

Chapter Three

Overview of Nepalese Small and Medium Enterprises

Introduction

Small and medium-sized enterprises (SMEs) comprise a substantial part of the economic activity of developing countries. During the year 2001, SMEs accounted for 96 percent of total industrial establishments, contributed 83 percent in employment generation by industrial sector, and shared about 80 percent in the industrial sector's contribution to national gross domestic product (GDP). In Nepal, the role of SMEs is often relatively greater. Small and medium enterprises (SMEs) play an important role in creating self-employment opportunities, mobilizing and using local resources, and raising the income of the rural populace. Since the late 1980s, Nepal has shifted to an open market regime. As a result, barriers to international trade have been removed or substantially reduced. Nepalese SMEs have been affected by this change and are finding it increasingly difficult to compete with imported products in the domestic and in the international markets for exportable goods. Nepal's development plans and other commerce related policies have been promising different incentives for SMEs, but lack of awareness, lapses in policy declaration and problems in actual implementation of the policies have largely prevented SMEs from getting any significant benefit.

SMEs in Nepal

Most of the Nepalese SMEs are involved in processing and manufacturing of food items, consumer and household goods, and textiles and related products, both for exports as well as the domestic market. Rice, pulses, oil and flour mills, dairy, aerated soft drinks, fruit juices and processed products, noodles, biscuits and light snack products, chocolates and candy, mineral water, dried vegetables, and some other household utilitarian and consumption goods have dominated SMEs activities in Nepal. Other areas of SMEs' involvement include forest fiber based industries, wooden and metal handicrafts, handmade paper and products, apparels and garments, woolen carpets, pashmina shawls and rugs and leather. SMEs' involvement is also high in metal and plastic household utensils, wooden, plastic and metal furniture, printing press, polythene pipes, utensils, jute products, poultry products, livestock products, wire drawing, nail and iron rod, sheet metal, gig and black pipes, rubber tires and tubes, plywood and boards, color paint products and zinc oxide. Agro-based industries like tea, vegetables and horticulture products, dairy and milk products, animal husbandry and floriculture are other areas where SMEs have started to invest. Due to the opening up of investment for infrastructure development to the private sector, investment in micro hydropower and tourism resorts and complexes have also been witnessed in some regions. At the micro, cottage and family level, a sizeable number of unregistered enterprises operate on a seasonal basis.

Common Features of SMEs

Nepal's SMEs share the characteristics that are usually common in SMEs of developing countries and LDCs. Research in Africa has shown that many of the characteristics found there are relevant in the Nepalese context as well. The common characteristics are:

- SMEs are family-level enterprise set up with family savings and sometimes supported by kith and kin.
- The ownership and management is usually controlled by the same individual with powers over all decision issues of the enterprise.
- Since personal and family savings are the major sources of equity capital, credit worthiness of SMEs is low, which impedes their development.
- Managerial competence requirements are perceived as not important the enterprise relies on entrepreneurial skills and initiatives of the founder/s.
- Recruitment of staff is often carried out without a proper job analysis and a job description. Even when employees are deemed to be competent, they are rarely delegated with authority and power to decide on their own.
- The technology used is usually locally innovated, limited in capacity and efficiency with frequent breakdowns which causes high wastage.
- Most SMEs produce and cater only to the local markets and export oriented SMEs are few. Those that are export-oriented are not able to expand due to various inherent constraints like poor quality control, unable to meet timely delivery and limited production.
- Access to institutional credit for SMEs, despite provisions for the same, is limited due to individual entrepreneur's inability to contribute to equity capital and collateral security.

Problems and Challenges Faced by the Nepalese SMEs

In general, SMEs in Nepal have traditional management practice, undeveloped entrepreneurial culture, low capital base, outdated and less efficient production process and technology, and poor knowledge and information about business

opportunities and marketing. Obviously, the challenges for the Nepalese SMEs are mounting. The challenges have become more profound due to the recent trends of globalization and economic liberalization. These challenges need to be addressed or it may result in a situation where the Nepalese SMEs may lose out to the regional and global players. Marketing constraints is observed to be one of the major disadvantages faced by the Nepalese SMEs. Given their size and limited access to resources, their production capacity is limited are unable to execute large orders. Fear of commercial disputes arising from delayed delivery, improper packaging, unforeseen costs, poor quality and failure to meet technical specifications also prevents them from approaching organized export markets. On the financial front, SMEs, more often than not, are unable to generate enough credit to carry out relatively larger volume of work. The lack of awareness on the part of entrepreneurs regarding financial institutions that may give them credit is one reason for their inability to raise financial resources. Even when SMEs manage to get credit, the relatively short time for repayment and high interest rates do not help their cause. On the product development and production front, SMEs require facilitation in the right choice of technology, as well as in acquiring technology suited to their specific needs and amenable to periodic upgrading. Lack of access to technology is having a major impact on the export capability of most SMEs. This also prevents SMEs from meeting different environmental regulations requirement of the export market.

SMEs, when developed properly, can be one of the major exportable products and high foreign currency earners for the country. If this sector is developed, it would help to reduce trade balance and earn more foreign currency for the development of the country. Although the sector has huge economic importance, there are many things that can be done for the development of this particular sector. Although various agencies and committees have been constituted to find solutions aimed at solving the problems faced by the SMEs sectors very little progress has been apparent.

Despite the importance and the contribution of the SME sector to the national economy, the sector itself is encountering serious adjustment problems under a changing and dynamic environment. Globalization and liberalization are creating new dynamics of production, enterprise development and international competition. Nepal's existing enterprise development strategies may no longer be effective in the light of these changes. Statistical records indicate that the Nepalese SMEs are finding it hard to survive in the new environment ushered in by increased competition. Government figures show that the registration of SMEs in Nepal is on a downward trend. The internal insurgency may have a role to play in the downturn of the industrial sector. In the Nepalese context, while the capital resource needs of SMEs are mostly met locally, they largely depend on raw materials from India, and in some cases, from China and other countries.

