



A ROADMAP TO POST-COVID RECOVERY FOR NEPAL'S AGRI AND TOURISM SMEs

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The Crisis for Nepal's SMEs

Covid-19 is having a significant impact on global economic growth, leading to the deepest global recession since the second world war that will affect both immediate and longer term economic growth worldwide.

Nepal's projected growth this fiscal year (ending mid-July) [has been lowered from around 7% to just 2.5%](#); this significant economic downturn results from the slowing of regional and domestic demand, a reduction in remittances (previously accounting for over 25% of Nepal's GDP), a complete standstill in tourist arrivals, and shrinking domestic and global investment. As the economies of trading partners reel from a similar economic downturn, the ripple effects can be felt through every sector and tier of Nepal's economy.

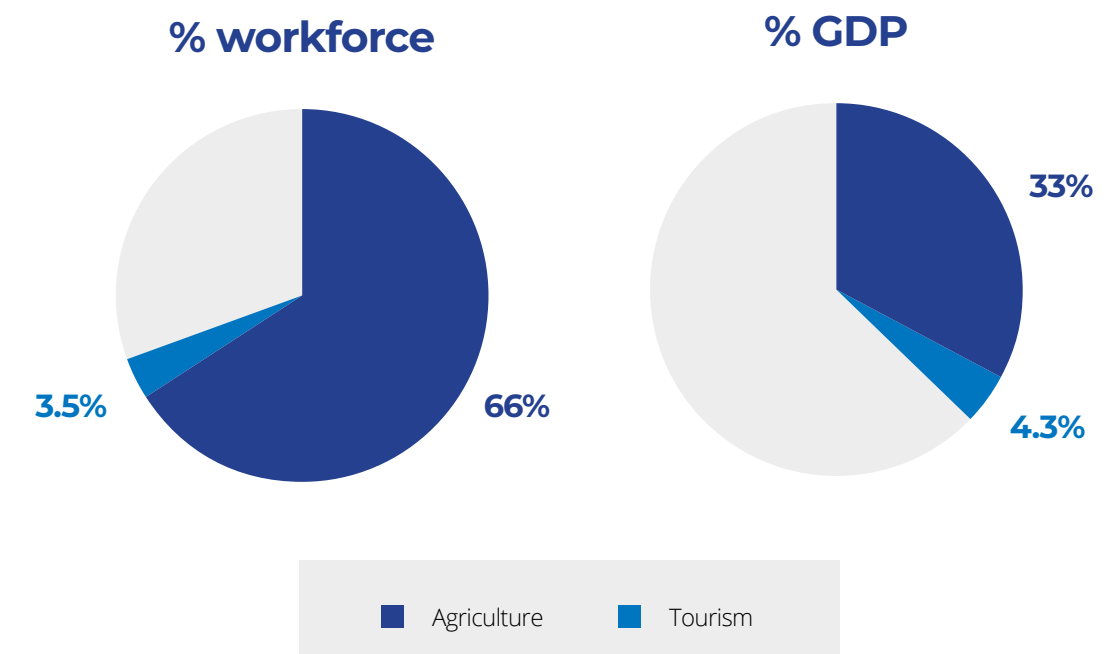
Small and medium sized enterprises (SMEs) in Nepal are crucial to the country's economic growth, creating 2.36 million jobs and contributing to 22% of the country's GDP, but have been hard hit by the Covid-19 crisis. Nepali SMEs – [defined as having fixed assets of between Rs100 million \(USD 830,000\) and Rs250 million \(USD 2,075,000\)](#) – have suffered both external and domestic effects as a result of Covid-19, including disruptions to their supply chains in terms of access to inputs and transportation of goods, and massive reductions in sales. The lack of access to finance – already acute for SMEs – has worsened due to Covid-19 because of impending credit squeezes due to potentially increasing non-performing loans. Further lockdowns and workforce mobilisation challenges has increased the pressure on vulnerable SMEs.

