours and additional incentives for overtime.</p> <p>13 public holidays and 15 days sick leave.</p> <p>Minimum wage rate to be followed by all enterprises.</p> <p>Provide safe and healthy working conditions.</p> <p>Accidental insurance applicable to trekking enterprises.</p> <p>Children below 14 not to be employed.</p> <p>Children should not be employed in hazardous activities.</p> <p>No forced employment of children.</p> <p>Children permitted to work from six AM to six PM.</p> <p>No discrimination in wage rate for same type of job.</p> <p>Enterprises to be classified as cottage and small scale, medium scale and large scale enterprises in terms of capital investment.</p> <p>No enterprise could hire as bonded labour.</p> <p>Government is empowered to set minimum wage rate.</p>			
1–9 workers	10–49	50–399	400–999	1000+

Discrimination in the regulatory provision based on various factors such as size of employment or size of investment or the nature of the enterprise creates a kind of threshold. It is thought that going beyond the threshold might invite a lot of legal complications and make it difficult in the management of an enterprise. It is assumed that meeting regulatory provisions involves major investment of time and the risk of penalty and higher costs. The existence of a threshold level creates potential growth traps in the growth of an enterprise. All labour-related laws presented in the various sections and subsections form five different thresholds based on size of employment. Except for basic employment-related provisions, such as the issue of an employment letter or minimum wage, none of the labour laws are applicable to a business with less than ten workers. As the threshold level increases, the business has to provide additional facilities to workers in addition

to the facilities provided in the lower threshold bracket. The first threshold size begins with 10–49 workers. It requires that the enterprise provide the workers with provident fund, various leaves in addition to public holidays, the right to form a trade union, collective bargaining, the right to a bonus, and so on. The second threshold, 50–399 workers involves the provision of crèches, rest room and an auxiliary health worker, in addition to all the facilities given in the lower-level threshold bracket. Similarly, the third threshold of 400–999 workers involves the additional provision of a trained medical assistant. The fourth threshold of above 1,000 workers involves the establishment of a health centre in addition to the facilities provided the first, second and third thresholds.

The Labour Act 1992 and other related Acts have not taken into consideration the peculiar characteristics of MSEs. It may be practically impossible and unwise to insist on the enforcement of the Labour Act 2048 (1992) against enterprises with less than ten employees. Since the survival capacity of MSEs is low, depending on the volatility of the market and competition from larger enterprises, the enforcement of strict labour laws and regulations does not hold any significance. Their continuity is unpredictable. The ability of MSEs to employ for a longer period is also uncertain. With such uncertainty prevailing in the MSE sector, the enforcement of complex labour laws and regulations may only act adversely. The MSEs have developed their own customized internal rules and regulations for workers and employers. These internal rules address issues relating to working hours, holidays, benefits, overtime payments, compensations, and codes of conduct. The rights and duties of both employers and workers have been laid down based on convenience and are tailor-made to meet the needs and requirements of both parties (ILO, 2005).

2.3 Enforcement status of labour laws

In order to examine the status of enforcement, an attempt has first been made to assess the situation of labour relations on the basis of a few indicators that should exhibit and reflect the situation of enforcement or any lack thereof of labour regulations. The number of trade unions has increased over a period of time. It was 172 in 2001, which increased to 1,125 in 2006, and then down to 566 in 2008 after increasing the number of inspections, revealing improved enforcement of the regulations (table 2.3). As a result of the formation of trade unions, the number of strikes and lockouts has also been increasing significantly. There were only five strikes and 13 lockouts in 2001, which increased to 57 and 59 respectively in 2008 (table 2.4).

Table 2.3. Number of establishments with trade unions (various years)

Year	No. of establishments	Total workers	No. of trade unions (enterprise level)	No. of inspections made	No. of prosecutions lodged
2001/02	3617	359323	172	--	--
2002/03	3630	307536	157	--	--
2003/04	4186	306430	202	1131	2
2004/05	3514	310900	217	992	--
2005/06	3425	310145	361	699	7
2006/07	3578	311069	1125	959	7
2008/09	3599	313190	566	1198	--

Source: Department of Labour and Employment Promotion, Ministry of Labour and Employment.

Table 2.4. Strikes and lockouts

	2001	2002	2003	2004	2005	2006	2008
No. of industrial action	18	20	7	2	11	23	116
Strikes	5	10	5	2	5	8	57
Lockouts	13	10	2	--	6	15	59
Source: Department of Labour and Employment Promotion.							

As a result of strikes and lockouts, man-days lost have also increased significantly. Though the man-days lost are fluctuating, they still form a significant number of days lost (table 2.5).

Table 2.5. Loss of work-days from strikes and lockouts

Year	Total work-days lost	- Strikes	- Lockouts	- Lay-offs	No. of lay-offs	Workers affected by lay-offs
2001	60758	12355	31908	16495	8	536
2002	20835	9792	8793	2250	3	126
2003	44891	35206	960	8725	6	521
2004	3400	3400	--	--	5	754
2005	100750	3850	84750	12150	2	185
2006	38853	38639	213	1	3	718
2008	36279	23531	12748	--	8	747
Source: Department of Labour and Employment Promotion.						

Over a period of time, it is observed that individual complaints are decreasing while collective bargaining is increasing. Individual complaints dropped from 1,393 in 2001 to 182 in 2008, whereas the number of complaints increased from 127 in 2001 to 203 in 2008. About half of the complaints were settled (table 2.6). This shows the delays that occur in solving the problem which again raises the issue of proper enforcement.

Table 2.6. Complaints lodged and settled (various years)

Year	Complaints lodged			Complaints settled		
	Total	Individual	Collective	Total	Individual	Collective
2001/02	1520	1393	127	1350	1242	108
2002/03	779	616	163	384	302	82
2003/04	547	468	79	331	259	72
2004/05	517	433	84	346	293	53
2005/06	359	231	128	266	200	66
2006/07	471	252	219	319	152	167
2008/09	385	182	203	270	148	122
Source: Department of Labour and Employment Promotion.						

A study by Asian Development Bank (ADB), Department for International Development (DFID), and ILO (ADB, DFID and ILO, 2009) has identified the key constraints of an institutional and political nature, arguing that the tradition of collective bargaining is both recent and undeveloped; that human resource and business management generally are often weak; and that trade unionism in Nepal, as elsewhere in South Asia, is structured around ideological lines, with unions closely affiliated within Nepal's political parties. The disputes emanating, thus, are more political than industrial in nature. Labour relations are further hampered by multi-unionism at the workplace, with rivalries as each union attempts to outbid the others for gains and for membership.

There is evidence to support a gradual shift in labour law enforcement in Nepal, from confrontational to more cooperative. However, in recent times significant problems have been reported in this area, leading to the closing down of many enterprises associated with the conflicts and transitional economy thereafter. The decline in manufacturing establishments is often cited as the reflection of increasing militancy of labour, although other business environment-related issues and lack of competitiveness may have been equally responsible.

Table 2.7. Summary of labour policy areas and their implementation practices

Labor policy areas	Implementation level				
	1 Not imple- mented	2	3 Somewhat implemented	4	5 Fully imple- mented
Collective bargaining and freedom of association			√		
Anti-discrimination/equal employment opportunity	√				
Prohibitions on forced labour/child labour				√	
Minimum wage				√	
Overtime/working-time limits			√		
Paid time off			√		
Social security (retirement, disability, death, sickness and health benefits)			√		
Unemployment insurance	√				
Workers' compensation	√				
Protection against unjust dismissal			√		
Occupational health and safety standards		√			
Advance notice and consultation (for large-scale lay-off) placement after dismissal			√		
Parental/family leave				√	
Employee consultation	√				
Protection of rights and entitlements on transfer of undertaking	√				

There are problems emanating from various unexpected circumstances as well, either due to the employers or the workers themselves. In recent years, efforts have been made to improve the situation. Both government and employers have recognized the workers organizations as social partners, at least in national policy. But to translate this recognition at the enterprise level still remains a major challenge. It is unclear the extent to which the laws in the books are actually enforced in practice. There is no mechanism to monitor the implementation of the provisions incorporated in the legislation and hence the working conditions differ from one enterprise to another (Pyakuryal, 2001). But the available references indicate that there is a significant problem in enforcement. It is observed that labour law enforcement is extremely weak as there aren't enough labour officers to pay inspection visits to the MSEs (Shakya, 2004).

Due to the lack of adequate awareness on labour law, neither enterprises nor workers utilize regulatory provisions to resolve labour-related issues. Many of the provisions of the labour laws are not practiced as is clearly indicated in table 2.7. For example, there is a provision for collective bargaining in Labour Act 1992. But there are times when such a provision is violated. This usually happens when labour unions are over-politicized. Similarly, the inflexible attitude of employees also creates problems frequently.

Discussion with several stakeholders reveals that MSEs face more problems from non-labour regulations than the labour laws. Legal provisions like minimum wage are also reported to be a burden on business enterprises. Minimum wages affects profitability and also the budget and cash flow. The enforcement may hamper the very survival of many MSEs as average earning, even that of the owners/entrepreneurs, may be below the minimum-wage level. Although the cost is generally shifted to the customers, competitiveness is affected.

2.4 Regulatory compliance cost and the effects of labour policy area (LPA) obligations

The regulatory compliance cost in Nepal is reported to be very high and has deeply affected cash flow of MSEs. The World Bank (2006) also estimates a very high compliance cost of these provisions. The LPA obligations have mostly affected budgeting and production activities of firms. Similarly, some of the obligations like minimum wage, paid time off, social security, workers' compensation, protection against unjust dismissal, advance notice, leave provision, family leave, and employee consultation have had an adverse effect on the management of human resources, in addition to the effect on budgeting and production. The LPA obligations may increase costs as well as prices reported by the professionals. Some activities, such as forced/child labour, minimum wage, overtime, paid time off, and workers' compensation, affect market access as well. Social security, unemployment, occupational health and safety standards, advance notice and leave provisions, family leave, employee consultation, and protection of rights and entitlements on transfer of undertaking bring operational changes in the firms. The cost of retrenching permanent workers is high because they have to be given certain months' salary depending upon the years of employment. Once a worker becomes permanent, it is impossible to lay him/her off or fire him/her without permission of the labour department, which can take months or even years. The protection against unjust dismissal and advance notice and consultation, employee consultation, and protection of rights affect general business conditions.

The LPA obligations increase cost of compliance and reduce the ability of MSEs to comply. Although prohibition of forced/child labour and workers' compensation is consistent with business practices, many LPA obligations increase complexities for firms which may be difficult to be borne by the small firms. On the other hand, the LPA obligations like minimum wage, overtime, paid time off, social security, unemployment insurance, family leave and protection of rights and entitlements on

transfer of undertaking are reported to be helping timely completion of jobs. The others costs associated are administrative and operational costs. The LPA obligation linked to overtime, paid time off, social security, unemployment insurance, and workers' compensation add to the cost to a greater extent.

The reduced competitiveness and profitability of firms are the main outcome of compliance requirement and LPA obligation. The cost of the LPA obligation is mostly absorbed by the business and the consumers. Nonetheless, there is no strict enforcement of LPA obligations due to poor implementation of laws and regulations.

2.5 Business registration

Businesses are required to be registered with various agencies based on the nature of the operation, size, environmental implications, and location. Such registration is also required with respective business associations, albeit voluntarily, though pressure is applied by peers and associations. Details of systems and processes of registration and licensing of industries/enterprises by different sizes are presented in table 2.8.

Table 2.8. Business registration regulations and agencies

Registration with company registrar	Registration Sole partnership Partnership Private company Renewal	Private Firm Registration Act Partnership Act Company Act
Registration with live agencies	Department of industry Small and cottage industries Trade Tourism Food technology and quality control	Industrial Enterprises Act Citizen charter of respective agencies
Registration with local agencies		Local Self-governance Act 1999
	Renewal Expansion of capacity capital, area, objectives, location	Industrial Enterprise Act 1992
Trademark and patent	Registering trademark Registering patent Renewal of trademark Renewal of patent	Patent Design and Trademark Act
Registration with other agencies	FNCCI Nepal Chamber of Commerce Trade bodies	

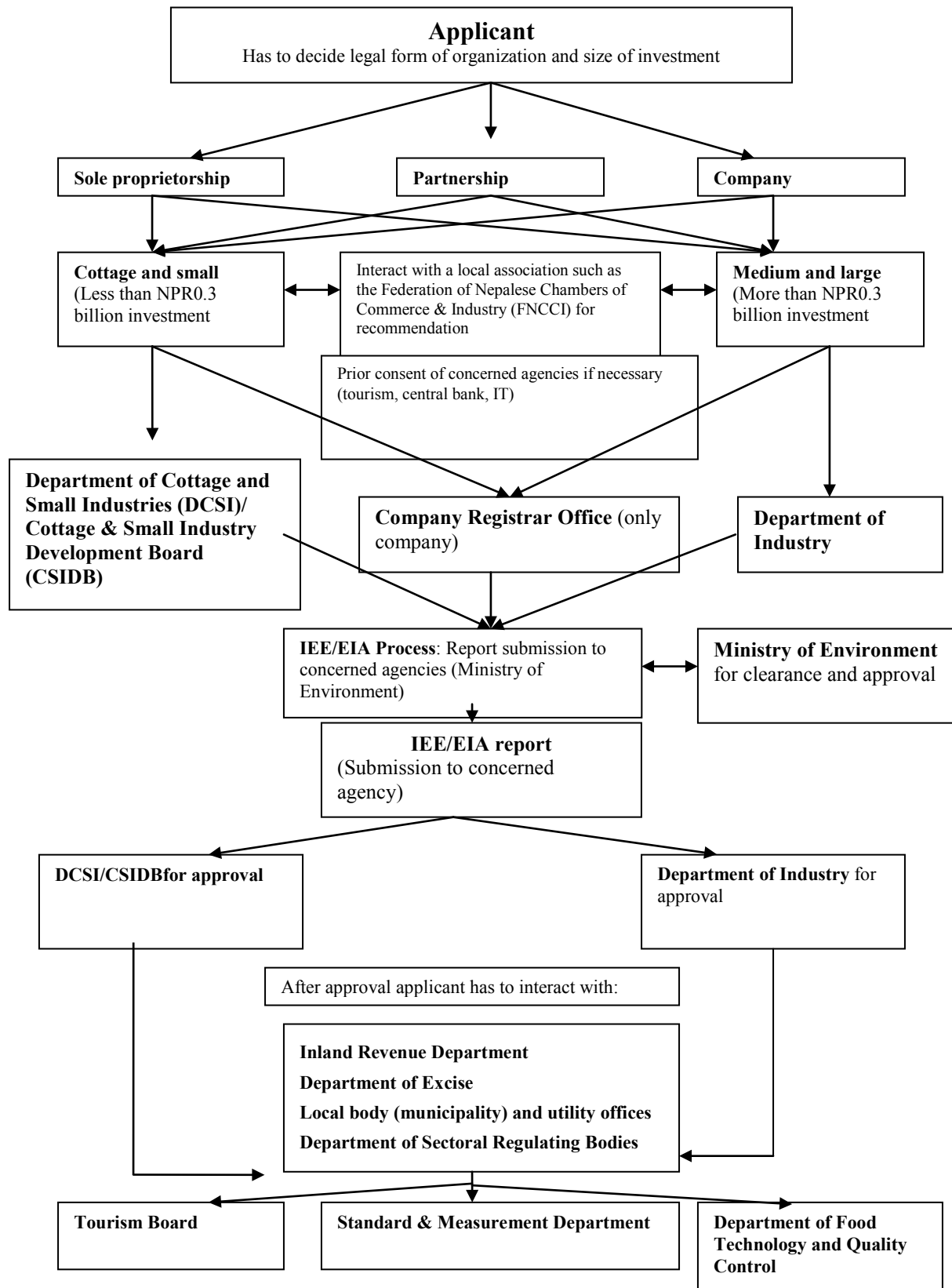
Some key issues include:

- Only 1.7 percent of micro-enterprises are registered under the Company Act, while 22.4 percent are registered under other laws. In comparison, 60.3 percent of small enterprises are registered with the Department of Cottage and Small Industries (DCSI). These indicate that micro-entrepreneurs are either not aware of the importance of registration or see little value in formalizing their enterprises by registering. They also find the process of registering too difficult or costly (ILO, 2003).
- Under the Industrial Enterprise Act 1992, the DCSI is responsible for the registration of cottage and small industries, while the Department of Industry is responsible for the registration of medium and large industries and companies. For registration purposes, industries are broadly grouped into two categories, viz. industries requiring a license and industries not requiring a license. All arms and ammunitions such as the over one foot long *kukri* (curved knife), explosives, security printings and coin minting industries, and cigarettes, tobacco, alcohol and beer industries need a license before they get registered. Despite the remaining industries not requiring a license to register, they do need to go through the Initial Environmental Evaluation/Environmental Impact Assessment (IEE/EIA) process according to the Environmental Conservation Regulation, 1998 (2054). MSEs are required to register with the central government as well as local government authorities (village development committees or VDCs and municipalities).
- The business is registered under three different legal forms – sole proprietorship, partnership and company. The sole proprietorship and partnership forms of registration are governed by the Citizen Charter of the Department of Commerce, Oct 8, 2008; Industrial Enterprise Act 1992, S. 10, Private Firm Registration Act 1958 S. 4, and Partnership Act 1964, S. 5 and S.6, while the public and private companies are registered under the Company Act 2006, S. 3. Similarly, the business can also be registered under the Cooperative Act (2048) to carry on cooperative business. The compliance cost of business registration differs depending on the legal form of the business and the size of investment. There are various government agencies for the registration of a business.
- The Company Registrar Office, Department of Industry, DCSI/Cottage and Small Industries Development Board (CSIDB), and Department of Cooperatives are undertaking registration-related activities. Similarly, the Department of Commerce is concerned with the registration of trading businesses. The compliance cost for registration of sole proprietorship and partnership firms ranges from NPR600 to NPR2,000 for micro enterprises and NPR4,000 to NPR15,000 for small scale enterprises depending upon the size of investment. The transaction cost involves three days for registration and approval is granted within 30 days after approval of IEE/EIA. An additional 21 days are required to process IEE and EIA.
- Enterprises registered either as sole proprietorship or partnership are subject to renewal every three years. This rule is governed by the Private Firm Registration Act 2014, S. 10.6.1S 7(4) and Partnership Act 2020, S.11 and S. 41(D). If not renewed, the enterprises are subject to penalty.
- The renewal fee varies from NPR300 to NPR2,300 in the case of sole proprietorship and from NPR100 to NPR300 in the case of a partnership firm. The size of investment may vary from NPR100,000 to NPR5000,000. This shows the existence of a threshold based on size of investment. A penalty of NPR1,000 is imposed if an enterprise is not renewed on time.
- The registration of private and public companies takes place at the Company Registrar Office as per the Company Act 2006, S. 6, after which the process is completed at the Department of Industry and only then can business commence. The compliance cost for a private company based on the size of investment is NPR1,000 for a micro-enterprise, NPR 4,500 to NPR 22,000 for a small-scale enterprise, and NPR 25,000 to NPR 43,000 for medium and larger enterprises.

The transaction cost for registering the company requires three days. The transaction cost in the Department of Industry, where the registration formalities are completed, and for environmental processing are the same as for a sole proprietorship and for a partnership.

- As the registration fee is based on the size of investment in the case of a private company, it also shows various threshold sizes in registration. Registration is identified as a high growth trap not only in terms of monetary cost but also in terms of transaction cost. If the smaller enterprises intend to increase fixed investment, they have to undertake EIA or IEE, as applicable, and the process is costly (explained later).
- Registration with the Inland Revenue Department is guided by the Financial Act 2008, S. 9 and S. 10. There is no charge for registration and obtaining tax clearance. But it takes seven days to obtain tax clearance from the Inland Revenue Department. It may also involve a heavy transaction cost.
- Enterprise registration with a local body (municipality) is governed by the Local Self-Governance Act 2055 (1999), S. 125 and Local Self-Governance Regulations 2056 (1999) 140–146. Depending on the type of location (commercial, main area or periphery), type of business and size of business, the local government determines the registration fees. The rate of fee varies from NPR 1,200 to NPR 55,000. This was introduced in lieu of octroi (local tax) which was in practice previously. This is applicable to the businesses located in the municipality. The rates of fee may vary from municipality to municipality. The transaction cost involves one day for processing in the municipality.
- Registration of tourism-related enterprises is governed by Local Self-Governance Act 2055 (1999), S. 125 and Local Self-Governance Regulations 2056 (1999) 140–146. The application fee for the first time is NPR50. The annual charges range from NPR10,000 for one star to NPR50,000 for a five-star hotel; NPR8,000 for a dance restaurant; NPR5,000 to NPR8,000 for a non-star lodge/hotel; NPR6,500 for a travel agency; NPR4,000 for trekking; and NPR55,000 for a safari. The transaction cost involves one day for processing.
- Registration of food-processing industries is governed by the Local Self-Governance Act 2055 (1999), S. 125 and Local Self-Governance Regulations 2056 (1999) 140–146. This is applicable to businesses located in the municipality. The annual fee ranges from NPR 7,000 for food products to NPR 10,000 for beverages. The application fee the first time is NPR50. This is a recurring cost and takes one day as transaction cost.
- Registration of carpet and garment industries is governed by the Local Self-Governance Act 1999, S. 125 and Local Self-Governance Rules 140–146, 14th Municipality Council Meeting on 24 January 2008. The annual fee ranges from NPR3,000 for handicrafts to NPR8,000 for carpet and garment industries. An application fee of NPR50 is needed for the first time only. The transaction cost is one day.
- Registration of information technology (IT) enterprises is governed by the Local Self-Governance Act 2055 (1999), S. 125 and Local Self-Governance Regulations 2056 (1999) 140–146. The municipality annual fee ranges from NPR 1,200 for Internet service providers to NPR 12,500 for IT networks with more than 20,000 customers. The application fee is NPR50 for the first time only. It takes one day to register.
- Enterprises requiring a license are governed by the Industrial Enterprise Act 1992, S. 5.1, and amended by the 90th Meeting of the Industrial Promotion Board, 2049/7/27. The refundable deposit amount ranges from NPR 1,000 to NPR 20,000, depending on the size of capital investment. This is an additional cost to each and every license. The license is provided within 30 days from the date of approval of EIA/IEE. Industries requiring a license as specified by the Industrial Enterprise Act 1992 are related to defence, public health and the environment.

Figure 2.2. Flow chart for registration and licensing, Nepal



2.6 Taxation

Taxation in Nepal is reported to be relatively simple. Nepal's tax rates are among the lowest in the region. The tax slabs are also limited. Paying taxes is, however, reported to be cumbersome and this, to a large extent, leads to avoidance strategies. However, despite procedural and other difficulties, taxation is not considered a critical constraint to investment. However, in view of the difficulties and burden (financial and non-financial), non-compliance is seen as a big problem. Value added tax (VAT) is applied to all products barring a few, with a defined threshold level that may act as a growth trap.

Table 2.9. Taxation regulations

Taxation	Income tax Corporate tax 25 per cent others- Exemption individual NPR150,000 and NPR200,000 for couple/family (2067/68-2068/69*) and tax slabs of 15 per cent for first and 25 per cent for the rest	Income Tax Act 2002
VAT	13 per cent VAT	VAT Act

Note:* Presently it is NPR 200,000 for individual and NPR 250,000 for a couple.

Key issues include:

- For natural persons and proprietorship firms in Nepal, the income tax is applied according to the Income Tax Act 2002 at the rate of 15 per cent for an annual income of more than NPR160,000 for proprietorship firms of an individual (1 per cent below the threshold level) and remunerated individuals (1 per cent below the threshold level), and for an annual income of more than NPR200,000 for proprietorship firms of a family (1 per cent below the threshold level) and remunerated married families including widows and widowers (1 per cent below the threshold level). Unregistered businesses are supposed to follow the remunerated individuals or married families. For general companies/firms/industries, the 25 per cent standard rate of corporate tax applies.
- The tax clearance takes one to three days. It is applicable to all corporate sector enterprises. However, there are two different offices to handle tax: large tax payers' and small tax payers' offices of Inland Revenue Department.
- Cost of non-compliance to tax payments is guided by the Income Tax Act 2002, S. 7. Costs of non-compliance are subject to a penalty of NPR 2,000 for non-submission of statement plus 0.1 per cent of the taxable income or NPR 100 per day, whichever is higher, with inclusion, if any, and without any deduction according to the Income Tax Act 2002, S 7. The provision allows 35 days for filing a case against the penalty.
- Timely non-payment of tax involves a penalty ranging from NPR 5,000 to NPR 30,000 or three-months' imprisonment or both (Income Tax Act 2002, S. 123). False statement submission involves a penalty ranging from NPR 40,000 to NPR 160,000 or six-months' imprisonment or both (Income Tax Act 2002, S. 123).
- The threshold for VAT in Nepal is not related to number of employees, but to annual turnover. There are certain industries which do not come under VAT obligation, e.g. cottage industries, carpet/garment sector and the following sub-sectors of agro processing: rice mill, oil mill and flour mill. An entity with an annual turnover of NPR2.0 million or more according to the VAT Act 1996 (and NPR one million in case of consulting and other services) is required to get registered with the Inland Revenue Office and 13 per cent VAT shall be applicable to it.