The fruits of liberalization have not materialized nor has it resulted in better access to inputs for SMEs. Domestic firms have found themselves affected by increased competition from foreign goods and by rising costs of production. Most Nepalese entrepreneurs thus find it difficult to compete with products from India where the costs of production are lower. Goods produced in Nepal utilizing Indian raw materials are seldom able to compete with similar goods imported from India. In Nepal, the enterprise sector shows a distinct dual structure. At one extreme, there exist a few large modern capital-intensive, resource-based, import-dependent and assembly-oriented enterprises, while at the other, there are small and informal sector enterprises that use very simple and traditional technologies and serve a limited local market. The number of medium sized enterprises is relatively less. This structural imbalance has arisen despite many SME promotion programmes of the government.

Since a substantial proportion of SMEs' output emanates from agriculture, there is always a risk that importing nations would restrict imports citing different SPS measures. Agro-exports from Nepal to existing trade partners are subjected to quarantine checks, which have created difficulty and given rise to delays and losses in transits. Nepal needs to abide fully by the provisions of the TRIPS Agreement from 1 January 2007. This agreement can potentially inflate the price of technologies that are critically important for upgrading the production facilities of the Nepalese SMEs. Another major challenge faced by the Nepalese SMEs involved in exports would be in the form of standards. High technical standards set by the importing countries may act as barriers for the Nepalese SME products.

Agriculture provides only seasonal employment for the rural population, which constitutes 88 per cent of the total population. Hence, off- season and off- farm activities such as weaving, knitting, basketry, teashops and roadside shops complement rural incomes. In addition, informal rural micro enterprises supply goods and services to local manufacturers using traditional technologies. Micro and small enterprises constitute a major source of income in the urban areas. Specific government policies target formal sector cottage and small industries (CSI). The Industrial Enterprises Act of 1992 classifies cottage industries as traditional industries that utilize specific skills or raw materials and resources, which are labor intensive and are related to national tradition, art and culture. Industries with a fixed capital investment of up to 30 million Nepalese

rupees are classified as small industries. Enterprises with a fixed capital investment of between 30 and 100 million Nepalese rupees are classified as medium-sized, and those with a fixed capital investment of more than 100 million Nepalese rupees are categorized as large. According to the Department of Industry, registered industries with an average of 12 employees per business numbered 27,658 (of which 4,678 were cottage industries and 22,980 were small-scale industries) compared to only 731 medium and large industries with an average of 99 employees per business during the period 1993/94 and 1995/96.

Among the SMEs, take the case of the handicraft industry which is unable to produce large quantities with uniformity and with equal quality standard. In Nepal, the production of handicrafts is an age-old occupation. Novel handicrafts are also developed in harmony with changing market taste. In the last 27 years, export of handicrafts of the country has considerably grown. Thus, the development of handicraft, on one hand, helps in preserving the national heritage of the country and on other hand; it contributes to eliminating poverty by creating job opportunities. Nepalese handicrafts industries have been providing employment to hundreds of thousands of people of the country. It has also been a prime source of foreign exchange required for the importation of necessities.

The export of Nepalese crafts started from the mid 60's of the last century. However, the systematic export started only from early 70's. Crafts have long been a major line of Nepalese exports. Currently, it has been the largest overseas export item of the country next to readymade garments and carpets. More than 20 handicraft products mainly the pashmina products, woolen goods, silver jewellery, Nepalese handmade paper and paper products, metal craft, woodcraft, cotton goods etc. are being exported to about 85 countries. USA (which alone absorbs around 25% of the total export of handicraft products), Britain, India, Canada, Germany, Japan, Italy, France, Australia, Netherlands and China are its major foreign buyers.

Policy and Regulatory Environment for SME growth

Support services for SMEs

The main government agency responsible for small enterprises is the Department of Cottage and Small Industry (DCSI). As its name suggests, this Department provides support only to cottage (micro) and small industries and not to medium-sized ones. In addition to the DCSI, the Industrial Enterprise Development Institute (IEDI) is responsible for the dissemination of information and technology to small enterprises. Its activities focus on entrepreneurship development and small business promotion through training in business creation and business management and the provision of research and consultancy services. Its Technology Transfer Development Project (TTDP) collected and disseminated information on technology, undertaking technology promotion and training activities and facilitating/establishing networks between national and international technology institutions and users.

The Export Promotion Board is the main agency for export facilitation. In addition, the Trade Promotion Centre encourages large enterprises to identify potential suppliers from the SME sector. It organizes SME trade fairs, publishes a directory of SMEs and facilitates interactions between large and small enterprises. Apart from the carpet and garment industries, it is generally not common for large industries to have SMEs in their supply chain. Attempts have been made by relevant government departments to encourage the purchase of cottage and small industry products. The Government has stated that it will give incentives to large national and multinational firms that subcontract small and cottage industries. Support activities are largely confined to the capital and urban areas at the district level and the support agencies generally lack specialized staff. There needs to be a greater emphasis on specific policy measures aimed at fostering competitive and specialized enterprises. Piecemeal initiatives, particularly in the area of technological support, have led to insignificant results.

One of the objectives of the Ninth Plan (1997-2002) is to diversify exports and increase exports originating from rural areas. It envisages:

- Identifying new export products;
- Promoting agro-based exports;
- Introducing quality control measures;
- Facilitating information networks in partnership with the private sector;
- Attracting foreign investment and technology;
- Implementing the duty drawback system in a more efficient and systematic way;
- Creating an export promotion fund;

- Establishing an export refining zone and developing an export-oriented village aimed at reducing the cost of production and integrating exportable items;
- Mobilizing foreign missions to facilitate Nepalese exports;
- Establishing an export- import bank; and
- Promoting external and internal trade exhibitions.

