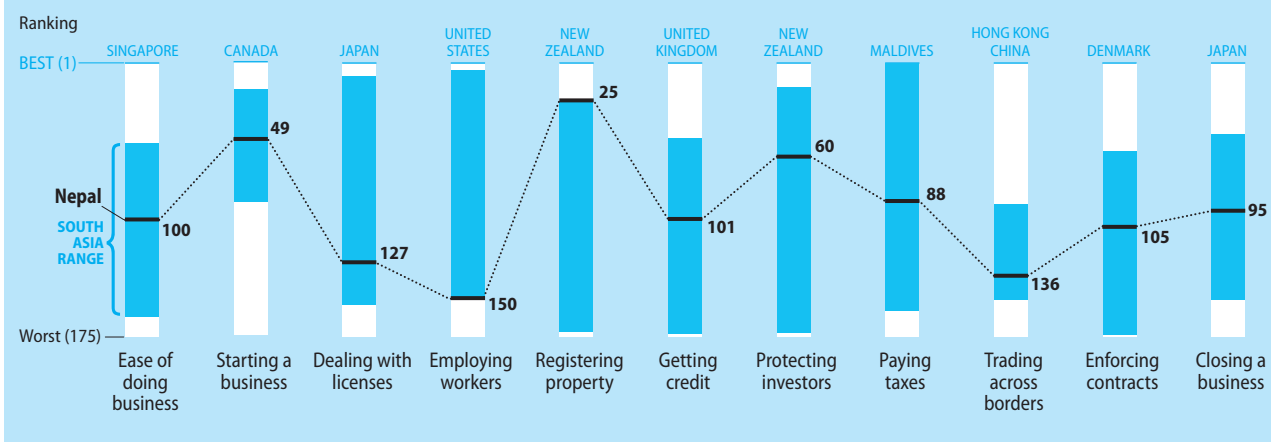


COUNTRY PROFILE

NEPAL The middle-ranking country for most indicators in the South Asia region

Starting a business

Nepal ranks 49th in the world on the ease of starting a business—a decline from last year’s position of 40th. There are only 7 procedures needed to start up a business, which take 31 days. While there is no minimum capital requirement, the cost of starting a business is relatively high at \$212 or 78.5% of income per capita. The expense is caused primarily by two procedures—verifying the memorandum and articles of association (\$136.73) and paying the fee to file the documents with the company registrar’s office (\$61.53).

What to reform

The new provision of the amended Companies Ordinance (amended October 2005) does not require a lawyer or accountant to verify the memorandum and articles of association. If enforced, it will cut costs significantly. Using standardized forms will also reduce the need to use a lawyer and pay related fees. There is room for further amendment of the Companies Act to improve the governance, accounting and auditing standards and disclosure requirements. The capacity of the Company Registrar must also be enhanced in terms of resources and expertise in order for it to properly carry out its functions.

Dealing with licenses

Dealing with licensing in Nepal continues to be cumbersome, time consuming and costly. It takes 15 procedures, 424 days and \$875, or 324% of income per capita, to fulfill the permit and licensing requirements for building a warehouse. The South Asia average is 16 procedures in 227 days, costing 376% of income per capita. Nepal

ranks lower than most of its South Asian neighbors, except India and Bhutan, placing 127th on the ease of dealing with licenses.

