INDUSTRY STATUS REPORT

BASED ON THE FIRST COMPREHENSIVE QUARTERLY INDUSTRIAL SURVEY OF NEPAL

MANUFACTURING INDUSTRY SPECIAL

THE SECOND EDITION

Q1
FY2078/79

CONFEDERATION OF NEPALESE INDUSTRIES

ACKNOWLEDGMENTS

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We also thank the President of Association of Pharmaceutical Producers of Nepal Mr. Prajwal J. Pandey, Past President of Footwear Manufacturer's Association of Nepal Mr. Krishna Fuyal, Managing Director of Nepal Ekarat Engineering Company (NEEK)., Mr. Kush Kumar Joshi, Managing Director of Tranweld Transformers Mr. Amul Shrestha, Immediate Past President of Plast Nepal Foundation Mr. Sharad K. Tibarewala, and Kiran Shoes Manufacturers for providing inputs on the footwear manufacturing industry.

About Industry Status Report

The Industry Status Report (ISR) provides a comprehensive analysis on the state of Nepali industries, leveraging an in-house industry survey. **In Nepal, what explains misdirected policy interventions aimed at private sector growth?** The absence of periodically available primary data on Nepali industries, either with the Government of Nepal or with the private sector associations, is one of the key reasons. Against this backdrop, ISR is produced as an effort to promote evidence-based policy-making. Each quarter, CNI Research Cell conducts an industrial survey and publishes this report to tease out changes across critical variables that either promote or stifle growth in industries.

ISR (The Second Edition)

The Industry Status Report (the Second Edition) is based on a survey of 62 industries. It was carried out from November 9, 2021 to December 24, 2021 and collects the information on Q1 of the Fiscal Year 2078/79 i.e. Shrawan-Asoj of 2078. On the whole, the Second Edition ISR offers **20 Key Industry Insights** on how industries performed in Q1 2078/79, along with a comparison of data from Q4 2077/78.

Apart from presenting the findings of the survey, each ISR covers one industry sector in depth. **The First Edition focused on the energy industry, whereas the Second Edition focuses on the manufacturing industry for four primary reasons.** First, industries in the manufacturing sector offer unique opportunities that help attain technological advancements. Second, the manufacturing industry has the greatest potential for generating well-paying jobs. Third, the manufacturing sector offers special opportunities for capital accumulation which is higher than that of agriculture and services; thus, an increasing share of manufacturing will drive economic growth. Fourth, the inclusion of industrialization in the 2030 Agenda for Sustainable Development as Sustainable Development Goal 9 (SDG 9) reaffirms its central role in the overall development picture.

What does the survey cover?

5 Areas and 20 Key Industry Insights

1. **Business Performance:** industry capacity utilization, revenue trends, demand in domestic market and market competition, export share
2. **Finance:** interest rates, share of loan, access to finance, NRB COVID-recovery loans
3. **Skills and Employment:** employment, hire and lay-off, skills gap & training, employee retention, share of Nepali workers
4. **Industrial Ecosystem:** regulation and industry administration, utilities, transportation and infrastructure
5. **Business Outlook:** confidence in the industrial sector, new investment plans

KEY STATISTICS (Q1 2078/79)

No of industries:
62 ↑ (Q4 47)

Total employees:
22343 ↑ (Q4 19,237)

Average employment per company:
397 = (Q4 397)

Share of Nepali workers:
94.8 ↑ (Q4 91.7%)

New employment:
992 ↑ (Q4 814)

Average age of industry (in years):
19.6

Average operational capacity utilization:
70.5% ↑ (Q4 64.8%)

Average share of credit for working capital:
39.9 ↓ (Q4 48.1%)

Median share of export of manufacturing industries:
20%

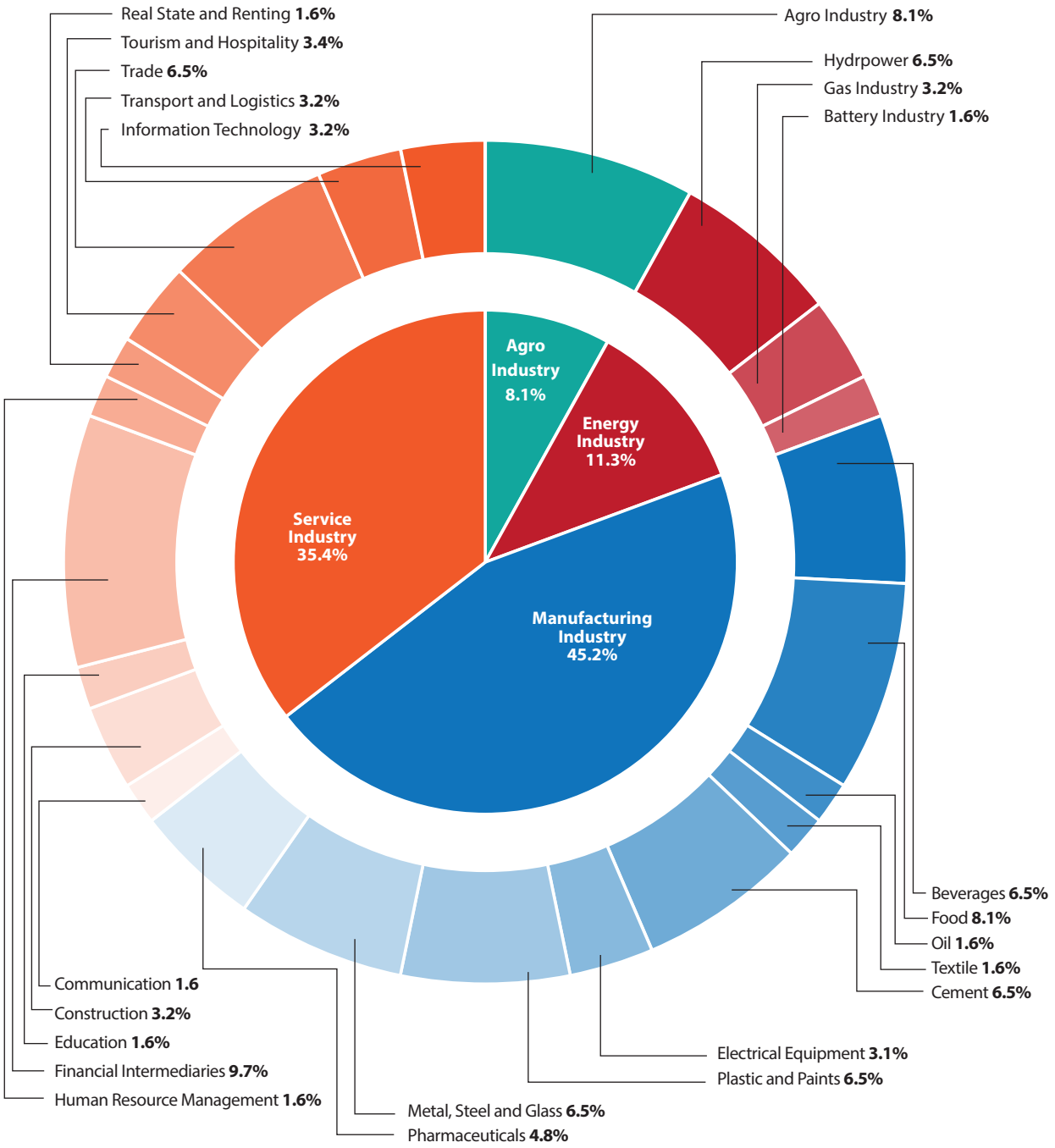
Average interest rate on loans:
8.4% ↑ (Q4 7.8%)

Average revenue growth rate:
41.4% ↑ (Q4 8.0%)

Average share of imported raw materials by the manufacturing/ agro industries:
47.4% / 31.2%

Note: Q4 in the parenthesis denotes the fourth quarter of the FY 2077/78

COMPOSITION OF THE INDUSTRIES SURVEYED



METHODOLOGY

The Industrial Status Report (Second Edition) is based on a survey of 62 industries from within CNI membership. A convenient sampling method was deployed. The reported values provide a good indicative reference on the status of the broader Nepali industries every quarter.