2.7 Environment regulations

Table 2.10. Environmental regulations

Environment	IEE for small enterprises and environmentally less sensitive activities	Industrial Enterprises Act
	EIA for large and environmentally sensitive activities.	"
	Obtain ECC	"

The EIA/IEE have been made mandatory by the Industrial Enterprise Act 1992 , S. 6 and Environment Conservation Rule 1997, Rule 3, Schedule 2. They are part of a rather complex process of getting a business registered in Nepal (figure 2.2) regardless of whether the industry is required to obtain certain licenses.

The official compliance cost requires a minimum of 21 days for processing by the Department of Industry for IEE. However, a minimum of 90 days are required by the Department of Industry for processing. An additional 30 days is required by the concerned ministry, depending upon the sector of the enterprises, for further processing. The non-compliance cost of EIA/IEE according to the Environment Conservation Act 1997, S.18 (1,2) amounts to a maximum penalty of NPR100,000 depending upon the gravity of the offence (S. 6) and a maximum of NPR50,000 if it is against the rule for the closure of the enterprise. Apart from official time, it also takes on an average as reported by concerned officials (seven days for spot study, ten days for desk study and four days for preparation of public hearing). The expertise cost for preparing IEE/EIA reports and for completing the aforementioned processes is also reported to be high.

The Industrial Enterprise Act 1992 also specifies the environmental regulations to obtain registration licenses. The industries requiring a license include all ammunitions except the kukri (less than one foot long), explosives, security printings and coin minting industries, and cigarettes, tobacco, alcohol and beer industries before they get registered. The DCSI and Department of Industry give licenses and register such industries. They cover 19 different industries. Registration of this group of industries and obtaining a license requires relatively longer time. In addition to the fee and time taken in the rest of the industrial establishments, this group of establishments has to also incur a longer transaction cost, in terms of both money and length of time.

According to the Industrial Enterprise Act 1992, S. 10, Decision No. 1 of Meeting No. 132 of the Industrial Promotion Board, 11 May 1997, the firm is allowed to change various aspects such as investment and locations but it should undertake the whole process of environmental regulation as specified for starting a business. This means the firm has to undergo the IEE/EIA again during expansion, inclusion of additional objectives and change in location. This applies to all industries of all thresholds.

2.8 Incentive schemes in Nepal in the context of MSE growth

The Industrial Policy of 1992 and the Industrial Enterprises Act 1992 extend a number of incentive schemes to MSEs in the industrial sector. The current incentive system provides tax exemption for cottage industries and nominal custom duty for imported raw materials used for export purposes. For turnover, the VAT Act has a threshold level of NPR2 million. Hence, most micro-enterprises do not come under the VAT Act. Other incentives include preferences for procurement without undergoing tender and other processes. There was also a provision of priority sector loans. Commercial banks

were required to extend 12 percent of their resources to identified priority sectors at concessionary interest rates. This provision has been abolished from 2007. However, there are some other financial services available through a network of microfinance schemes provided by commercial and private banks, public development banks, cooperatives, as well as private and community-based lenders. In addition, a number of rural development banks and microfinance organizations provide credit facilities to the MSEs.

There are also a number of support services for MSE development currently in place, which are run by non-governmental organizations (NGOs) and donor agencies. Many of these operate in rural areas and focus on poverty alleviation. They include support for marketing, training, credit, and technology services. These services are made available to women, lower-income families, and lower castes or tribes in targeted areas. The government has also developed and tested its own approaches to micro-enterprise development. A number of government-sponsored MSE promotion organizations provide services that include training in enterprise development, business management and skill training, credit facilities, marketing linkages (including trade fairs, exhibitions, exposure visits), technology transfer, technical and business information dissemination, environment and quality control, and business counselling. Various agencies provide business development services to the MSEs. A number of organizations provide services such as skills training in enterprise development. Other business development services available in Nepal include sub-sector promotional programmes ranging from marketing assistance, training, product development and testing, and services in environmental protection. A number of programmes assist socially and economically deprived groups

Tax exemption is limited to certain types of enterprises and those located in remote regions. It is available to cottage industries (i.e. micro-size industries of up to NPR200,000 capital investment) and fruit-based production industry in stipulated districts. Export-oriented industries (like carpet and garment industries and hydropower, irrespective of company size) are exempt from VAT. Other incentives include subsidy in interest for specific activities based on size and specific provisions and schemes to sick industries.

Table 2.11. Regulations regarding incentives

Income tax	Tax exemption for cottage industries (with capital investment up to NPR 200,000). Tax holidays of ten years for hydropower projects and fruit-based wines industries located in remote regions. Tax Rebate of 1010, 25 per cent to 30 per cent for industries located in undeveloped, underdeveloped and extremely underdeveloped regions.	Income Tax Act 2002
	25 per cent tax rebate to industries established in technology parks. 50 per cent rebate in industries using foreign technology and management.	
VAT	No VAT for up to NPR two million turnover Exception for raw materials of feed industries, hydropower production, and 20 per cent rebate for cloth, wooden match, tires and tubes. 50 per cent rebate for sugar, flour and oil mills and cellular mobile industry.	VAT Act

Customs duty	Refund on exports.	Finance Act
interest	Reduction of 2.5 per cent to 3.5 per cent for relending to cottage industries. 1.5 per cent for silk industries.	
Capital Subsidy	25 per cent of total cost of machinery for tea industry.	Budget Speech, 2009
Bonded warehouse facility	For enterprises exporting 60 per cent of total output	Finance Act

Thus the regulatory environment presents many potential growth traps along with the adoption of a number of avoidance strategies that do not augur well for the promotion of healthy enterprise development.

2.9 Status and trend of MSE growth in Nepal

The role of MSEs in Nepal's economy is extremely important. Many MSEs are in the manufacturing sector, which, however, is declining and is contributing less than seven percent to the country's gross domestic product (GDP). MSEs play a crucial role in employment generation in Nepal. More than 43,000 MSEs provide employment to above 1.6 million people (CBS, 1999B). The small manufacturing establishment accounted for 0.121 million employed in 1999, which increased marginally to 0.122 million in 2008 (table 2.12). In addition to generating employment, these enterprises also promote economic growth. Besides being relatively more labour-intensive, they predominantly use local raw materials as they have strong backward linkages; evidence suggests that they are increasingly also creating forward linkages by supplying intermediate goods to larger enterprises. Moreover, information from DCSI reveals that some 6,000 new cottage and small industries are registered each year in Nepal. During the period 1997–98 to 2001–2002 there were 30,464 cottage and small industries registered with the DCSI. CBS (2000) data show that more than half of the enterprises operating are engaged in the manufacturing sector. This is followed by trade (21.3 percent) and services activities (17.3 percent). Similarly, almost 79.2 percent of micro-enterprises are in rural areas. This additionally indicates the importance of SMEs from employment and livelihood perspectives.

MSEs, in many cases, have contributed to sustained livelihoods, particularly in rural Nepal. They operate at the local level to meet the requirements of the local people. Very few have extended their market to the district or national level. A large number of such enterprises are neither recognized nor recorded, so they are not linked to proper marketing systems and/or opportunities. MSEs may be either formal or informal. Informal enterprises are generally initiated by an individual family to engage in economic activities via their traditional craft skills, whereas formal enterprises are initiated by entrepreneurs as well as government and other agencies as income-generating programmes for poor families. Formal enterprises are, to some extent, backed by training and funds. Business counselling and market linkages are, however, not thoroughly considered. They are regarded to be more profitable entities in view of non-valuation of labour inputs of the owners. In least-developed countries like Nepal, MSEs are recognized to be viable alternatives to create more job opportunities, raise productivity and reduce poverty. Moreover, in societies like Nepal, which are characterized by social exclusion and unequal development, such enterprises (MSEs) can operate in different socio-economic realities across varied castes/ethnicities, classes, age groups, and locations. Despite immense possibilities, however, complex labour laws and compliance

provisions, among others, are regarded to be creating some sort of MSE growth trap situation. Many studies in this area indicate such a possibility.

Table 2.12. Status and growth of manufacturing establishments (formal sector) in Nepal

Indicators	Large-scale industries				Small-scale industries		
	1991	1996	2001	2006	1991	1999	2008
Number of establishments	4271	3557	3213	3446	46418	43671	32326
Number of persons employed	223463	196708	191853	177550	140784	121270	122200
Number of paid employees	213653	187316	181943	169891	54081	46051	67376
Paid employee as % of total persons employed	96	95	95	96	38	38	55
Total wage and salary (in NPR million and in constant price)	13573	10110	12208	12084	2652	2264	4734
Fixed assets (in NPR million and in constant price)	81342	65997	77133	118506	20069	16743	30203
Manufacturing value added (in NPR million and in constant price)	55330	54498	62294	61591	10391	13687	15139
Output (in NPR million and in constant price)	133755	136839	181145	234799	30527	53200	54815
Salary/paid employee/month	5294	4498	5591	5927	4086	4097	5855
Paid employees/establishment	50	53	57	49	1	1	2
Persons employed/establishment	52	55	60	52	3	3	4
Productivity/worker/month	498	696	944	1322	217	439	449
Fixed assets/worker	364008	335506	402042	667451	142552	138060	247163
Value added/fixed assets	0.68	0.83	0.81	0.52	0.52	0.82	0.50
Value added/worker	247603	277048	324696	346895	73810	112863	123885
Deflator	24.57	40.14	52.34	66.57	24.67	48.77	75.69

Note: A large-scale establishment is defined as one which employs ten or more hired workers. A small-scale establishment is defined as one which employs at least one hired worker.

Source: Computed from Census of Manufacturing Establishments, Nepal, various years.

As shown in Table 2.12, there is a decreasing trend in the number of establishments in both categories during the period under consideration. There is also a decreasing trend in total employment in both types, i.e. in recent times manufacturing industries may not have been performing in a desired manner as is also proven by the reduction in the contribution of the sector to GDP. The number of manufacturing MSEs was 46,418 in 1991, which decreased to 43,671 in 1999 and went down even further to 32,326 in 2008, providing employment to 140,000, 121,000, and 122,000 respectively. This shows a decreasing trend in both number and employment terms. The reason for decreasing number of manufacturing MSEs is poor business environment, particularly political instability.

2.10 Labour law and the growth trap effect

An ILO policy review report on MSEs in Nepal indicates that the absence of a policy framework for MSEs without an adequately integrated incentive package and mechanisms for support services, especially from gender perspectives, has created a growth trap situation beyond which the MSEs have not been able to grow in terms of productivity and income (ILO, 2005). A recent ILO (2006) study further points out that a partial exclusion of enterprises below a certain threshold size from complying with legislation has severe disadvantages. It leaves workers unprotected and implies the risk of “growth traps” whereby enterprises would stop growing (or disguise their growth by remaining/turning informal) in order to avoid passing the threshold level. An earlier ILO survey from 2002 provided some information regarding the possibilities of bunching or growth traps. It finds that out of the total micro-enterprises as much as 76 percent remain outside the purview of labour laws. Similarly, among the small enterprises, around 40 percent do not come within the orbit of the labour law. One additional feature is that micro-enterprises registered under the Companies Act are negligible. Even among small enterprises, the ratio is only 24 percent (table A.1). The results reveal a possibility of bunching of enterprises below threshold sizes, including a tendency of growth traps for MSEs in relation to labour law.

Table 2.13. Legal status of MSEs (in %)

Size of enterprises	incorporated* (included) under Company Act	Incorporated* (included) under other Acts	Not incorporated (not included)	Total
Micro	1.7	22.4	75.9	100.0
Small	23.8	36.5	39.7	100.0

Note: * Incorporated is different from registration.

Source: ILO Survey, 2002.

Based on the policy review in 13 countries, ILO points out that labour laws are often too complex in several countries for MSEs to be able to comply, thus creating a kind of “growth trap” situation beyond which these enterprises are unable to grow (ILO, 2004). Amidst such evidence, there is continued pressure on developing countries to deregulate their labour laws. It is believed that such a step will enable them to promote their enterprises and thereby expand employment opportunities (World Bank, 2004a, 2005, 2006). The World Bank studies further add that policy uncertainty and macroeconomic instability are principal obstacles to the operation and expansion of enterprises in developing countries. Across all firms surveyed by the World Bank, close to 60 per cent of respondents are said to be reporting that labour market regulations are one of the major obstacles to business and industrial development. Among the enterprises, medium-sized firms are said to be the most severely affected. Big divergence among firm categories is because of the absence of labour legislation in MSEs. Some studies also point out that in some South Asian countries, all enterprises below a certain threshold size (generally ten workers) are excluded from the scope of application of all labour laws (Daze, 2005). In other countries, some categories of workers are excluded due to narrow definitions adopted in the employment relationship (e.g. “daily workers”) (Fenwick et al., 2006).

From the review of labour- and non-labour-related regulations, the growth traps identified were categorized into three different scales – high, medium and low. Altogether 31 different growth traps were identified as high-scale growth traps (table 2.14).

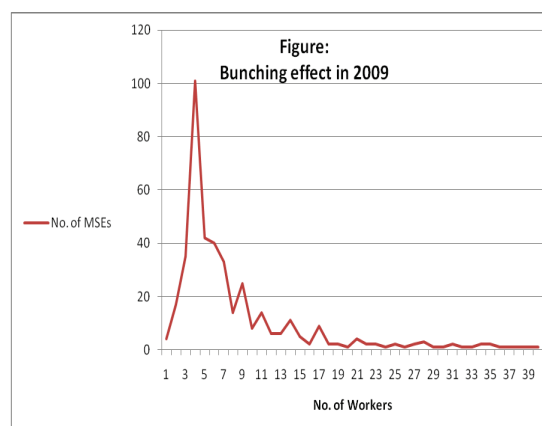
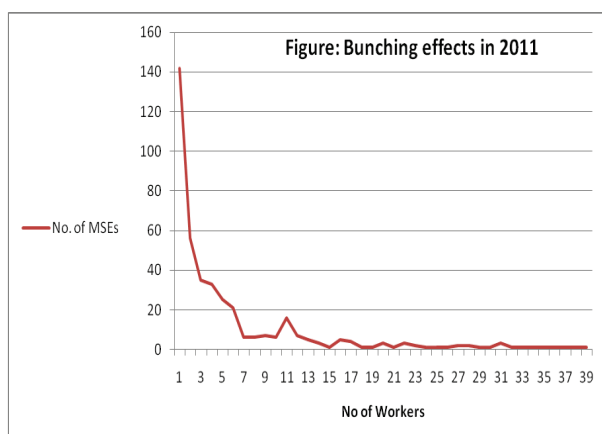
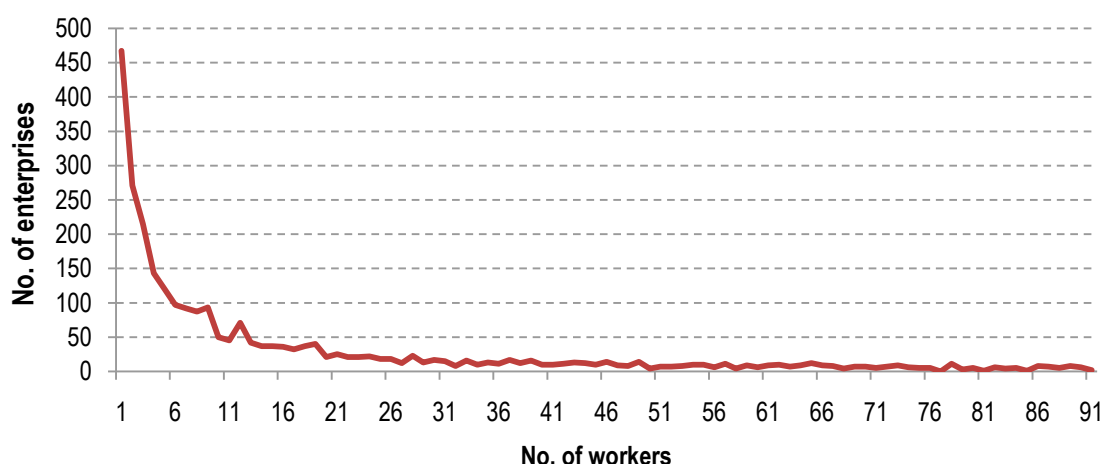
Table 2.14. Potential growth traps identified for field verification

Scale of growth traps	Labour laws	Registration and business regulations	Environmental regulations	Custom and tax incentives	Total
High	8 Trade union, unfair labour practice, collective bargaining, minimum wage, gratuity, termination of employment, provident fund, annual leave	16 Registration in Department of Cottage and Small Scale and Industries., registration of trading enterprises in Dept. of Commerce, registration fee for private company, registration fee for public company, renewal for sole proprietorship and partnership, capacity increment, change in business objective, change in location, registration with Inland Revenue Department, registration with local authority, registration with tourism department, registration with DFTQC, cost of filing returns, corporate tax rate file submission, VAT provision	4 Preparation and submission of EIA, preparation and submission for IEE license	3 Tax exemption, tax holiday, tax rebate	31
Medium	2 Annual wage increment, payment of bonus			2 Subsidized credit, concessional interest rate,	4
Low	10 Suspension, maternity benefit, compensation for death/injury, sanitary bathroom, fully-equipped medical room, provision of health workers, provision of nursery, accommodation facility, child labour	15 Registration in own association like FNCCI, carpet/garment association, hotel association and IT association, renewal of membership, stamp fee, trademark, renewals of trademarks, license for patent right, renewals for patent, license for design, recommendation for certificate of origin, food quality test Dollar availability for imported raw materials, raw material import under bank guarantee, bonded warehouse facility Access to subsidized training, access to subsidized marketing and export assistance	1 Refundable deposit for acquiring license	7 import license for industries without LC, import from third countries, issue of quota, import under bonded warehouse, VAT exemption, customs duty exemption, access to credit	33
Total	20	31	5	12	68

Out of total high growth traps, 16 were felt in the regulation of registration, eight in labour laws, four in environmental regulation, and three in tax incentives. The four growth traps were identified as medium in nature and 33 growth traps were of low level. These growth traps were identified for field verification by conducting a survey in seven districts with a sample size of 409 MSEs.

2.11 Bunching effect

Figure 2.3. Bunching effect based on census data



The bunching effect estimated for 2011 and 2009, based on the survey data, shows a large number of MSEs below the specified threshold level, though not at the threshold itself, indicating the absence of the bunching effect. Based on both sets of information, this suggests that the bunching effect is not a part of avoidance strategies. It only shows the normal pattern of a larger number at the lower end.

Chapter 3: Research methodology

3.1 The study framework

The basic objective of this study is to explore the persistence, or otherwise, of the growth traps that may induce enterprises to remain below the threshold level to avoid the application of laws or reduce or altogether avoid compliance costs. To this end, business-related laws and regulations, including incentive schemes, were reviewed carefully and examined to identify the presence of discriminatory provisions and thresholds in various laws. The review covered labour laws, business laws, monetary policy, industrial policy, government budgets and other relevant plans, strategies and secondary data and information. The actual situation at the enterprise level was identified on the basis of the representative survey. The focus of the survey was in determining the actual costs of doing business in terms of both labour laws and other non-labour related laws, as well as to assess the implication of the regulatory framework and the compliance thereof. In addition, the survey was expected to identify non-legal and non-regulatory factors that pose a significant impact constraining the growth of micro-, small and medium enterprises (MSMEs) and employment expansion.

3.2 Rationale behind sector selection

The survey on business enterprises covered micro- and small enterprises (MSEs) from four sectors of the economy, namely agro-based, carpet/garment, manufacturing, information technology (IT), and tourism. The rationale behind this selection is to examine the impact of regulatory and non-labour laws on MSEs based on their importance in the national economy. The sectors have been proposed keeping in mind their importance in the economy, the existence of employment relations, and the representation of manufacturing, services and trade.

Agro-based industries are scattered across the country. Not only do they contribute to the national economy but also significantly contribute to the local economy, both through employment and income generation. Tourism is very important as this sector is the single largest earner of foreign exchange as well as generating significant employment opportunities. The carpet and garment sector contributed 47.7 per cent of total exports in 1999–2000, although, since then, this figure has declined continuously, reaching 13.1 per cent in 2009–10. Besides, both the sectors are highly labour-intensive in nature. This is an employment-intensive sector. IT is an emerging modern sector. This is a knowledge-based industry where highly skilled persons are employed.

3.3 Distribution of MSEs in the sample sectors

A mixed trend is noticed in terms of enterprise numbers as well as employment generated by them. The number of agro-processing enterprises as well as employment generated from them has declined in consonance with the general trend in the manufacturing sector. The growth in carpet and garment industries, have been able to increase employment significantly despite drop in export earnings. However, it should be noted that change in employment is mainly due to replacement by paid employees for unpaid family workers indicating that these enterprises are increasingly being institutionalized. In the tourism sector, both the number as well as employment has increased significantly. Only limited information is available regarding enterprises in the IT sector.

Table 3.1. Number and growth of enterprises in selected sectors

Sector	Number of enterprises			Employment		
	2008	1999	Change (%)	2008	1999	Change (%)
Agro processing	14747	22091	-33.24	17079	18390	-7.3
Carpet/garment	5566	1316	322.9	11711	612*	1813.7
Tourism	2966	1728	71.6	197000	114000	72.8
IT	1130	n.a.		n.a.	n.a.	
Note: Includes only paid employees but the total employment is 3,346.						

Thus, the selected sectors exhibit varying features. This means that a survey of these enterprises should provide a useful scenario about the proposed research questions and issues raised for this study.

3.4 Sampling frame

Three different sets of frames have been used for this survey. The first set, a combination of several sources comprising the list of establishments, was used to allocate weights to select districts and wards. This frame comprised the list of establishments belonging to the four activity sectors assigned for the survey. The second set of frames consisted of the list of districts and wards representing areas at different levels. A third frame constituted a list of establishments that were constructed through field visits made in the wards and segments chosen for the survey. The *Census of Manufacturing Establishments* (CBS, 1998) and the Survey of Cottage and Small Industries provided the figures on establishments belonging to agro-processing and carpet/garment manufacturing enterprises. The *Survey of Selected Services 2004/05* CBS, Nepal, provided the figures on the number of establishments in the IT sector. Likewise, *Registered Tourism Related Enterprises – 2008* gave figures on establishments in the tourism sector. Furthermore, for the sake of allocating probability in the selection of districts and wards, establishments with 5–70 workers, with at least one hired employee, were considered eligible.

3.4.1 Area frame

The list of all 75 districts during the first-stage selection of the sampling procedure and the wards from both the urban and rural areas within the districts selected at the second stage represented the area frame for this survey.

3.4.2 List frame

A list of all the establishments which was collected through a door-to-door campaign within the selected primary sampling units (PSUs) constituted the list frame for the survey. This list was the final source for the selection of establishments interviewed for the main survey.

3.5 Period of survey

The survey began from April 2011 and was completed by the end of November 2011. The listing operation and interviews of establishments were conducted from April to June 2011.

3.6 Questionnaire

After a series of discussions with the advisory team, a questionnaire was developed and finalized for a pre-test. The questionnaire was pretested by interviewing 16 business enterprises in three

districts of Kathmandu, Lalitpur and Rupandehi. Out of the 16 enterprises interviewed, eight were selected from Kathmandu and Lalitpur districts and the remaining eight enterprises were selected from Rupandehi. Each interview, on average, took roughly two hours. At the end of a month-long pre-test, a report was submitted by the research team to ILO with suggestions for necessary amendments to be made. Enterprises from all the four different sectors of the economy and those on either side of the threshold were selected for the interview. In consultation with the ILO, the questionnaire was finalized after incorporating the changes.