What to reform

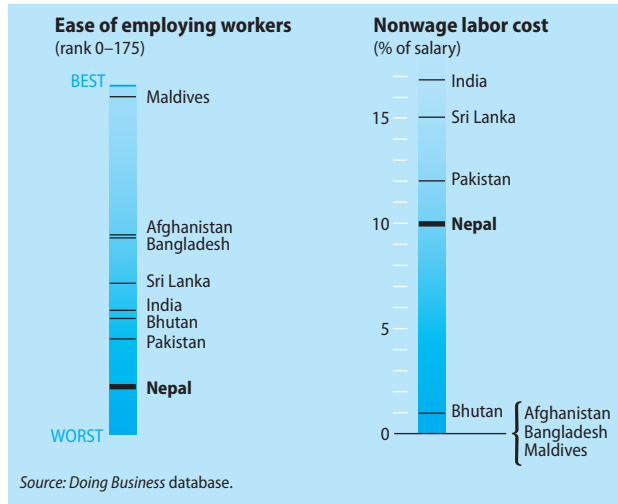
Instead of having to visit municipalities and utilities separately, an entrepreneur should be able to obtain permits from one window, i.e., from each municipality. This may require improvements in infrastructure. Although it is significantly easier to set up telephone lines due to the entry of private sector players, connecting to power, water and sewerage continues to be time-consuming and costly.

Employing Workers

Nepal ranks 150th globally on the ease of employing workers (figure 2.12). The cost of hiring is 10% of salary compared with a South Asia average of 7%. Rules on hiring and conditions of work are relatively flexible, with the exception that term contracts are limited to fixed term tasks. Firing workers is difficult and costly with severance payment equivalent to 90 weeks of wages—the 3rd most expensive country in which to fire workers in South Asia, along with Pakistan. Through an ordinance by the King the Labor Law was amended in March 2006 to address some of the rigidities in the previous law. But it was later revoked by the new government. The revoked amendment contained more flexible provisions for hiring workers on a contractual basis, increasing the probationary period, allowing retrenchment during rationalization of businesses, encouraging a safe working place, and making it easier for a business to set its own minimum remuneration.

FIGURE 2.12

Employing workers in Nepal



What to reform

Since the March 2006 amendment was revoked, Nepal again faces the same issues as before. Nepal’s labor law lacks flexibility for employers in terms of hiring and firing workers. There is an urgent need to allow for hiring workers on a contractual basis and to permit retrenchment during business rationalization. Minimum severance payments are very high. Provisions of the law also should encourage a safe working place, enable businesses to set their own minimum remuneration and reduce the number of holidays permitted to carry out union work. The process for filing court appeals in labor disputes requires streamlining and the time it takes should be reduced. The capacity of the Labor Department and the government to adopt much needed reforms needs to be enhanced.

Registering property

Nepal ranks 25th worldwide and leads South Asia on the ease of registering property. It takes only 3 procedures and 5 days to register property transfers. The process is expensive, however, at 6.4% of the property value. And although registration appears efficient, the indicator hides the fact that to get things done, a facilitator must be recruited and “deputized” to the land registry. Hiring the facilitator increases the overall cost somewhat—already steep due to the registration fee of 6% of the property’s value. Property disputes are rife, indicating that the speedy procedures are not providing greater security of property rights.

What to reform

Reducing the 6% registration fee or setting a nominal flat fee can promote the truthful declaration of actual property values. Automating the land registry can dispense with the need to hire a facilitator and help create an accurate database for expanding access to credit. The land registry currently lacks the institutional capacity and resources to carry out the necessary comprehensive reforms.