68% of the sample comprises old respondents, while 32% industries are new respondents. The respondents are categorized under the Nepal Standard Industrial Classification (NSIC) Code for the purpose of the survey and further aggregated into four distinct industrial sectors: agro industry, energy industry, manufacturing industry, and service industry. The across-industry-averages presented in the report are adjusted to approximate the actual sectoral composition of CNI membership.

10 key questions were mandatory, while the 30 remaining ones were optional. The report rests on the assumption that the respondents have provided accurate information. The survey was carried out using the survey platform, KoBoToolbox, and further analysis of the data was done on Stata. The survey questionnaire is available online via this QR code.

THE UNIT OF ANALYSIS

The unit of analysis is one industrial establishment.

BUSINESS PERFORMANCE

Periodic performance measurement is a vital part of monitoring the growth and progress of any business. This section summarizes the performance of industries within key variables in Q1 78/79.

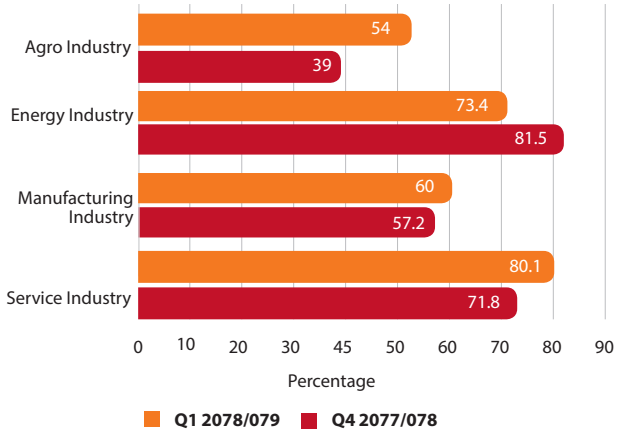
INDUSTRY CAPACITY UTILIZATION: 70.5%

KEY INDUSTRY INSIGHT I

On average, the industries were operating at 70.5% in Q1 78/79 whereas they were operating at 64.8% in Q4 77/78. The service industry was the most operational at 80.1% which increased from 71.8%. It performed considerably well in Q1 78/79 compared to the preceding quarter as the service sector experienced full-fledged operations almost after two years.

While the capacity utilization of the manufacturing industry and agro industry increased to 60.0% from 57.2% and to 54.0 from 39.0 respectively in Q1 78/79, the energy industry experienced a decrease to 73.4% from 81.5 compared to last quarter.

INDUSTRY CAPACITY UTILIZATION



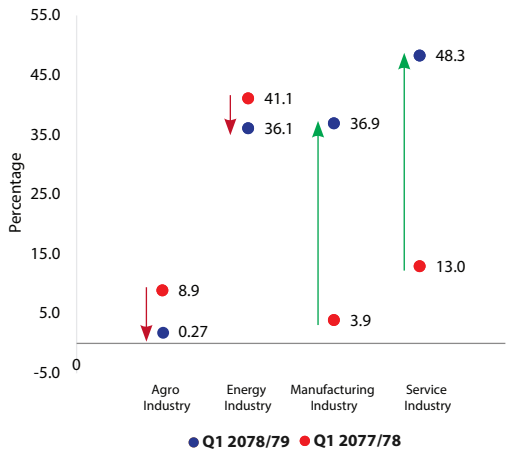
REVENUE TRENDS: 41.4% GROWTH

KEY INDUSTRY INSIGHT II

In Q1 78/79, the across-industry-average was a 41.4% growth whereas the revenue growth was 10.4% in Q1 77/78, which is a massive 31.0 percentage point growth. There has been a substantial increase in the growth rate of revenue in the manufacturing and service sectors, while agro and energy industries experienced lower growth in revenue during Q1 78/79 as compared to Q1 77/78.

While there has been a substantial increase in the growth rate of revenue in the manufacturing and service sectors, agro and energy industries experienced lower growth in revenue during Q1 78/79 as compared to Q1 77/78. This reflects that the manufacturing and service sector have been recovering from the pandemic, while the scenario is yet to be optimal for the agro industry.

REVENUE GROWTH RATE



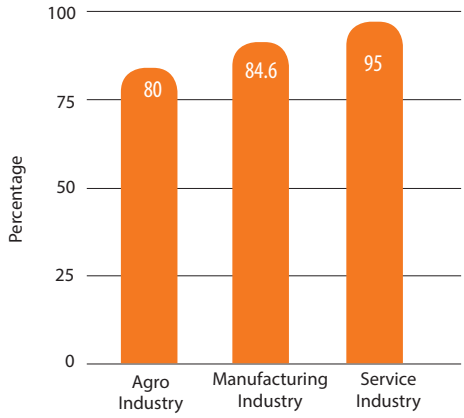
DOMESTIC MARKET DEMAND: 90.1% & MARKET COMPETITION: 95.9%

KEY INDUSTRY INSIGHT III AND IV

90.1% of the respondents stated there is enough demand for their goods and services in the Nepali market, while 9.9% of them answered otherwise. 80% of the surveyed agro industry responded that there was sufficient demand for their goods in the domestic markets, whereas 84.6% of the manufacturing industries reported so. The demand for goods and services produced by Nepali industries is encouraging.

95.9% of the surveyed industries perceived their goods to be competitive in the market in relation to imported goods, which gives optimism to the domestic industries. All agro industry respondents perceive their products as competitive, while 92% of the manufacturing industries also responded so.

DOMESTIC MARKET DEMAND



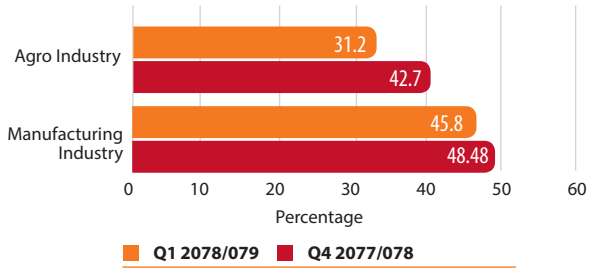
SHARE OF RAW MATERIALS IMPORTED: 44.7%

KEY INDUSTRY INSIGHT V

The survey results show that Nepali agro and manufacturing industry heavily rely on foreign raw materials. On average, **44.7%** of the raw materials were imported across industries in Q1 78/79. While the agro industry imported 31.2% of the raw materials, the manufacturing industry imported 45.8% of it.

The survey shows that a huge proportion of raw materials are sourced from abroad. Such industries are vulnerable to external

RAW MATERIALS IMPORTED



shocks such as changes in the value of Nepali rupees against foreign currencies, as well as volatility in foreign trade.

SHARE OF EXPORT: 30.8% FOR MANUFACTURING INDUSTRY

KEY INDUSTRY INSIGHT VI

30.8% of the sampled manufacturing industries exported their goods in Q1 78/79, which mostly belonged to manufactured foods and textiles. The median share of export out of their total production was 20%. One of the textile-related industries exported 75% of its production which is the largest margin of export among the surveyed industries. Interestingly, its share of imported raw materials is 59.2%, which is 14.5percentage points higher than the average share of raw materials imported among all manufacturing industries.

MAIN DIFFICULTIES TO ACCESS DOMESTIC MARKET: EXCESS COMPETITION

KEY INDUSTRY INSIGHT VII

While the respondent industries continued being confident about their goods and services in Q1 78/79, they still had difficulties in accessing the domestic market. The following table highlights the main difficulties expressed by manufacturing and agro industry:

Manufacturing Industry	Agro Industry
▪ Excess Competition Affecting Price Margins ▪ COVID Pandemic ▪ Consumer Bias for Foreign Goods/ Services	▪ Consumer Bias for Foreign Goods/ Services Excess Competition Affecting Price Margins

The other difficulties were establishing the credibility of Nepali goods and the reluctance of retailers to sell them.

BUSINESS PERFORMANCE ANALYSIS

Industries were better off financially in Q1 78/79 compared to Q4 77/78. The domestic industries were operating at a considerable level, thereby producing more quantity of goods, leading to an increase in the revenue growth. Therefore, Q1 78/79 saw an increase in the share of imported raw materials as well. Similarly, the majority of the industrialists are confident that their product is competitive and there is enough market demand for domestic products; which is a critical factor for expanding a broader industrial base in Nepal. Furthermore, a good share of industries are exporting goods, which indicates that their goods are competitive beyond the domestic market. It may also be extrapolated that exporting industries on average import more shares of raw materials, and **competitive industries can be established even if raw materials are not available in the country.**

FINANCE

This section provides insights into the ability of industries to access credit, the share of loans in working capital, NRB COVID-recovery loans, and prevailing interest rates.