3.7 Limitations of the survey

- Nepal, politically, remains in a transitional period and hence lacks a stable business environment necessary for the survey. There appeared to be a strained relationship between management and labour, particularly in the industrial districts, resulting in a number of non-responses.
- Due to the small sample size (four per cent), inferences drawn for the IT sector may be a little shaky and therefore caution is recommended in the use of the results pertaining to this sector. The small sample size is a result of this sector being urban-oriented and with a level of employment that was lower than what was required for the survey criteria of one paid and five regular employees.
- A major limitation of this survey was the lack of current sampling frame from which sample PSUs were selected. Basically, the sampling frames available for the survey were outdated and collected from different agencies, i.e. Central Bureau of Statistics (CBS) and Tourism Industry Division, MOCTC.
- Tourism-related enterprises could not be included in the frame during sample selection due to the lack of a complete list at village development committee (VDC) and ward levels, and the absence of data on regular paid employees.
- The application of consistency checks, through data entry at the field level, was beyond the scope of the survey. All possible checks were carried out during the supervision and at the time of data-entry activities conducted at the central level in Kathmandu. Hence, a revisit of the enterprises was not applicable.

Chapter 4: Survey findings

4.1 Some salient features of the MSEs surveyed

4.1.1 Ownership patterns of MSEs

Sole proprietorship is observed to be the most significant type of legal business structure among the surveyed micro- and small enterprises (MSEs) in Nepal irrespective of employee size. With 82 per cent of the total surveyed MSEs being sole proprietorships, it is evident that this structure is not a growth trap for expanding businesses (figure 4.1). Even among businesses with ten or more employees, around 71 per cent were sole proprietorships.

“Staying informal”, it was found, was not a popular strategy. Only five per cent of the surveyed firms were unregistered, but how many of them intentionally tried to stay informal was unknown. It may be noted that in terms of business registration, a comparatively higher proportion of 21 per cent of enterprises were reported as not registered. The difference in response to the two different questions may be due to two possible reasons. First, enterprises reporting as being registered under sole proprietorship may not all have been registered; they only reported themselves thus so that they could operate under sole ownership. Second, a higher proportion of enterprises were derived as a residual of whether the enterprises are registered under any of the seven given types of registration. However, taking into account actual practice, the proportion of unregistered enterprises is likely to be higher than five per cent.

There is not much difference in the patterns of legal structure of MSEs across different business sectors (table 4.1). The proportion of MSEs that are sole proprietorships is highest in the carpet/garment sector and lowest in the information technology (IT) sector. In the case of MSEs working in the latter sector, the share of partnership businesses (13 per cent) is comparatively higher than that in other sectors. For MSEs operating in the agro-processing sector, the share of corporate limited companies is relatively higher (ten per cent).

Figure 4.1. Percentage distribution of MSEs in Nepal across type of legal structure

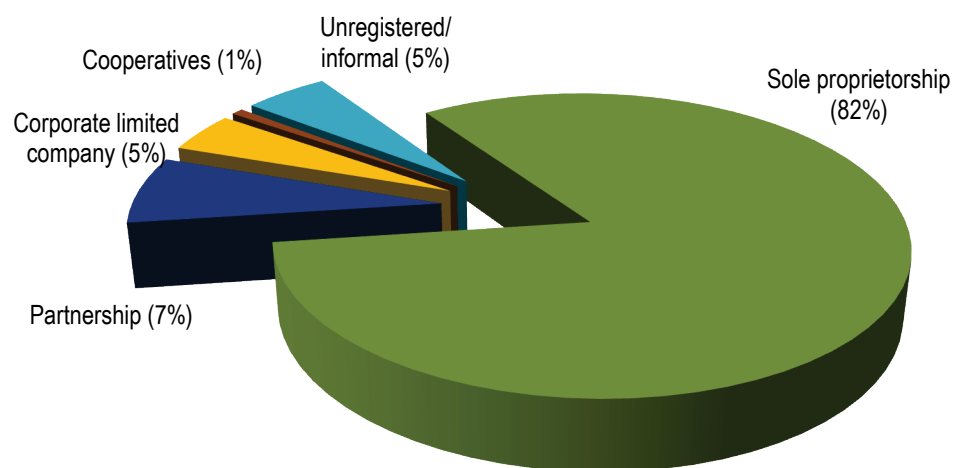


Table 4.1. Distribution of MSEs in Nepal across type of legal structure in different business sectors

Legal structure	Agro processing	Carpet/garment	Tourism	IT	All
Sole proprietorship	78%	89%	82%	73%	82%
Partnership	6%	4%	10%	13%	7%
Corporate limited company	10%	1%	3%	7%	4%
Cooperatives	0%	0%	2%	0%	1%
None (unregistered/informal)	6%	6%	4%	7%	5%
All MSEs	100%	100%	100%	100%	100%
Base (total MSEs)	98	108	188	15	409

4.1.2 Employment

4.1.2a Employee composition

Among the four surveyed sectors in Nepal, *casualization* or *informalization* of labour is not observed to be significant (tables 4.2 and B.1). Overall, casual workers as a share of total paid workers were only seven per cent in 2011, which was marginally higher than that of five per cent in 2009. The share of casual paid workers is slightly higher in the case of smaller enterprises with 5–9 workers (11 per cent) as compared to those with ten or more employees (four per cent).

Overall, 92 per cent of total paid workers were observed to be full-time workers in 2011, which is slightly lower than 94 per cent two years earlier. The distribution pattern of paid workers across employment type is similar across the two worker groups. All the unpaid workers in the MSEs being surveyed were observed to be working full time (100 per cent) in both 2011 and 2009.

Of the total workers (including unpaid workers) in the surveyed MSEs, 78 per cent were male in 2011 (tables B.2 and B.4). Among the four surveyed sectors, the share of male workers was relatively higher in agro-processing and IT sectors (84 per cent each) (tables B.3 and B.5). The scenario was similar in 2009 as well, when 79 per cent of total workers were male. The proportion of female workers was comparatively higher in the case of casual workers, even though it has reduced slightly from 39 per cent in 2009 to 31 per cent in 2011. It should be noted that in the case of paid part-time workers, the proportion of females has increased considerably from ten per cent in 2009 to 24 per cent in 2011. Among the four sectors, MSEs in the agro-processing sector had the highest jump in share of paid part-time female workers, from zero per cent in 2009 to 33 per cent in 2011.

Table 4.2. Distribution of employees in MSEs in Nepal across type of employment for different worker groups, 2011

Nature of employment	Enterprise with 5–9 workers	Enterprise with 10–70 workers	All enterprises
Paid workers			
Full time	88%	94%	92%
Part time	1%	2%	2%
Casual/temporary	11%	4%	7%
Total	100%	100%	100%
Base (paid workers)	1371	2006	3377
Unpaid workers			
Full time	100%	100%	100%
Part time	0%	0%	0%
Casual/temporary	0%	0%	0%
Total	100%	100%	100%
Base (unpaid workers)	635	206	841

4.1.2b Mode of wage payment

The survey revealed that a little higher than two-thirds of the workers (69 per cent) were paid on a monthly basis (table B.6). The next popular mode of payment was observed to be piece rate (23 per cent). Around two per cent to three per cent of firms reported paying their workers on a daily basis or a lump sum amount. In the case of MSEs working in the garment/carpet sector, more than 80 per cent of the workers are paid on piece-rate basis. In each of the other three sectors, more than 85 per cent of workers are paid on a monthly basis.

4.1.3 Business and related registration

In Nepal, MSEs are required to register with both the central government as well as the local government authorities. It was observed during the survey that 21 per cent of the enterprises surveyed were not registered with any of the seven types of registration/license (table B.7). It should be noted that the actual proportion of unregistered/informal enterprises is only five per cent, as reported under “type of legal structure” (figure 4.1). The share of MSEs with none of the seven types of registration rises to 39 per cent among the carpet- and garment- manufacturing firms. In the IT sector, all enterprises were registered with one or more type of registration.²

Tax registration (Permanent Account Number or PAN/value added tax or VAT) seems to be the most popular type of registration undertaken by enterprises, with 69 per cent of MSEs having PAN/VAT registration (figure 4.2). The second most practiced registration is observed to be that with local authorities (municipality/village development committee or VDC), with two-thirds of the enterprises (66 per cent) registered with them, followed by registration with the Department of Cottage and Small Industries (DCSI/Cottage and Small Industries Development Board (CSIDB) (51 per cent). It should be noted that tax registration (PAN) is compulsory for all sizes of businesses. In addition municipalities also has made it mandatory for all the businesses operating within

² Registration with Department of Industry (DoI) does not emerge as it is related with larger industries while MSEs are registered with Department of Cottage and Small Industries (DCSI)/Cottage and Small Industries Development Board (CSIDB).

municipality to register. However, VAT registration is mandatory for those enterprises with a turnover of two million Nepalese rupees (NPR) or more with the exception of a few food-sector enterprises. It means that the government has not been fully able to implement taxation laws. The percentage of MSEs who have tax registration is highest in the agro-processing sector (88 per cent), followed by the IT sector (80 per cent). On the other hand, registration with local authorities is highest in the case of the tourism sector (74 per cent), followed by the agro-processing sector (67 per cent). While only eight per cent of all MSEs have company registration, 21 per cent of MSEs in the IT sector have this license (table 4.3).

Legal requirement is reported to be the most important reason for obtaining any type of license by the MSEs (table B.8). Except for registration with the Department of Food Technology and Quality Control (DFTQC) and Department of Commerce, more than 80 per cent of MSEs with each of the other five types of licenses reported that they got the license because it was legally required. Of those MSEs registered with the DFTQC, around 12 per cent reported that they registered themselves in order to avail government, donor or non-governmental organization (NGO) schemes. Again, among those MSEs registered with the Department of Commerce, 11 per cent reported that they registered with this department either to qualify themselves for credit or because it was required by suppliers or buyers.

The absence of legal obligation has been cited by around half of the MSEs as the reason for not acquiring each of the five types of registration, except for tax (PAN/VAT) registration and registration with the local government authorities (table B.9). While 31 per cent of MSEs without tax registration cited their reason for being unregistered as “It is not legally required”, another 58 per cent demonstrated the “avoidance by choice” strategy. Similarly, 51 per cent of MSEs not registered with local government authorities cited reasons that reflect the “avoidance by choice” strategy. A considerable proportion of 14 per cent MSEs without a license from DFTQC also gave their reason as lack of awareness about the legal obligation.

The reported transaction cost of registration was highest with the Company Registrar (ten days on average) followed by that with tax registration (six days) (table B.10). The transaction cost was found lowest with cooperatives and the Department of Commerce, with an average length of 1.6 days and 1.5 days respectively. However, it should be noted that several of them will have to be combined to complete the registration process including the environmental assessments/certificates discussed separately. The reported cost of registration was found highest with the Company Registrar at an average fee of NPR4,017 since it registers relatively large enterprises. In contrast, the cost of registration with the Department of Commerce was NPR679. Again, this cost was zero with the Department of Cooperatives. The cost renewal of registration/license was once again found highest with the Company Registrar at an average fee of NPR4,741, while that with the Department of Commerce was NPR957 and NPR250 with the Department of Cooperatives (tables B.11 and B.12).

Even though a small share of eight per cent of MSEs had company registration; more than one-third reported having hearing of informal payments being made for this type of registration (table B.13). Around 47 per cent of MSEs with tax registration (PAN/VAT) and 45 per cent of MSEs with local government registration reported having heard of informal payments being made to acquire them. Among the seven types of registration, the share of MSEs who actually reported having made informal payments was highest in the case of license for a cottage industry. Of those who had heard of informal payments being made for this industry, 43 per cent had actually made such payments to acquire the license.

Figure 4.2. Percentage of MSEs in Nepal who have different business registration

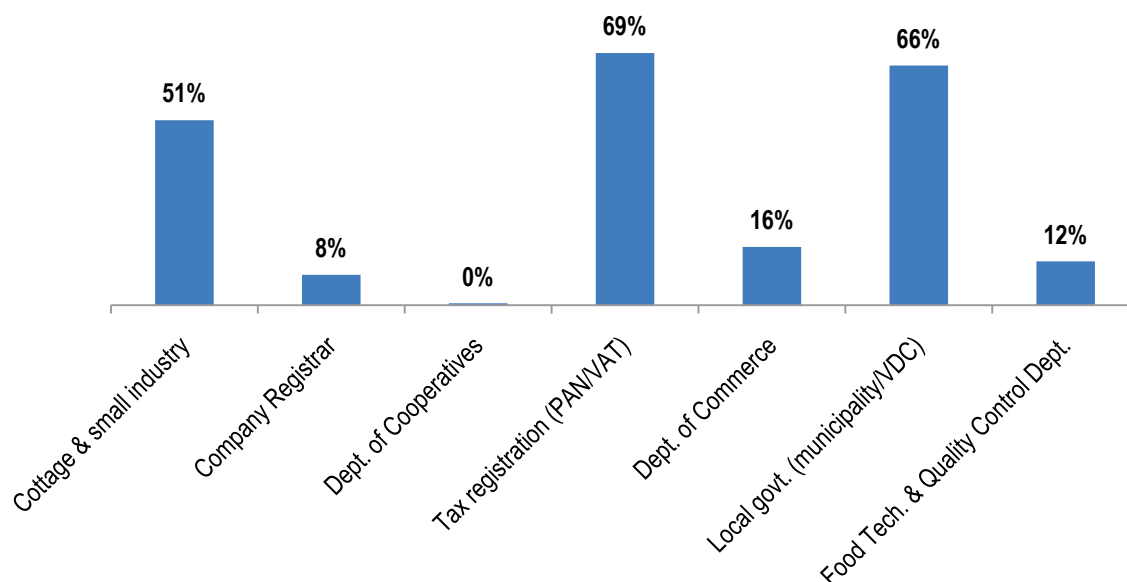


Table 4.3. Percentage of MSEs in Nepal with different licenses, by business sector

Licenses	Agro processing	carpet/garment	Tourism	IT	All
Cottage & small industries	80	30	89	8	207
Company Registrar	9	6	16	3	34
Dept. of Cooperatives	2	0	0	0	2
Tax registration (PAN/VAT)	85	47	138	12	282
Dept. of Commerce	25	5	29	6	65
Local govt. (municipality/VDC)	66	54	140	8	268
DFTQC	32	0	17	0	49
Base (total MSEs)	98	108	188	15	409

4.1.4 Business inspection

The survey revealed that 46 per cent of MSEs had been inspected by government officials during the 12 months prior to the survey. However, there was a clear variation across the four sectors. The percentage of establishments that were visited by inspectors was highest in the agro-processing sector (62 per cent) followed by IT (53 per cent), tourism (45 per cent) and carpet/garment (31 per cent) sectors. Establishments that never had even a single inspection during the year prior to the survey comprised of more than half of the total surveyed MSEs (54 per cent) (table 4.4). While 39 per cent of establishments were inspected once or twice, another five per cent were inspected three to five times. Establishments that were inspected more than ten times comprised only one per cent of the total sample.

Of the five different types of inspection covered by the survey, inspection by a tax inspector had relatively better coverage (table B.14). Of the total sampled firms, 39 per cent reported that they were visited by tax inspectors, followed by 28 per cent of MSEs who were inspected by officers from DFTQC and 22 per cent by labour inspectors. It should be noted that around half of the MSEs reported that they had been visited by officers or departments other than the five specific ones mentioned in the survey. These include municipalities and monetary and evaluation agencies like the monetary cell of the Prime Minister's Office, the Prevention of Abuse of Authority Commission and the National Vigilant Centre. There were considerable sectoral differences observed in terms of business inspection by government officials. While more than half of the MSEs in agro-processing and IT were inspected by tax inspectors, the proportion was only 22 per cent for the garments/carpet sector and 38 per cent for the tourism sector. Similarly, the proportion of MSEs being inspected by labour inspectors was highest in agro processing (30 per cent) and lowest in tourism (16 per cent).

Table 4.4. Percentage distribution of MSEs in Nepal by frequency of official inspection in different business sectors

Frequency of government inspection	Agro processing	carpet/ garment	Tourism	IT	All
Not once	38%	69%	55%	47%	54%
1-2 times	56%	29%	37%	40%	39%
3-5 times	5%	1%	7%	7%	5%
10 or more times	1%	2%	1%	7%	1%
Total	100%	100%	100%	100%	100%
Base (total MSEs)	98	108	188	15	409

4.1.5 Employment register

Among the four surveyed sectors in Nepal, overall 63 per cent of MSEs reported not maintaining employment registers for their workers (table 4.5). However, in firms with 10-70 employees, this percentage was much lower (36 per cent). Again, if we look at this behaviour across business sectors, we find that in the IT sector around one-third of MSEs did not maintain employment registers, while this proportion was 76 per cent in the garments/carpet sector.

When MSEs not keeping employment registers were asked the reasons for their non-compliance, around 44 per cent said that they didn't because it was not legally required (table B.15). There were other reasons cited by a considerable proportion of MSEs that reflects "avoidance by choice" behaviour. These include reasons such as "It is legal, but not enforced" (19 per cent) and "Unnecessarily complicated (do not see the benefit)" (35 per cent). Around 27 per cent of MSEs not maintaining employment registers also stated that it was not necessary since they provided daily-wage payments.

Table 4.5. Percentage of MSEs in Nepal that maintained official employment registers, across business sectors and worker groups

Sector\worker group	Enterprises with 5–9 workers		Enterprises with 10–70 workers		All	
	% MSEs	Base (total MSEs)	% MSEs	Base (total MSEs)	% MSEs	Base (total MSEs)
Agro processing	40%	57	83%	41	58%	98
Carpet/garment	21%	85	35%	23	24%	108
Tourism	24%	147	61%	41	32%	188
IT	62%	13	100%	2	67%	15
All	28%	302	64%	107	37%	409

4.1.6 Presence of trade unions

Despite the threshold of a minimum of ten employees in an enterprise to form a trade union, the Trade Union Act of 1993 allows all enterprises, including those employing less than ten workers, to join a trade union federation, making the Act practically applicable to all sizes of businesses in Nepal.

Around one-third of the surveyed MSEs in Nepal (32 per cent) reported that none of their employees either joined or formed a trade union even though they were aware of the regulation (table 4.6). On the other hand, more than half of the MSEs (56 per cent) reported that they were not aware that any regular employee can join a trade union federation while employees in enterprises with ten or more workers can form a trade union within the enterprise (table 4.7). Lack of awareness regarding regulations on trade unions seems to be highest in the garment/carpet sector (56 per cent) and lowest in the IT sector (40 per cent).

Many of the MSEs who were aware of regulations on trade union formation, but never joined/formed any, provided reasons that looked legitimate such as “Workers have not demanded it” (72 per cent) and “It is not legally required” (33 per cent) (table B.16). However, some gave reasons that did not seem legitimate such as “There are regular meetings/communication with workers” (15 per cent). A relatively smaller proportion of firms provided reasons that reflect “avoidance by choice” behaviour such as “It is legally required, but not enforced” (ten per cent) and “Too costly” (two per cent).

Only those MSEs who had either joined a trade union federation or formed a trade union were asked about the number of working days lost in the preceding year due to labour disputes. Overall, 18 per cent of the firms who had either formed or joined a trade union reported losing working days due to labour disputes (table 4.7), most of them having lost between one and five days. Among the four sectors, the proportion of MSEs who lost working days was relatively higher in the tourism sector.

Overall, 63 per cent of MSEs in Nepal reported an overall wage increase for their employees during the year prior to the survey (table B.17). The proportion of firms who increased wages was maximum in the garments/Carpet sector (73 per cent) and minimum in the tourism sector (54 per cent). Of these, 37 per cent of MSEs experienced a wage increase of less than ten per cent, while 17 per cent experienced a wage increase ranging from ten per cent to 15 per cent, and 16 per cent to 25 per cent (table B.18). A significant share of 15 per cent of MSEs reported that they had an overall wage increase in the range of 36 per cent to 75 per cent among their employees.

Table 4.6. Percentage distribution of MSEs in Nepal across their knowledge on joining/ forming a trade union, across business sectors

Status of awareness	Agro processing	Carpet/garment	Tourism	IT	All
Aware and their employees joined a trade union federation	14%	5%	4%	7%	7%
Aware and their employees have formed a trade union	9%	6%	4%	7%	6%
Aware but employees have not joined or formed a trade union	30%	24%	36%	47%	32%
Not aware	47%	66%	56%	40%	56%
Total	100%	100%	100%	100%	100%
Base (all MSEs)	98	108	188	15	409

Table 4.7. Percentage distribution of MSEs with a trade union across number of days lost due to labour disputes in preceding year, by business sector

Days of work lost due to labour disputes	Agro processing	Carpet/garment	Tourism	IT	All
0 days	96%	73%	67%	100%	82%
1–5 days	4%	18%	13%	0%	10%
6–20 days	0%	9%	0%	0%	2%
21–50 days	0%	0%	7%	0%	2%
51 days and above	0%	0%	13%	0%	4%
All MSEs who joined/ formed a trade union	100%	100%	100%	100%	100%
Base (total MSEs whose employees have either joined or formed any trade union)	23	11	15	2	51

4.1.7 Parallel units

Of the total surveyed MSEs, only 12 owners (three per cent of MSEs) had parallel units in the same or neighbouring district, out of which six businesses had smaller number of employees than the threshold of ten employees (table B.19). These six firms with parallel units formed two per cent of the total MSEs below the threshold level. There is a likelihood that they might have created parallel units as part of their “*staying below the threshold*” strategy.

4.1.8 Environmental regulations

The Environmental Impact Assessment (EIA) and the Initial Environmental Evaluation (IEE) have been made mandatory in Nepal according to the Industrial Enterprise Act 1992 and Environment Conservation Rule 1997. They are part of a rather complex process of getting a business registered in Nepal regardless of whether the industry is required to obtain certain licenses. The EIA is required for large and environmentally sensitive activities and the IEE for small enterprises and environmentally less sensitive activities. Besides, any industry whose pollution level is deemed to be less than the prescribed national standards shall receive a pollution control certificate (PCC) or Environmental Clearance Certificate (ECC). The IT sector is exempt from environmental regulations.

Of the total surveyed MSEs in Nepal, excluding those in the IT sector, while 18 per cent went through IEE, only six per cent have a PCC or ECC and only one agro-processing firm went through EIA. Among the MSEs working in the agro-processing sector, compliance to environmental regulations is relatively higher with 46 per cent of MSEs having undergone IEE (figure 4.3). When asked about the reasons for non-compliance with any of the three environmental regulations, the responses were similar across IEE/EIA and PCC/ECC. Around 53 per cent to 55 per cent of MSEs gave the reason as “It is legally not required” (table 4.7). Again, a considerable share of 29 per cent of MSEs reported that they were not aware of the requirement regarding compliance to these regulations. There were some MSEs who provided reasons that can be considered “avoidance by choice” such as “It is legally required, but not enforced” (seven per cent to eight per cent), “Complicated/do not see the benefit” (four per cent to five per cent) and “Takes too much time” (less than one per cent).

It was observed during the survey that the average transaction cost for preparing reports for IEE compliance was around two days; taking government approval took around three days (tables B.20 and B.21). However, it took much longer (15 days on average) to prepare reports for EIA compliance. In the case of PCC or ECC, the average time required to prepare compliance reports was around two days and around five days to get approval from the government. The average fees paid by the surveyed MSEs to the government or the actual cost of the study for initial licensing (table B.22) were observed to be NPR1,453 for IEE. Again, the official government licensing fee for either PCC or ECC, as reported by the surveyed MSEs, was found to be NPR381, on average.

Of the total MSEs surveyed, 48 per cent had heard of penalties for non-compliance with various environmental regulations (table B.23). This awareness was highest in the IT sector (73 per cent) and minimum in garments/carpet sector (34 per cent). Of the MSEs who are aware of the existence of penalties for non-compliance of environmental regulations, 17 per cent were able to describe at least the category of penalty correctly (table B.24).

Around 21 per cent of MSEs reported hearing about informal payments being made in order to avoid compliance with environmental regulations (table B.25). Of these, two per cent reported having made such payments, and all the surveyed MSEs who made informal payments happened to be from the tourism sector.