Nepal has taken measures to cushion the economic fallout of Covid-19, but is unable to put in place robust support packages for SMEs comparable with those of developed countries due to limitations on resources. In the immediate aftermath of the lockdown, the Government of Nepal [took some measures to ensure liquidity in the financial system and support access to credit](#), advising banks and financial institutions to provide [interest subsidies and to defer loan payments](#) to businesses operating in key sectors hit by the spread of Covid-19. However, additional, longer term support will be required to ensure smaller firms in key sectors can stay afloat.

Key Sectoral Impacts: A Lens on Agriculture and Tourism

The economic impact of COVID-19, and the economic recovery, will play out differently at the sectoral and sub-sectoral level. Agriculture and tourism are particularly critical in the context of Nepal, and both represent significant sources of employment as well as providing high current and future potential for SMEs.

Prior to Covid-19, tourism and agriculture were significant drivers of recent GDP growth, and both accounted for significant employment opportunities for large percentages of the population. The current lockdown has brought tourism to a complete standstill and disrupted Nepal's planned 'Visit Nepal 2020' campaign, and the [agricultural sector is suffering](#) from market disruptions and constrained transportation for agricultural products.



The new fiscal budget for FY20/21 (highlights below), announced in late May, has made some provisions to rejuvenate key sectors for the Nepali economy, including a spotlight on agriculture and tourism, and tax relief for SMEs. However, some have criticised the budget for [insufficient ambition to depart from previous policies in a way that will tackle COVID-specific economic challenges](#), in particular how to meaningfully reintegrate large swathes of returnee migrants into the economy once the current lockdown eases, as well as how to sufficiently deregulate the economy so as to attract more capital.

FY20/21 BUDGET AT A GLANCE



25 to 75% income
tax exemption
for SMEs



**Rs500 million
(USD 4.1 million)**
subsidised loan
fund for tourism
SMEs at **2%** interest



20% tax
exemption for
tourism industry



**Reduced import
duty** on machinery
and raw materials
for livestock and
agricultural SMEs



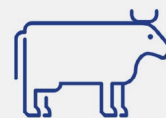
**Reduced customs
duty** on the
import of seeds
and primary
agricultural tools



**Rs41 billion
(USD 340.3 million)**
for farming and
irrigation



11% increase
in the subsidy
for chemical
fertiliser



Ambition for
self-reliance in meat,
poultry and dairy
production

With the recent (21st July) announcement of the lifting of the 4-month lockdown in Nepal, it will be important for Nepal to analyse key sectors and support them towards economic recovery in a manner to crowd in investment and bolster trade in transformative growth sectors like agriculture and tourism. In this paper, Ecorys and Nathan update the analyses we conducted in Nepal in late 2018/2019 as part of a UK Department for International Development (DFID) funded private sector development programme, to investigate implications for post-Covid-19 SME recovery in the Nepalese tourism and agriculture sectors.

The Impact of Covid-19 on Agricultural SMEs in Nepal

Prior to the Covid-19 crisis, agriculture made up one third of Nepal's GDP, growing by 5.3% in FY2017, and employed more than two thirds of the country's labour force. Covid-19 has significantly affected many of the above sectoral dynamics and in turn disrupted the production and trading of agricultural SMEs in Nepal. The biggest impact has been on:

Demand for agricultural goods and products

- ▶ During the Covid-19 crisis, in general the demand for essential, non-processed agricultural inputs has continued. However, given the continued difficulties to access Nepal's own rural supply, many large distributors are managing to import processed food products.
- ▶ Government policies have identified high-demand, essential agricultural goods and staple food resources (rice, flour, salt, sugar and cereals) during the Covid-19 crisis, and implemented measures to ensure mass distribution of these staples.
- ▶ Cross-border purchases between Nepal and India have been reduced on both sides given concerns about hygiene standards from buyers in border communities. Inter-province sales of certain products (such as vegetables) has been encouraged by the Government given that supplemented stock from India has reduced, and in some cases prices have increased.
- ▶ Exported items such as cardamom, tea, ginger and coffee have been heavily impacted due to the decrease in global demand for commodities like this. This risks certain key crops perishing unless new revenue sources are found.