CREDIT LINE: 39.9 % OF WORKING CAPITAL FROM CREDIT LINES

KEY INDUSTRY INSIGHT VIII

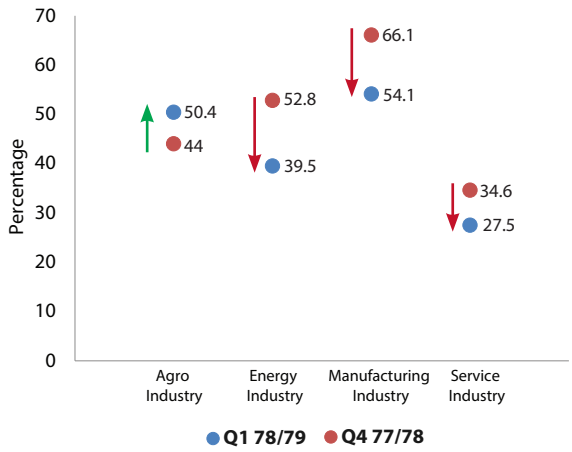
On average, **39.9** percent of the working capital of the surveyed industries came from credit lines in Q1 78/79 as compared to 48.1% in Q4 77/78.[1] 54.1% of the working capital for the manufacturing industry was financed through credit lines, followed by 50.4% for the agro industry, 39.5% for the energy industry and 27.5% for the service industry. The share of working capital financed through credit lines is lower for all industrial sectors in Q1 78/79 as compared to Q4 77/78.

THE VULNERABILITY MEASURE:

KEY INDUSTRY INSIGHT IX

This measure helps assess the vulnerability of industries to fluctuation in interest rates. The higher share of loans for a given industry brings more financial burden when interest rates fluctuate. For illustration, with the largest share of loans among all industry sectors, the Vulnerability Measure shows that manufacturing industries are the most vulnerable. Further, abrupt regulatory change by Nepal Rastra Bank (NRB) to decrease the amount of working capital based on loans available to industries can also bring unforeseen challenges.

SHARE OF WORKING CAPITAL FROM CREDIT LINES



AVERAGE INTEREST RATE: 8.4%

KEY INDUSTRY INSIGHT X

In Q1 78/79, the average interest rate on loans was **8.4%**, which is 0.6 percentage points higher than the Q4 77/78. In Q1 78/79, the interest rate for all industrial sectors has increased, with the highest observed in the manufacturing industry. An increase in the interest rate will lead to a decrease in the rate

1. A credit line is a flexible loan option offered by financial institutions to individuals and corporate entities.

of return, while the risk and repayment time of the existing loan may increase. **Furthermore, industries are less likely to expand their business and increase their investment.**

AVERAGE INTEREST RATE ON LOANS

Interest rate	Q1 78/79	Q4 77/78
Agro Industry	8.7	8.3
Energy Industry	7.7	7.4
Manufacturing Industry	8.7	7.7
Service Industry	8.2	8.4

NEPAL RASTRA BANK COVID-RECOVERY LOANS

Nepal Rastra Bank set up the Business Continuity Loan Facility and Refinance Facility for businesses to mitigate the difficulties from the pandemic. Business continuity loans have been extended to the COVID-affected tourism, cottage, small and medium industries for payment of salaries to workers and employees in line with 'Business Continuity Loan Procedure, 2077'. NPR 1.07 billion worth of loan has been approved as of mid-November 2021. Survey results showed that 90% of the industries that applied for the Business Continuity Loan received it, which is encouraging for the survival of industries during the pandemic.

The outstanding amount through the Refinance Facility remained NPR 120.11 billion as of mid-November 2021. Similarly, 57.1% of respondents that applied for the Refinance Facility received it.

PERCENTAGE OF INDUSTRIES THAT RECEIVED THE COVID-RECOVEY LOANS

	NRB Business Continuity Facility	NRB Refinance Facility
Percentage of respondents who received the loan among the applied	90	57.1

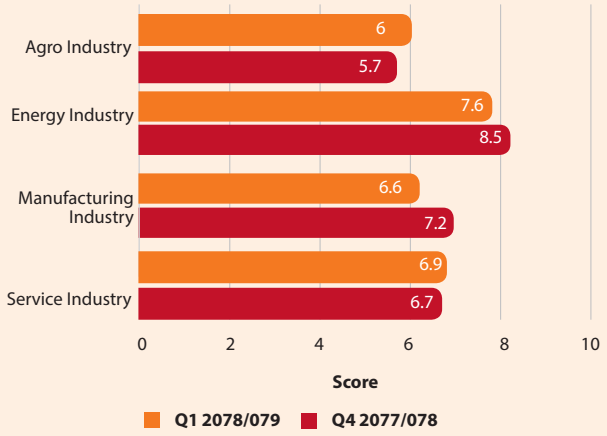
FINANCIAL ANALYSIS

Working capital from credit lines in Q1 78/79 decreased by 6 percentage points as compared to Q4 77/78, while the interest rates on loan have hiked up across all industries. Given that the higher share of loans for a given industry brings more financial burden (also attributed to higher interest rates), this may explain the reduction in the share of credit availed during Q1 78/79.

Manufacturing industries are the most vulnerable to fluctuating interest rates, as they have the highest share of loans as well as the interest rates.

When asked to rate the access to finance on a scale of 1 to 10 (with 1 being the lowest and 10 being the highest), **the across-industry-average score stood at 6.8 in Q1 78/79 compared to a score of 6.9 in Q4 77/78.** Uncertainty generated by the pressing issue of ongoing liquidity crunch and increase in interest rates is reflected in the financial indicators of the survey (refer to the graph).

SCORE ON EASE OF ACCESS TO FINANCE



SKILLS AND EMPLOYMENT

This section highlights the trends in employment and employee skills in the industries surveyed.

TOTAL EMPLOYMENT: 22343

KEY INDUSTRY INSIGHT XI

The surveyed industries employed 22343 staff in total. On average, an industry establishment employed 392 individuals (with a range of 9-4200).

With 11637 employees, the manufacturing sector was the largest employing sector, followed by the service industry with 9389 employees, energy industry with 789 employees and agriculture with 528.

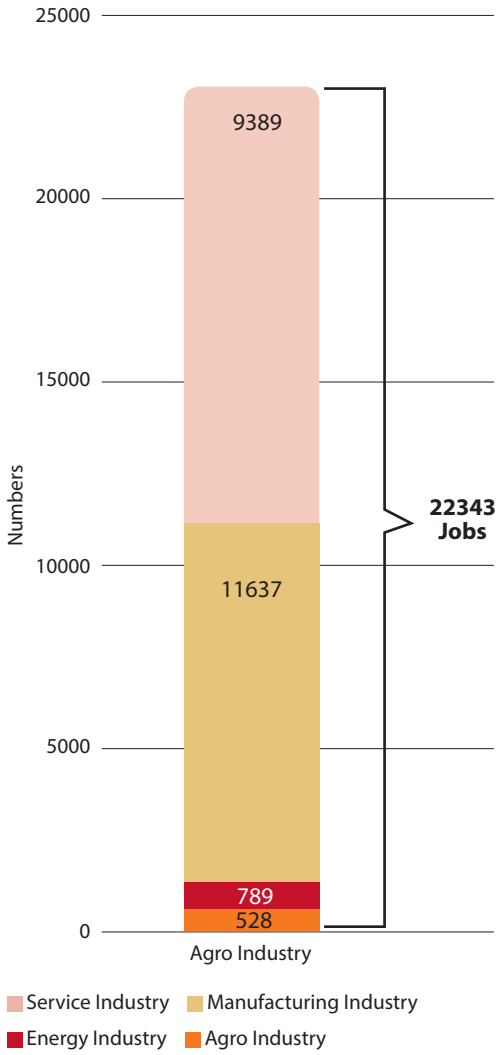
Average employment among sectors. The service sector was at the top with 458 jobs while manufacturing industries were right behind with 449 jobs. The numbers were 63 jobs and 48 jobs in the agro and energy industry sector respectively.