Figure 4.3. Percentage of MSEs in Nepal who comply with different environmental regulations, by business sector

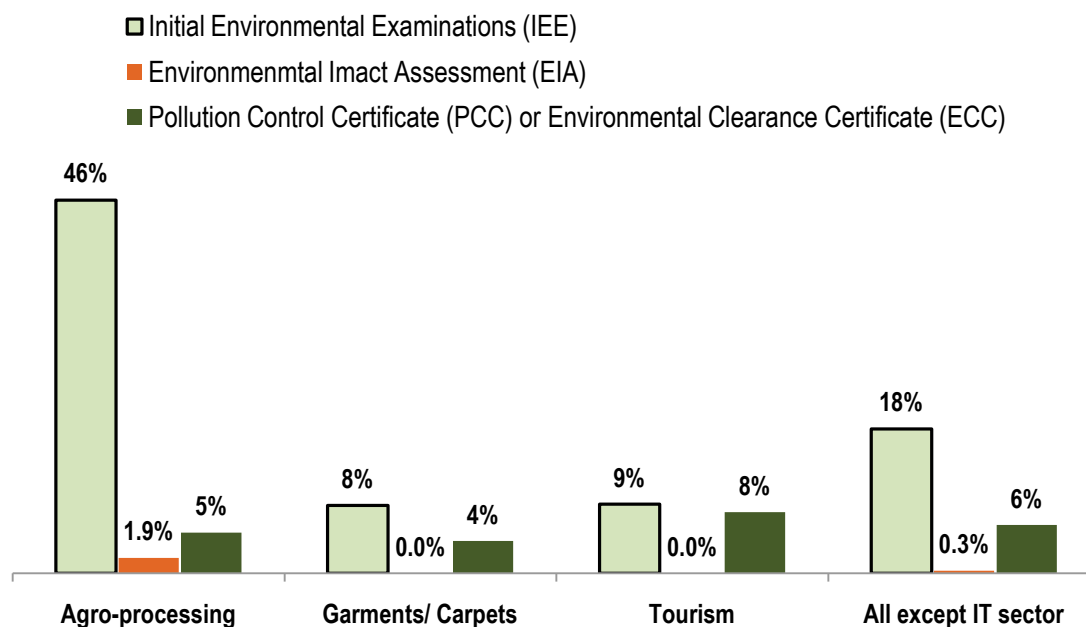


Table 4.8. Distribution of MSEs in Nepal across reasons for not registering/acquiring an environmental license

Reason(s) for not registering/ acquiring license	Initial Environmental Examinations (IEE)	Environmental Impact Assessment (EIA)	Pollution Control Certificate (PCC) or Environmental Clearance Certificate (ECC)
It is not legally required	55%	53%	56%
It is legal, but not	7%	8%	7%
Takes too much time	0%	1%	1%
Complicated/do not see	5%	5%	4%
Not aware of	29%	29%	29%
Other	4%	4%	3%
MSEs that did not comply with the regulation	324	323	333

4.1.9 Incentive programmes

The survey revealed that access to incentive programmes was significantly low among the MSEs in Nepal. Of the total MSEs surveyed, a negligible share of only one per cent (six enterprises from the total sample of 409 MSEs) reported that they had started their businesses with support from the government, a donor or an NGO (table B.26). Among the four business sectors, the percentage of MSEs who availed the support of such incentive programmes was marginally higher in the agro-processing sector (3 per cent).

4.2 Analysis of survey findings in terms of the study objective

One of the key objectives of this study in Nepal was to find out whether labour- and business-related factors act as plausible growth traps for MSEs. For the purpose of analysis, this overall objective was translated into the following four major questions to elicit the responses of the enterprises:

Question 1: Does compliance with the payment of statutory minimum wages act as a plausible growth trap for the MSEs surveyed?

Question 2: Does compliance with the payment of statutory non-wage benefits act as a plausible growth trap?

Question 3: Do business-related factors, such as income tax and VAT, act as plausible growth traps for MSEs?

Question 4: Does the informal payment system impact compliance with labour laws?

4.2.1 Does compliance with the payment of statutory minimum wages act as a plausible trap for the MSEs surveyed?

Legislation on minimum wages is applicable to all businesses in Nepal. The survey revealed that while half of the MSEs were not aware of this legislation, around 36 per cent reported being aware of the legislation and paying their workers accordingly.

Around 13 per cent of MSEs were aware of government-specified minimum wage obligations but still avoided paying minimum wage to their workers (table 4.9). This behaviour was more widely observed in the agro-processing sector (19 per cent). Again, avoidance behaviour is slightly higher in firms with 5–9 workers (15 per cent) than in those with 10–70 workers (ten per cent). The reason for non-compliance with regulations on minimum wage, as stated by the maximum proportion of MSEs, was the absence of legal requirement (44 per cent) (table B.27). Of all those who did not comply with the regulation, a significant proportion of MSEs cited reasons that reflect “avoidance by choice” behaviour such as “It is legal, but not enforced” (13 per cent), “Takes too much time” (five per cent), “Unnecessarily complicated (do not see the benefit)” (15 per cent), and “Too costly” (24 per cent).

Overall, 48 per cent of MSEs reported that they were aware of the amount of national-level minimum wage specified by the government in their sector of business (table B.28). This perceived awareness was highest in the IT sector. Out of the MSEs who reported being aware, a majority (63 per cent) referred to the minimum wage as falling within the range of NPR4,000 to NPR7,000. The actual range of minimum wage during the period of the survey was NPR4,600 to NPR 4,960, and despite the majority guess lying within the range, they were not aware of the actual minimum wage level.²

Half of the surveyed MSEs (50 per cent) reported hearing about the existence of penalties (table B.29). Out of these, ten per cent were able to describe at least the category of the penalty correctly (table B.30). However, there was not a single MSE who could describe the exact quantum and category of the penalty. More than two-thirds of the MSEs (68 per cent) who had heard of the penalties reported not knowing what exactly the penalties were.

² The current minimum wage level is NPR6,200.

Overall, 31 per cent of MSEs reported that they had heard of informal payments being made in order to avoid complying with minimum wage regulations in their sector of business (table B.31). Out of those who were aware, only 11 per cent were honest enough to report making such payments to avoid compliance with the minimum wage regulations.

Table 4.9. Percentage distribution of MSEs in Nepal across status of awareness and payment of government-specified minimum wage, by business sector

Status of awareness and payment	Agro processing	Carpet/garment	Tourism	IT	All
Aware and pay	33%	34%	36%	60%	36%
Aware but do not pay	19%	7%	14%	13%	13%
Not aware	48%	58%	50%	27%	51%
Total	100%	100%	100%	100%	100%
Base (total MSEs)	98	108	188	15	409

4.2.2 Does compliance with payment of statutory non-wage benefits act as a plausible growth trap?

The statutory non-wage benefits referred to in this section can be subdivided into four specific types: (i) payment of employer contribution to the provident fund or employees' provident fund (EPF); (ii) payment of gratuity on retirement or completion of the stipulated period of service; (iii) compensation for injury or death; and (iv) annual paid leave.

4.2.2a EPF

In Nepal, the contribution to the employee's provident fund (EPF) is applicable to businesses with ten or more workers and all enterprises within industrial estates.

Except for only one sampled enterprise from the tourism sector, "staying below the threshold level" strategy in order to avoid compliance with EPF legislation was not at all observed among the surveyed MSEs in Nepal. Again, more than two-thirds (71 per cent) of MSEs below the threshold level reported not being aware of the EPF legislation (table 4.10). The proportion of MSEs not aware of the EPF legislation was highest in tourism (74 per cent) and lowest in the IT sector (38 per cent).

Of all the surveyed MSEs that were above the threshold level (with ten or more workers and all MSEs within industrial estates), as high as 81 per cent reported not making EPF contributions (table B.32). Among the four sectors, the share of MSEs that did not comply with EPF regulations was relatively less in the tourism sector (72 per cent). When MSEs that did not comply with the legislation were asked their reasons for non-compliance, around 23 per cent reported that it was not a legal requirement (table B.33). However, the most popular reason cited was that the workers did not demand EPF payments (46 per cent), which clearly reflects the "avoidance by choice" strategy which also includes other reasons such as "Employees preferred to receive take-home pay" (34 per cent), "It is legal, but not enforced" (20 per cent) and "Unnecessarily complicated" (11 per cent). Around 45 per cent of MSEs above the threshold level, who complied with EPF regulations, reported taking one to two hours every month to file the monthly EPF returns (table B.34), while 32 per cent of MSEs mentioned taking half an hour to one hour.

Overall, 40 per cent of MSEs reported being aware of the rate of EPF contributions that businesses need to make (table B.35). This perceived awareness was highest in the IT sector (67 per cent) and lowest in the garments/carpet sector (31 per cent). Out of the MSEs who reported being aware of the rate, a majority (58 per cent) referred to the rate of EPF as ten per cent.

More than one-third of the surveyed MSEs (38 per cent) reported hearing about the existence of penalties for non-compliance with EPF legislation (table B.36). However, only three per cent of MSEs were able to describe at least the category of penalty correctly (table B.37). However, not a single MSE could describe both the quantum and category of the penalty.

Awareness of informal payments for avoidance of EPF legislation was observed to be quite low among MSEs in Nepal. Overall, 15 per cent of the MSEs reported hearing of informal payments to avoid compliance with regulations on EPF (table B.38). Out of these, two per cent were honest enough to report making such payments to avoid compliance with EPF regulations.

Table 4.10. Percentage distribution of MSEs in Nepal with less than ten workers and outside industrial estate across awareness of EPF payment and its impact on growth

Status of awareness and impact on growth	Agro processing	Carpet/garment	Tourism	IT	All
Aware and tried to stay	0%	0%	1%	0%	1%
Aware but not affecting	34%	27%	24%	62%	28%
Not aware	66%	73%	74%	38%	71%
Total	100%	100%	100%	100%	100%
Base (MSEs with less than ten workers & outside industrial estate)	53	83	145	13	294

4.2.2b Gratuity

In Nepal, gratuity as separation payment is applicable to businesses with ten or more workers and to all enterprises inside industrial estates. The liability emerges when employees complete seven years of service. The gratuity to be provided ranges from half a month's salary for each year for employees with seven to 15 years of employment and one month salary for each year completed in excess of 15 years.

Among the surveyed MSEs as a whole, the majority of paid workers (90 per cent) were found to be working for less than seven years, while only ten per cent had reportedly worked for seven years or more (table B.39). Even though the share of full-time workers in total employment is very high (92 per cent), most of them (89 per cent) tend to work for less than seven years. Among the surveyed MSEs, there was hardly any firm that had either part-time or casual paid workers working for seven years or more.

None of the surveyed MSEs with less than ten workers outside industrial estates reported that they tried to stay below the threshold level in order to avoid gratuity payments (i.e. there is non-existence of the "staying below the threshold level" strategy) (table 4.11). There were 79 per cent of MSEs who were not aware of gratuity payment obligations on crossing the applicable threshold. While the IT sector had the lowest share of MSEs (54 per cent) not aware of gratuity payment obligations, the agro-processing sector had the highest share (87 per cent) of MSEs who were unaware.

Of the total MSEs above the threshold level, 83 per cent reported never making gratuity payments to their workers (table B.40). Among the four surveyed sectors, the share of MSEs not complying with gratuity obligations was observed to be highest in the garments/carpet sector (88 per cent). When MSEs above the threshold level, who did not comply with gratuity regulations, were asked their reasons for non-compliance, 46 per cent reported there was no resignation/retirement in their corresponding enterprise (table B.41). One-fourth of MSEs also reported that it was not legally required for them. However, there were some MSEs whose reasons can be considered “avoidance by choice” behaviour and included, among others, reasons such as “Workers have not demanded it” (47 per cent), “It is legally required, but not enforced” (11 per cent) and “Too costly” (six per cent).

Of the total MSEs being surveyed, 25 per cent claimed they knew the amount of the gratuity payment that businesses above the threshold level are required to make for those who workers have completed seven years of service (table B.42). However, the number of firms who reported the amount as being relatively small, ranging from NPR 1,500 to NPR 30,500.

Almost one-third of the total MSEs in Nepal (32 per cent) reported hearing about the existence of penalties for non-compliance with regulations on gratuity payment (table B.43). Out of these, only two per cent were able to describe at least the category of penalty correctly (table B.44). However, there was not a single MSE that could describe both the quantum and category of penalty.

Overall, 13 per cent of MSEs reported hearing of informal payments for non-compliance with regulations on gratuity payment in their sector of business (table B.45). Out of those who were aware, only two per cent were honest enough to report making such payments to avoid compliance. Knowledge of informal payments was relatively higher in firms with ten or more workers (23 per cent), compared to firms with 5–9 workers (ten per cent).

Table 4.11. Percentage distribution of MSEs in Nepal with less than ten workers outside industrial estates across awareness of gratuity payment requirements and its impact on growth

Status of awareness and impact on growth	Agro processing	Carpet/garment	Tourism	IT	All
Aware and tried to stay below threshold	0%	0%	0%	0%	0%
Aware but not affecting growth	13%	22%	22%	46%	21%
Not aware	87%	78%	78%	54%	79%
Total	100%	100%	100%	100%	100%
Base (MSEs with less than ten workers outside industrial estates)	53	83	145	13	294

4.2.2c Compensation for injury or death

The legislation on compensation for injury or death applies to businesses with ten or more workers and all enterprises inside industrial estates. The employer must provide compensation such as all treatment expenses according to the recommendation of the government medical officer (in the event of injury at work); 100 per cent salary for treatment in a hospital and 50 per cent salary for treatment at home subject to the limitation of one year (if the employee is unable to resume work immediately and is required to undergo treatment at a hospital or at his own home); five years of his/her remuneration (in the event of disability caused by injury at work); compensation of disability to be calculated on a proportionate basis by taking five years' remuneration for 100 per cent disability as the basis; and/or three years' drawing salary as compensation (in the event of death as a result of an accident at work).

Of the total MSEs with less than ten workers, the proportion that preferred to stay below the threshold level to avoid compliance was very low at one per cent ("staying below the threshold level" strategy) (table 4.14). Around 30 per cent of MSEs below the threshold level reported being unaware of the legal obligation to provide compensation for injury/death to the workers. The proportion of MSEs unaware of this legislation was relatively lower in the agro-processing sector (14 per cent) compared to the other three sectors.

Of the total MSEs above the threshold level, while 59 per cent reported they had never provided compensation for injury or death at work, a significant proportion of 85 per cent stated that they had never provided treatment to workers for injury at work (table 4.13). The proportion of MSEs above the threshold level that had neither provided compensation nor treatment to workers was 44 per cent. Among the MSEs who neither provided compensation nor treatment, the majority said it was because it had not been necessary to provide compensation (85 per cent) due to the absence of any death or injury in their enterprise (table B.46). Around 11 per cent of MSEs also mentioned that it was not a legal obligation for them to provide compensation or treatment to their workers. A comparatively smaller share of MSEs also provided reasons that reflected the "avoidance by choice" behaviour such as "It is legally required, but not enforced" (13 per cent), "It has not been demanded" (11 per cent), "Too costly" (four per cent), and "Takes too much time" (two per cent).

During the survey, 61 per cent of all MSEs claimed that they knew the kind of compensation for injury or death to be provided (table B.47). This proportion was much higher in the IT sector (80 per cent), followed by the agro-processing sector (73 per cent). When these MSEs were asked to specify the compensation amount for the case of death or most severe injury, only a small proportion (25 per cent) could specify the amount which ranged from NPR1,500 to NPR5,00,000.

The survey revealed that perceived awareness of the penalties for non-compliance of laws on compensation for injury or death was considerably high among the MSEs in Nepal. Around half of the MSEs (53 per cent) reported they had heard about the penalties (table B.48). However, of those who were aware, only six per cent were able to describe at least the category of penalty correctly (table B.49). On the other hand, a significant share of 70 per cent of MSEs, who claimed to have heard about penalties, was unable to specify what the penalties were for non-compliance.

Of the total MSEs being surveyed, 40 per cent claimed they had heard of informal payments in order to avoid compliance with regulations on compensation for injury or death (table B.50). This is the highest score among regulations that are reportedly associated with informal payments. Out of these MSEs, four per cent were honest enough to report having made such payments to avoid compliance with such regulations.

Table 4.12. Percentage distribution of MSEs in Nepal with less than ten workers across their knowledge of the provision for compensation for injury/death to their workers

Status of awareness and impact on growth	Agro processing	Carpet/garment	Tourism	IT	All
Aware and tried to stay below threshold	2%	1%	1%	0%	1%
Aware but not affecting growth	84%	67%	65%	69%	69%
Not aware	14%	32%	35%	31%	30%
Base (MSEs with less than ten workers)	57	85	147	13	302

Table 4.13. Percentage of MSEs in Nepal with ten or more workers who have ever provided compensation for death/injury or provided treatment to workers, by business sector

Business sector	% MSEs who provided compensation for injury/death at work	% MSEs who provided treatment for a worker for injury at work	Base (MSEs with ten or more workers)
Agro processing	49%	22%	41
Carpet/garment	35%	4%	23
Tourism	39%	15%	41
IT	0%	0%	2
All	41%	15%	107

4.2.2d Annual paid leave

The regulations on annual paid leave in Nepal apply to businesses with ten or more workers and all enterprises inside industrial estates. The employer must provide the following: 52 weekly leaves; 13 public holidays; 15 sick leaves (half pay); home leave (one day for every 20 days worked) to be accumulated for 60 days; 13 days mourning leave; and 30 days without pay, up to a maximum of six months for whole service period.

The survey revealed that only two per cent of MSEs with less than ten workers preferred to stay below the threshold level to avoid compliance with legal obligations on annual paid leave. Around 60 per cent of MSEs reported being unaware of the regulations on annual paid leave that are applicable to those above the threshold level (table B.51). The proportion of MSEs who were unaware of these regulations was relatively higher in the tourism sector (66 per cent) and lowest in the IT sector (24 per cent).

Of the total MSEs above the threshold level, 44 per cent reported they had never provided any paid leave to their workers (table 4.14). It was observed that the proportion of MSEs that had never provided any annual paid leave to their workers was much higher in the garments/carpet sector (83 per cent) than in the other three sectors. Around 11 per cent of MSEs above the threshold level reported they had provided only sick leave to their workers. A considerable proportion of MSEs

who did not comply with regulations on annual paid leave, provided reasons that reflected the “avoidance by choice” strategy such as “It has not been demanded” (49 per cent), “It is legally required, but not enforced” (29 per cent), “Too complicated” (9 per cent) and “Too costly” (nine per cent) (table B.52). Another reason mentioned by around one-third of MSEs (34 per cent) was that it was not a legal requirement for them to comply with the regulations.

Overall, 40 per cent of MSEs reported hearing about the penalties for non-compliance with laws on annual paid leave (table B.53). However, for those MSEs above the threshold level, who actually have the legal obligation to comply with this regulation, the knowledge about penalties is quite widespread (58 per cent). Among the four business sectors, the proportion of MSEs who have heard about penalties is found to be lowest in the garments/carpet sector (26 per cent). Of all the MSEs who have heard about the penalties, seven per cent were able to describe the category of penalty correctly (table B.54). Almost two-thirds of the MSEs (65 per cent) who claimed they had heard about the penalties were unable to specify what the penalties were. If we study the knowledge on penalties among businesses above the threshold level, it is clear that only three per cent could correctly state the category of penalty; none of the MSEs, whether above or below the threshold level, could correctly mention both the quantum and the category of the penalty.

Overall, 19 per cent of the surveyed MSEs claimed they had heard of informal payments being made to avoid compliance with regulations on annual paid leave (table B.55). Out of those who had heard of informal payments being made, only three per cent of MSEs (only two out of 409 sampled MSEs) reported making such payments to avoid compliance with these regulations.

Table 4.14. Percentage of MSEs in Nepal with ten or more workers who have ever provided paid sick leave, paid home leave or paid mourning leave to a worker, by business sector

Business sector	% MSEs who provided paid leave under all categories	% MSEs who provided sick leave only	% MSEs who did not provide any paid leave	Base (No. of MSEs with ten or more workers)
Agro processing	46%	12%	41%	41
Carpet/garment	9%	9%	83%	23
Tourism	61%	12%	27%	41
IT	100%	0%	0%	2
All	45%	11%	44%	107

4.2.3 Do business-related factors, such as income tax and VAT, act as plausible growth traps for MSEs?

4.2.3a Income tax

In the case of income tax in Nepal, the threshold level is not related to number of employees, but to annual income level. For proprietorship firms, the income tax is applied at the rate of 15 per cent for an annual income of more than NPR160,000 for proprietorship firms of an individual (one per cent below the threshold level) and remunerated individuals (one per cent below the threshold

level) and for an annual income of more than NPR200,000³ for proprietorship firms with family (one per cent below the threshold level) and remunerated married couples and families including widows and widowers (one per cent below the threshold level). For general companies/firms/industries, the 25 per cent standard rate of corporate tax applies.

Only two MSEs (one per cent of the total sample) among those that are either sole proprietorships or unregistered businesses reported being aware of income tax regulations and still tried to avoid compliance by keeping their income below the threshold level, thereby following the “staying below the threshold level” strategy (table 4.15). On the other hand, 60 per cent of all sole proprietorships and unregistered businesses reported being unaware of income tax regulations on earnings of more than NPR200,000 (with dependent family) or NPR160,000 (filing returns as an individual), that in either case they are required to pay income tax. Among the four surveyed sectors, the proportion of such firms (unaware of these regulations) is relatively less in the IT sector (42 per cent) and the agro processing sector (48 per cent).

Overall, 42 per cent of MSEs in Nepal reported they did not pay income tax (table B.56). The proportion of MSEs who did not pay income tax was observed to be lowest in the IT sector (seven per cent) and highest in the garments/carpet sector (60 per cent). The reason stated by most of the MSEs (64 per cent) for not paying income tax was that they were legally exempted from making income tax payments (table B.57). However, since data on annual turnover of MSEs was not collected during the survey, it was uncertain whether all of these 64 per cent firms not paying income tax were legitimately exempted because their earnings were actually less than the threshold level or not. Though relatively smaller in percentage, some MSEs provided reasons for non-compliance which can be considered “avoidance by choice” strategy such as “Unnecessarily complicated (do not see the benefit)” (29 per cent), “It is legally required, but not enforced” (16 per cent), “Too costly” (20 per cent) and “Takes too much time” (three per cent).

Of all the firms who reported paying income tax, 31 per cent paid it at the rate of 15 per cent, while 21 per cent paid it at the rate of 13 per cent (table B.58). Only seven per cent of MSEs paid income tax at a rate greater than 20 per cent. A majority (72 per cent) of MSEs who reportedly paid income tax mentioned the transaction cost (time required) for filing and paying income tax as being one day (table B.59), followed by another 18 per cent who mentioned the average time required to be two days. There was not much difference among business sectors in the distribution pattern of MSEs across transaction cost for income tax payment, except the tourism sector where a relatively larger proportion of firms (82 per cent) reported taking only one day to file and pay income tax.

Around 58 per cent of MSEs in Nepal reportedly heard of the existence of penalties for evading payment of income tax (table B.60). Of these, 16 per cent were able to describe at least the category of penalty correctly (table B.61). However, there was not a single MSE that could describe both the quantum and the category of penalty.

Around one-third of MSEs (33 per cent) reported hearing of informal payments being made to avoid compliance with regulations on income tax (table B.62). Of these, 13 per cent reported having actually made such informal payments to avoid compliance.

³ The exemption limits were defined in 2009–10. The current exemption limits are NPR 200,000 for individuals and NPR 250,000 for married couples and families since the fiscal year 2013–14.

Table 4.15. Percentage distribution of MSEs in Nepal that are sole proprietorships and unregistered businesses across their knowledge of income tax regulations and its impact on growth

Status of awareness and impact on growth	Agro processing	Carpet/ Garment	Tourism	IT	All
Aware and tried to stay below threshold level	0%	0%	1%	0%	1%
Aware but not affecting growth	15%	18%	18%	42%	18%
Not aware	48%	68%	62%	42%	60%
MSEs that did not answer this question	38%	14%	19%	17%	22%
Base (MSEs that are either sole proprietorships or unregistered businesses)	82	103	161	12	358

4.2.3b VAT

The threshold for VAT in Nepal is the annual turnover of an enterprise and not the number of employees. There are certain industries that do not come under VAT obligation, for example, cottage industries, carpet/garment sector and the sub-sectors under the agro-processing industry (rice mill, oil mill and flour mill). An entity with an annual turnover of NPR2.0 million or more is required to get registered with the Value Added Tax Office and 13 per cent VAT shall be applicable to it.