Supply of inputs and logistics and other supporting services

- ▶ All agricultural value chains are being heavily impacted due to labour shortages, reducing the output of actors along the supply chain from aggregators to manufacturers. This is a result of domestic restrictions on movement domestically, and reluctance of people to leave home and work in their fields due to a fear of contracting Covid-19.
- ▶ Movement of highly perishable, essential items such as vegetables, milk, fruit and staples continued during the lockdown, despite mixed messages and misunderstanding around which goods are able to be transported between districts and provinces (which resulted in delays). Imports have been significantly reduced for any items other than essential food and pharmaceuticals.
- ▶ Access to market information is a key issue, as the price of agricultural goods has been fluctuating significantly due to volatility in supply and demand of products. While smallholders have access to information from cooperatives and traders, they provide a short-term view of a small area unreflective of national prices. Farmers do not have enough information for future planning, which is crucial given the seasonal nature of production in Nepal. This results in high levels of uncertainty about which crops to grow (planting staples versus pricy commodities) with a significant impact on cash forecasting.

Ecorys and Nathan through our global programmes are actively responding to Covid threats by exploring pilot interventions that aim to help markets recover and develop, including on Ecorys' EU funded TAMAP project in Sri Lanka and Nathan's DFID funded Invest Salone project in Sierra Leone.

Reduced capital flows

- ▶ Prior to Covid-19 there was already a significant gap in financing for the entire agricultural supply chain in Nepal. Smallholder farmers are affected by fluctuating demand, volatile pricing for products and limited access to liquidity.
- ▶ Many of the Government's financial support policies to cushion businesses against the impact of the lockdown are based on subsidising or discounting interest on existing loans. Banks are continuing to retreat from new loans due to constrained credit lines, the trade deficit and limited access to foreign currency. This will mean that rural smallholders who were struggling to access bank finance prior to the crisis will now find getting new loans almost impossible, when it is most needed.
- ▶ Remittances from family members are often the most viable source of cheap finance for rural agri-SMEs. Covid-19 has significantly reduced remittance inflow and therefore the cash which rural smallholders would have been relying on for a crisis.

The Impact of Covid-19 on Tourism SMEs in Nepal

Tourism is also one of Nepal's highest grossing sectors for forex as well as a provider of jobs for people across the country. As of 2017, there were 940,218 tourists per year visiting Nepal, contributing to 4% of GDP and directly supporting 497,500 jobs (3.2% of employment). Prior to Covid-19, GoN was aiming to increase tourist arrivals to 2 million by 2020 through the Visit Nepal 2020 initiative.

As such a significant industry, the impact of Covid-19 related quarantine and flight restrictions has been catastrophic during the first half of 2020. The key disruptions have been:

Impact on demand for goods and services in the tourism industry

- ▶ The impact on the demand for tourism services is significant given that tourists cannot enter the country and that there are less tourist dollars globally, given the global contraction in GDP. The current estimated figures are predicting that only [234,000 foreign visitors will visit the country this year, a reduction of 45 – 80% compared to last year \(1.17 million visitors were recorded last year\)](#).
- ▶ China and India both account for more than 35% of inbound tourists to Nepal. China has been one of the most affected countries by the outbreak, along with India, where the cases of infection are on the rise.
- ▶ Furthermore, there is also the concern that countries with poor healthcare regimes like Nepal will continue to have low tourist numbers due to fears of contracting Covid-19 while on holiday and not being able to access adequate treatment.