Access to finance

As a result of liberalization, the number of commercial banks has increased to 26 some of which have foreign bank equity participation. More than 40 development banks and around 75 finance companies have come into existence in a short period. However, distortions in the sector persist. Government-owned or controlled banks have reduced their services in rural areas in the quest for profitability. In urban areas, banks continue to favor short-term lending and maintain a high spread between deposit and lending rates. Apart from rural development banks, formal banking institutions are confined to urban areas because of high operating costs in rural areas. There are concerns about the apparent flow of financial resources from rural to urban areas as a result of the use of deposits collected by commercial banks in rural areas to finance business and commercial activities in urban areas.

Many SMEs are reluctant to seek formal sector credit because they consider the process complicated and overly bureaucratic. Instead, they continue to depend on informal credit, despite high interest rates, owing to its easy and timely availability. Some rural development banks and NGOs use the Grameen Bank model of Bangladesh. Other approaches include direct lending by banks to self-help group members and lending to savings and credit cooperatives or NGOs who, in turn, lend to their members. The group-guarantee method is also used with respect to priority sector lending. However, these lending schemes are not without problems. Some charge high delivery costs and others do not reach the intended target groups. Even in the case of priority sector lending, small and medium-sized entrepreneurs are of the view that they are not benefiting as they should.

Public-private sector dialogue

Prior to liberalization, dialogue between the public and private sector on policy formulation and implementation was virtually non-existent. In fact, business associations began to be established only after 1986 (a notable exception being the Federation of Nepalese Chambers of Commerce and Industry (FNCCI), which was established in 1965), and the majority, only after the country's democratization in 1990. Following liberalization, policy makers have sought to interact more closely with the private sector, including transferring certain responsibilities to private sector associations, such as company registration and the issuance of export licenses. The emergence of private sector representative bodies has also contributed to the establishment of dialogue and they are gradually becoming more effective in representing their members' interests. As more SME association are formed, they too are drawn into the dialogue.

Membership of FNCCI comprises commodity associations and 72 district and local chambers whose members are mainly large commercial traders. The Federation's main activities include advocacy and lobbying on behalf of its members and providing them with information, advice, arbitration and training. It also organizes trade fairs. SMEs are generally represented through industry or sectoral associations, if at all. These associations are often organized along the lines of caste or community because specific groups have traditionally engaged in certain professions. Rural enterprises are largely excluded from public private sector dialogue because they are not as well organized and because existing representative organizations are active only in urban areas.

Nepal's policy shift in favour of a market-oriented economy was intended to create an enabling business environment for private sector development. However, SMEs do not seem to have benefited from the change. Further improvements are necessary to address policy inconsistencies in the trade regime, corruption, and the general failure of industrial policy measures to promote industrial development. The lack of stability and transparency in policy implementation is a major obstacle to private sector development. Policies need to be carefully formulated in order to ensure consistent and coherent implementation. In particular, the adverse effects of the trade reforms should be addressed in order to ensure a level playing field for domestic enterprises.

The majority of micro and small enterprises are survival SMEs. Business development services are needed to transform those with potential into dynamic growth oriented enterprises. Hence, enterprise development policies should encourage the progressive expansion of enterprises, and support services for entrepreneurship development should be enhanced. Regular evaluations of support institutions should be carried out to ensure their continued relevance and the effectiveness

of their programmes. One of the major constraints to SME growth in Nepal is the market. Marketing should be given due importance in the provision of support services. In the area of SME finance, there is a need to develop measures for encouraging financial institutions to service the SME sector. Such measures should be complemented by strengthened business development training and services, including marketing and access to technology.

SMEs will have to enhance their technology and improve the quality of their human resources in order to benefit from Nepal's membership to the WTO. The development of SMEs in the present scenario needs to be seen not merely from the perspective of balanced economic development and for direct attack on poverty at the grassroots level, social harmony and environment protection. All this calls for increased focus on productivity, competitiveness and efficiency as well as the need to explore new frontiers of business opportunities brought by information technology and digital revolution. The focus now should be on how to make best use of WTO membership to serve the interest of SMEs.

Nepal can still protect selected sectors in which SMEs have a competitive advantage. Traits such as flexibility, adaptability, inventiveness and innovativeness, which are inherent in SMEs, can go a long way towards helping them to become globally competitive. However, this sector needs to be nurtured and backed by conducive policies and effective support mechanisms if it is to survive the challenges and realize the benefits and opportunities. Technical assistance and business support services in the form of business and market information dissemination, skill upgradation, minimum regulation and hassle free facilitation from the government agencies, and alliances and networking arrangements between and amongst the smaller enterprises as well as larger producers and exporters can greatly help the small producers in enhancing their capacities. There is a need to focus on the expansion of SMEs in high value and labour-intensive activities. Areas that have the potential to grow include horticulture, agro-based and non-timber forest products, information and knowledge based technology services, educational institutions, modern agro-based products and services sector, among others. To develop these products and services, it is important to ensure an enabling environment for SMEs. Otherwise Nepal will have to continue with the present trade practice of exporting unprocessed agriculture and forest based raw products and importing finished products for domestic consumption.

The government and the SME related federations/associations should work together to identify products and services that have comparative and competitive advantage at the international level. They also need to work in close collaboration to facilitate and enhance the capability to achieve and retain competitive edge. The government should provide financial and technical support to undertake need focused training programmes, business and market promotion activities and other business development services for SMEs.

One of the fundamental weaknesses of the Nepalese SMEs is the lack of awareness relating to information on market opportunities and their inability to allocate sufficient management and financial resources to exploit these opportunities effectively. Though a vast amount of trade related information is available at the central level, most SMEs continue to rely heavily on private contacts for market related information. The government should support SMEs to identify market opportunities.

For the development of the scattered micro and informal producer groups, special mechanisms need to be initiated and supported by the government in collaboration with different private sector associations and federations. The programmes should encourage and support strategic alliances and networking; promote export trading houses; facilitate the establishment of export production villages, free trade and economic development zones; and facilitate SMEs' participation in specialized trade fairs and marketing missions.