The survey found that VAT legislation was not perceived to be a growth barrier by around 42 per cent of MSEs from the tourism and IT sectors in Nepal. Only around two per cent of the surveyed MSEs reported they had tried to keep their income below the exemption threshold to avoid paying VAT (table B.63). On the other hand, more than half of the MSEs (55 per cent) claimed they were not even aware of the VAT legislation.

Of the total MSEs surveyed, 74 per cent did not pay VAT (but how many of them were below the threshold level cannot be specified) (table 4.16). The proportion of MSEs who did not pay VAT was much higher in the tourism sector (70 per cent) than in the IT sector (40 per cent). It is interesting to note that even though the garments/carpet sector is exempted from VAT, 19 per cent still reported paying VAT.⁴ Around three-fourth of the MSEs (75 per cent) who did not pay VAT had stated that they did so because it was not legally required or because they were exempted from making VAT payments (table B.64). Some of the other reasons stated for non-compliance reflected the “avoidance by choice” strategy such as “Unnecessarily complicated (do not see the benefit)” (24 per cent), “It is legally required, but not enforced” (16 per cent), and “Too costly” (16 per cent).

Of the total MSEs, about 17 per cent reported that they had paid VAT at the rate of 13 per cent, which is exact compliance of the regulation. While six per cent reported that they pay VAT at a rate

⁴ For import of inputs, 13 per cent VAT is charged which is later reimbursed. However, obtaining the reimbursement is cumbersome. The appearance of VAT in the carpet/garment sector may be due to non-obtaining of the reimbursement.

less than equal to ten per cent, another three per cent claimed to be paying VAT in the range of 15 per cent to 25 per cent. When one-fourth of the total surveyed MSEs who pay VAT were asked about the transaction cost (time spent) for collecting and paying VAT, around two-thirds (69 per cent) reported that they took one day to do so, every four months (Table B.65). The average time spent on VAT payment by all MSEs is estimated to be two days. Among the four surveyed sectors, the average time spent by the agro-processing sector is observed to be relatively higher (six days) compared to the other three.

Around half of the total MSEs (51 per cent) stated they had heard about the penalties for non-compliance with VAT regulations (table B.66). Of those who had heard, only four per cent could specify the category of penalty correctly (table B.67). However, none of the MSEs could specify both the category and the quantum of the penalty for evading collection and payment of VAT.

Of the total MSEs surveyed, 28 per cent claimed they had heard of informal payments being made to avoid compliance with regulations on VAT (table B.68). Out of these, seven per cent of MSEs were honest enough to report having made such payments to avoid compliance with such regulations. The proportion of MSEs who claimed to have made informal payments was marginally higher in enterprises with 10–70 employees.

Table 4.16. Percentage distribution of MSEs in Nepal by status of VAT payment, by business sector and worker group

Status of VAT payment	Enterprise with 5–9 workers	Enterprise with 10–70 workers	Agro processing	Carpet/garment	Tourism	IT	All
% paying VAT							
@ less than 10%	5%	7%	9%	2%	5%	20%	6%
@ 13%	11%	34%	11%	15%	21%	27%	17%
@ 15%– 25%	2%	5%	0%	2%	4%	13%	3%
MSEs that pay VAT	19%	46%	20%	19%	30%	60%	26%
MSEs that do not pay VAT	81%	54%	80%	81%	70%	40%	74%
Base (total MSEs)	302	107	98	108	188	15	409

4.2.4 Does the informal payment system impact compliance with labour laws?

4.2.4a Informal payments to avoid compliance with laws/regulations

Large proportions of MSEs were aware of the informal payments being made with regard to compensation for injury and death (40 per cent), minimum wage rate (31 per cent), income tax (33 per cent), and VAT (28 per cent). A sizable proportion of 21 per cent of MSEs were also observed to be aware of informal payments being made with regard to environment regulations (table B.69). Of those who had heard of informal payments being made, 13 per cent actually made informal payments on income tax, 11 per cent on minimum wage, seven per cent on VAT, four per cent on compensation for injury/death, and two per cent on environmental regulations (table B.70).

4.2.4b Informal payments to acquire a license or registration

The MSEs were asked whether they had heard of or made informal payments in order to acquire each of the different types of registration or licenses (table 4.17, figure 4.4). A little more than two-thirds of the MSEs who had company registration had heard of businesses paying for the services of agents or making payments to government officers to get this particular registration. Knowledge of informal payments was comparatively lower among those with licenses from Department of Commerce (42 per cent).

Among the MSEs with different types of license/registration, the proportion of those who admitted having actually made informal payments was highest among those who had registration from Department of Cottage & Small Industries (22 per cent). On the other hand, a considerably smaller share of MSEs reported having to make informal payments in order to get a license from the Department of Commerce (12 per cent) and from DFTQC (12 per cent).

Figure 4.4. Percentage of MSEs in Nepal with different licenses who have heard of, or made, informal payments to acquire that licence/registration

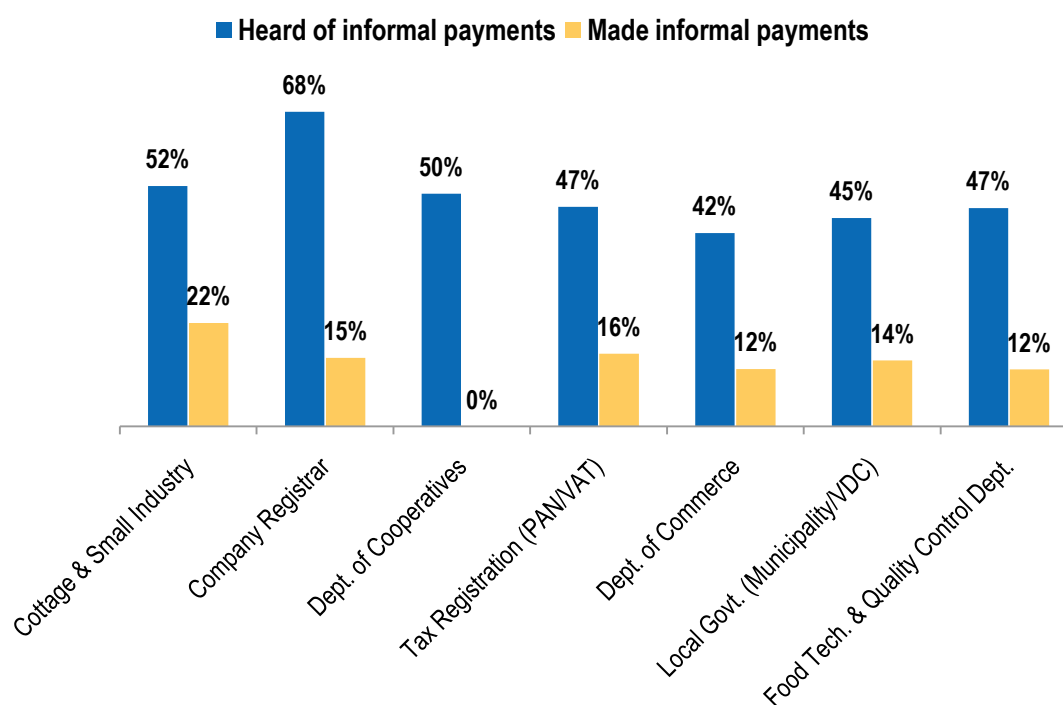


Table 4.17. Percentage of MSEs in Nepal with different licenses who have heard of, or made, informal payments for each Licence

Licences	Heard of informal payments	Made informal payments	Base (MSEs with that particular licence)
Cottage & small industries	52%	22%	207
Company registrar	68%	15%	34
Dept. of Cooperatives	50%	0%	2
Tax registration (PAN/VAT)	47%	16%	282
Dept. of Commerce	42%	12%	65
Local govt. (municipality/VDC)	45%	14%	268
DFTQC	47%	12%	49

4.3 Perception-based ranking of factors influencing business growth

Different from Bangladesh and Sri Lanka, when compared to the level of awareness, compliance and avoidance to labour laws confirmed through the survey, the perception-based ranking of factors from the Nepal survey did not demonstrate consistent tendency of overstating the impact of positive factors or understating the impact of negative factors.

- While 57 per cent of MSEs perceived compliance with environmental and sanitary regulations as positively affecting business growth, of the total MSEs, excluding those in the IT sector, only 18 per cent went through the IEE, six per cent have a PCC or ECC and only one agro-processing firm went through an EIA.
- While 40 per cent of firms perceived maintaining of employment registers as having a positive or strongly positive influence on business, an almost similar proportion (37 per cent) of the surveyed businesses actually maintained employment register.
- Around 62 per cent perceived paying the minimum wage as positively affecting growth of business, while only 37 per cent of the surveyed MSEs claimed to be paying the minimum wage.
- While 72 per cent of the total surveyed MSEs were below the EPF threshold, overall 65 per cent of the firms perceived it as not an issue for business growth and 20 per cent mentioned that EPF contributions do not influence growth of business. Of those above the threshold level, 19 per cent reported making EPF contributions, which is actually five per cent of the total MSEs (above and below the threshold level), compared to nine per cent of MSEs who perceived compliance with EPF regulations as having a positive impact on business growth.
- Having a trade union and collective bargaining process was perceived to be not facilitating growth of business by half of the MSEs (51 per cent) and have no influence by 29 per cent MSEs. In line with this perception, only 13 per cent of the surveyed businesses joined or formed a trade union.
- While 76 per cent of firms perceived workers' injury compensation as a positive step, only 41 per cent of MSEs above the threshold level (with 10–70 employees) reported having paid such compensation.

- While only 31 per cent of firms perceived annual leave for workers in positive light, 45 per cent of MSEs above the threshold level (with 10–70 employees) claimed that they had provided all kinds of paid leave to their workers.

4.3.1 Influence of factors related to general investment climate

When the MSEs in Nepal were asked how they see the different factors that can encourage or hinder business growth, the views were split (table B.71). According to them, the cost of land and premises had the strongest negative influence (29 per cent) on growth of business, followed by availability of electricity (21 per cent) and access to skilled workers (18 per cent) among various factors. Non-payment of dues by customers is another factor that is perceived to have a negative impact on business growth by 63 per cent of MSEs.

4.3.2 Influence of business environment-related factors (laws and regulations)

The MSEs were specifically asked how they would rank the influence of laws and regulations relating to the business environment on business growth (table B.72). The top three factors relating to business regulations that are perceived to have a great positive influence on business growth are cost or time required to register a business (62 per cent), maintaining minimum product standards and certification (60 per cent), and complying with environmental and sanitary regulations (57 per cent). On the other hand, more than half of the MSEs believe that obtaining patents and copyrights (59 per cent) and complying with import and export regulations (53 per cent) are among the factors that do not affect business growth.

4.3.3 Influence of factors relating to labour laws and regulations

Within the boundary of labour laws and regulations (table B.73), the top five positive factors were: “Complying with health and safety standards for workers” (82 per cent), “Workers’ injury compensation” (76 per cent), “Paying the minimum wage” (62 per cent), “Limits on working time” (47 per cent) and “Maintaining an employment register” (37 per cent). The proportion of MSEs who perceived labour laws as having a negative or strongly negative impact on business growth is considerably small. It is to be noted that almost half (49 per cent) of the MSEs perceived laws on dismissal procedures and disputes as having no influence on business growth.

Chapter 5: Summary and conclusion

Based on the survey of 409 micro- and small enterprises (MSEs) in Nepal, covering the four sectors of agro processing, garments/carpet, tourism, and information technology (IT), the key findings are summarized below.

5.1 Summary

5.1.1 Regulatory framework

There is a large regulatory framework governing enterprise development in Nepal. However, despite the prolific existence of such a framework, the survey analysis reveals that there are a number of issues, including lack of clarity, with regard to many laws. This does not augur well for the promotion of MSEs, which are often but not necessarily characterized by small size, created to meet subsistence and livelihood requirements, and are vulnerable to both internal and external shocks. The limited capability of MSEs is also exhibited by their informal nature, the existence of a large proportion of family unpaid workers, and the desire to escape from regulatory and other requirements. This survey also proves their relative small size, with an average workforce of 8.4 workers. Even in enterprises with 10–70 workers, the average number of employees is small. This clearly shows that MSEs in Nepal, in terms of size, are small and operating in an informal way in many cases.

5.1.2 Growth of MSEs

The total number of industrial enterprises in the country is declining, both in micro-enterprises as well as larger enterprises. This means the business environment in the country is not conducive to business growth as is also reported by a large number of studies, including the IFC study on *Doing Business*. The exception is enterprises in the carpet/garment, tourism and IT sectors in the 5–9 worker category, where an increase has been seen.

Not only is the overall number of enterprises declining, so too is the number of employees. Employment creation within the country is becoming an arduous task and this is not a good sign for development. Currently there may be the cushion of foreign employment to fall back on, but any problem therein is bound to create a substantial crisis. Concrete action is crucial to promote employment creation within the country by making due reforms in the regulatory framework, creating and improving the business and investment environment, and promoting economic activities in the country including promotion of MSEs, which are generally more labour-intensive by nature.

5.1.3 Employee composition

While only seven per cent of the workforce in the surveyed MSEs constituted casual/temporary labour, “*casualizing labour*” appears to have gone beyond the figure of seven per cent. Around 82 per cent of businesses from the carpet/garment industry paid wages on a piece-rate basis, while the majority of payments in other sectors was made on a monthly basis. This would indicate the casual nature of the “full-time” employees in the carpet/garment manufacturing sector.

5.1.4 Business and related registration

Non-registration of enterprises is low, with only 21 per cent of surveyed enterprises registered with any of the seven popular types of registration/license. The carpet/garment manufacturing firms were found to be unregistered because it was legally not required. Another 50 per cent

demonstrated the “avoidance by choice strategy”. Similarly, 44 per cent of MSEs not registered with local government authorities cited reasons that reflect the “avoidance by choice” strategy. A considerable proportion of 14 per cent of MSEs without a license from the Department of Food Technology and Quality Control (DFTQC) also gave their reason for non-compliance as lack of awareness of the obligation.

A majority of the surveyed MSEs in Nepal (82 per cent) were found to be in the sole proprietorship category, followed by partnership (seven per cent), unregistered/informal (five per cent), corporate limited company (five per cent), and cooperative (one per cent) categories.

5.1.5 Employment register

A majority of MSEs reported they did not maintain employment registers for their workers, while larger firms (10–70 employees) were found to be maintaining the register, except for 36 per cent who didn’t. One of the key reasons for non-maintenance of the employment register was that it was not legally required. A considerable proportion of MSEs cited other reasons that reflect “avoidance by choice” behaviour.

5.1.6 Environmental regulations

Of the total MSEs in Nepal, excluding those in the IT sector, only a small proportion (18 per cent) went through the IEE, only one agro-processing firm went through the EIA and six per cent had a PCC or ECC. The reasons for non-compliance included lack of awareness and absence of any legal requirement, and also others that can be considered “avoidance by choice” strategy.

5.1.7 Business inspection

The survey found that business inspection was not popular, with a majority of establishments (54 per cent) never having had an inspection even once during the year prior to the survey. Some, however, were inspected multiple times. Inspection was more prevalent in the agro-processing sector (62 per cent) followed by the IT (53 per cent), tourism (45 per cent) and carpets/garment sectors (31 per cent).

5.1.8 Minimum wage

Only a small proportion of MSEs (13 per cent) were aware of government-specified minimum wage obligations but still avoided paying minimum wage to their workers. The main reason provided was the absence of legal requirement (44 per cent), while the others reflected “avoidance by choice” behaviour.

5.1.9 Employees’ provident fund (EPF)

Except for one MSE in the tourism sector, “staying below the threshold level” in order to avoid compliance with EPF regulations was not at all observed among the surveyed MSEs. It was observed that the majority (71 per cent) of MSEs below the threshold level were not aware of regulations related to EPF payments. Further, a majority (81 per cent) reported not making EPF contributions. The reason for non-compliance was given as “It is not legally required”. The responses such as “Employees preferred to receive take-home pay” (34 per cent), “It is legal, but not enforced” (20 per cent) and “Unnecessarily complicated” (11 per cent) indicated some prevalence of “avoidance by choice” strategy.

5.1.10 Gratuity

Besides being applicable to businesses with ten or more employees, the liability of gratuity in Nepal emerges with employees completing seven years of service. The survey revealed that none of the surveyed MSEs “decided not to grow or employ workers beyond seven years in order to avoid making gratuity payments” (i.e. there was no “staying below the threshold level” strategy). Around 79 per cent of enterprises were unaware of the gratuity obligations. A majority of MSEs above the threshold level (83 per cent) reported never making gratuity payments to their workers. One legitimate reason was that there was no resignation or retirement in their corresponding enterprise and one-fourth of the MSEs reported that it was not legally required for them to make such a payment. However, there were some MSEs who gave reasons that can be considered as “avoidance by choice” behaviour.

5.1.11 Trade union

Trade union participation existed among a large section of MSEs except for about a third of the surveyed MSEs. A majority of enterprises reported that they were not aware that any regular employee can join a trade union federation, while employees in enterprises with ten or more workers can form a trade union within the enterprise. Lack of awareness regarding regulations on trade unions seems to be highest in the carpet/garment sector. A relatively smaller proportion of firms provided reasons that reflect “avoidance by choice” behaviour.

5.1.12 Income tax

The survey revealed that a significant number of MSEs in Nepal did not pay income tax. Non-payment was prominent in the carpet/garment sector. The reason for non-payment was given as legal exemption. However, since data on annual turnover of MSEs was not collected during the survey, it is uncertain whether all of these 64 per cent firms not paying income tax were legitimately exempted because their earning was actually less than the threshold level or not. “Avoidance by choice” strategy seemed to exist only among a smaller proportion of MSEs.

5.1.13 Value added tax (VAT)

A majority of MSEs did not pay VAT. Only a marginal proportion (two per cent of MSEs) tried to keep their income below the exemption threshold to avoid paying VAT (i.e. following the “staying below the threshold level” strategy). Lack of awareness was high, particularly in the tourism sector. A large proportion of MSEs did not pay VAT because it was not legally required or because they were exempted from making VAT payments. That may be true given the high threshold of annual turnover of two million Nepalese rupees (NPR) as well as exemptions given to cottage industries, the carpet/garment sector and the three sub-sectors of agro processing (rice mill, oil mill and flour mill). Some of the other reasons given for non-compliance by MSEs reflected “avoidance by choice” strategy.

5.1.14 Compensation for injury or death

Of the total MSEs with less than ten workers, the proportion that preferred to stay below the threshold level to avoid compliance was very low at one per cent (“staying below the threshold level” strategy). A few reported they were not aware of the legal obligation to provide compensation for injury/death to workers. However, a significant proportion of MSEs had not made compensation payments for either death or injuries. The reason cited was that it was not necessary to provide compensation (85 per cent) due to absence of any death/injury in their enterprise. Around 11 per cent of MSEs also mentioned that it was not a legal obligation for them to provide

compensation or treatment to workers. A comparatively smaller share of MSEs also provided reasons that reflected “avoidance by choice” behaviour.

5.1.15 Annual paid leave

Very few MSEs provided annual paid leave to their workers. Around 60 per cent of MSEs reported that they were not aware of the regulations on annual paid leave that are applicable to those above the threshold level. It was observed that the proportion of MSEs that never provided any annual paid leave to their workers was much higher in the carpet/garment sector (83 per cent) than in the other three sectors. A considerable proportion of MSEs who did not comply with regulations on annual paid leave provided reasons that reflected the “avoidance by choice” strategy.

5.1.16 Informal payments

A large proportion of MSEs were aware of informal payments being made with regard to non-compliance with compensation for injury and death (40 per cent), minimum wage rate (31 per cent), income tax (33 per cent), and VAT (28 per cent). A sizable proportion of MSEs (21 per cent) were also aware of informal payments being made with regard to non-compliance with environment regulations. Out of those who had heard of such informal payments being made, 13 per cent actually made informal payments with regard to non-compliance with income tax, 11 per cent on minimum wage, seven per cent on VAT, four per cent on compensation for injury/death, and two per cent on environmental regulations.

The MSEs were asked whether they had heard of or made informal payments in order to acquire each of the different types of registration or licenses. Around 68 per cent of MSEs who had company registration had heard of businesses paying for the services of agents or making informal payments to government officers to get this registration. Knowledge of informal payments was comparatively lower among those with licenses from the Department of Commerce (42 per cent). Of the MSEs with different types of license/registration, the proportion who admitted making informal payments was highest among those who had registrations from cottage and small scale industries (22 per cent). On the other hand, considerably a smaller share of MSEs reported making informal payments in order to get licenses from the Department of Commerce (12 per cent) and the DFTQC (12 per cent).

5.1.17 Perception-based rating of factors affecting business growth

Different from Bangladesh and Sri Lanka, when compared to the level of awareness, compliance and avoidance of labour laws confirmed through the survey, the perception-based ranking of factors from the Nepal survey did not demonstrate any consistent tendency of overstating the impact of positive factors or understating the impact of negative factors.

- While 57 per cent of MSEs perceived compliance with environmental and sanitary regulations as positively affecting business growth, of the total MSEs, excluding those in the IT sector, only 18 per cent went through an IEE, six per cent have a PCC or ECC, and only one agro-processing firm went through an EIA.
- While 40 per cent of firms perceived maintaining employment registers as having a positive or strongly positive influence on business, an almost similar proportion (37 per cent) of the surveyed businesses actually maintained employment registers.
- Around 62 per cent viewed paying the minimum wage as positively affecting growth of business, while only 37 per cent of the surveyed MSEs claimed to be paying the minimum wage.

- While 72 per cent of the total surveyed MSEs were below the EPF threshold level, overall 65 per cent of firms perceived it as not conducive to business growth and 20 per cent mentioned that EPF contributions did not influence growth of business. Of those above the threshold level, 19 per cent reported having made EPF contributions, which is actually five per cent of the total MSEs (above and below the threshold level), compared to nine per cent of MSEs who perceived compliance with EPF regulations as positively affecting business growth.
- Having a trade union and collective bargaining process is perceived to be not conducive to growth of business by half of the MSEs (51 per cent) and have not influence by 29 per cent MSEs. In line with this perception, only 13 per cent of the surveyed businesses had joined or formed a trade union.
- While 76 per cent of firms viewed workers' injury compensation as positive, only 41 per cent of MSEs above the threshold level (with 10–70 employees) reported having paid such compensation.
- While only 31 per cent of firms perceived paid annual leave for workers as positive, 45 per cent of MSEs above the threshold level (with 10–70 employees) claimed that they had provided all kinds of paid leave to their workers.
- Regarding laws and regulations, around 25 percent of MSEs viewed cost of taxation (income tax, sales tax/VAT) negatively.
- Compliance with health and safety standards of workers as well as workers' injury compensation seem to have been given high level of attention.

5.2 Conclusion and recommendations

- Currently, Nepal has a lot of disincentives in the form of excessive politicization of labour, frequent strikes and political interference, lack of flexibility in managing labour costs due to difficulties of shedding labour when business conditions deteriorate, and excessive regulation (ADB, DFID and ILO, 2009). The very sensitive issues pertaining to employment legislation, trade unions and labour relations require careful handling. Effective policy and institutions need to be built and capacitated taking into account the various concerns from different perspectives, including promoting discussions and negotiations to arrive at solutions, especially given that imposed solutions are unlikely to work.
- Regarding many of the labour laws, it was observed that a large majority of MSEs lacked proper awareness of their existence. Perhaps lack of awareness combined with different avoidance strategies lead to poor compliance levels of several business regulations that were applicable to all businesses in Nepal. It was also observed that awareness regarding penalties relating to non-compliance of regulations was moderate among the surveyed firms.
- Labour laws need to be reformed to provide flexibility to investors while protecting workers' rights and security concerns. Additionally, and importantly, thresholds should be gradually eliminated. The labour law application may not be immediately corrected in view of the arguments provided earlier, but as an initial step, some form of a labour code of conduct should be put in place to ensure that MSEs also adhere to some responsibilities towards labour, gradually bringing all formal organizations under the single labour Act. This will, to a great extent, eliminate avoidance strategies. The regulations need to be made less cumbersome; they should be simple and clear, without ambiguity, to ensure that even MSEs will be ready to come under the purview of the new rules.