HIRING AND LAYOFF: ALL INDUSTRIAL SECTORS GENERATED JOBS

KEY INDUSTRY INSIGHT XII

In Q1 78/79, the survey respondents generated 992 jobs, for which 7648 individuals applied. The sharp asymmetry between the demand and supply of employment opportunities is reflected

EMPLOYMENT IN SURVEYED INDUSTRIES



in the survey results. The service industry generated 67.4% of the new employment opportunities while it only comprised 35.4% of the sample. The second highest employment generating sector was the manufacturing industry with 25.3% of the total new employment (sample percentage of 45.2).

During Q1 78/79, 830 employees from the respondent industries were laid off or left the job, leading to a net employment generation of 162 jobs.

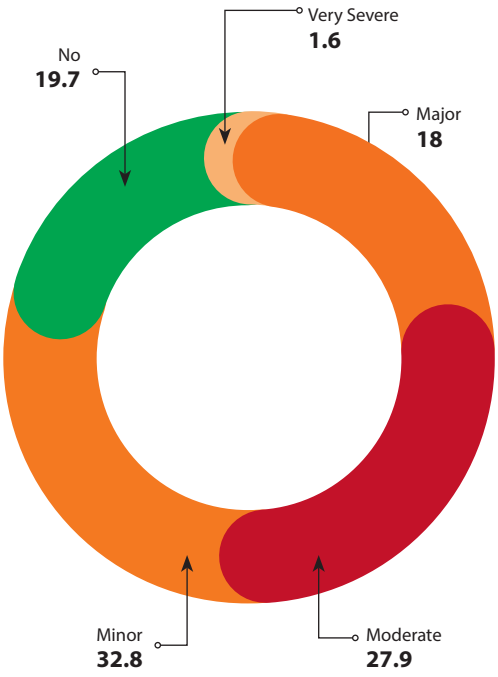
All industry sectors were net employment generators in Q1 78/79. Whereas in Q4 77/78, only the service and manufacturing sector were net employment generators. This shows all sectors are in the phase of recovery.

EMPLOYEE RETENTION

In response to the questions relating to the difficulty in the retention of employees, 32.8% of respondents across sectors stated this was a minor problem whereas 18.0% stated it as a major hassle. While 27.9% considered this to be a moderate hassle, 19.7% of the respondents stated that retention was not an issue at all. Only 1.6 % stated retention was a very severe problem for their business.

For the agro industry and energy industry, retaining employees is not a major problem. For the manufacturing industry, 70.3% of the respondents responded that they have minor to moderate obstacles in retaining employees. Similarly for the service industry, 51.9% of the respondents say that they have moderate to major obstacles in retaining employees.

IS RETAINING EMPLOYEES AN OBSTACLE TO SMOOTH OPERATIONS?

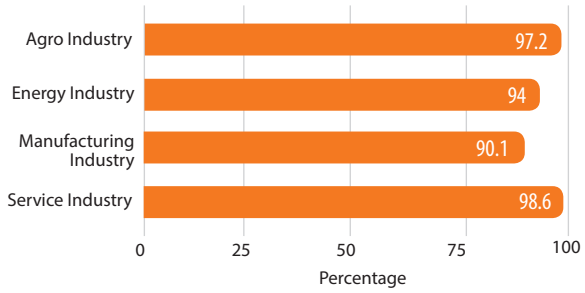


SHARE OF NEPALI WORKERS: 94.8%

KEY INDUSTRY INSIGHT XIII

Of the industries surveyed, a reported average of 94.8% in the labor market are Nepali citizens. The service sector had the highest share of Nepali workers at 98.6%, followed by the agro industry 97.2%. The manufacturing sector has the lowest share of the national workforce at 90.1%.

SHARE OF NEPALI WORKERS



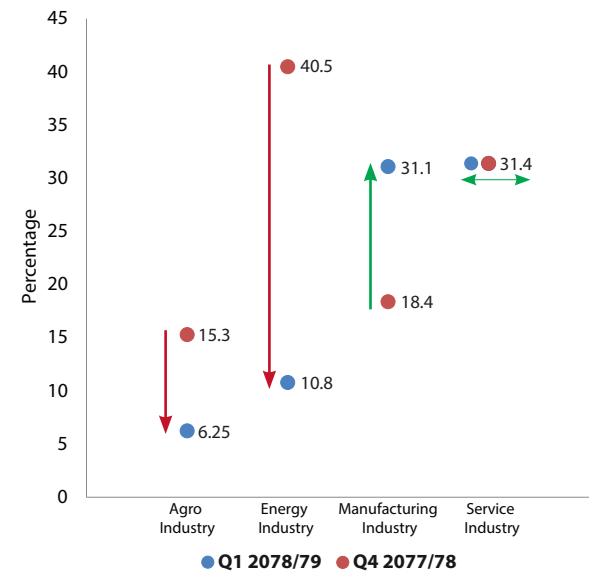
SKILL GAP AND TRAINING: 29.6% RECEIVED TRAINING

KEY INDUSTRY INSIGHT XIV

The survey result shows that across sectors, **29.6%** of the total employees received training during Q1 78/79. The service sector provided training to 31.4% of the total workforce in Q1 78/79 (same in Q4 77/78), followed by the manufacturing sector with 31.1% of the employees receiving training.

63% of the respondents stated the "technical skill gap" as a challenge. Technical Skills were followed by professional skills and interpersonal skills in the case of agro industries and manufacturing industries. In the case of service industries, the employees show a skill gap in the interpersonal area followed by technical and professional skills. **Closing these skills gaps is essential to realize the optimum potential of all industries.**

EMPLOYEES THAT RECIEVED TRAINING



WHAT ARE THE SKILLS GAPS YOU EXPERIENCE AMONG EMPLOYEES IN YOUR INDUSTRY?

Skills Gap	In percentage			
	Agro Industry	Energy Industry	Manufacturing Industry	Service Industry
Technical Skills	100	60	70	52
Professional Skills	80	60	43	42
Interpersonal Skills	60	40	30	58

LABOUR MARKET ANALYSIS

The highest job creating sector in the last two subsequent quarters was the service industry.

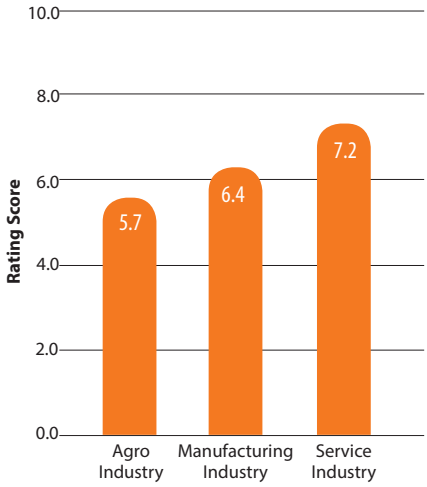
The survey result showed a sharp asymmetry between the demand and supply of the labour force in the industries, as the number of people applying for a job opening is overwhelming. Therefore, so many people are actively looking for jobs. Coupled with a lack of the "market-relevant" skilled human resources, the competition is stiff for lower skilled or easily replaceable jobs. Such labour market situations only favour the selected few skilled individuals who are on high demand. Therefore, both the government and the private sector need to train and produce workforce that are guided by the immediate needs of the market.

A reported average of 94.8% in the labor market are Nepali citizens. **This might be an underreported figure because of the contentious nature of the issue.**

INDUSTRIAL ECOSYSTEM

This section focuses on the various aspects of the regulatory environment, state-provided utilities, transportation and infrastructure that have a direct bearing on the competitiveness of industries.

QUALITY OF ELECTRICITY



1. UTILITIES

ELECTRICITY: 61.8% INDUSTRIES STILL DEPLOY A GENERATOR

KEY INDUSTRY INSIGHT XV

On average, industries experience 9.3 power outages per week.