Given the weak financial management of the SMEs, different banks and financial agencies need to play the role of a development partner to facilitate the growth of SMEs as only with the growth of the industrial and services sector will the financial sector grow. On the other hand, SMEs also need to infuse transparency in financial operation and adopt standardized accounting and auditing practices. In order to help improve the competitiveness of SMEs, banks and financial agencies should ease access to working capital and export financing, they should also enlarge pre- and post shipment credit facilities as well as export credit guarantees.

Chapter Four

Export Oriented Small and Medium Enterprises (SMEs)

Current export performance

The current export performance of Nepal is high for cardamom, tea, and ginger. In contrast, Nepal's export performance is seen as being particularly unfavorable for mandarin oranges, honey, wooden handicraft, medicinal plants, and coffee.

Well-performing sectors have already proven their export capacity and can thus be considered as also having high potential for future exports.

- Exports in value: The larger a sector's exports are currently in value terms, the greater is its potential for future growth. Nepal has significant exports in cardamom, silk and pashmina products, pulses, and gems and jewellery products. The success of exporters in these selected sectors suggests that they are well positioned for potential future increases. On the contrary, exports are negligible for mandarin oranges, honey, and coffee, and moreover, Nepal does not currently have a capacity to export mandarin oranges.
- Nepal's world market share is a good indicator of the competitiveness of an industry. Nepal has a substantial world market share in cardamom, handmade paper, and ginger. In contrast, Nepal's world market share is particularly low for cut flowers, coffee, honey and mandarin oranges. The export value favors large industries and thus introduces a bias. In contrast, the world market share can favor small industries: by dividing export value by world exports, small industries can achieve a high market share.
- Export growth: Sectors with rapid export growth suggest that Nepal is highly competitive in the world markets, while stagnant or declining growth rates indicate the opposite. Nepal experienced a significant export growth in tea and cut flowers between 2000 and 2004. Particularly, the growth rate of cut flower exceeded more than 250% per year during the same period. With everything being equal, fast growth exports point at product groups for which Nepal has a particular potential worth studying in more details. These trends are likely to reflect Nepal's future trade. In contrast, honey, silk and pashmina products, and wooden Handicrafts sectors have shown export declines.
- Nepal's trade balance indicates the efficiency of the productive capacity of industries. The trade balance is calculated as the difference between exports and imports. If exports exceed imports, representing a trade surplus, national production exceeds national consumption. All things being equal, this suggests that the industry has efficient productive capacity and can be considered competitive. In contrast, if exports are lower than imports, representing a trade deficit, national production is not sufficient to cover national consumption. Leather and Wooden handicrafts are exclusively exported with no evidence of wooden handicraft imports. In contrast, Nepal is a net importer of mandarin oranges.

Crosscutting issues

- As a land locked country Nepal is disadvantaged by very high transportation costs by air. At the same time, transportation by road or sea are both unreliable and complicated. Bulkier products are often sent by road through India and then loaded onto container ships at Kolkata Port. Due to the difficult, mountainous, terrain and the poor condition of roads in Nepal, trucks cannot operate with high axle loads on most parts of the road network. As a consequence Nepal probably has one of the highest ratios in the world of freight by expensive courier. Efforts have been made to reduce the impact of these costs on exports by focusing on high value, low volume products.
- Inadequate inland infrastructure. For more or less all the agro-sectors unavailability of (all-season) roads hamper getting produce to the next step in the supply chain. Similarly, access to irrigation is a problem for small farmers.
- Lack of support services in the form of market information. Problems of substandard quality appear to be compounded by a lack of information on national quality and grading standards, as well as a lack of access to laboratory facilities or training facilities.
- Limited value added. In many sectors, one of the major obstacles to export and export earning growth is the inability to process the commodities, and accordingly to add value and diversify products. Instead, often Indian companies benefit by processing Nepalese produce before re-exporting them.
- Lack of capital is a major obstacle to export growth. Credit facilities are limited and, according to the interviewees, banks only extend credit on collateral of land and buildings. Other potential sources of collateral, such as designs,

inventory, export management capability, experience, remain unrecognized.

- A shortage of skilled and high-skilled labour. A large number of Nepalese migrants, currently send remittances back to Nepal. According to one source, the value of these remittances is surpassing the agricultural GDP of the country. This, however, has a major draw back which is the “brain-drain” it causes. There have been comments on the fact that the education facilities were producing too few graduates as well as on the tendency of the few graduates to get poached by overseas job opportunities very quickly.
- Insufficient cost competitiveness. In most sectors, Nepal’s exports are curbed by high production costs. The government and other stakeholders need to pay attention to two major cost factors compromising Nepal’s competitiveness: the labour cost and the productivity and transportation costs.
- Unstable political environment. The Maoist insurgency has hit most of the sectors hard, disrupting the supply chain in many sectors by making areas unsafe to transport goods and hampering investment by creating a risky environment. Business houses have shown an unwillingness to expand their businesses because of the economic uncertainty. The latest political developments in Nepal are, however, very promising steps towards mitigating this problem.

The following presents the main findings by industry with respect to the export potential of individual items.