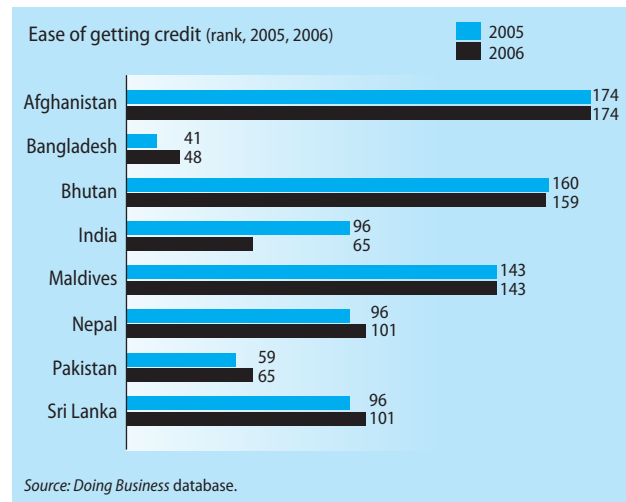
Getting credit

Nepal ranks 101st on the ease of getting credit, and is significantly behind Bangladesh, India and Pakistan (figure 2.13). Access to credit is perceived by Nepalese firms as one of the greatest barriers to doing business. The underlying reason—weak legal rights for taking and enforcing collateral. A new Insolvency Act has been passed but has not yet been enforced due to the absence of commercial courts. Similarly, a new Secured Transaction Act has been passed but there is no implementing agency to register movable assets as collateral. In the absence of such a registry, financial institutions have developed the practice of recording pledges on movable assets in the land registry in cases where land is also mortgaged as collateral. The result of these shortcomings is that lending is more risky and financial institutions are less willing to extend credit to businesses.

Nepal also has a credit bureau—the Credit Information Center—which in 2004 was transferred from the central bank to private ownership. Now 90% of the credit bureau is owned by financial institutions, while the central bank has retained 10% ownership. The bureau is mostly used to verify whether a potential borrower is a defaulter

FIGURE 2.13

Getting credit—country rankings in South Asia



or on a blacklist without having to check the borrower's full credit history. It is mandatory for all banks and finance companies to submit credit information on a periodic basis failing which strict penalties may be imposed. The bureau is functioning relatively well although it is resource and capacity constrained. It does not, however, gather information on loan sizes smaller than NPR 1 million.

What to reform

The government needs to quickly identify what is the best institution to host the movable collateral registry. In addition, the government also needs to (a) ensure the allocation of an adequate budget for the Secured Transaction Act to be implemented, (b) build the necessary capacity to implement the act, (c) train the staff and increase public awareness of the act, (d) ensure that the registry is fully computerized and that staff are fully trained and (e) enact a single law for the creation, registration, and determination of priorities to collateral.

Access to credit can be enhanced by improving the capacity and legal status of the newly privatized credit bureau. A special ordinance for credit bureaus can improve the quality of information by guaranteeing the borrower the right to review the bureau's data and have errors corrected. The credit bureau could also improve the quality of its information by expanding its coverage to include utilities, trade creditors and retailers. More than 2 years of historical credit information and information on smaller loans should also be distributed to the lenders. A new national policy on microfinance is currently under consideration, which may encourage access to finance.

Protecting investors

Nepal ranks 60th worldwide on the protecting investors indicator, along with Sri Lanka and the Maldives and ahead of Afghanistan and Bhutan. The Companies Act, amended in 2005 through an ordinance and recently ratified by parliament, aims to strengthen shareholders' rights. The new law increases disclosure requirements and restricts personal benefits for company directors. However, the law also includes a provision whereby the new protections for investors do not apply to transactions that are part of the "company's ordinary course of business." In practice, directors can avoid all the heightened investor protections of the new law by claiming the transaction in question is a part of the company's ordinary course of business. Furthermore, the capacity of regulatory authorities to monitor compliance with the law, however, continues to be extremely weak.

What to reform

Disclosure requirement in the company's annual report can be more effective if the threshold is reduced to transactions greater than 10% of the company's reported value, ensuring that major transactions receive adequate scrutiny. A great step in the right direction is the new rule in the Companies Act of 2005 that a director of a company should not derive any personal benefits through the company. The impact of this provision is limited, however, because directors can escape all liability simply by making the necessary disclosures. Other countries, for example Malaysia, excuse directors from liability only if the shareholders in a general meeting approve their actions. Nepal can encourage equity investment and open additional lines of finance for entrepreneurs by requiring shareholder approval for inside deals.

Paying taxes

Nepal is ranked 88th on the ease of paying taxes. Tax rates are high—32.8% of commercial profits—although lower than the regional average of 45.1%. The compliance requirements are cumbersome and time consuming—a business must make 35 payments per year and spend 408 hours fulfilling tax requirements. Pakistan is the only country in the region where it takes longer to pay taxes. Although corporate tax should be payable on profits, the tax authorities continue to tax income on sales turnover rather than net profits, as profits are often underreported. Tax laws have been amended in recent years but lack clarity and are often subject to various interpretations.