Due to high number of power outages, **61.8%** of the respondent industries are compelled to deploy a generator. The use of generators has led to 5.0% increase in the monthly operation cost of the surveyed industries. Further, when asked to rate the quality of electricity provided, based on voltage fluctuation and frequency of power tripping on a scale of 1 to 10 (with 1 being the lowest and 10 being the highest), the average rating is 6.9.

2.REGULATIONS

GOVERNMENT ONLINE SERVICES: 4.6 RATING

KEY INDUSTRY INSIGHT XVI

Online	Q1 78/79
Agro Industry	3.3
Energy Industry	4.5
Manufacturing Industry	4.3
Service Industry	5.0

When asked to rank the quality of online services on a scale of 1 to 10 (with 1 being the lowest and 10 being the highest), the average score of the respondents was 4.6. Agro and manufacturing responded with the lowest score of 3.3 and 4.3 respectively, while the service industry with an average score of 5.0 (which is the highest).

ENVIRONMENTAL COMPLIANCE: moderate obstacle

KEY INDUSTRY INSIGHT XVII

When asked if environmental compliance is an obstacle to their industry, moderate obstacle was the most recorded answer across sectors. Environment-related compliance for agro industry stands as a minor obstacle (75%) in the operation of business. 66.7% of the energy industry stated environmental compliance as a major obstacle. For the manufacturing industry, environmental compliance is a moderate obstacle (opted by 52.4%), whereas it is a minor obstacle for the service industry (opted by 56.3%).

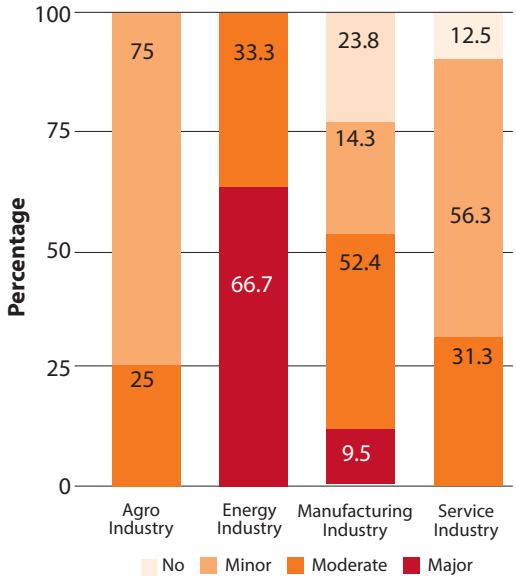
3. TRANSPORTATION, TRADE, AND LOGISTICS

GOODS LOST DURING TRANSPORT AND STORAGE: 1.8 PERCENTAGE

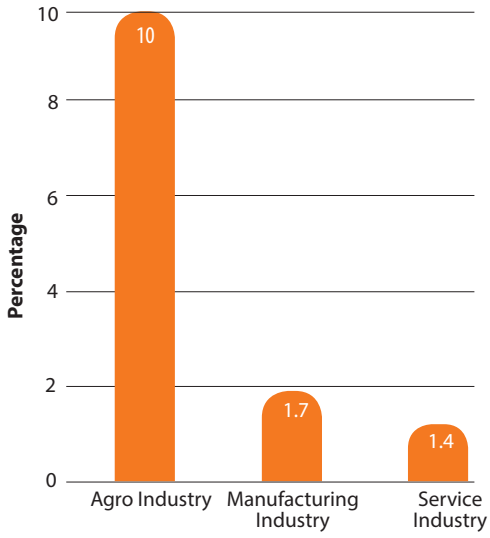
KEY INDUSTRY INSIGHT XVIII

1.8% of the goods were lost during transport and storage. Transport and storage of goods is still an obstacle for

IS ENVIRONMENTAL COMPLIANCE AN OBSTACLE TO YOUR INDUSTRY?



GOODS LOST DURING TRANSPORT AND STORAGE



the producers. This highlights the need of better transportation and logistic infrastructures for realizing the industrial-led economic growth in Nepal.

Major Challenges

Among the specific challenges reported, "quality of roads" was unanimously the biggest concern across all industrial sectors. For the agro industry, occasional road blockage is another big concern given the perishable nature of their products. In the case of the manufacturing industry, the trucking syndicate was the second biggest challenge. Arbitrary pricing of transportation and logistics was the second biggest concern for the service industry.

Agro Industry	Manufacturing Industry	Service Industry
Quality of roads	Quality of roads	Quality of roads
Road blockage	Trucking syndicate	Arbitrary Pricing

INDUSTRIAL ECOSYSTEM ANALYSIS

It goes without saying industrial competitiveness can only be achieved with a robust industrial ecosystem in place. Across the board, industries expressed dissatisfaction about the industrial ecosystem within which they operate.

It is not surprising that all industries mention "quality of roads" as a major hindrance to smooth functioning of business. It is also ironic that the country that boasts of having the potential to supply clean energy across South Asia struggles to provide quality electricity to its industries.

Although the government has been prioritizing digitization of the economy, the survey results reveal that respondents on average were not delighted with the quality of online services provided by various public entities.

BUSINESS OUTLOOK

This section presents the confidence outlook of surveyed industries regarding their own business and the industrial sectors as a whole for Q2 2078. Compared to the earlier sections, this is the only forward-looking segment in the report.

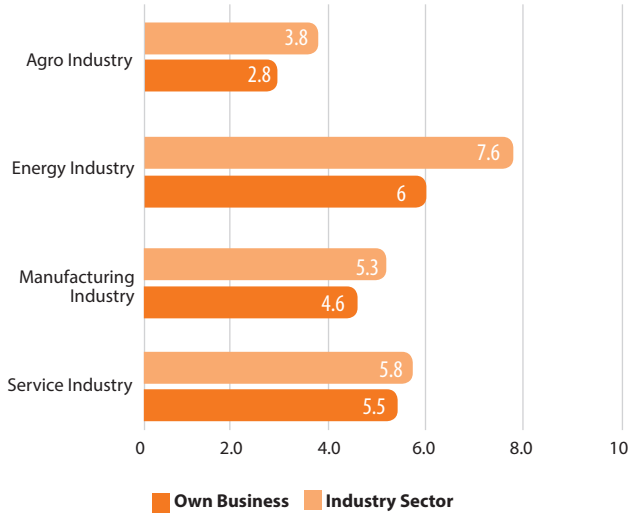
THE CONFIDENCE MEASURE: MODERATE CONFIDENCE

KEY INDUSTRY INSIGHT XIX

For Q2 78/79, industries reported a moderate outlook towards their own business as well as their industry sectors. When asked to rank the favorability for their own business on a scale of 1 to 10 (with 1 being the least favorable and 10 being the most favorable) in terms of revenue and investment opportunities, regulatory environment, access to finance, labor and better utility facilities, the average score across sectors is **5.6** which is the same as Q1 78/79. The energy industry is most optimistic with a score of 7.6 as it was the least affected sector by the pandemic.

Furthermore, when asked about the favorability for their respective industry sectors, the score was 5.1.

HOW FAVORABLE IS Q1 2078/79 FOR YOUR OWN BUSINESS AND INDUSTRY SECTOR?



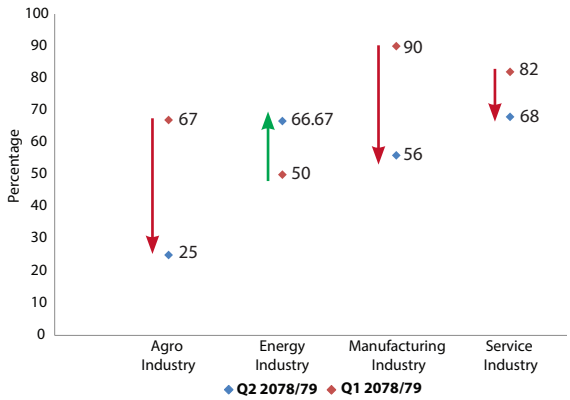
NEW INVESTMENT PLANS: 61.7% HAVE NEW INVESTMENT PLANS

KEY INDUSTRY INSIGHT XX

New investment plans provide an insight on how optimistic a business is for the future. 61.7% of the respondents across sectors plan to expand their business during Q2 78/79. In comparison, 83% of the respondents were looking forward to expanding their business in Q1 78/79 (when they were surveyed in Q4 77/78).