1. Silk and pashmina products: High export potential

The silk and pashmina sector is considered high export potential. Pashmina shawl exports boomed in the late nineties reaching a staggering figure of NR 5.6 billion in 2000/01. In the following year, however, a sharp, spiraling decline reduced exports to a third of the level. Since then exports have remained stable. There are a number of explanations for the sudden decline. The main cause is thought to have been strong competition from neighboring and other countries, which were using very low quality pashmina, non-pashmina or fake materials to manufacture and export items similar to Nepalese pashmina. In a bid to compete with foreign countries Nepalese entrepreneurs were forced to use inferior quality materials imported from China, Mongolia or India. This greatly damaged the reputation of Nepalese pashmina shawls. It is likely that by focusing on improving quality and by introducing measures to ensure consistency, such as registering pashmina as a recognized trademark, Nepal will be able to rejuvenate the pashmina export sector. Once it has re-established itself as a high quality producer there is tremendous potential to rapidly increase production, as current capacity is heavily underutilized. In addition, productivity is likely to increase greatly, as traditional processes of production are being modernized. Market prospects therefore are more favorable as previously envisaged, especially if efforts to upgrade quality are successful. However, the extent of sericulture in Nepal is still small, and as a result less than 2 percent of the silk, which is used for blending into pashmina products (mostly 70/30 ratio), is sourced locally. There are big plans afoot for large increases in cocoon production mainly by increasing the area devoted to sericulture cultivation. This appears promising.

100% Pashmina Double Ply (High Quality) 100% Pashmina Single Ply (High Quality) 70% Pashmina 30% Silk (High Quality)

The sector currently requires a much smaller number of labors --around 5,000 people at a conservative estimate. Currently, the contribution of pashmina and silk shawls to the total export earnings of Nepal remains relatively high, particularly compared to other sectors analyzed in this study. The sector is labour intensive and lacks mechanization. The collection of wool and sericulture are an important source of income for rural areas. In contrast, the manufacturing side of the sector offers little rural development. By improving rural incomes, growth in the sector is likely to contribute toward empowering women. The chances of a sustainable livelihood for the rural people, farmers and landless laborer, are likely to be improved greatly by encouraging the successful practice of sericulture and Chyangra farming. Finally, the pashmina industry can broadly be considered environmentally friendly, with the exception of the use of chemical dyeing materials in the final stages of production. The planting of

sericulture, however, can help to control soil erosion and desertification.

2. Cardamom: High export potential

Cardamom is considered high export potential. The recent export trend of Nepalese large cardamom to India and other markets has been very encouraging. Nepal is one of the major producers of large cardamom and has a share of 50% in world exports. The main consuming countries of large cardamom are located in South Asia, with only very few countries consuming this product in other world regions. 90% of the Nepalese production is exported, and mostly to India (which is then often re-exported to Pakistan or UAE). Nepal's other major direct export destinations are Pakistan, UAE, Singapore and, Afghanistan. Tariffs for Nepalese cardamom are low in the major importing countries, and Nepal (together with Sri Lanka) enjoys a very preferential tariff rate on exports to the Indian market compared to other exporters. Cardamom is considered as a high-value crop and is mostly produced in Eastern Nepal. While no formal grading takes place, informed opinion considers the quality of Nepalese cardamom to be better than the one from India or Pakistan. The major processing, which takes place in Nepal, is the drying. Efforts are currently underway to spread the use of a superior drying method. However, further value-added (grading, cleaning, etc.) is usually done in India. There is great potential for increasing production, both by increasing the area and by improving production techniques. At the same time, encouraging a number of derivative products such as essential oils could expand demand for the cardamom plant. Finally, there are a number of diseases, which could potentially affect the harvest of cardamom. It is worth being aware of this risk. Around 5,500 people are estimated to be involved in the growing and treatment of large cardamom, with many families partly depending on growing or processing cardamom. The farming of cardamom does not have any known negative ecological consequences. However, drying requires large amounts of firewood, which could lead to increased deforestation.

Nepal becomes world's largest cardamom producer

KATHMANDU, Oct. 31 (Xinhua) -- Nepal has become the global leader in production and export of large cardamom, surpassing India and Bhutan, the two other big producers, local media reported on Wednesday.

"Some 51 percent of large cardamom traded across the world is exported from Nepal," said a report of International Trade Center, a Geneva-based agency, quoting by local leading eKantipur.com website.

The report, which was submitted to the Nepali government and released recently, shows Nepal, India and Bhutan, in 2005/06, produced a total of 12,832 tons of large cardamom, also called black cardamom, of which 6,647 tons were produced in Nepal

3. Pulses: High export potential

Pulses are considered high export potential. Nepalese Pulses consist mainly of lentils, which represent 90% of total exports. They are mostly exported to India and Nepal's exports seem to be driven mainly by Indian demand. The diverse climatic and environmental conditions of the country allow cultivation of at least one dozen species of Nepalese pulses lentils, which are of good quality and are said to be preferred in India. The area, production and yield of lentils have been increasing over the last years. The majority of farmers in the mountains and hills grow pulses primarily for consumption while in the lower plains (Terai region) pulses are mainly grown for the domestic market and exports. Pulses are, however, susceptible to pests and diseases. There is, therefore, risk inherent in increasing production. The expansion of pulses production is further limited by its low return compared to other crops. Competitiveness prospects are average. The outlook for the continuation of production increases is favourable, provided the yield and area continue to increase. World markets prospects are very promising. Compared to other sectors, South Asian countries are mainly the most attractive markets. In the longrun, the soya bean markets may be of interest to Nepal. Estimate of the total number of farmers directly involved in pulse cultivation are 12,500 people as a full-time employment. Pulses are an important basic subsistence food in Nepal. Aggregated, pulses rank fourth in terms of acreage and fifth in terms of production after rice, maize, wheat and millet. Pulses also help farmers to supplement their low-protein diets. At the same time, they constitute a useful cash-crop allowing farmers to earn extra money by selling their excess crops. Despite their importance, pulses are considered traditional crops, of secondary importance. As a consequence, little attention has been paid by farmers to adopting new methods to improve cultivation. The number of people involved in the sector is not likely to be very high as it takes much less labour to work on a hectare of pulses than it would to work on a hectare of tea, for example.