- Besides improving the regulatory framework, there is a strong need to improve the enforcement of regulations. Simply enacting laws is not enough. Laws also need to be comprehensively implemented to attain the true spirit of the regulations in a transparent manner. This will require improved inspection and monitoring. Ultimately, the overall capacity of the implementing institutions, including that of the labour courts, should be significantly enhanced. Capacity improvement should focus on improvement in human resources for appropriate agencies as well as enhancing their capacity in terms of quality, enforcement, policy formulation in addition to equipping them with essential physical, financial and technological resources.
- It was seen that incentive programmes did not seem to exist for MSEs as only a small proportion (one per cent) reported such programmes. In order to promote MSEs, the government must put together a tangible incentive scheme that can be easily availed. It should also be one which will contribute to enhancing competitiveness of MSEs, at least for a period of time, so that these enterprises become capable and competitive. The total number of beneficiary MSEs may be less, but whatever is promised must be distributed. Such schemes should be scientifically designed to discourage misuse and bunching in order to pass eligibility criteria. MSEs should receive incentives for a limited period; the scheme should not drain on the government's budgetary resources.

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Appendix I. sampling design

I. Primary sampling units

The primary sampling unit (PSU) for this survey, in both urban and rural areas, is a ward. A ward in Nepal is the smallest geographical and administrative unit in the country.

II. Sampling procedure

In line with the sampling guidelines provided by the ILO, this survey has adopted a three-stage sampling methodology.

II(a). First-stage sampling

In the first stage, ten percent of the total districts (10 per cent of 75 = 7.5 = 8 districts) were selected on the basis of Probability Proportional to Size (PPS). The measure of size being the number of enterprises with 5–70 regular paid employees and belonging to the first three sectors, namely agro processing, carpet/garment, and information technology (IT). Enterprises belonging to the tourism sector could not be included due to figures on employment being unavailable. A cumulative method was used for PPS sampling.

As a result, seven districts have been selected, with Kathmandu featuring twice in the selection. The following are the districts selected for the survey.

1. Morang
2. Siraha
3. Kathmnadu
4. Kathmandu
5. Parsa
6. Kaski
7. Rupandehi
8. Kanchanpur

II(b). Second-stage sampling

A complete list of enterprises for each urban and rural ward for the selected seven districts was prepared. There were 286 wards in the seven selected districts and some 1,000 enterprises with 5–70 regular paid employees.

A set of 40 PSUs (wards of municipalities or VDCs) from seven districts were again selected on the basis of PPS sampling. Since Kathmandu district was selected twice, of the total 40 sample PSUs drawn, ward 31 of Kathmandu metropolitan city was selected twice.

II(c). Third-stage sampling

All wards that were found to be too large for a listing operation or those with more than 400 households were subjected to segmentation. After the segmentation, five with the largest number of enterprises were identified in close consultation with the local ward officials. A PPS selection procedure was then applied to select a segment for listing all the enterprise within it. All enterprises belonging to the four sectors, with 5–70 regular workers, and those that have been in operation for a minimum period of three years in each PSU were listed. The list of enterprises was then sorted out by each sector (agro processing, carpet/garment, IT, tourism) at the district level. A

sample size of 480 enterprises was set for the survey to be selected from four sectors (120 each) proportionally representing two employment sizes of 5–9 workers and 10–70 workers.

The listing operation provided the list of enterprises in the four sectors and two employment size groups for each district. All enterprises thus collected from the seven districts are combined together into four sectors and two employment sizes as shown in the boxes below.

Step I: Combined list of enterprises, by individual industry sector, for two employment groups from all the seven districts.

<u>Industry sector 1</u>	<u>Industry sector 2</u>	<u>Industry sector 3</u>	<u>Industry sector 4</u>
Worker group 1 Worker group 2	Worker group 1 Worker group 2	Worker group 1 Worker group 2	Worker group 1 Worker group 2

Step II

<u>Industry sector 1 (275)</u>
Worker group 1 (200) Worker group 2 (75)

From each category, 120 enterprises were selected for both worker groups proportional to the total number. For example, suppose the combined list of 275 enterprises of industry sector one has the following individual worker group composition:

Thus, from worker group one

$n_1 = 200 \times 120 / 275 = 87$ was selected at random

And from worker group two

$n_1 = 75 \times 120 / 275 = 32$ was selected at random

Total of all these ($87 + 32 = 120$) will be 120 for the industry as a whole.

Step III: The same procedure is replicated for the other three industry sectors to get a total of 480 enterprises (aggregate level).

III. Formation of segments

Since most PSUs, particularly those in the urban areas, have households ranging from 6,000 to 10,000 units, they had to be segmented to simplify the listing of the enterprises. Hence, PSUs with more than 400 households have been considered to be too large for listing and therefore were subjected to segmentation. Based on this criterion, 16 urban PSUs (ward) and ten rural PSUs were segmented. PSUs that were not necessary for segmentation were subjected to a complete listing of enterprises.

The PSUs that underwent segmentation are composed of several blocks/segments and one of them had to be selected for the listing of enterprises. In order to get information, various government and private sector agencies were approached, but to no avail. Finally, the Ward Offices (local government bodies) were approached seeking support in this direction and were found to be very

useful. Altogether five segments with the largest number of enterprises were identified in each PSU with the support of the Ward Offices and the segment with the largest number of establishments was selected for the listing operation. Table A1 presents the number of PSUs that underwent segmentation by districts and location.

IV. Sample allocation

IV(a). Total sample size

The sample size for the survey was set at 480 establishments. To draw the set sample of establishments a door-to-door listing operation was launched. During this operation all establishments located in the structures within the boundary of the 40 PSUs were listed. The first round of the listing operation conducted in the 40 PSUs as expected did not yield an adequate number of establishments required for the survey. Only a total of 371 establishments could be listed during this operation. This was lesser than the sample size set for the survey. Consequently, an additional 20 percent of PSUs were once again selected on the basis of PPS, in consultation with ILO. This additional percentage of PSUs was subjected to a further listing of establishments. This additional listing of establishments yielded a total of 487 establishments. From this list of 487 establishments, 480 establishments were selected using a systematic random sampling procedure. Out of the sample, the response from 409 enterprises (84.0 percent) was considered satisfactory and adequate.

Table A.1: Distribution of sample PSUs, by district and urban/rural sector

District	Urban	Rural	Total	No. of sample MSEs	No. of enterprises	% of responses
Morang	2	3	5	36	34	94
Siraha	1	0	1	18	18	100
Kathmandu	10	8	18	132	97	73
Parsa	4	3	7	82	82	100
Kaski	3	0	3	57	46	81
Rupandehi	4	5	9	117	89	76
Kanchanpur	2	3	5	45	43	96
Total	26	22	48	487	409	84

IV(b). Enumeration area

The enumeration area for the survey comprised a ward. And in wards that underwent segmentation, the enumeration area was the chosen segment out of them.

V. Field operation for listing and main survey

The field operation for listing and the main survey were done separately. In the first phase, the listing operation was conducted after completing the segmentation of the 26 wards. A separate training programme was conducted for listing and segmenting activities. The training programme was conducted from April to May 2011, and it lasted for almost two months. Altogether 12 interviewers participated in this operation.

VI. Training, field supervision and quality control

For data management and processing, CSPro software was used to develop a data entry and editing system. To control the quality of the data, a consistency check during the process of data entry was strictly performed using the CSPro software. STATA software was used to generate the tables and MS Excel was used to create the graphs. The final data set is provided in SPSS and STATA format, readable in other statistical software packages.

Distribution of Sample MSEs by District

Ecological Belt

- Mountain
- Hill
- Terai

Boundary

- District
- Regional
- International

N=Number of Sample MSEs by District

Regions: FAR WESTERN REGION, MID WESTERN REGION, WESTERN REGION, CENTRAL REGION, EASTERN REGION

Districts and Sample MSEs:

- BAITADI
- DADELDHURA
- DOTI
- KANCHANPUR 43
- KAILALI
- BARDIA
- BANKE
- DANG
- SURKHET
- DAILEKH
- KALIKOT
- JUMLA
- BAJHANG
- DARCHULA
- HUMLA
- MUGU
- DOLPA
- RUKUM
- MYANGDI
- BYANGDI
- KASKI 56
- PARBAT
- GULMI
- SYANGJA
- TANAHU
- PALPA
- ANGRAKHANCHI
- PIUTHAN
- ROLPA
- SALYAN
- MAKAWANPUR
- CHITWAN
- NAWAL PARASI
- KAPILBASTI 116
- RUPANDEHI
- PAUNSI
- BAJA
- RAUTAHAT
- SARANI
- MECHAPATI
- PHULBANI
- SINDHULI
- RAMCHAP
- DOLAKHA
- NUWAKOT
- SINDHUPALCHOWK
- KATHMANDU
- BHAKTAPUR
- LALITPUR
- KAVRE
- ORAHADHUNGA
- SOLUKHUMBU
- SANKHUWAKABHANG
- TAPLEJUNG
- TEHRATHUM
- CHANKUTA
- PAWANKHAR
- ILAM
- JHAPA
- MOORANG
- SAPTARI
- UBAYAPUR
- 35
- 18
- 82

Map Source: Department of Survey, Government of Nepal

VII. Estimation procedure

The estimation procedure for establishments was developed on the basis of the sampling methodology, with attention to the following factors:

- For the estimation of enterprises, probabilities at each stage of selection were considered.
- Estimates were required separately for each sector, and the total sample was proportionately allocated for each sector so that each sector provided a representative sample of disaggregation of the country.

1. First stage: Probability of selecting a particular district $i = S_i * \frac{N_i}{\sum_j N_i}$

Where,

N_i is the number of establishments of 5–70 employees in i th district in the sample frame, $\sum N_i$ is the total number of establishments of 5–70 employees in the i th district of sampling frame, and S_i is the number of the PSUs in the i th district.

In the process of cartographic work done in a selected ward i , a number of sub-wards are created with size $K_{i1}, K_{i2}, K_{i3} \dots$, where the total size of the ward $\sum K_{ij}$ is unlikely to be equal to the original size of the ward N_i . One of these sub-wards is then selected with PPS for inclusion in the survey.

2. Intermediate stage: Probability of selecting the j th sub-ward $= \frac{K_{ij}}{\sum_j K_{ij}}$

Where,

K_{ij} is the number of establishments of 5–70 employees counted in the j th sub-ward of ward i in the cartographic work, and

$\sum_j K_{ij}$ is the total number of establishments of 5–70 employees counted in the i th ward in the cartographic work.

The interviewer then visits the j th sub-ward during the survey, lists all the structures and attempts to interview the selected establishments (no substitutes are allowed).

3. Final stage: Probability of selection of establishments of 5–70 employees $= \frac{n_{ij}}{K_{ij}^*}$

Where,

n_{ij} is the number of establishments successfully interviewed, and

K_{ij}^* is the number of establishments of 5–70 employees counted at the listing stage.

The overall probability of selection for an individual establishment of 5–70 employees is the multiple of the selection probabilities at the three stages.

$$\text{Overall selection probability} = S_i * \frac{N_i}{\sum N_i} * \frac{K_{ij}}{\sum_j K_{ij}} * \frac{n_{ij}}{K_{ij}^*}$$

The raising factor is the inverse of this probability, and the formula can be rewritten as follows:

$$\text{Raising up factor} = \frac{\sum N_i}{h_i} * \frac{\sum K_{ij}}{N_i} * \frac{K_{ij}^*}{K_{ij}} * \frac{n_i}{n_{ij}}$$

(1) (2) (3) (4)

Where,

$h_i = S_i * n_i$, total number of enterprises selected in the i th PSU and

n_i = number of enterprises selected in the i th PSU.

In the first selection of 40 PSUs, the above formula of raising factor was used for multiplying the figures. For the additional eight PSUs drawn from the frame of eight selected districts, the raising factor has been calculated on the same basis after subtraction of the establishments belonging to the former 40 PSUs.

Appendix II. Detailed tables for chapter 4

Table B.1. Percentage distribution of employees in MSEs in Nepal across type of employment for different worker groups, 2009

Nature of employment	Enterprise with 5–9 workers	Enterprise with 10–70 workers	All enterprises
Paid workers			
Full time	90%	97%	94%
Part time	1%	1%	1%
Casual/temporary	9%	3%	5%
Total	100%	100%	100%
Base (paid workers)	1336	1871	3207
Unpaid workers			
Full time	100%	99%	100%
Part time	0%	1%	0%
Casual/temporary	0%	0%	0%
Total	100%	100%	100%
Base (unpaid workers)	611	196	807

Table B.2. Percentage distribution of employees in MSEs in Nepal across gender for different types of employment, 2011

Nature of employment	Male	Female	Total
Paid workers			
Full time	82%	18%	100%
Part time	76%	24%	100%
Casual/temporary	69%	31%	100%
Total	81%	19%	100%
Base (paid workers)	2721	656	3377
Unpaid workers			
Full time	68%	32%	100%
Part time	100%	0%	100%
Casual/temporary	.	.	.
Total	68%	32%	100%
Base (unpaid workers)	576	265	841
Total workers (paid + unpaid)			
Full time	79%	21%	100%
Part time	77%	23%	100%
Casual/temporary	69%	31%	100%
Total	78%	22%	100%
Base (total workers)	3297	921	4218

Table B.3. Distribution of employees in MSEs in Nepal across gender for different types of employment in each sector, 2011

Paid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	90	10	67	33	69	31	86	14
Carpet/garment	64	36	100	0	69	31	65	35
Tourism	87	13	79	21	0	0	87	13
IT	81	19	0	0	0	0	81	19
Total	82	18	76	24	69	31	81	19
Unpaid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	75	25	100	0	0	0	75	25
Carpet/garment	72	28	0	0	0	0	72	28
Tourism	63	37	0	0	0	0	63	37
IT	95	5	0	0	0	0	95	5
Total	68	32	100	0	0	0	68	32
Total workers (paid + unpaid)								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	87	13	68	32	69	31	84	16
Carpet/garment	66	34	100	0	69	31	66	34
Tourism	81	19	79	21	0	0	81	19
IT	84	16	0	0	0	0	84	16
Total	79	21	77	23	69	31	78	22

Table B.4. Percentage distribution of employees in MSEs in Nepal across gender for different types of employment, 2009

Nature of employment	Male	Female	Total
Paid workers			
Full time	83%	17%	100%
Part time	90%	10%	100%
Casual/temporary	61%	39%	100%
Total	81%	19%	100%
Base (paid workers)	2612	595	3207

Unpaid workers			
Full time	68%	32%	100%
Part time	100%	0%	100%
Casual/temporary	.	.	.
Total	69%	31%	100%
Base (unpaid workers)	553	254	807
Total workers (paid + unpaid)			
Full time	80%	20%	100%
Part time	91%	9%	100%
Casual/temporary	61%	39%	100%
Total	79%	21%	100%
Base (total workers)	3165	849	4014

Table B.5. Distribution of employees in MSEs in Nepal across gender for different types of employment in each sector, 2009

Paid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	93	7	100	0	58	42	87	13
Carpet/garment	67	33	83	17	100	0	67	33
Tourism	87	13	90	10	100	0	87	13
IT	82	18	0	0	0	0	82	18
Total	83	17	90	10	61	39	81	19
Unpaid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	74	26	100	0	0	0	75	25
Carpet/garment	72	28	0	0	0	0	72	28
Tourism	63	37	100	0	0	0	63	37
IT	100	0	0	0	0	0	100	0
Total	68	32	100	0	0	0	69	31
Total workers (paid + unpaid)								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	89	11	100	0	58	42	85	15
Carpet/garment	68	32	83	17	100	0	68	32
Tourism	81	19	91	9	100	0	81	19
IT	86	14	0	0	0	0	86	14
Total	80	20	91	9	61	39	79	21

Table B.6. Percentage distribution of MSEs in Nepal across payment modality

Payment modality	Agro processing	Carpet/garment	Tourism	IT	All
Hourly basis	0%	0%	0%	0%	0%
Daily basis	10%	0%	1%	7%	3%
Weekly basis	0%	1%	0%	0%	0%
Monthly basis	86%	6%	95%	93%	69%
Piece-rate	3%	82%	1%	0%	23%
Lumpsum	1%	0%	3%	0%	2%
Other	0%	10%	0%	0%	3%
Total	100%	100%	100%	100%	100%
Base (Total MSEs)	98	108	188	15	409

Table B.7. Percentage distribution of MSEs with at least one of the seven population types of registration

Sector	At least one registration	No registration	Total
Agro processing	92%	8%	100%
Carpet/garment	61%	39%	100%
Tourism	81%	19%	100%
IT	100%	0%	100%
All	79%	21%	100%

Table B.8. Distribution of MSEs (various reasons) for having each licence (% MSEs)

Licences	It is legally required	To qualify for credit	To avail government / donor/ NGO schemes	Needed by suppliers / buyers	Others	Base(MSEs with the particular licence)
Cottage & small industries	88%	6%	3%	2%	1%	207
Company Registrar	85%	9%	3%	0%	3%	34
Dept. of Cooperatives	100%	0%	0%	0%	0%	2
Tax registration (PAN/VAT)	81%	16%	1%	1%	1%	282
Dept. of Commerce	75%	11%	2%	11%	2%	65
Local govt. (municipality/VDC)	81%	6%	10%	2%	1%	268
DFTQC	76%	4%	12%	6%	2%	49

Note: DFTQC = Department of Food Technology and Quality Control.

Table B.9. Percentage distribution of MSEs in Nepal who have not acquired different licenses across reasons for not acquiring them

Licences	It is not legally required	It is legal, but not enforced	Takes too much time	Complicated/ do not see the benefit	Don't want to pay the required fees	Don't want to become taxable	Not aware of requirement	Others	Base (MSEs without the particular licence)
Cottage & small Industries	46%	27%	1%	12%	1%	0%	6%	5%	202
Company Registrar	53%	19%	1%	11%	1%	2%	11%	3%	375
Dept. of Cooperatives	55%	17%	1%	10%	2%	3%	9%	2%	407
Tax registration (PAN/VAT)	31%	24%	2%	13%	6%	4%	11%	8%	127
Dept. of Commerce	56%	16%	1%	13%	1%	2%	8%	3%	344
Local govt. (municipality/VDC)	38%	23%	0%	14%	6%	1%	11%	7%	141
DFTQC	51%	21%	1%	8%	3%	1%	14%	3%	360

Note: DFTQC = Department of Food Technology and Quality Control.

Table B.10. Average number of days taken by MSEs in Nepal to complete the registration/ acquire license

Licences	Average no. of days taken to complete the registration/ acquire license
Cottage & small industries	4.6
Company Registrar	9.9
Dept. of Cooperatives	1.5
Tax registration (PAN/VAT)	6.3
Dept. of Commerce	1.6
Local govt. (municipality/VDC)	4.6
DFTQC	3.6

Note: DFTQC = Department of Food Technology and Quality Control.

Table B.11. Average official government fees paid by MSEs for initial registration/licensing in Nepal

Licences	Average amount actually paid (NPR)
Cottage & small industries	2236
Company Registrar	4017
Dept. of Cooperatives	.
Tax registration (PAN/VAT)	1650
Dept. of Commerce	679
Local govt. (municipality / VDC)	1330
DFTQC	1863

Note: DFTQC = Department of Food Technology and Quality Control.
NPR = Nepalese rupees

Table B.12. Average annual renewal fee for registration/license reported to have been paid by MSEs in Nepal

Licences	Average amount actually paid (NPR)
Cottage & small industries	1765
Company Registrar	4741
Dept. of Cooperatives	250
Tax registration (PAN/VAT)	2575
Dept. of Commerce	957
Local govt. (municipality/VDC)	1181
DFTQC	1378

Note: DFTQC = Department of Food Technology and Quality Control.
NPR = Nepalese rupees

Table B.13. Percentage distribution of MSEs in Nepal with different licenses who have heard of/made informal payments for each licence

Licences	Heard of informal payments	Of those who heard, percentage who made informal payments	Base (MSEs with the particular licence)
Cottage & small Industries	52%	43%	207
Company Registrar	68%	22%	34
Dept. of Cooperatives	50%	0%	2
Tax registration (PAN/VAT)	47%	33%	282
Dept. of Commerce	42%	30%	65
Local govt. (municipality/VDC)	45%	32%	268
DFTQC	47%	26%	49

Note: DFTQC = Department of Food Technology and Quality Control.
NPR = Nepalese rupees

Table B.14. Percentage distribution of MSEs in Nepal inspected by different officers/ departments

Officers/departments	Agro processing	Carpet/ garment	Tourism	IT	All
Labour inspector	30%	27%	16%	20%	22%
Industrial inspector	31%	3%	2%	7%	9%
Environmental inspector	21%	2%	1%	0%	6%
DFTQC	52%	1%	34%	7%	28%
Tax inspector	55%	22%	38%	53%	39%
Other	53%	56%	52%	27%	52%
Base (total MSEs)	98	108	188	15	409

Note: DFTQC = Department of Food Technology and Quality Control

Table B.15. Percentage distribution of MSEs in Nepal that do not maintain official employment registers(various reasons)

Reason	% MSEs
It is not legally required	44%
It is legal, but not enforced	19%
Takes too much time	7%
Unnecessary complicated (do not see the benefit)	35%
Too costly	5%
Not necessary, daily-wage payment	27%
Other: specify	31%
Base (MSEs that do not maintain an employment register)	256

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.16. Percentage distribution of MSEs in Nepal who are aware of trade unions and whose employees have neither joined a trade union federation nor formed any trade union (various reasons)

Reason	No. of MSEs
It is not legally required	33%
It is legally required, but not enforced	10%
Too costly	2%
There are regular meetings/communication with workers	15%
Workers have not demanded a union	72%
Others	32%
Base (MSES whose employees have neither joined a trade union federation nor formed any trade union)	130

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.17. Percentage distribution of MSEs in Nepal across status of overall wage increase for their employees during one year prior to the survey in each business sector

Status of wage	Agro processing	Carpet/Garment	Tourism	IT	All
There is overall wage increase	69%	73%	54%	67%	63%
No wage increase	31%	27%	46%	33%	37%
Base (total MSEs)	98	108	188	15	409

Table B.18. Distribution of MSEs in Nepal that had an overall wage increase for their employees during the year prior to the survey across rate of wage increase

Rate of wage increase	Agro processing	Garment/Carpet	Tourism	IT	All
Less than equal to 10%	34%	41%	39%	20%	37%
10%–15%	10%	9%	25%	30%	17%
16%–25%	24%	10%	19%	20%	17%
26%–35%	21%	15%	8%	10%	14%
36%–75%	12%	25%	9%	20%	15%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs whose employees had overall wage increase)	68	79	102	10	259

Table B.19. Percentage distribution of MSEs in Nepal with more than one parallel business unit, by business sector and worker group

Business sector/ worker group	Percentage of MSEs managing more than one business in the same and/or neighbouring district	Base (no. of MSEs)
Agro processing	1%	98
Carpet/garment	2%	108
Tourism	4%	188
IT	7%	15
Enterprise with 5–9 workers	2%	302
Enterprise with 10–70 workers	6%	107
All	3%	409

Table B.20. Average no. of days taken by MSEs in Nepal to prepare reports for the environmental compliance process, by worker group

Environmental license/regulation	Enterprise with 5-9 workers	Enterprise with 10-70 workers	All enterprises
			Average days actually taken
Initial Environmental Evaluation (IEE)	1	3	2
Environmental Impact Assessment (EIA)	15	n.a.	15
Pollution Control Certificate (PCC)/Environmental Clearance Certificate (ECC)	2	4	2
Note: No officially set duration for preparing reports.			

Table B.21. Average no. of days taken by government agencies to approve environmental registration/licence, by worker group

Environmental license/regulation	Enterprise with 5-9 workers	Enterprise with 10-70 workers	All	
			Average days actually taken	Officially defined duration (no. of days)
Initial Environmental Evaluation (IEE)	1	7	3	21
Environmental Impact Assessment (EIA)	1	n.a.	1	120
Pollution Control Certificate (PCC)/Environmental Clearance Certificate (ECC)	3	6	5	3

Table B.22. Average official government fee (cost of study) for initial environmental licensing

Environmental license/regulation	Actual amount paid	Officially set fee
Initial Environmental Evaluation (IEE)	1453	No officially set fee
Environmental Impact Assessment (EIA)*	n.a.	No officially set fee
Pollution Control Certificate (PCC)/ Environmental Clearance Certificate (ECC)	381	Ranges from NPR400 to NPR5000 plus maximum bank guarantee of NPR300000
Note: * There is one sampled MSE with an EIA.		