The service industry was the most enthusiastic at 68% to make new investments in Q2 78/79, closely followed by the energy industry at 66.7%, the manufacturing industry at 56% and the agro industry at 25%.

INVESTMENT PLANS Q2 2078/79 VS Q1 2078/79



BUSINESS OUTLOOK ANALYSIS

While the business outlook has not changed significantly between Q2 78/79 and Q1 78/79, the decrease in the share of new investment plans for Q2 78/79 is substantial. This can be a result of the increase in interest rates, fears about liquidity crunch, and the broader macroeconomic situation of the country which does not seem the most conducive for new investments at the moment.

MANUFACTURING INDUSTRY

The International Standard Industrial Classification (Rev 4) **defines manufacturing** as, "the physical or chemical transformation of materials, substances, or components into new products, although this cannot be used as the single universal criterion for defining manufacturing. The materials, substances, or components transformed are raw materials that are products of agriculture, forestry, fishing, mining or quarrying as well as products of other manufacturing activities. Substantial alteration, renovation or reconstruction of goods is generally considered to be manufacturing."

There is ample theoretical and empirical evidence that demonstrate how manufacturing sector can be a significant driver of economic development, as summarized in the following points:

1. **Capital accumulation is considered one of the aggregate sources of growth.** The manufacturing sector offers special opportunities for capital accumulation which is higher than that of agriculture and services; thus, an increasing share of manufacturing will lead to economic growth.
2. The **potential of economies of scale is higher** in the manufacturing sector in comparison to agriculture or services.
3. Industries in the manufacturing sector **offer unique opportunities for technological progress** (Cornwall, 1977).
4. Linkage and spillover effects refer to the direct backward and forward linkages between different sectors and subsectors that create positive externalities to investments in given sectors (Cornwall, Tregenna, 2007) **are stronger in manufacturing than in agriculture or services.** The transfer of resources from agriculture to manufacturing provides a structural change bonus.
5. Helps to **move informal subsistence workers into formal sectors,** increases productivity, increases government revenues.
6. "The inclusion of industrialization in the 2030 Agenda for Sustainable Development as Sustainable Development Goal 9 (SDG 9) **reaffirms its central role in the overall development picture."**

THE FIVE SELECTED INDUSTRIES

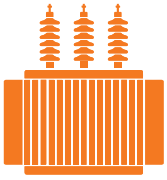
While the manufacturing industry is very diverse, 5 promising industries are featured in the Second Industry Status Report based on:

Footwear Industry

Garment/Textile Industry

Pharmaceutical Industry

Plastic Industry



Power Transformer Industry

a. Potential to achieve self-sufficiency
b. Considerable domestic demand (progressively increasing in the years to come)
c. Huge potential for creation of industrial jobs
d. Capability to generate sustainable revenue for the government
e. Potential for substantial exports

MANUFACTURING INDUSTRY AT A GLANCE: NEPAL

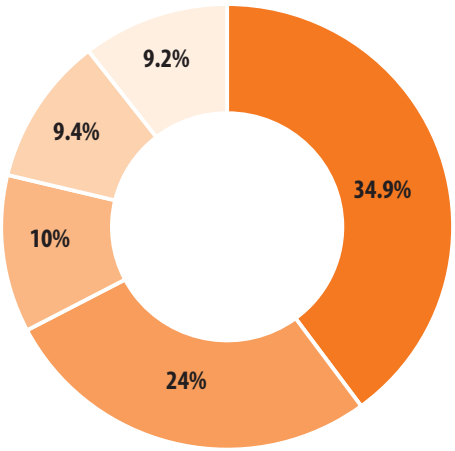
The information provided below is based on the Analytical Report Manufacturing Industry, Economic Census 2018.

Number of registered manufacturing industries: **104,058; 11.3%** of all industries in Nepal.

Manufacturing is the third largest industry in terms of number of establishments after Wholesale and Retail Trade (**498,069** establishments, **53.9%**) and Accommodation and Food Service Activities (**130,540** establishments, **14.1%**).

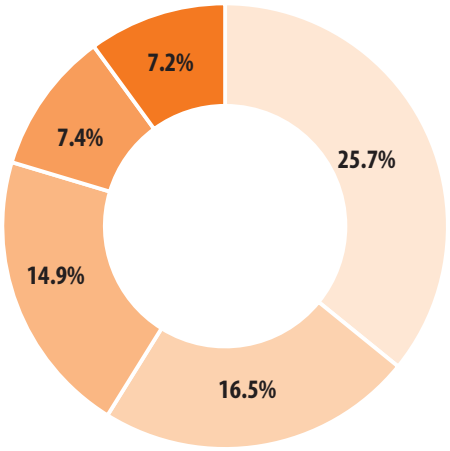
TOP 5 SUB-SECTORS OF MANUFACTURING INDUSTRY

According to the Number of Registered Establishment



1. Manufacturing of Wearing Apparel: **36,268** establishments (34.9%)
2. Manufacture of Food Products: **24,939** establishments (24%)
3. Other Manufacturing: **10,385** establishments (10%)
4. Manufacture of Fabricated Metal Products Except Machinery and Equipment: **9,806** establishments (9.4%)
5. Manufacture of Furniture: **9,578** establishments (9.2%)

According to the Number of Employment



1. Manufacture of other Non-metallic Mineral Products: **130,993** persons (25.7%)
2. Manufacture of Food Products: **84,217** persons (16.5%),
3. Manufacture of Wearing Apparel: **76,223** persons (14.9%),
4. Manufacture of Fabricated Metal Products: **37,565** persons (7.4%)
5. Manufacture of Furniture: **36,963** persons (7.2%).

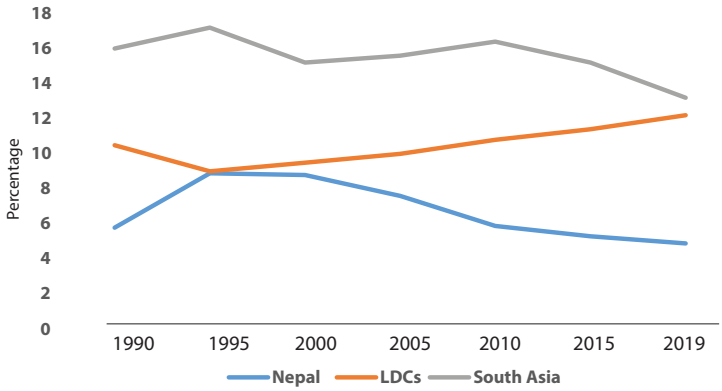
INDUSTRY TRENDS

The proportion of 104,058 establishments in the manufacturing industry that started the business in 2070-73 and 2074-75 are 36.9% and 20.0% respectively. This means that more than half of the establishments in the manufacturing industry started business between 2070 and 2075.

The proportion of establishments established in between 2070-2075:

1. Manufacture of Wearing Apparel: **66.3%**
2. Manufacture of Leather and Related Products: **59.6%**
3. Manufacture of Coke and Refined Petroleum Products: **66.7%**
4. Manufacture of Motor Vehicles, Trailers and Semi-trailers: **66.7%**
5. Manufacture of Furniture: **63.4%**

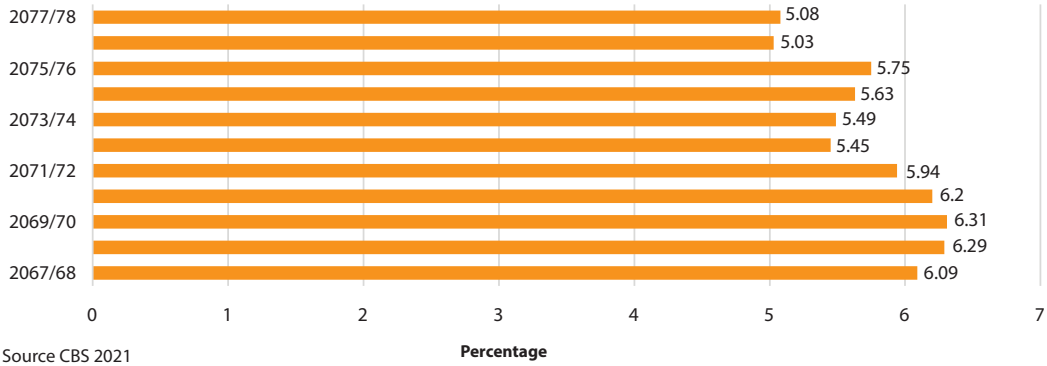
MANUFACTURING VALUE ADDITION (% SHARE OF GDP)



Source: World Bank

In comparison to other South Asian countries and LDCs, Nepal's manufacturing value addition in GDP has remained staggeringly low.