4. Gems and jewellery: Medium export potential

Gems and jewellery are considered medium export potential. Over the past 15 years, export has been growing at an annual average rate of 13 per cent. However, a decreasing trend has been noticed recently. Major markets for Nepalese silver jewellery are the US, Canada, Italy, Japan, the U.K., and Germany. Since the ancient times, Nepalese craftsmen of the Shakya and Sunwar families have produced exquisite pieces of gold and silver jewellery. The production and trading activities are mainly located in and near the Kathmandu valley. There are a total of 50,000 craftsmen in the country, and 40 per cent of them are concentrated in Kathmandu where there are over 10,000 craftsmen working on silver jewellery alone. The craftsmen are still using traditional artistic designs, skills and techniques. There are about a dozen gems processing units that supply gems to local manufacturers. Domestic supply of raw materials is not enough for export purposes. There is an absence of export-friendly and transparent legislation and simplified procedures to facilitate mining, processing, manufacturing, exporting, importing, re-exporting of precious metals, gems, stones, and jewellery. Global market conditions for silver jewellery look favorable. Nepal benefits from favourable market access conditions especially to EU, USA, Japan and India. The world market prospects are very favorable. The most attractive markets for Nepalese Gems and Jewellery are some EU countries, the US, Hong Kong, and India. The most important selling point for Nepalese jewellery is the traditional, handmade production process. Nepalese jewellery often incorporates religious or traditional motifs and is considered to possess significant value. Currently, Nepalese jewellery is becoming increasingly popular outside of Nepal and appears to be competing well with similar produce from neighboring countries.

Half edge carved pendant with 18x25mm oval cab stone

It is estimated that there are currently around 10,000 households, which are directly dependent on the silver jewellery and gems business in Nepal. While the sector currently contributes only marginally to Nepal's exports any further development in the mining and processing of gemstones will have a direct impact on Nepalese development by generating additional employment in rural populations, as well as encouraging the acquisition of skills for many individuals working in the jewellery sector.

5. Leather: Medium export potential

Leather is considered medium export potential. The current export performance is just average compared to other sectors. Most of the production is exported: 70 per cent in the form of wet-blue leather, 20 per cent in the form of crust leather and only 10% as finished leather. The major destinations for hides and skin are Asian countries (India, Hong Kong,

China and Thailand) and Italy. Nepal has a sizeable livestock population to support the leather industry. However, there are significant problems with the infrastructure supporting the livestock. Currently, there are only two slaughterhouses in the country. Nepal's tanneries also appear to be outdated. Adding to this, there are complaints from some tannery owners, over shortages of raw materials such as goat and buffalo skins. The suggestion is that they are

consumed in the country. In addition, the insurgency has further worsened the hide collection process. Good quality finished hides for shoes and finished goat leather for leather garments are being imported. As a result, more than 70% of the finished goods made in Nepal are made from leather bought from India. Finally, there is no quality standards set in the country for this sector. Competitiveness prospects are below average. The great potential of Nepal's leather sector remains largely unrealized and the country's leather industry has not kept pace with the substantial growth of leather and leather goods in other developing regions. In order to be competitive, the supply value chain needs to be better organized. This may be worth pursuing as, although the total world demand for wet-blue hides has shown a decline, numerous markets like India, China, Romania and South Africa are showing strong demand. The global market for hides in crust and finished is performing very strongly. The international market access conditions are favourable around the world. World market prospects are therefore above average. Some EU countries, East Asian countries, Pakistan, India, and South Africa are the most attractive markets for Nepalese leather products.

Nepalese Embroidered Yak Leather Shoes

Shoemaker at work

The sector requires around 6,300 people who have engaged in tannery activities or intermediaries such as hides and skin collectors. In its current sub-optimal performing state, the sector already contributes to 1.3% of national export earnings. The leather industry in Nepal is important for its job creation impact. Successful development of the leather industry will contribute to poverty reduction in rural areas as well. There is legitimate concern, however, over the negative environmental impact of the leather industry, especially its contribution to water degradation.

6. Tea: High export potential

Tea is considered high export potential. The current export performance is strong compared to other sectors. Nepal produces both CTC (lowland), which is primarily for domestic consumption, and highland orthodox tea, which is mainly exported. The tea sector experienced significant growth, following its liberalization over a decade ago. From an average of 80Mt exports grew to over 400Mt last year. The tea industry has been expanding in recent years along with an expansion of its plantation areas from 3,500 hectares in 1996 to 15,000 hectares in 2004. There is large potential to expand the cultivated area. With the positive conditions in this sector, the government has set very ambitious production targets. However, the tea sector is unlikely to meet the targets, mainly due to problems relating to the insurgency, the fragmentation of production, and the lack of auctioning facility or quarantine laboratory. The world market, at the same time, is showing its first sign of price recovery since its slump caused by massive overproduction. Overall, Nepal has favourable market access conditions to the most attractive markets including Japan, US, EU and Russia. Its production of tea is, however, rather specialized in niche markets such as highland orthodox tea and high quality and organic. The job creation impact of this sector is very high compared to other sectors. This sector seems to be a strong engine for farmer's income generation and poverty reduction as orthodox Tea gives higher returns compared to other crops. This sector is also likely to have a high impact on total employment compared to other sectors, especially female employments as estimates suggest that it already accounts for around 105,000 people.