Resulting impact on supply of goods and services in the tourism industry

- ▶ Tour operators, tea houses and small hotels have struggled to survive the disruption caused by the 4-month lockdown in Nepal. With the compulsory closure of hotels by the Hotel Association of Nepal (HAN), [1300 starred and tourist standard hotels have closed with the majority of staff being paid just 12.5% of basic monthly salary. In addition, more the 3,500 travel and 2,600 trekking agencies](#) are reported to have had to close due to the nationwide lockdown.
- ▶ The impact of job losses in the tourism sector will be severe, affecting the sector's ability to recover. [Tourism employs around 1.034 million](#) people in Nepal; the impact on Everest expeditions alone is estimated to cause 20,000 job losses among trekking agencies and tour guides.

Reduced capital flows

- ▶ The majority of the businesses in Nepal's tourism industry (airlines, hotels, restaurants, tours) tend to be small companies with limited retained earnings to weather economic shocks. In order to survive many of the companies have had to cut staff time or make layoffs. [The ADB estimates that the decline in tourism revenue will amount to a loss of 0.1% of GDP \(i.e. USD 29.1 million\)](#). While small businesses will be hardest hit even large hotel chains will have to think about liquidating or consolidating assets.
- ▶ Limited access to affordable finance. To date, the tourism sector has relied on access to finance through international and domestic investment, and on prioritised government support given the high number of people employed. Sadly, the reduced forex cashflow coupled with the diminished inflow of remittances has brought the industry to its knees.

Opportunities for the Covid-19 Economic Recovery

Nepali SMEs are focusing their attention on survival in the wake of the Covid-19 crisis.

This is dependent on:

Adaptability:

the ability to use market information to pivot, manoeuvre systems, processes and accessibility to get products to their consumers

Linkages:

understanding the market and adapting their production to new realities

Liquidity:

ability to ensure cashflow despite reduced revenue from the drop in tourist numbers.

The 4-month nationwide lockdown in Nepal was lifted on 21st July, with widespread easing of measures either immediately or by mid-August. Restaurants and hotels are now permitted to open, and trekking and mountaineering are also permitted, with international and domestic flights and long-distance public transport within Nepal resuming from August 17th.

In light of this gradual economic reopening, and considering the above analysis of key sectoral impacts, below we recommend some key opportunities for Nepali agricultural and tourism SMEs to 'build back better' in the wake of Covid-19.

Adaptability

In agriculture, SMEs and agribusiness will need support from Government and donors to help them adapt to highly volatile changes in demand, fluctuations and supply chain blockages, in order to help them adapt to a post-Covid 'normal'. This should include a focus on encouraging innovation in businesses with the potential to leverage smallholders across value chains; in support functions (logistics, distribution); and technology-based solutions.

Tourism needs support to reposition and market Nepal as a world class, safe and environmentally responsible tourism destination. There is high potential for this sector to reinvent itself and attract a higher paying tourist than has traditionally been possible in Nepal, to professionalise through skills development (including of returnee migrants), as well as to capitalise on opportunities to strengthen eco-tourism and sustainability.

Tourism needs support to focus on reigniting cashflow, commencing with a focus on the domestic market. The lifting of inter-province travel restrictions this month may encourage more Nepali tourists to visit previously popular domestic spiritual tourism sites, and bring a flow of income to heavily affected SMEs that service the industry, from tour operators to teahouses. Such an approach would allow businesses to bed in new procedures for hosting tourists prior to re-opening to international travellers in mid-August. This would help safeguard Nepal's reputation as a safe travel destination.

Tourism umbrella organisations should focus on preparing for Nepal's reopening, including pushing a marketing campaign for regional visitors, and ensuring that accommodation providers, tour operators and transportation providers have adequate knowledge of and access to supplies for infection/contamination control.