Contribution of manufacturing sector to Nepal's GDP



Source CBS 2021

In the last 10 years, the manufacturing industry has not grown at the rate of the national economic growth. The low manufacturing value addition is also reflected in the decreasing share of contribution of the manufacturing sector to the GDP.

How does the Industry Enterprise Act 2076 support manufacturing industries?

A. "A manufacturing industry is entitled to twenty percent exemption on the rate of tax leviable on the income earned by it."

B. "A manufacturing industry established with the investment of more than one billion rupees and providing direct employment to more than five hundred individuals throughout the year is entitled to hundred percent income tax exemption for the first five years from the date of commencement of transaction and fifty percent exemption on the income tax for next three years."

FOOTWEAR INDUSTRY

Nepal can comfortably be self-sufficient in footwear products, as local brands have already established themselves among Nepali consumers. Nepal domestic industries annually produce 56.5 million pairs of footwear, meeting 63% of local demand, as per Footwear Manufacturer's Association of Nepal (FMAN).

OVERVIEW

- **Number of industries:** 6 large scale, 15 medium scale, 300 small scale industries and 1200 micro-scale, 200 felt and handmade industries (DoI Study 2021)
- **Employment:** 60,000 people
- **Domestic demand:** 90-100 million pairs annually
- **Imports:** 3.19 million pair (FY 2075/76)
- **Export:** 3.59 million pair (FY 2075/76)

CHALLENGES

According to Mr. Krishna Fuyal, Past President of FMAN, some of the challenges the footwear industries are facing are as follows:

- Illegal imports of cheaper shoes due to open distorts the Nepali market.
- Export of semi-processed leather that could have been used in Nepal itself. The country imports processed leather at a higher cost.
- Unavailability of skilled human resources and cultural that prevent people from involving in the foot-wear manufacturing occupation.
- Heavy reliance on imported raw materials. From the 40-50 raw materials used in shoe manufacturing, around 40 items are imported.

What should be done?	The Impact
Import duty in footwear manufacturing machinery to be 0%.	This will help reduce the cost of production of footwear in the Nepali market.
Implement proper controls, checks & regular audits at customs.	This will reduce the quantity of unauthorized goods in local markets, and prevent distorting market prices for these goods.
Introduce safeguards, anti-dumping and countervailing measures.	This should also discourage the rampant practice of underbilling & arbitrary pricing.
As the high quality leather from goats and sheep is being wasted, introducing leather collection facilities is much needed.	It will provide the raw materials needed for footwear industries which are currently being imported in large sums.
Incentivize higher value addition in processed leather production.	Export higher value added leather and reduction in importing processed leather.

Suggestions from Kiran Shoes Manufacturers, who produce Goldstar, Vida & G10 brand shoes. Goldstar is a robust brand made, and is now sold in all over Nepal & India. Gradually, it is gaining popularity in western countries too. **The following suggestions have been made on behalf of the entire footwear industry:**

- Set minimum valuation of imported slippers NRs.500/- pair, for sports & party shoes NRs. 2000/- pair. Import revenue will increase up to 50% as goods will be rightly valued (estimated increase in inland revenue by 3 times).
- Footwear soles to be imported in pairs instead of Kgs with minimum valuation of PVC sole NRs. 150/- pair, PU sole NRs. 200/- pair, Sports sole NRs. 200/- pair & Rubber sole NRs. 200/- pair.
- Footwear uppers to be imported in pairs instead of Kgs with minimum valuation of NRs. 250/- per pair.
- Footwear upper & soles to be charged custom tariff on par with Finished Goods at 30%.

Picture: Kiran Shoes Manufacturers

GARMENT/TEXTILE INDUSTRY

Textiles and garments were one of the first industrial sectors to experience massive export growth, which lasted until the early 2000s. Garments alone constituted on average 27% of exports in the 1990s. While textiles and clothing constituted 43.8% of value added in manufacturing in 1994, the share decreased to 5.5% in 2011, and remained stagnant even until 2020 (World Bank).

However, the industry still has great domestic demand, potential for exports and can generate a good number of jobs in Nepal. Recent export data shows the industry is slowly growing after a decade and half long decline with an export of NPR 6 billion of exports in 2019. Research conducted by a Bangladesh firm also shows that Nepal's readymade garment exports could exceed USD 1 billion, resulting in the direct employment of 100,000 people. Furthermore, with top garment exporting countries like China, India, Bangladesh and Vietnam located in the proximity of Nepal, the country could use this to its advantage and integrate in the regional supply chains. However, this can only be achieved if the existing structural impediments are addressed, and the private sector also takes a proactive role in identifying such opportunities abroad.

OVERVIEW

Number of industries: 1,932 textile establishments and 36,103 garments establishments

Employment: 26,764 + 76223 workers

Textile recognized as a high export potential product, while readymade garments identified as another potentially high-performing sector according to the Nepal Trade Integration Strategy 2016

CHALLENGES

- Hindrances to become cost competitive: Mass production of cheaper textiles in other countries has been the major challenge for hand-made Nepali textile
- Significant informal imports—around 80 percent of textiles in the Nepali market enter informally from India, according to NTIA
- Lack of skilled and efficient human resources leading to lesser value addition in the goods we manufacture
- Boosting demand for Nepali-manufactured goods
- Diversification of the exports market

What should be done?	The Impact
Introduce integrated textile-garments policy that addresses issues such as which fabrics Nepal should aim to produce domestically and the kind that should be imported	Will demonstrate government commitment towards the promotion of textile-garments sector and attract local and international investors
Provide interest subsidies on investments in upgrading technology to increase the productivity of the industry	Will enhance productivity of workers as well as the quality of product, thus supporting Nepali textile and garment industries towards being globally competitive.
Facilitate integration in regional supply chains	Will help in supply chain integration and achieving economies of scale in the production of certain goods.

PHARMACEUTICAL INDUSTRY

Until 2017, the number of registered drug manufacturers in Nepal was approximately 50. Three years later, the number rose to 109, according to the Department of Drug Administration, the national regulatory authority. This shows there has been a promising rise in the number of drug manufacturers in the last three years. It should be noted that the National Drug Policy 2074 was introduced around this time too.

If the installed capacity of 66 actively running industry is aggregated, the pharmaceutical industries can reach a combined production capacity of 2.06 billions tablets annually . At present, industries have only been operating at 55% of the installed capacity. But if they were to operate at the full capacity, the Nepali producers alone can cater 73% of domestic demand. Association of the Pharmaceutical Producers of Nepal (APPON) states that 55 molecules/products are oriented towards self-reliant status.

Active Pharmaceutical Ingredients (API), raw materials for the pharmaceutical industry, production plant is economically not feasible in Nepal at present due to Nepal's market size. Even though API is imported, the value addition of this sector is more than 30%

OVERVIEW

- **Number of industries:** 109 drug registered manufactures; 66 running
- **Employment:** 20000 direct employment
- **Workforce consists of administrative, skilled and technical, non-skilled, marketing:** 10%, 30%, 30% and 30% respectively.
- **Value addition:** 30%
- **Annual national demand:** 53.66 metric tones
- **Annual nation demand in monetary value:** 53 NPR billion (approx USD 430 million)
- **Import worth**: 28.65 billion NPR (54.5% of total market demand)
- **Domestic manufacturing supply:** 24 billion (45.5% of total market demand).

CHALLENGES

- No barriers on imported products that are being sufficiently manufactured by domestic producers.

