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Making Regulations More Navigable for Direct Foreign Investors

Background

Invest for Impact Nepal (IIN) is an initiative funded by British International Investment (BII); FMO, the Dutch Entrepreneurial Development Bank; and the Swiss Agency for Development and Cooperation (SDC), running from 2021 to 2025. It aims to complement existing efforts to attract more investments and advance the development of Nepal by channelling efforts to unlock the possibilities of investing patient, flexible impact capital to support private sector growth and innovation.

Main IIN Objective

- Support DFIs active or interested in Nepal with the ultimate objective to accelerate transformative DFI investment.
- Facilitate coordination between DFIs to reduce risks, raise returns and enhance development impact.
- In partnership with development partners, facilitate collaboration to shape Nepali market to unlock patient, flexible capital to support private sector growth and innovation.
- Support strengthening of key investment market-system actors and foster partnerships for a conducive environment for foreign investments.

Context and Objectives

The Government of Nepal has made significant progress on improving doing business in Nepal and a number of policy reforms have been carried out and are planned for creating conducive investment for foreign investment in Nepal. However, these reforms are currently not informed by or considering the opportunities that Development Finance Institutions (DFIs) investment brings. Furthermore, the emerging economic and financial pressures that have been brought about by the COVID-19 crisis and liquidity crunch in the financial sector, has highlighted the need and demand for foreign investment. Together, these have presented an important and rare opportunity to support reforms in ways that may unlock future DFI investment.

In this context, IIN worked with closely with DFIs, FIs, Funds, Private Sector stakeholders, and regulators to understand challenges and opportunities within existing regulatory framework. The specific objectives were to:

- Carry out in-depth assessment of existing regulatory framework related to DFI and Fund investment,
- Prioritization of issues based on severity (the impact of an issue on investment), feasibility of reforming issues in current political economy landscape, and achievability in terms of costs, time and other resources,
- Inform and collaborate with investment ecosystem stakeholders to advocate for reform.

Key Activities and Results

- Carried out in-depth assessment of existing regulatory framework related to DFI investment in Nepal and Identified 39 transaction-specific challenges and opportunities within Nepal's foreign direct investment (FDI) framework.
- Validated the findings with DFIs working group and prioritised 5 issues for further policy advocacy.
- Carried out in-depth assessment of existing regulatory framework related to DFI investment in Nepal and identified 15 transaction-specific challenges and opportunities within Nepal's regulatory framework to increase investment by PEVC funds.
- Validated the findings and prioritised 6 issues for further policy advocacy.
- Informed findings to regulators through key investment ecosystem stakeholders such as DFIs, DPs, Funds, and Private Sector.
- Developed a policy advocacy strategy.

Lessons Learnt

- Government of Nepal is positive towards DFI investment and expressed an interest to discuss key policy reforms.
- Investment ecosystem stakeholders including DPs, DFIs, FI, Funds and Private Sector are ready to collaborate for improving the investment environment.
- A concerted effort is required from all stakeholders with evidence to engage and demonstrate the opportunities and potential for reforms with government institutions. Critically neutral entities like IIN can play a crucial role to connect stakeholders and facilitate engagement.

Recommendation & Next Steps

- Continue collaboration and inform investment ecosystem stakeholders about the regulatory challenges and opportunities.
- Work closely with champions of change to better inform regulators about requirements of policy reforms for more FDI including DFI investment in Nepal.
- Organise policy dialogues in partnership with investment ecosystem stakeholders and publish policy documents through national print and online medias including social media platforms.

High Priority Issues

The prioritisation of the issues were set out based on an assessment of and consultations with key stakeholders:



Severity – pertaining to (i) the severity of its impact on delay in foreign investment; (ii) the importance of being reformed or done away with to simplify foreign investment; and (iii) potential (in terms of accelerating DFI investment if unlocked).

Feasibility –Pertaining to (i) feasibility for reform in today's political economy landscape; and (ii) pragmatism for reform (in terms of costs, time and other resources).

High Prioritised Issues for DFI Investment
» Payment of Loan Related Fees Pre Disbursement
» Taxation on Change of Control
» Taxation Exemption
» Restriction on FDI into Agri-Processing Businesses
» GoN Approval for Creation of Security Interest

High Prioritised Issues for Funds
» Explore the impact on PE/VC funds from the consequences of the blacklisting directive
» Blanket approval for offshore fund and onshore FDI fund to make investment in Nepalese industries.
» The capital requirement of NPR 1 billion for funds that are set up as investment companies needs review.
» SEBON re-examine a prescribed limit for funds to invest in debt instruments while also specifying the kinds of debt instruments permissible (e.g. debentures, profit participation instruments etc.).
» Office of Company Registrar should confirm the non-requirement of audit report of 3 years so that young companies are able to issue shares at a premium valuation.
» The negative list of the Foreign Investment and Technology Transfer Act needs to be revised so that impact driven foreign investors can make investment in sectors with the potential to make social impact, particularly around agri-based businesses.

Invest for Impact Nepal

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