Nepalese Green Tea

7. Ginger: Medium export potential

Ginger is considered medium export potential. The export performance is satisfactory. The value of ginger export is increasing over the years and doubled from 1994 – 2003. Almost all export is to India. Nepal is a significant producer of Ginger and ranks within the top 15 world exporters. The total cultivated land area for ginger has been increasing over the years. More than 75% of the production is traded as fresh and almost 25% in dried form. From the fresh consumption market perspective, the quality of Nepali ginger is considered inferior to Indian and Jamaican ginger and elite varieties of other countries because of Nepal's high fiber content and dirty look. Production is still concentrated in small, family owned business. The concept of 'company' has not yet penetrated into ginger trading. Forward or backward linkages in the supply chain are non-existent. Nevertheless, competitiveness prospects are satisfactory. There is still a large tract of land that could be brought under ginger cultivation. Improving production techniques could also significantly increase production. There is very high potential for diversifying Nepal ginger trade into processed products. Ginger world market is dynamic but prospects are not so encouraging. The most attractive markets for Nepal are Pakistan, Netherlands, Malaysia, US, and Singapore. However, China's exports are gaining market share at an impressive rate reaching three quarters of total world exports in 2005. The US is not likely to provide a realistic export market either owing to the high cost of transporting a bulky commodity like ginger. It may be possible to export higher value products, such as organic ginger, profitably. Chinese exporters have so far dominated other promising Asian markets, such as Bangladesh and Malaysia. The sector currently requires around 66,600 people for 2 months per year, which is estimated around 11,000 people. Ginger is Nepal's most important spice export commodity. Ginger farming is one of the main sources of cash income for the farmers of mid-hills. Most of the farmers producing ginger are small farmers for whom it is the main source of cash income. Most workers involved in the supply chain are poor, manual workers. The net income of farmers involved in ginger cultivation is significantly higher than that of competing crops. Environmentally, ginger cultivation contributes towards reducing soil erosion in the mid-hills.

8. Medicinal plants and essential oils: Medium export potential

Medicinal plants and essential oils are considered medium export potential. Medicinal and aromatic herbs in mountainous areas of Nepal are increasingly finding an important place in the local and international markets. These districts have more than 700 medicinal plants found in large quantity. Various plant-based essential oils are also produced and exported from Nepal. Every year in Nepal's Himalayan highlands, villagers gather some 20,000 tons of Medicinal and Aromatic Plants (MAP) from the wild pack and dry them and sell them to traders for export. The bulk of the MAPs end up in India. The large scale cultivation of MAPs is non-existent and processing is limited to distilling of essential oils. Wastage and unnecessary losses occur due to improper drying and storage. In order to minimize these losses collectors may benefit from additional training in post harvest techniques. Much more can also be done in terms of semi-processing such as sorting and grading of qualities, powdering, boiling, cooking, making aqueous solutions etc. in order to derive more from the value chain. The global consumer has developed a strong preference for natural healthier foods, natural healthcare products and natural cosmetics. The global market for herbal products covering medicinal, cosmetic and other purposes is estimated to be worth around USD 65 billion. While there is no shortage of market for Nepal's MAPs, however, astringent non-tariff barriers limit Nepal's export capacity. There are 40,000 people involved in aromatic plant harvesting, trade and processing who derive their income solely from essential oils. By providing proper support and interventions for favourable policy, the sector can create a number of new job opportunities (i.e. aromatic plant harvesting, collection of medical plants). As a consequence, it is capable of having a very positive impact on poverty reduction and rural development. The proper development of this sector has great potential as a good source of income to local communities in Nepal.

9. Hand made paper: Medium export potential

Hand made paper is considered medium export potential. The bulk of Nepalese paper and paper products are exported to the US, EU countries and Japan. Nepali entrepreneurs believe that Nepal has quite a good market share of the high-end market in the US and EU where Nepal which it is targeting with its unique and high quality products. Built on traditional skills, Nepali handmade paper-making has been thriving primarily due to an abundant supply of Lokta resources. Nepalese handmade paper is famous for its unique quality, strength, durability, and resistance to insects. A diverse range of paper products are produced for export. Indeed, the bulk of production is exported, either directly or via tourists. Production is small scale and scattered throughout the country. As a result, its competitiveness is below average. There is, however, a growing market demand for Nepalese handmade paper. The Argeli plant, a close family

of Lokta plant, which grows in lower altitudes than Lokta, offers a promising alternative. World market prospects appear to be above average. From a broader perspective, which includes the diverse range of handmade paper products currently available, the international market for Nepalese Handmade paper is even larger. There is great potential to increase production by diversifying into the market for stationary and art items like envelopes, cards, artist paper, book bindings and household items like lampshades etc. The most attractive markets are EU countries, Jordan and India.

Gift Bag

Wrapping Paper

Lamp Shade

Note Book

The full-time employment estimates more than 22,000 people in the sector. This sector has a high potential for job creation, and profit margins for all market actors from Lokta producers to Exporters are high.

10. Wooden handicrafts: Low export potential

Wood craft is considered low export potential. The contribution of wooden handicraft products to Nepalese total export earnings is small, but has shown a tendency to increase in recent years, especially with the development of strong world demand for wooden handicrafts (over USD 1.5 billion in 2005). Nepal has abundant forestry resources, indicating no threat to the supply of raw materials. In addition, Nepalese industry has a capability to design unique and traditional artistic works. Yet, the sector faces a number of constraints including a lack of quality,

Kumari Window

Lamp Stand

Window

insufficient finance for investment in seasoning plant, inadequate training to maintain the quality of products and export expansion. Tariff barriers commonly at low rates, do not constrain the ability to export Nepalese wooden handicrafts overseas. More worryingly, the international supply of wooden handicrafts is highly dominated by countries such as China and Indonesia, which have the technology to produce low cost, innovatively designed products. The full-time employment estimates approximately 4,000 people directly involved in this sector. While the sector is not a major source of employment, its main contribution, in terms of development, is to develop skilled labors, contributing to more value-added products.

11. Cut flowers: High export potential

Cut flowers are considered high export potential. Nepal's export performance is overall satisfactory. The value of export has grown over the last six years, making Nepal a net exporter of flower products. Currently, the Netherlands, USA, India, Japan and Denmark are the main markets. Border trades through illegal channels between Nepal and India are very common, and it is very difficult to estimate the true value of border trade transactions. Nepal is noted for its exceptionally rich bio-diversity, as it possesses a wide variety of topographical and climatic conditions within a small area. Floriculture business has been flourishing in Nepal since the early nineties driven by entrepreneurial

enthusiasm and investment caused by the growth in consumption in the domestic market. Today, there are 550 small and medium-sized nurseries and flower growers, with a combined turnover, in 2006, of Rs.230 million. Despite a positive prospect for the future expansion of the flower sector, the present volume of flower production is limited by low productive efficiency. The sector has the potential to expand further provided that it obtains support in terms of resources, R&D, man power and financial support; strong market information marketing infrastructure support (e.g. cold chains) and a favourable policy regulatory environment that addresses issues such as high cost of input imports. Global market conditions seem very competitive as a number of large producers, such as Kenya, China etc, have already successfully established the in the EU where Nepalese products are required to meet SPS measures.