Table B.23. Percentage distribution of MSEs in Nepal who have heard that there are penalties if businesses do not comply with environmental regulations

Worker group/ business sector	Percentage of MSEs who heard about existence of penalties	Base (total MSEs)
Enterprise with 5–9	41%	302
Enterprise with 10–70	66%	107
Agro processing	61%	98
Carpet/garment	34%	108
Tourism	46%	188
IT	73%	15
All	48%	409

Table B.24. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for non-compliance of environmental regulations, across knowledge of different penalties

Knowledge about penalties	Percentage of MSEs
Unable to specify the penalties	63%
Answer mismatched	21%
Knows category and the quantum	2%
Knows category but not the quantum	15%
Total	100%
Base (no. of MSEs who have heard of the existence of penalties)	195

Table B.25. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with environmental regulations

Business sector/ worker group	Heard of informal payments	Of those who heard, percentage who made informal payments	Base (no. of MSEs)
Agro processing	13%	0%	98
Carpet/garment	15%	0%	108
Tourism	29%	4%	188
IT	20%	0%	15
Enterprise with 5–9 workers	19%	0%	302
Enterprise with 10–70 workers	26%	7%	107
All	21%	2%	409

Table B.26. Percentage distribution of MSEs in Nepal whose businesses started with support from a government donor or NGO, by business sector

Business sector	Percentage of MSEs who received support	Base (total no. of MSEs)
Agro processing	3%	98
Carpet/garment	1%	108
Tourism	1%	188
IT	0%	15
All	1%	409

Table B.27. Percentage distribution of MSEs in Nepal who are aware of minimum wage regulations but do not comply with the regulations (various reasons)

Reason	% MSEs
It is not legally required	44%
It is legal, but not enforced	13%
Takes too much time	5%
Unnecessary complicated (do not see the benefit)	15%
Too costly	24%
Other: specify	55%
Base (total MSEs who are aware but do not comply with regulations on minimum wage)	55
Note: Percentages do not add to 100% because the same enterprise can give more than one reason.	

Table B.28. Percentage distribution of MSEs in Nepal who reported that they are aware of the national minimum wage

Business sector	Percentage of MSEs aware of national minimum wage	Base (total MSEs)
Agro processing	57%	98
Carpet/garment	35%	108
Tourism	50%	188
IT	60%	15
Enterprise with 5–9 workers	42%	302
Enterprise with 10–70 workers	66%	107
All	48%	409

Table B.29.: Percentage distribution of MSEs in Nepal who have heard that there are penalties if businesses do not comply with minimum wage regulations

Worker group/ business sector	Percentage MSEs who heard about the existence of penalties	Base (total MSEs)
Enterprise with 5–9 workers	43%	302
Enterprise with 10–70 workers	69%	107
Agro processing	70%	98
Carpet/garment	35%	108
Tourism	45%	188
IT	87%	15
All	50%	409

Table B.30. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for non-compliance with minimum wage regulations, across knowledge about different penalties

Knowledge about penalties	Percentage of MSEs
Unable to specify the penalties	68%
Answer mismatched	23%
Knows category and the quantum	0%
Knows category but not the quantum	10%
Total	100%
Base (MSEs who have heard about the existence of penalties)	204

Table B.31. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on minimum wage

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (total MSEs)
Agro processing	27%	15%	98
Carpet/garment	23%	8%	108
Tourism	36%	12%	188
IT	53%	0%	15
Enterprise with 5–9 workers	28%	12%	302
Enterprise with 10–70 workers	40%	9%	107
All	31%	11%	409

Table B.32. Percentage distribution of MSEs in Nepal with ten or more workers and all MSEs within industrial estates who make EPF contributions, by business sector

Business sector	Percentage of MSEs who make EPF contributions	Base (MSEs with ten or more workers & all MSEs within industrial estates)
Agro processing	20%	45
Carpet/garment	4%	25
Tourism	28%	43
IT	0%	2
All MSEs with ten or more workers & all MSEs within industrial estates	19%	115

Table B.33. Percentage distribution of MSEs in Nepal with ten or more workers and all MSEs within industrial estates who do not file a monthly EPF return (across reasons)

Reason	Percentage of MSEs
It is not legally required	23%
It is legal, but not enforced	20%
Unnecessarily complicated	11%
Too costly	4%
Workers have not demanded it	46%
Employees prefer to receive higher take-home pay	34%
Other: specify	31%
All MSEs with ten or more workers & all MSEs within industrial estates who do not file monthly EPF returns	93

Table B.34. Percentage distribution of MSEs in Nepal with ten or more workers and all MSEs within industrial estates who make EPF contributions, across time required to file a monthly EPF return

Time	Percentage of MSEs
Less than 30 minutes a month	9%
30–60 minutes a month	32%
1–2 hours a month	45%
More than two hours a month	14%
All MSEs with ten or more workers & all MSEs within industrial estate	22

Table B.35. Percentage distribution of MSEs in Nepal who reported that they are aware of the rate of EPF contributions that businesses are required to make

Business sector	Percentage of MSEs aware of EPF rate	Base (total MSEs)
Agro processing	48%	98
Carpet/garment	31%	108
Tourism	38%	188
IT	67%	15
Enterprise with 5–9 workers	32%	302
Enterprise with 10–70 workers	62%	107
All	40%	409

Table B.36. Percentage distribution of MSEs in Nepal who have heard that there are penalties if businesses do not contribute to EPF

Worker group/business sector	Percentage of MSEs who have heard about the existence of penalties	Base (total MSEs)
Enterprise with 5–9 workers	33%	302
Enterprise with 10–70 workers	53%	107
Agro processing	51%	98
Carpet/garment	25%	108
Tourism	36%	188
IT	80%	15
All	38%	409

Table B.37. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for not contributing to EPF, across knowledge of different penalties

Knowledge of penalties	All MSEs (%)	MSEs with ten or more workers (%)
Unable to specify the penalties	73%	72%
Answer mismatched	24%	28%
Knows category and the quantum	0%	0%
Knows category but not the quantum	3%	0%
Total	100%	100%
Base (MSEs who have heard about the existence of penalties)	157	57

Table B.38. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on provident fund

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (no. of MSEs)
Agro processing	11%	0%	98
Carpet/garment	10%	0%	108
Tourism	21%	3%	188
IT	13%	0%	15
Enterprises with 5–9 workers	12%	0%	302
Enterprises with 10–70 workers	24%	4%	107
All	15%	2%	409

Table B.39. Percentage distribution of paid workers in MSEs in Nepal across duration of employment by nature of employment, 2011

Nature of employment	Working for > = 7 years	Working for < 7 years	Total
Full time	11%	89%	100%
Part time	0%	100%	100%
Casual/temporary	0%	100%	100%
Total	10%	90%	100%
Base (total paid workers)	347	3030	3377

Table B.40. Percentage distribution of MSEs in Nepal with ten or more workers and all MSEs within industrial estates who have ever made gratuity payments, by business sector

Business sector	MSEs (%) who make gratuity payments	Base (MSEs with ten or more workers & all MSEs within industrial estates)
Agro processing	13%	45
Carpet/garment	12%	25
Tourism	21%	43
IT	50%	2
All	17%	115

Table B.41. Percentage distribution of MSEs in Nepal with ten or more workers and all MSEs within industrial estates who have never paid gratuity (across reasons)

Reason	MSEs (%)
It is not legally required	25%
It is legal, but not enforced	11%
There was no resignation/retirement	46%
Too costly	6%
Workers have not demanded it	47%
Other: specify	34%
All MSEs with ten or more workers & all MSEs within industrial estates who never paid gratuity	96
Note: Percentages do not add to 100% because the same enterprise can give more than one reason.	

Table B.42. Percentage distribution of MSEs in Nepal who were aware of the amount of gratuity payment that businesses with ten or more regular employees are required to make

Business sector	MSEs (%) aware of gratuity payment amount	Base (total MSEs)
Agro processing	24%	98
Carpet/garment	19%	108
Tourism	28%	188
IT	40%	15
Enterprises with 5–9 workers	20%	302
Enterprises with 10–70 workers	40%	107
All	25%	409

Table B.43. Percentage distribution of MSEs in Nepal who have heard of penalties if businesses do not make gratuity payments

Worker group/business sector	MSEs (%) who heard about the existence of penalties	Base (total MSEs)
Enterprises with 5–9 workers	25%	302
Enterprises with 10–70 workers	49%	107
Agro processing	45%	98
Carpet/garment	18%	108
Tourism	30%	188
IT	67%	15
All	32%	409

Table B.44. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for not making gratuity payments, across knowledge of different penalties

Knowledge of penalties	MSEs (%)
Unable to specify the penalties	72%
Answer mismatched	26%
Knows category and the quantum	0%
Knows category but not the quantum	2%
Total	100%
Base (MSEs who have heard about the existence of penalties)	129

Table B.45. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on gratuity

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (no. of MSEs)
Agro processing	10%	0%	98
Carpet/garment	8%	0%	108
Tourism	18%	3%	188
IT	13%	0%	15
Enterprises with 5–9 workers	10%	0%	302
Enterprises with 10–70 workers	23%	4%	107
All	13%	2%	409

Table B.46. Percentage distribution of MSEs in Nepal with ten or more workers, who never provided compensation for death/injury/treatment (across reasons)

Reason	MSEs (%)
It is not legally required	11%
It is legally required, but not enforced	13%
Takes too much time	2%
Too costly	4%
It has not been demanded	11%
It has not been necessary (no injury or death)	85%
Others	23%
Base (total MSEs who never provided compensation or treatment)	47
Note: Percentages do not add to 100% because the same enterprise can give more than one reason.	

Table B.47. Percentage distribution of MSEs in Nepal who reported that they are aware of the kind of compensation for injury or death that businesses with ten or more regular employees are required to provide to their employees

Business sector	MSEs (%) aware of the kind of compensation for injury or death	Base (total MSEs)
Agro processing	73%	98
Carpet/garment	50%	108
Tourism	60%	188
IT	80%	15
Enterprises with 5–9 workers	56%	302
Enterprises with 10–70 workers	77%	107
All	61%	409

Table B.48. Percentage distribution of MSEs in Nepal who have heard that there are penalties if businesses do not provide compensation for death/injury

Worker group/business sector	MSEs (%) who heard about the existence of penalties	Base (total MSEs)
Enterprises with 5–9 workers	46%	302
Enterprises with 10–70 workers	73%	107
Agro processing	73%	98
Carpet/garment	35%	108
Tourism	51%	188
IT	80%	15
All	53%	409

Table B.49. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for not providing compensation for death/injury, across knowledge of different penalties

Knowledge of penalties	All MSEs (%)	MSEs with ten or more workers (%)
Unable to specify the penalties	70%	63%
Answer mismatched	25%	32%
Knows category and the quantum	0%	0%
Knows category but not the quantum	6%	5%
Total	100%	100%
Base (MSEs who have heard of the existence of penalties)	217	78

Table B.50. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on compensation for injury/death

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (total MSEs)
Agro processing	33%	6%	98
Carpet/garment	35%	5%	108
Tourism	45%	4%	188
IT	53%	0%	15
Enterprises with 5–9 workers	37%	2%	302
Enterprises with 10–70 workers	46%	10%	107
All	40%	4%	409

Table B.51. Percentage distribution of MSEs in Nepal with less than ten workers across their knowledge of the obligation to provide annual paid leave to workers and its impact on growth

Status of awareness and impact on growth	Agro processing	Carpet/garment	Tourism	IT	All
Aware and tried to stay below threshold	5%	0%	2%	0%	2%
Aware but not affecting growth	44%	40%	32%	77%	38%
Not aware	51%	60%	66%	23%	60%
Base (MSEs with less than ten workers)	57	85	147	13	302

Table B.52: Percentage distribution of MSEs in Nepal with ten or more workers who never provided paid leave, across reasons

Reason	No. of MSEs
It is not legally required	34%
It is legally required, but not enforced	28%
Too complicated	9%
Too costly	9%
It has not been demanded	49%
Others	34%
Base (MSES who never provided paid sick leave/home leave/mourning leave)	47

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.53. Percentage distribution of MSEs in Nepal who heard that there are penalties if businesses do not comply with regulations on annual paid leave

Worker group/business sector	MSEs (%) who heard about the existence of penalties	Base (total MSEs)
Enterprises with 5–9 workers	33%	302
Enterprises with 10–70 workers	58%	107
Agro processing	58%	98
Carpet/garment	26%	108
Tourism	34%	188
IT	87%	15
All	40%	409

Table B.54. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for not providing annual paid leave, across knowledge of different penalties

Knowledge of penalties	All MSEs (%)	MSEs with ten or more workers (%)
Unable to specify the penalties	65%	61%
Answer mismatched	28%	35%
Knows category and the quantum	0%	0%
Knows category but not the quantum	7%	3%
Total	100%	100%
Base (MSEs who have heard of the existence of penalties)	162	62

Table B.55. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on annual paid leave

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (no. of MSEs)
Agro processing	13%	8%	98
Carpet/garment	15%	0%	108
Tourism	23%	2%	188
IT	27%	0%	15
Enterprises with 5–9 workers	16%	2%	302
Enterprises with 10–70 workers	28%	3%	107
All	19%	3%	409

Table B.56. Percentage distribution of MSEs in Nepal who pay income tax, by business sector

Business sector	MSEs (%) who pay income tax	Base (total MSEs)
Agro processing	74%	98
Carpet/garment	40%	108
Tourism	56%	188
IT	93%	15
All	58%	409

Table B.57. Percentage distribution of MSEs in Nepal who do not pay income tax across reasons for not paying

Reason	No. of MSEs
It is not legally required/exempted	64%
It is legally required, but not enforced	16%
Takes too much time	3%
Unnecessarily complicated (do not see the benefit)	29%
Too costly	20%
Others	39%
Base (total MSEs who do not pay income tax)	173
Note: Percentages do not add to 100% because the same enterprise can give more than one reason.	

Table B.58. Percentage distribution of MSEs in Nepal who pay income tax across rate of income tax in each business sector

Income tax rate	Agro processing	Carpet/garment	Tourism	IT	All
0%	32%	12%	9%	7%	17%
1%–12%	16%	7%	10%	7%	11%
13%	4%	23%	29%	36%	21%
15%	18%	47%	33%	29%	31%
16%–20%	29%	7%	7%	14%	14%
Greater than 20%	1%	5%	11%	7%	7%
Base (MSEs who pay income tax)	73	43	106	14	236

Table B.59. Percentage distribution of MSEs in Nepal who pay income tax across time spent on filing and paying for income tax, by business sector

Time spent filling and paying income tax	Agro processing	Carpet/garment	Tourism	IT	All
Less than 1 day	4%	2%	1%	0%	2%
1 day	64%	65%	82%	64%	72%
2 days	22%	21%	13%	29%	18%
3 or more days	10%	12%	4%	7%	7%
Total	100%	100%	100%	100%	100%
Base (No. of MSEs who pay income tax)	73	43	106	14	236

Table B.60. Percentage distribution of MSEs in Nepal who have heard of penalties for evading payment of income tax

Worker group/business sector	MSEs (%) who heard about the existence of penalties	Base (total MSEs)
Enterprises with 5–9 workers	51%	302
Enterprises with 10–70 workers	79%	107
Agro processing	69%	98
Carpet/garment	48%	108
Tourism	56%	188
IT	87%	15
All	58%	409

Table B.61: Percentage distribution of MSEs in Nepal who are aware about existence of penalties for evading the payment of income tax, across knowledge about different penalties

Knowledge of penalties	MSEs (%)
Unable to specify the penalties	66%
Answer mismatched	18%
Knows category and the quantum	0%
Knows category but not the quantum	16%
Total	100%
Base (MSEs who have heard of the existence of penalties)	238

Table B.62. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on income tax

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (no. of MSEs)
Agro processing	21%	19%	98
Carpet/garment	28%	10%	108
Tourism	40%	13%	188
IT	53%	0%	15
Enterprises with 5–9 workers	31%	10%	302
Enterprises with 10–70 workers	38%	20%	107
All	33%	13%	409

Table B.63. Percentage distribution of MSEs in Nepal (agro-processing and carpet/garment sector) across their knowledge of VAT regulations and its impact on growth

Status of awareness and impact on growth	Tourism	IT	Total (tourism & IT)
Aware and tried to stay below threshold*	3%	0%	2%
Aware but not affecting growth	41%	60%	42%
Not aware	56%	40%	55%
Base (MSEs excluding those in agro-processing and carpet/garment sector)	188	15	203
Note: * Threshold for VAT payment: turnover of the business should be NPR2 million or more in a year.			

Table B.64. Percentage distribution of MSEs in Nepal who did not pay VAT, across reasons for not paying

Reason	MSEs (%)
It is not legally required/exempted	75%
It is legally required, but not enforced	16%
Takes too much time	1%
Unnecessarily complicated (do not see the benefit)	24%
Too costly	16%
Others	37%
Base (total MSEs who do not pay VAT)	303
Note: Percentages do not add to 100% because the same enterprise can give more than one reason	

Table B.65. Average number of days spent by MSEs in Nepal on collecting and paying VAT on a four-monthly basis

Business sector	Average number of days spent in collecting and paying VAT
Agro processing	6
Carpet/garment	1
Tourism	1
IT	2
All	2

Table B.66. Percentage distribution of MSEs in Nepal who have heard that there are penalties if businesses do not comply with environmental regulations

Worker group/business sector	MSEs (%) who heard about the existence of penalties	Base (total MSEs)
Enterprises with 5–9 workers	44%	302
Enterprises with 10–70 workers	71%	107
Agro processing	60%	98
Carpet/garment	41%	108
Tourism	49%	188
IT	87%	15
All	51%	409

Table B.67. Percentage distribution of MSEs in Nepal who are aware of the existence of penalties for evading collection and payment of VAT, across knowledge of different penalties

Knowledge of penalties	MSEs (%)
Unable to specify the penalties	67%
Answer mismatched	29%
Knows category and the quantum	0%
Knows category but not the quantum	4%
Total	100%
Base (MSEs who have heard about existence of penalties)	209

Table B.68. Percentage distribution of MSEs in Nepal who have heard of or made informal payments to avoid compliance with regulations on VAT

Business sector/worker group	Heard of informal payments	Of those who heard, the percentage who made informal payments	Base (no. of MSEs)
Agro processing	19%	16%	98
Carpet/garment	23%	8%	108
Tourism	33%	5%	188
IT	47%	0%	15
Enterprises with 5–9 workers	25%	5%	302
Enterprises with 10–70 workers	34%	11%	107
All	28%	7%	409

Table B.69. Percentage distribution of MSEs in Nepal across different business sectors who have heard of informal payments being made to avoid compliance with regulations in their business

Business sector/worker group	Environmental regulations	Minimum wages	Provident fund	Gratuity	Income tax	VAT	Compensation for death & injury	Annual paid leave	Base (no. of MSEs)
Agro processing	13%	27%	11%	10%	21%	19%	33%	13%	98
Carpet/garment	15%	23%	10%	8%	28%	23%	35%	15%	108
Tourism	29%	36%	21%	18%	40%	33%	45%	23%	188
IT	20%	53%	13%	13%	53%	47%	53%	27%	15
Enterprises with 5–9 workers	19%	28%	12%	10%	31%	25%	37%	16%	302
Enterprises with 10–70 workers	26%	40%	24%	23%	38%	34%	46%	28%	107
All	21%	31%	15%	13%	33%	28%	40%	19%	409

Table B.70. Percentage distribution of MSEs in Nepal across different business sectors who made informal payments to avoid compliance

Business sector/worker group	Environmental regulations	Minimum wages	Provident fund	Gratuity	Income tax	VAT	Compensation for death & injury	Annual paid leave
Agro processing	0%	15%	0%	0%	19%	16%	6%	8%
Carpet/garment	0%	8%	0%	0%	10%	8%	5%	0%
Tourism	4%	12%	3%	3%	13%	5%	4%	2%
IT	0%	0%	0%	0%	0%	0%	0%	0%
Enterprises with 5–9 workers	0%	12%	0%	0%	10%	5%	2%	2%
Enterprises with 10–70 workers	7%	9%	4%	4%	20%	11%	10%	3%
All	2%	11%	2%	2%	13%	7%	4%	3%

Table B.71. Percentage distribution of MSEs in Nepal across factors influencing business growth

Factors of influence	Strongly positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Market demand for your products or services	11%	84%	0%	5%	0%	0%	100%
The cost of labour	2%	84%	5%	8%	0%	0%	100%
The level of taxation	1%	49%	7%	21%	2%	21%	100%
Regulations and inspections (labour, taxation, registration, licensing, etc.)	0%	50%	10%	18%	1%	21%	100%
The cost of finance (e.g. interest rates)	2%	61%	10%	23%	1%	4%	100%

Access to credit (procedural)	0%	26%	32%	22%	5%	15%	100%
Access to appropriately skilled workers	2%	19%	2%	58%	18%	1%	100%
Transport infrastructure	11%	68%	8%	5%	1%	7%	100%
Effectiveness of courts dealing with disputes	0%	19%	57%	6%	1%	15%	100%
Government corruption	0%	11%	36%	12%	5%	35%	100%
Non-payment By customers	1%	23%	7%	52%	11%	5%	100%
Availability of land and premises for business	2%	30%	3%	47%	13%	6%	100%
Cost of land and premises for business	1%	20%	3%	40%	29%	7%	100%
Availability of Electricity	0%	28%	1%	48%	21%	3%	100%
Cost of electricity	0%	30%	2%	55%	10%	2%	100%
Water and sanitation facilities	1%	75%	3%	17%	3%	2%	100%
Availability of raw materials	4%	73%	5%	8%	1%	9%	100%
Industrial security (extortion, threat to life for business persons)	0%	16%	44%	11%	5%	24%	100%
Others	0%	1%	18%	1%	2%	78%	100%

Table B.72. Percentage distribution of MSEs in Nepal across factors influencing business growth (laws and regulations)

Factors of influence	Strongly positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Cost or time required to register a business	1%	62%	2%	17%	1%	17%	100%
Cost and time required to obtain a business license	0%	54%	2%	19%	2%	22%	100%
Complying with banking and credit regulations	0%	32%	21%	18%	3%	26%	100%
Cost and time required to register for taxation	0%	52%	3%	18%	2%	24%	100%
Cost of taxation (income tax, sales tax/VAT)	0%	32%	7%	25%	4%	32%	100%
Time required to complete tax administration	0%	47%	7%	19%	2%	25%	100%
Complying with labour regulation and inspections (health and safety, social security, hiring and firing, leave and other benefits)	1%	42%	23%	11%	2%	22%	100%
Complying with environmental and sanitary standards (regulations)	0%	57%	18%	2%	0%	22%	100%
Maintaining minimum product standards and certification	1%	60%	14%	1%	1%	22%	100%

Complying with food and health standards (for products)	2%	55%	8%	1%	1%	33%	100%
Obtaining patents and copyrights	7%	13%	15%	4%	1%	59%	100%
Complying with import and export regulations	1%	26%	14%	5%	1%	53%	100%
Registering land and other property	0%	42%	19%	7%	9%	23%	100%
Other	0%	2%	19%	0%	1%	78%	100%

Table B.73. Percentage distribution of MSEs in Nepal across elements of labour law and regulation influencing business growth

Element of labour law and regulation	Strongly positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Maintaining an employment register	3%	37%	25%	8%	1%	27%	100%
Paying the minimum wage	1%	62%	14%	10%	0%	13%	100%
Complying with health and safety standards for workers	2%	82%	8%	3%	1%	4%	100%
Dismissal procedures and disputes	0%	15%	49%	15%	2%	19%	100%
Severance payments (retrenchment, gratuity, EPF)	0%	13%	21%	4%	2%	60%	100%
Provident fund contributions	0%	9%	20%	4%	1%	65%	100%
Paying for annual leave	0%	31%	9%	5%	0%	55%	100%
Unions and collective bargaining	0%	12%	27%	8%	2%	51%	100%

Workers' injury compensation	1%	76%	9%	3%	1%	10%	100%
Limits on working hours (per day, week, etc.)	1%	47%	13%	4%	1%	34%	100%
Insurance	0%	9%	16%	1%	2%	71%	100%
Others	0%	1%	17%	1%	1%	81%	100%