What to reform

Consolidating various types of taxes and eliminating minor taxes can considerably reduce processing time and hassle for businesses. The tax law needs to be simplified and the tax administration needs to build its capacity. The appeals process can be made significantly more transparent, and the tax recovery process can be improved.

Trading across borders

As a land-locked country, Nepal's trade regime is constrained, and the problem is further compounded by inadequate infrastructure and bureaucratic procedures. Exporting requires 7 separate documents and takes 44 days. Importers need to submit 10 separate documents and wait 37 days before goods are made available (table 2.6). Nepal ranks 136th on the ease of trading across borders—a further decline from 133rd place last year.

TABLE 2.6
Trading across borders, Nepal

	Nepal	Region	OECD
Documents for export (number)	7	8.1	4.8
Time for export (days)	44	34.4	10.5
Cost to export (US\$ per container)	1,599	1,236	811
Documents for import (number)	10	12.5	5.9
Time for import (days)	37	41.5	12.2
Cost to import (US\$ per container)	1,800	1,495	883

Source: Doing Business database.

What to reform

Red tape in the form of paperwork and documentation requirements is the major constraint in both import and export trade. Nepal can do away with unnecessary steps like the need to obtain a certificate of origin. Simple and standardized paperwork is essential. Electronic filing of trade documents can cut delays and corruption. Ongoing reforms in dry port facilities such as Birgunj along the Indo-Nepalese border should ease the trade and transit process.

Enforcing contracts

Nepal ranks 105th on the ease of enforcing contracts, behind Afghanistan, Bangladesh, India and Pakistan. It takes 28 procedures and 590 days to enforce a simple commercial contract through the courts, at a cost of 24% of the value of the claim.

What to reform

Nepal can streamline contract enforcement by introducing summary judgments. With these, a plaintiff only needs to present the judge with evidence of the transaction and nonpayment. Cutting the number of allowable appeals will also reduce delays. Finally, Nepal can introduce case management, where the same judge follows the dispute from start to end. Faster proceedings are also less costly for litigants, thus providing greater access to the courts for the poor.

Nepal also needs to amend provisions of the Debt Recovery Act to make possible the efficient implementation of creditor rights. Enhancing the capacity of the

Debt Recovery Tribunals is essential to improving their speed and impartiality in resolving disputes. The government can help establish a permanent facility for the initial and ongoing training of judges and court staff, such as a national judicial academy. The government can also develop proper library facilities and university legal training programs to meet the needs of legal practitioners. The creation of specialized units to handle fast track and other civil cases can strengthen the courts' capacity to ensure fair, quality and timely case handling. Sound and transparent procedures must be established to prevent and fight corruption.

Closing a business

Nepal ranks 95th worldwide on closing a business—a decline from its 88th position last year. After a firm becomes insolvent in Nepal, it takes almost 5 years to close, and costs are 9 percent of estate value. Creditors typically recover only 25 cents on the dollar.

What to reform

Although a new insolvency law was passed through an ordinance in 2005, it needs to be ratified by the new parliament, and is yet to be implemented by the government. The new law provides for the administration of companies that have failed to pay the debts due to their creditors and have thus become—or are about to become—insolvent. The regulation provides for both the liquidation and restructuring of companies. It covers limited liability companies as well as banks, financial institutions and insurance companies (with the approval of the relevant regulator) but does not cover individuals. Most businesses in Nepal are sole proprietorships and hence the law needs to be extended to bankruptcy of individuals. The government also needs to improve the capacity of insolvency professionals and their regulators, set incentives for insolvency administrators to maximize the value of the bankruptcy estate, and reduce the number of allowed appeals—which is a major cause of delays. A suitable formal out-of-court restructuring process could greatly assist banks to restructure borrowers having financial trouble.