According to the FAN, the 550 small and medium farm units involved in floriculture production and their associated networks employ about 2,500 people. With necessary supply-side conditions, it is possible to create employment opportunities with a direct impact on poverty reduction and improvement in women empowerment.

12. Coffee: Medium export potential

Coffee is considered medium export potential. The recent export trend of Nepalese coffee has been very encouraging. Japan and EU are the major export markets for Nepalese coffee, while the USA is also emerging as an important buyer. All the coffee planted in Nepal is Arabica as the climate and soil in the mid and high hills of Nepal are very suitable for the Arabica bean. The total areas under coffee cultivation, total production as well as total yield have been increasing over the last decade. Yields in Nepal are, however, still relatively low compared to their major competitors. There are approximately 15,000 farmers involved in coffee production. They do not appear to be facing any major production problems. While coffee production in Nepal has only emerged recently, it is mostly cultivated under conventional methods. The system of coffee processing is mostly wet process. The major problem currently facing Nepali coffee production is the great variation in the quality of dried coffee beans. The problem comes from the fact that the beans are collected from many small farmers and, in the absence of a quality standard for coffee (other than dry cherries), this has led to great variation. There are eight major processing enterprises handling almost all coffee produced in Nepal. There are a number of re-occurring processing errors in both the wet and dry processing systems. By removing many of these errors it would be possible to significantly improve the quality of the coffee. Traders also reported significant quality loss in transit due to accumulated heat in the containers. A shortage of temperature-controlled containers appears to be the major source of this problem.

Competitiveness prospects are very favourable. There are still large tracts of land, which could be brought under coffee cultivation. Improving the yield rate could increase production. Very significant increases in production can be achieved through improved processing efficiency. In addition, Nepal possesses great potential for product diversification in terms of 'Speciality Coffee' (De-caffeinated coffee, Organic coffee, one estate coffee, One variety coffee, Highland coffee). World market prospects are very favourable. The niche in organic and specialty highland coffee offers real opportunities. For a small producer like Nepal, the fact that these niche products only occupy seven percent of the total world market is not a constraint. An indicator of future potential in this area is the great popularity of Nepalese organic coffee in Japan. The most attractive markets for Nepalese coffee are a number of EU countries and the US. It may also be possible to develop India as a market for Nepalese coffee. The current socio-economic impact of this sector is relatively low. More than 7,700 people directly involved in this sector are estimated as a full-time employment. While coffee is, as yet, not a very important export commodity for Nepal, in terms of total income, its importance as an agricultural export item has been increasing. Apart from the farmers, there are a large number of ancillary workers dependent on this sector. Coffee farming also contributes towards rural development in several aspects. It has direct impact on the economy of the rural people. In addition, coffee plants contribute towards reducing soil erosion in the mid-hills.

13. Honey: Low export potential

Honey is considered low export potential. While export statistics for Honey are unreliable, it is estimated that Nepal exports more than half of its domestic production of honey. India is by far the most important export destination. Exports to India have, however, recently been threatened by increasing competition from rival suppliers such as China and Australia. Total domestic production is estimated at being around 600-1000 Mt (around 0.5% of world production). The production is scattered and usually small-scale, and production methods are traditional, but have recently shown some modernization. Exports are, however, controlled by a small group of traders, who have some considerable market

power over producers. Quality standards are an important issue. Currently, Nepal faces problems exporting to the EU and Norway, and exports to Korea, currently the major export market next to India, are becoming increasingly difficult. Nepal enjoys preferential access in some markets (e.g. India, EU), but faces high tariffs in Japan and Korea. There is scope for improving production methods. This would allow production to increase, as well as improving quality levels. There may be considerable potential to diversify export markets; however, this is likely to hinge on overcoming quality issues such as sanitary requirements. Only around 13,000 people full time might rely on this sector for their livelihood. Honey plays however an important role in reducing rural poverty by providing an income to the different people involved in the production chain.

14. Mandarin oranges: Low export potential

Mandarin oranges are considered low export potential. Traditionally mandarin oranges have been exported to India, mainly through informal channels. More recently Nepal has started exporting oranges to Bangladesh. Mandarin Oranges (*Citrus reticulata*) are the main fruit among the citrus crops and are an important commercial fruit crop in the mid-hill regions of Nepal. The productive area and total production is increasing over the years. The yields remain very low. The mid-hill region is the production area of oranges in Nepal. The vast majority of the crop is traded in fresh form. There is only one major processing unit producing orange juice and selling mainly in the domestic markets. Competitiveness prospects for mandarin oranges are below average. Yet, there is ample scope for enhancing the quantity as well as the quality of the fruit. No orange quality standards exist in Nepal. Significant losses occur due to disease, insects and bulk transportation. The oranges pass through a rather simple marketing channel involving two main stops – collection centers and assembly points. Each of the players in the supply chain is a small, family owned and operated business. The concept of ‘company’ is not established in orange trading. World market prospects are below average. The most attractive markets for Nepal are EU countries and Russia. Informed opinion considers Nepal to be highly underrepresented in these markets. Traders are of the opinion that the Nepal oranges have great potential for exports to India and Bangladesh. Around 17,000 farm families are dependent on this sector. Orange cultivation is one of the main sources of cash income for the farmers of mid-hills and is grown in almost all mid-hill districts. But so far, oranges have not been a very important export commodity for Nepal. Orange cultivation serves a beneficial environmental purpose by helping to check soil erosion.