Linkages

In agriculture, SMEs need to have access to clear and current market information, both for market prices and for public health information. Agri-SMEs should use the extensive networks on offer from umbrella organisations like the chambers of commerce to access information around what products in demand and gaps in supply that they can adapt to fill. The Federation of Nepal Cottage and Small Industries (FNCSI) and Federation of Nepali Chambers of Commerce and Industry (FNCCI) all have extensive networks that can be leveraged to link agri-SMEs to one another, to markets, and to information.

Tourism should focus on systematically addressing the need for improved quality in the sector, including better development of road infrastructure (ensuring that this does not affect natural habitats or increase the potential for landslides), improved waste management systems (toilet facilities, litter collection), health facilities near remote destinations and respectful engagement with rural communities through itineraries that can support inclusive development. Advocacy for improved quality in the sector should be led by the National Tourism Board and private sector umbrella organisations like the Trekking Agencies' Association of Nepal (TAAN), Nepal Mountaineering Association, Nepal Association of Rafting Agents (NARA), Nepal Association of Tour & Travel Agents (NATA) and the Hotel Association of Nepal (HAN).

Liquidity

Governments, donors and impact investors will need to rapidly bolster commercial bank and microfinance lending to SMEs through risk-sharing mechanisms and relaxed regulatory requirements where appropriate. At the same time using less traditional financing channels including fin-tech models and direct government programmes to get credit flowing, Government must make extra funds available for BFIs (including cooperatives and microfinance institutions) to lend to the private sector at more appealing rates and on better terms (e.g. reducing collateral requirements given that collateral assets have also reduced in value). This could be hedged against funding from Government, donors and Development Finance Institutions (DFIs).

The efficacy and applicability of existing funds should be reviewed to ensure they are addressing the specific working capital and liquidity needs of SMEs (including agribusinesses) in response to the Covid-19 crisis. There is already significant infrastructure to access Government loan schemes such as Micro Cottage and Small Industries Fund, Youth and Small Entrepreneur Self-employment Fund, and Rural Self Reliance Fund. This is an opportunity, but the structures of these funds could be adapted in response to needs arising from the Covid economic recovery.

Donors and the Government should consider re-risking investments into Nepal through matched funding, funding mechanisms which encourage investor research and feasibility assessments into high potential sectors, and removing the regulatory barriers to foreign investment in agriculture.

Non-bank finance and deregulation – including Environment, Social & Governance (ESG)-driven impact investment and to a lesser extent equity and venture capital – could begin to be more appealing as Nepal's investment ecosystem is growing. Although the appetite for taking on new investments in emerging markets will be low for the foreseeable future, investors who will be successful will be those that recognise the need to encourage agility and innovation in the businesses they invest in.

Sectoral dialogues and advocacy from umbrella bodies should focus on supporting lenders, suppliers and real estate providers/landlords to recognise the benefit of delayed payments in the reduced cash outlay for SMEs which will ensure future business for both parties. Globally, payment terms are emerging as a huge source of flexibility for SMEs; good relationships with suppliers and buyers can support SMEs to renegotiate payment timing to retain working capital. Similarly, rent is a significant cash outlay in the tourism sector and could be retained by SMEs in cases where active lenders and real estate providers reschedule payments. Many SMEs have also renegotiated their debt terms with

Given its reliance on SMEs for economic growth and job creation, Nepal must capitalise on every opportunity to bounce back quickly from the economic fallout of Covid-19, and reposition itself in sectors with transformative economic potential. This requires shifts in the policy framework and the incentives provided to businesses in several sectors.

Although agriculture and tourism have always been important growth- and job-generating sectors for Nepal, the Covid-19 crisis will require a redoubling of effort from the government and private sector to support adaptability, linkages and liquidity for SMEs in the agri and tourism sectors. This will likely require closer dialogue between the private sector and the Government of Nepal for years to come, to ensure what works is promulgated across these sectors, and that fit-for-purpose regulatory frameworks are in place to attract investment and tourists. Development partners and DFIs will be essential support actors here in addition to national, provincial and local government in Nepal.



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