Table B.74. Growth trap table

Related laws/regulations	Cost/benefits associated	Time (transaction cost) associated	Cost of non-compliance	Eligibility criteria	Conclusion
Trade Union Act 1993 (2049), Chapter 3, S. 9	Increased pressure for the implementation of the Labour Act 1992. Violation of the Labour Act leads to a penalty of up to NPR 10,000.	No prescribed time	Could result in transaction cost	10+ employees	High growth trap
Labour Act 1992, S. 25 S. 57, Chapter 2, S. 4 and S. 4a Unfair labour practices		Appeal time 35 days	Triple amount of compensation, and NPR 10,000 penalty	10+ employees	Medium growth trap
Labour Act 1992, S. 79 S. 1-6 and 79 (a) Collective Bargaining	Refreshment cost for negotiation	<ul style="list-style-type: none"> • 21 days for amicable settlement • If not settled, takes 15 days more for settlement by labour office 		10 + employees All enterprises working inside the industrial estate irrespective of number of employees	High growth trap

		<ul style="list-style-type: none"> • If not settled, takes 15 days to settle by tripartite committee for arbitration • 35 days to appeal against tripartite committee • 60 days to settle appeal • 21 days to 146 days 			
<p>Labour Act 1992, S. 21 SS. 1–6 as per 1st Amendment 28 January 1998, published in Gazette part 58, no. 3423/8/65</p> <p>Minimum wage</p> <p>Labour Act 1992, S. 25, SS. 2, 3, 4</p>	<ul style="list-style-type: none"> • Monthly salary of NPR3050 plus NPR1550 dearness allowance for an apprentice • Monthly salary of NPR3100 plus NPR1550 dearness allowance for semi-skilled workers • Monthly salary of NPR3210 plus NPR1550 dearness allowance for skilled workers • Monthly salary of NPR3400 plus NPR1550 as dearness allowance for highly skilled workers • Daily wage labour NPR 190 for an adult 	Appeal time 35 days	Triple amount of the wage due to be paid	All enterprises	High growth trap

<p>Labour Act 1992 as per 1st Amendment 2054 (1999), S. 21 (a)</p> <p>Annual increment Labour Act 1992, S. 25, S. 2, 3, 4</p>	<p>Half of the daily salary</p>	<p>No prescribed time</p>	<p>Triple amount of the due to be paid</p> <p>Within six months to be settled by labour office</p> <p>Appeal time 35 days</p>	<p>10 +</p> <p>- All enterprises working inside the industrial estate irrespective of number of employees</p> <p>-</p>	<p>Medium growth trap</p>
<p>Labour Act 1992, S. 39 and AL Rules 1994</p> <p>Payment of Gratuity</p> <p>Labour Act 1992, S. 25 (3)</p>	<ul style="list-style-type: none"> • Gratuity: half month's salary for each year for seven years of service completed • Gratuity: 2/3 month's salary for each year to employees completing the service period above seven years to 15 years • One month's salary for each year in excess of 15 years of services for each service year 	<p>Appeal time 35 days</p>	<ul style="list-style-type: none"> • Triple amount of gratuity payable • Appeal time 35 days 	<ul style="list-style-type: none"> • Formal sector enterprises with +10 employees • All enterprises working inside the industrial estate irrespective of number of employees 	<p>High growth trap</p>
<p>Bonus Act 1974, S. 5 –8</p> <p>Payment of Bonus</p> <p>Labour Act 1992, S. 20</p> <p>Bonus Act 1974, S. 20</p>	<p>10% of the net profit</p>	<p>Appeal time 35 days</p>	<p>Up to NPR5000 penalty</p>	<p>10 + employees</p>	<p>Medium growth trap</p>

Labour Act 1992 S. 12(3) Termination of employment Labour Act 1992 S. 25(3), S. 57	<ul style="list-style-type: none"> • One month's salary or one month's prior notice • 30 days drawing salary for each year of completed service multiplied by no. of years of service completed 	Maximum two months' time for approval from government	Triple amount of compensation plus penalty of up to NPR10000 Compensation if unjustified plus penalty of NPR10000 Appeal time 35 days	10+ employees	High growth trap
Labour Act 1992 S. 52(1), and S. 53, Labour Rules 1994 Suspension Labour Act 1992, S. 57	Three months absent (three months of productivity lost)	Seven days for explanation	<ul style="list-style-type: none"> • NPR10 000 plus NPR100 per day for repeated violation • Appeal time 35 days in labour court 	10+ employees	Low growth trap
Provident Fund Act 1985, Labour Act 1992, S. 39, and Labour Rules 1994, Rules 26 Employees' provident fund Labour Act 1992 S. 25(3)	10% of the salary from the employee, 10% contribution from the employer	1 day to enrol	<ul style="list-style-type: none"> • Triple amount of provident fund payable as compensation • Penalty provision of NPR10 000 in the violation of the Act in Nepal • Appeal time 35 days 	10 + employees	High growth trap
Labour Act 1992, S. 40 and Labour Rules 1994, Rules 34 Labour Act 1992, S.57	<ul style="list-style-type: none"> • 52 days on each occasion • Two times during the whole service period 	n.a.	Triple the amount to be paid	10+ employees	Low growth trap

<p>Labour Act 1992 S. 16 and S. 40 and Labour Rules 1994. S. 16 Rule 29 Rule 31 Rule 30</p> <p>Paid annual leave Rule 32 Rule 33</p> <p>Labour Act, 1992, S. 57</p>	<ul style="list-style-type: none"> • 52 Weekly leaves • 13 Public holidays • 15 Sick leaves (half pay) • Home leave (one day for every 20 days worked) to be accumulated for 60 days • 13 days mourning leave • 30 days without pay special leave in a year, maximum six months for whole service period 	<p>Appeal time 35 days</p>	<p>Penalty of up to NPR10000 plus NPR100 per day for repeated violation of the provision</p>	<p>10+ employees</p>	<p>High growth trap</p>
<p>Labour Act 1992 S. 38 & 39 Labour Rules 1994 (2050)], 15-17</p> <p>Death/injury</p> <p>Labour Act 1992, S 25(3)</p>	<ul style="list-style-type: none"> • Three years of drawing salary as compensation • All treatment expenses as per recommendation of govt. medical officer • 100% salary for treatment in hospital and 50% salary for treatment at home, subject to the limitation of one year 	<p>No prescribed time</p>	<ul style="list-style-type: none"> • Triple the amount of compensation • Appeal time 35 days 	<ul style="list-style-type: none"> • 10+ employees • All enterprises working inside the industrial estate irrespective of number of employees 	<p>Low growth trap</p>

Labour Act 1992, S. 37, S. 38 Labour Rules 1994, Rule 15, 16 and 18 Welfare fund and 79 various compensation schemes for physical injuries and disablement	Ranges from minimum 4% of the three years drawing salary to 100% of the same depending upon the percentage of disabilities. The percentage of disabilities constitutes lowest 4% for metacarpal (<i>karam asthi</i>) to 100 for major organs (such as loss of sight, loss of hearing, paralysis, loss of both hand, and loss of both legs, etc.)	Appeal time 35 days		10+ employees	Low growth trap
Labour Act 1992, S. 27 Installing and maintaining a sanitary bathroom	Salary of cleaner NPR3000 per month NPR250 per sq ft for construction, a one-time cost and NPR 3000 per month recurring cost	n.a.		Enterprises with 50+ employees	Low growth trap
Labour Act 1992, S. 43 and Rules 27 Fully equipped medical room for immediate treatment	NPR80000 NPR400 per sq ft, a one-time expenditure	No prescribed time		Enterprises with 50+ employees	Low growth trap
Labour Rules 1994, Rule 27 Employing a health worker	Salary of NPR8280 per month NPR120 grade for 15 years for an AHW	Daily service		Enterprises with 50+ employees	Low growth trap

Labour Act 1992, S. 42 Providing a nursery	<ul style="list-style-type: none"> • Salary of a caretaker • Room: • First-aid box • Salary of a caretaker is about NPR8 000 per month • Room rent is NPR150 per sq ft • The cost of a first-aid box is NPR1000 per box 	Daily service		Enterprises with 50+ employees	Low growth trap
Labour Act 1992, S. 41 Accommodation facility to workers	5% of the gross profit every year to be spent on the development of accommodation facility	n.a.		Only in the tea sector and also no threshold	Low growth trap
Labour Act 1992, S.5 Child prohibition Act 2000, S.3, S. 19 and S. 48			NPR10000 penalty or three months' imprisonment or both.		

Business registration						
for sole proprietorship & partnership firms under Cottage & SSI	Industrial Enterprise Act 1992, S. 10 Private Firm Registration Act 1958 Partnership Act 1964 Registration fee	NPR600 to NPR2000 for micro-enterprises NPR4000 to NPR15000 for Small Scale Industries (SSI) Present registration fees: <ul style="list-style-type: none"> • Up to NPR100000 	Three days to register Registration has to be approved within 30 days from the date of approval of the IEE/EIA			High growth trap

		<p>Capital NPR600 for both sole proprietorship and partnership</p> <ul style="list-style-type: none"> • Up to NPR300000 capital, NPR2000 for both sole proprietorship and partnership • Up to NPR 500000 capital, NPR 4000 for both sole proprietorship and partnership • Up to NPR1000000 capital, NPR 7500 for both sole proprietorship and partnership • Up to NPR5000000 capital, NPR 10000 for both sole proprietorship and partnership • Above NPR 5000000 capital, NPR 15,000 for both sole proprietorship and partnership 				
Registration fee for sole proprietorship & partnership trading firms under Department	Citizen Charter of Department of Commerce, 2008, 8 October Industrial	<ul style="list-style-type: none"> • NPR600 for micro-enterprises • NPR 2000–NPR 15000 for small-scale industries 	Has to be approved within 30 days from the date of approval of IEE/EIA.	Registration fee applicable depending on the size		High growth trap

of Commerce	Enterprise Act 1992, S. 10 Private Firm Registration Act 1958, S.4 Partnership Act 1964, S. 5 and S. 6 Registration fee under Department of Commerce	<ul style="list-style-type: none"> • NPR15000 for medium beyond SSI 		of capital investm ent of the trading firm		
Registration fee for a private limited company	Company Act 2006, S. 3	<ul style="list-style-type: none"> • NPR1 000 for micro-enterprises • NPR 4 500–NPR 22 000 for small-scale industries • NPR 25 000–NPR 43 000 for medium-size enterprises 	Three days to register	Regis- tration fee appli- cable dependi ng on the size of the capital investm ent of the firm.		High growth trap
Registration fee for a public limited company	Company Act 2006, S. 3 Registration fee for a private limited company	<ul style="list-style-type: none"> • NPR 15 000 – NPR 40 000 for small-scale industries • NPR40 000 for medium-sized industries beyond SSI 	Three days to register	Fee appli- cable dependi ng on the size of the capital investm ent of the firm.		High growth trap
Renewals fee (recurring expendi- ture) and late fees for sole proprie- torship and partnership firms	Private Firm Registration Act 2014, S. 10.6.1	Present fee for renewals: <ul style="list-style-type: none"> • Up to NPR100000capital,NPR300 for sole proprietorship and NPR100 for partnership. 	Renewal immediately after the expiry date.	All sole trading and partners hip firms and of all thre- sholds.		High growth trap

	<p>S 7(4)</p> <p>Partnership Act 2020, S.11 and S. 41(d)</p> <p>Renewals fee</p>	<ul style="list-style-type: none"> • Up to NPR300000 capital, NPR500 for sole proprietorship and NPR125 for partnership. • NPR500000 capital, NPR800 for sole proprietorship and NPR150 for partnership. • Up to NPR1000000 capital, NPR1200 for sole proprietorship and NPR200 for partnership. • Up to NPR5000000 capital, NPR1700 for sole proprietorship and NPR250 for partnership. • Above NPR5000000 capital, NPR2300 for sole proprietorship and NPR300 for partnership. 				
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Environmental regulations						
Related laws/regulations	Cost/benefit Associated	Time (transaction cost) associated	Cost of non-compliance	Eligibility criteria	Conclusion	
Environment Conservation Act 1997, S. 6 and Environment Conservation Rules 1997, Rule 3,	IEE – Depends on the nature of the project. Based on the minimum time required by the professional	Minimum 21 days to process by the Department of	All prescribed projects set out in the relevant regulations, for example,	Few	High growth trap	

Schedule 1 IEE	(seven days' spot study, ten days' desk study and four days' preparation of public hearing and transportation; a minimum fee charged by a professional is NPR3000 per day.	Industry for IEE. However it depends on scope and nature of environmental issues examination.	distilleries with 5000 to 25 000 litres; tanneries producing not more than 100 pieces a day; carpet-washing; milk processing of not more than 26000 litres a day; agro industries producing jam, jellies, squash, juice, cheese baby foods, animal feed; cold storage with a capacity between 1000 and 5000 metric ton; commercial fish farming in more than 1 hectare; hotel with 20 to 100 beds, etc.		
Environment Conservation Act 1992, S. 6 and Environment Conservation Rule 1997, Rule 3, Schedule 2 EIA	Based on the minimum time required by the professional (21 days' spot study, 60 days' desk study and nine days' preparation time for public hearing and transportation. The minimum fee charged by a professional is NPR3000 per day. It requires at least three different professionals	Minimum 90 days to process by Dept. of Industry and 30 days to concerned ministry.	All prescribed projects set out in the relevant regulations, for example, distilleries with more than 25 000 litres; tanneries producing more than 100 pieces a day; carpet-washing; milk processing not more than 26,000 litres a	Few	High growth trap

	specializing in three different fields.		day; cold storage with a capacity between 1000 and 5000 metric ton; commercial fish farming in more than 1 hectare; a hotel with more than 100 beds, etc.		
<p>Environment Conservation Rules 1997, Rule 16(1)</p> <p>Pollution Control Certificate (PCC)</p> <p>Environment Conservation Act 1997, S.18 (1,2)</p>	Heavy transaction costs	<p>Takes longer time</p> <p>Appeal time is 35 days</p>	<ul style="list-style-type: none"> • Stop action • Maximum penalty of NPR100000 for not having IEE/EIA depending upon the gravity of the offence as against LCA S. 6. • Maximum NPR50 000 if it is against the rule. 	Some of the industries prescribed in Environment Conservation Rules, 1997, such as asbestos industry, cement, ceramic, chemical, engineering, metal, fertilizers, food and agro-based products, mineral processing, pulp and paper, cotton textile, etc.	High growth trap
<p>As per Industrial Enterprise Act 1992, S. 10</p> <p>Decision No. 1 of Meeting No. 132 of Industrial Promotion Board, 11 May 1997.</p>	If the enterprise exceeds production capacity as specified in the Environment Protection Act 1997 and Environment Protection Rules 1997, the whole	Approved within seven days of receipt of approval of the revised IEE.	Enterprises of all thresholds.	Need for re-conducting IEE/EIA.	High growth trap

Expansion of capital, capacity inclusion of additional objectives, and transfer place	process is to be restarted and a different registration fee paid.				
Financial Act 2008, S. 9 and 10 Enterprise registration in the Inland Revenue Department	No charge	Seven days	All enterprises		High growth trap
Local Self Governance Act 1999, S. 125 and Self governance Rules 140–146, Enterprise registration with local body (municipality)	NPR1200–NPR55000	One day	Applicable to The municipality		High growth trap
Local Self Governance Act 1999, S. 125 and Self-governance Rules 140–146 Registration of tourism related enterprises with a local body	<ul style="list-style-type: none"> • Ranges From NPR10000 for one star to NPR50000 for five-star hotel • NPR8000 for a dance restaurant. • NPR5000 to NPR8000 for lodge/hotel without a star • NPR6500 for travel agency • NPR4000 for trekking • NPR55000 for safari Application money:NPR50 for first time only.	One day			High growth trap
Local Self Governance Act 1999, S. 125 and Self-Governance	• Ranges from NPR7 000 for food products to	One day	Applicable to industries located at		High growth trap

Rules 140-146 Registration of food sector industries with a local body	<ul style="list-style-type: none"> • NPR10 000 for beverages • Application money: NPR50 for first time only 		municipality		
Local Self Governance Act 1999, S. 125 and Self-Governance Rules 140–146 14th Municipality Council Meeting on 24 January 2008 Registration of carpet and garments enterprises with a local body	<ul style="list-style-type: none"> • Ranges from NPR3 000 for handicrafts to NPR8 000 for carpet and garment enterprises. • Application money: NPR50 for first time only 	One day	Applicable to industries located at municipality		High growth trap
Local Self Governance Act 1999, S. 125 and Self-Governance Rules 140–146 Registration of IT sector establishments with a local body	<ul style="list-style-type: none"> • Ranges from NPR1 200 for internet service to NPR12 500 for IT network with more than 20,000 customers • Application money: NPR50 for first time only 	One day	Applicable to industries located at municipality		High growth trap
FNCCI Business Directives 2006, 1.7.1 Service fee for both sole proprietorships and partnerships by district Chamber of Commerce & Industry	<ul style="list-style-type: none"> • Ranges from NPR100 for 0.1 million to NPR300 for NPR0.5 million capital investment for District Chamber and above NPR 0.5 million NPR50 for every 0.1 million. • NPR100 for 0.1 million NPR in the case of 	Same day for all enterprises	For all industries. One time for a company, but sole proprietorships and partnerships need renewals.		Low growth trap

	FNCCI and .005% of capital investment in excess of NPR0.1 million				
FNCCI Business Directives 2006, 5.5.1 Renewals in FNCCI for sole proprietorship and partnership	<ul style="list-style-type: none"> • NPR50 for firms with capital investment up to NPR100000 (w/in micro), NPR100 beyond NPR100000 for District Chamber • NPR50 for capital investment of NPR100000 and NPR25 for every 0.1 million NPR in excess of 0.1 million NPR investment in the case of FNCCI. 	Same day for all enterprises			Low growth trap
Civil Code 2020, Civil Procedure 220, Amendment 1993, 25 August Stamp Fee	An NPR5 stamp is required in the application to submit in government offices.	n.a.	All enterprises		Low growth trap
Government decision to use this authority by FNCCI recommendation for certificate of origin.	0.12% of export value for recommendation fee.	One day		Applicable to all enterprises that require certificate of origin. Charged every time at the time of export	Low growth trap
Citizen Charter of Department of Food Technology and Quality	NPR200–NPR1460	Five to seven days		Applicable to all food-related industries	Low growth trap The

Control2004 Food technology and quality control					charge depends on the number and types of sample tests. This is done by the department either upon the request of enterprise or as a random check. This is done upon complaints and client requests.
Citizen Charter of Department of Commerce 29 September 2007 Import license for industries without LC	NPR100 plus 1% value of import	Two days		For all types of enterprises	Low growth trap
Citizen Charter of Department of Commerce 29 September 2007 Import from developing countries	NPR100 plus 1% value of import	Two days		For all types of enterprises	Low growth trap
Citizen Charter of Department of Commerce 29 September 2007 Import from India	NPR100 plus 1% value of import	One day		For all types of enterprises	Low growth trap
Income Tax Act 2002, S. 4, Annex 1	25 %	One to three days	Timely non-payment of tax involves a penalty	For all types of enterprises	High growth trap

Corporate Tax Rate (%) Income Tax Act 2002, S. 7			<p>ranging from NPR5000 to NPR30000 or three months' imprisonment or both. (Income Tax Act 2002, S. 123)</p> <p>False statement submission involves a penalty ranging from NPR 40000 to NPR 160000 or six months' imprisonment or both. (Income Tax Act 2002, S. 123)</p>		<p>NPR2000 for non-submission of statement plus 0.1% of the taxable income or NPR100 per day whichever is higher with inclusion, if any, and without any deduction .</p>
VAT Act 1996, S. 7	13 %	One to three days		All enterprises with more than two million NPR transaction	High growth trap

Tax incentives					
	Tax exemption	No taxes, (A benefit of 15% of the taxable income on first slab of NPR1000, and 25% on the remaining taxable income)	Tax returns often involves 60 days	Low incentives. Cottage industries (i.e. micro-size up to NPR200000 capital investment), fruit-based production industry in stipulated districts.	Low growth trap

	VAT Act 1996, S. 5(3) VAT exemption	No VAT	60 days	Carpet and garment industries and hydropower upon the recommendation of the Hydropower development department (irrespective of company size)	Low growth trap
	Financial Act 2008, Group 11 No. 20	50% VAT raised to be kept by the enterprises	60 days	Sugar, flour and domestic oil mills, and cellular mobile phone industry.	Low growth trap
	Financial Act 2008, Group 11 No. 18	100% VAT raised to be used by the industrial enterprises	60 days	Applicable to cloth, wooden match, and tyres and tubes	Low growth trap
	Financial Act 2008, Group 11 No. 26	No VAT on raw materials		Feed industries	Low growth trap
	Financial Act 2008, Annex 1: custom, 11(3) Customs duty exemption	Refund of all sorts of duties (tax, VAT and customs) if exported through export house	Two months	Applicable to cottage and handicraft industries	High growth trap
	Financial Act 2008, Annex 1: 11(3)	Refund of duty on the basis of ratio of local use and export	Two months	For all industries	High growth trap
	Income Tax Act 2002, Chapter 4 S. 11(3) Tax holiday	25% of taxable income for a ten-year period	Two months	Fruit-based wine industries having capital investment up to NPR2.5 million, located in	Low growth trap

				remote districts	
	Income Tax Act 2002, Chapter 4 S. 11(3)(B) Tax rebate	Tax rebate of 30%, 25% and 20%	60 days	Industries (no size limit) established in most underdeveloped, underdeveloped and less underdeveloped areas respectively	Low growth trap
	Income Tax Act 2002, Chapter 4 S. 11(3)(A)	Ten years' tax exemption	45 days	For all industries established in remote areas	Low growth trap
	Income Tax Act 2002, Chapter 4 S. 11(3)(D)	50% tax rebate	45 days	Industries using foreign technology and management and also in royalty	Low growth trap
	Income Tax Act 2002, Chapter 4 S. 11(3)©	25% tax rebate	45 days	Information technology industries established in Information technology parks	Low growth trap

Targeted loan schemes for MSEs					
Monetary Policy 2065 (2008), Annex 5, No. 50 Preferred access to (subsidized) credit	Reduction from 3.5% to 2.5% interest rate for export re-lending on the same security	Relending and rescheduling take time (needs to provide scheme of the firm which takes a week to prepare and approved by the bank)		Cottage and small-scale industries (that is up to 200, 000 NPR capital investment) (The size of capital investment matters to get access to subsidized credit)	Medium growth trap
Monetary Policy 2065 (2008), Annex 5, No. 74 Loans at concessionary	2.5% interest rate for re-lending on the same security	Relending and rescheduling take time (needs to provide		Cottage and small-scale industries	Medium growth trap

interest rates		scheme of the firm which takes a week to prepare and approved by the bank)			
Monetary Policy 2065 (2008), Annex 1 No. 50	1.5% interest rate for sick industries	Relending and rescheduling take time (needs to provide scheme of the firm which takes a week to prepare and approved by the bank)		Sick industries	Medium growth trap
Monetary Policy 2065 (2008), No. 122 Financial Act 2008 Annex 1 No. 11	2.5% rate on pledging export documents	Longer process		Export industries	Medium growth trap
Budget Speech 2009, 54	Interest subsidy for cold storage (of total investment)	Longer process		Cardamom, tea coffee-related products	Medium growth trap
Donor-assisted programme Micro Enterprise Development Programme (MEDEP) Department of Cottage and Small Scale Industry (DCSI) Informal Sector Enterprise Development & Enterprise Generation Programme (Elam) , Hevetas	Amount depends upon the assessment of requirement - DCSI provides NPR10000 for the persons trained under its programme. Establishes linkages between entrepreneurs and Banks through a professional group.	Limited to capital equipment arrangement for very poor (It is planned based on the baseline survey)		Cottage- and household-level enterprises. Women, lower-income families, and lower-castes or tribes in targeted areas. Limited to two districts – Bara and Parsa of the Central Development Region.	No growth trap MEDEP 1 st Phase 2 nd UNDP/DE FID/Aus Aid and New Zealand 1998-2007, Total cost US\$8.5 million 2008–2010,

Access to credit IED					Total cost US\$4 million Elam, Helvetas Micro Enter- prise Develop. Prog. 2002- 2010, Total cost £ 102600 0
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Priority Sector Lending					
Budget speech 2065 (2009), 60 Access to capital investment subsidy	25% of total cost of machinery	No prescribed time (about one week for preparing scheme and submit to bank for processing)		Tea processing industry	No growth trap
	25% cost of machinery	No prescribed time (about one week for preparing scheme and submit to bank for processing)		Dairy industry if operated by dairy cooperative	No growth trap
Monetary Policy 2009, 123 Access to raw material subsidy	Dollar availability for importing raw materials from India	No prescribed time but seems to take very short period		All types of industries	No growth trap