  For example: While there are 15 domestic producers producing a particular molecule, still the same molecule is being imported.
- Unauthorized import of the drug from the bordering town of India to Nepal is another issue domestic manufacturers are compelled to deal with.
- Research and Development (R&D): Nepali pharmaceutical manufacturers have been producing generic patent-free medicines. This industry relies on constant innovation for sustenance, and there is inadequate research and development in the pharmaceutical industry

MR. PRAJWAL JUNG PANDEY

President, Association of Pharmaceutical Producers of Nepal (APPON)

Mr. Pandey states there is an urgent need of introducing barriers on import of molecules which are produced by the Nepali manufacturers if the country is serious about achieving self-reliance in a number of pharma-related products, as mentioned in the National Medicine Policy 2074. Government should introduce a policy measure to restrict the import of the molecules if it is produced by more than five domestic producers. Similar approach has been adopted by Bangladesh, which has achieved self-reliance and also exports pharmaceutical products.

Furthermore, Mr. Pandey mentions that Nepal should immediately utilize the patent exemptions provided by the TRIPS Agreement to least developed countries, as the country will lose such privilege when it graduates to developing country status in 2026. Therefore, existing pharma companies should utilize this limited time-window to enhance their productive capacity and achieve competitiveness before such exemptions are revoked.

What should be done?	The Impact
Streamlined license approval system for the manufacturers: including manufacturing, sales and marketing licenses	This will ensure an easy entry process and the manufacturers can timely cater to the demand of new molecules
Periodically regulate the border area markets and punish sellers/ traders selling unauthorized drugs	Consumption of registered and approved medicines only as well as demand of domestic medicines increases
Introduce Tariff Barriers for Import of Drugs If 5 domestic industries manufacture a specific molecule in Nepal itself, or a medicine has been produced in Nepal for more than 10-plus years, restrictions on import of such molecules should be made	Domestic industries will attain economies of scale due to the increased sales of medicine and increased market share for their produced goods

PLASTIC INDUSTRY

Plastic is widely used across multiple industries, from construction to textiles, consumer products, transportation, electrical and electronics and industrial machinery and so on. **The industry has seen double digit growth in the last few years, and has a potential to meet Nepal's growing demand for plastic-based products.** Although, this is only possible with adequate support from the state, as per Mr. Sharad Tibarewala, Founder and Immediate Past President of Plast Nepal Foundation (PNF).

Nepali industries are already self-sufficient in a growing number of plastic-based products, but cheaper alternatives are being imported at a low price, which makes it hard for Nepali industries to compete. Plastic manufacturers argue that at least a 30% customs duty on these goods is needed for Nepali manufacturing to truly be competitive.

OVERVIEW

Number of industries: 400 industries industries (organized) , 300-350 (unorganized)

Employment: 50000 plus workers

Growth rate:10% per annum

Imports of raw materials: 275,000 MT of polymer per annum and converted into finished goods

Production of plastics articles: 12,087 MT in Fiscal Year 2075/76

MR. SHARAD KUMAR TIBAREWALA

Founder and IPP of Plast Nepal Foundation

Nepal can potentially be self-reliant in processed raw materials and finished products of plastic (apart from the ones relying on petroleum-based raw materials). The value addition within Nepal in plastic-based products starts from 20% and progressively increases with added-innovation in the production processes.

Presently, Nepal imports a nominal amount of finished products as majority of its demand is catered by domestic production. Considerable imports are happening in flexible packaging. However, if the import tariff is adjusted in favour of domestic manufacturers, this can be reversed as products can be offered at a more competitive price and quality.

The great promise of plastic recycling industries. A significant fraction of used-plastic is wasted and not put back into productive use. Tax free and holiday schemes for industries seeking to enter the plastic recycling business can be provided with special tax exemptions. Priority of the government should be encouraging the use of waste plastic back in the production cycle.

Plast Nepal Foundation (PNF) is a non-profit entity which aims to create awareness of plastics and its benefit among it's consumers and respective government & public bodies. PNF also aims to establish a testing facility, provide training and technological knowledge to the local workforce and promote awareness of 3R (reuse, reduce and recycle).

CHALLENGES

- Import duty in the SAARC region is 5-7.5% on plastic raw materials (known as plastic granules), whereas in Nepal, the import duty is 10%. Bringing this down to 5 percent will help Nepali plastic manufacturing become more cost-competitive vis-à-vis SAARC countries.
- Manufacturers that use waste plastic as a raw material for reproduction of plastic-based goods are not eligible to receive National Standard. Millions of plastic bags are used once and thrown away in Kathmandu Valley itself everyday. So much of this plastic pollution makes its way into drains, rivers, cultivated land etc.

What should be done?	The Impact
Effective implementation of two-tiers duty difference on raw material and finished goods.	This will make the imported products expensive thus leading to an increased demand for domestic products.
Nepal Standard should also be granted to industries that use recycled plastic as raw material.	Import of large volumes of raw material can be minimized.
Effective policy to encourage industry producing flexible packaging as it is the major import for Nepal.	Reduction of imports of flexible packaging plastic and increase in the domestic market share of domestic producers.
Address the issue of unauthorized imports which is adversely affecting local manufacturers.	It will create a regulated market where the undervalued imported products does not impact the domestic products.

POWER TRANSFORMERS

There are numerous factors that drive demand for electrical power transformers in Nepal and in the global market. Apart from the growing consumption of electricity, the increasing focus on renewable electric power generation, deployment of smart grids and smart transformers, replacement of existing aged power transformers are some other factors responsible.

Nepal foresees a generation of approximately 10-15 GW of hydroelectricity in the next ten years. This translates into a need for dramatic transformation of electricity infrastructure, including the construction of substations, transmission lines, and distribution systems, to provide households and industries access to better quality electricity at higher amounts. While the government has begun encouraging households to use electricity for more applications, the current infrastructure (including higher capacity transformers) can not support the increased demand.

OVERVIEW

- Annual National Demand: 15,000 units demand from NEA and 4,000 units demand from private sector (estimates based on interviews)
- Valuation of global power transformer market size: USD 27.7 billion 2019, expected to reach USD 50.8 billion by 2027 (Source: Allied Market Research)
- Some notable power transformer industries in Nepal:
  - Nepal Ekarat Engineering Company Pvt. Ltd (NEEK)
  - Transweld Nepal Pvt. Ltd.
  - ABC Transformer Pvt. Ltd.
  - Eastern Transformers Industries
  - Sew Transformers

CHALLENGES

- Quality screening of imported products has been an issue because sometimes sub-optimal transformers make it to the Nepali market.
- In its procurement processes, NEA should consider technical specifications that fit what the domestic manufacturers are able to offer.

MR. KUSH K. JOSHI

Managing Director, NEEK and Former President of FNCCI

NEEK is one of the major domestic manufacturers of power transformers. It initially inherited its technology from a Thailand-based company. Mr. Joshi states that NEEK currently produces robust and low-loss-leakage transformers, which are also exported abroad.

The government should effectively implement a two-tier customs tariff on import raw materials and final goods. This will simultaneously reduce the import of low-priced transformers and make the domestic producers cost-competitive via-a-vis imported transformers.

MR. AMUL SHRESTHA

Managing Director, Transweld Nepal Pvt. Ltd.

Nepali manufacturers are capable of catering to an increasing market share of power transformers. The national demand for transformers is an aggregate of public and private consumption. While the private demand constitutes hotels and other pirate entities likewise public demand is the bulk procurement by the Nepal Electricity Authority. Transweld currently has an annual capacity of producing 1500-1600 units and is expanding in the near future which then will be able to produce 4000 units per year.

NEA should be considerate in its procurement processes so as to prioritize domestic manufacturers. This would help Nepali industries make long-term plans to expand industrial production capacity and encourage the establishment of new industries."

About CNI

The Confederation of Nepalese Industries (CNI) was established by the captains of Nepal's industrial and corporate sector on April 17, 2002. Its core mandate is to help enhance the business environment for the private sector.

It has a membership base consisting of nearly all of the big corporate houses of Nepal, Nepali blue-chip companies, joint venture companies, etc. spread across a wide and diversified spectrum of industries.

About CRC

CNI Research Cell was established due to a dearth of evidence-based research on Nepali industries, especially based on primary data. CNI aspires to be a trusted development partner of the Government of Nepal. The data and research generated by CRC is transparent, unbiased and will be kept confidential. The team comprises Research Director Mr. Nirnaya Bhatta and Research Officers Mr. Pratap Adhikari and Ms. Astha Wagle.

CONFEDERATION OF NEPALESE INDUSTRIES