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BACKGROUND PAPER

Indian Foreign Direct Investment in Agro-processing Industry in Nepal
A Case Study of Dabur Nepal Pvt. Ltd.

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1. Introduction

Although foreign direct investment (FDI) is not a panacea for the development ills facing developing countries in general and the least developed countries (LDCs) in particular, its indispensability in the era of rapid global integration is hard to challenge. This is more so in the context of riveting historical narratives of several East Asian countries, which followed a development trajectory that relied, *inter alia*, on promoting trade and investment nexus to achieve remarkable prosperity in a matter of decades (see, for example, Urata 2001; Chow 2012). In the era characterized by slicing up the value chain *a la* Krugman (1995) and rapid integration of trade and disintegration of production *a la* Freentsa (1999), efficiency seeking FDIs is where the future of FDI lies, although resource-seeking FDIs will continue to find its niche in the global and regional markets.

Despite vital significance of agricultural sector for the livelihoods of billions of people across the developing world, the global flow of FDIs leaves this sector relatively untouched because they flow mostly in services, manufacturing and "extractive" industries. In the case of Nepal, which is the focus of this paper, manufacturing sectors still accounts for a significant portion of FDIs and agriculture accounts for a meager 1 percent of the cumulative FDI approved between 1998/99 and 2010/2011.[2]This shows that the significance of foreign investment in contributing to agricultural growth, which helps in achieving the first goal of the Millennium Development Goals (i.e., poverty and hunger)is under-appreciated. Breaking from this tradition, this paper underscores the significance of attracting FDI in the agricultural sector. The focus of this paper is, however, on the agro-processing sector, if not in hard core agricultural sector (such as plantation of cereals, cash crops and livestock), not least because attracting FDI in this sector helps resource and technology-starved LDCs such as Nepal to move up the value chain ladder towards achieving gradual structural transformation.

Nepal, which has recently overcome the problem of armed insurgency and is in a transition towards a peaceful democratic order, has been the worst performer in South Asia in terms of attracting FDI. However, whatever investment the country has been able to receive so far, a lion share comes from its southern neighbour, India. This is particularly because Nepal has a bilateral trade agreement with India, and the two neighbours not only share open borders but also have cultural and linguistic

[1] The paper is based on the presentation made by the author at the Regional Consultation on "Potential Regional Trade in Agriculture in South Asia" organized by ADB, UNCTAD, Commonwealth Secretariat and SANEM, in Dhaka on 28 May 2012. The author benefitted from comments and suggestions provided by participants at the consultation, in particular, Nazneen Ahmed, Rajeev Kher, Rashmi Banga and Safdar Sohil. The author would like to thank Posh Raj Pandey and Puspa Sharma for their valuable comments and suggestions.

[2] See Figure 2 below.

similarities. Among them Dabur Nepal Pvt. Ltd. (DNPL) stands out not only because it is the single largest contributor to agricultural FDI in and exporter of agricultural products from Nepal, but also because of the contribution it has made to help Nepal harness the potential of trade-investment nexus. Therefore, this paper is based on a case study of DNPL. The two main objectives of this paper are to: a) analyze the prospects and challenges of such investments in Nepal, and b) shed lights on the possibility of replicating such model elsewhere in South Asia.

The paper is structured as follows. Section 2 presents a situational analysis of FDI in Nepal. Since the major focus of this paper is on the agricultural sector, Section 3 highlights the rationale for promoting agriculture-related sector in Nepal, in which a brief description of the potential areas of investment and trade in agriculture-related sectors is also provided. Section 4 discusses the dynamics and potentials of Indian investment in agriculture-related sector, in particular agro-processing sector, in Nepal. Section 5, then provides an analysis of Indian investment in the agro-processing industry with a case study of DNPL. Section 6 concludes the paper.

2. Situational analysis of FDI in Nepal [3]

2.1 Trends in FDI

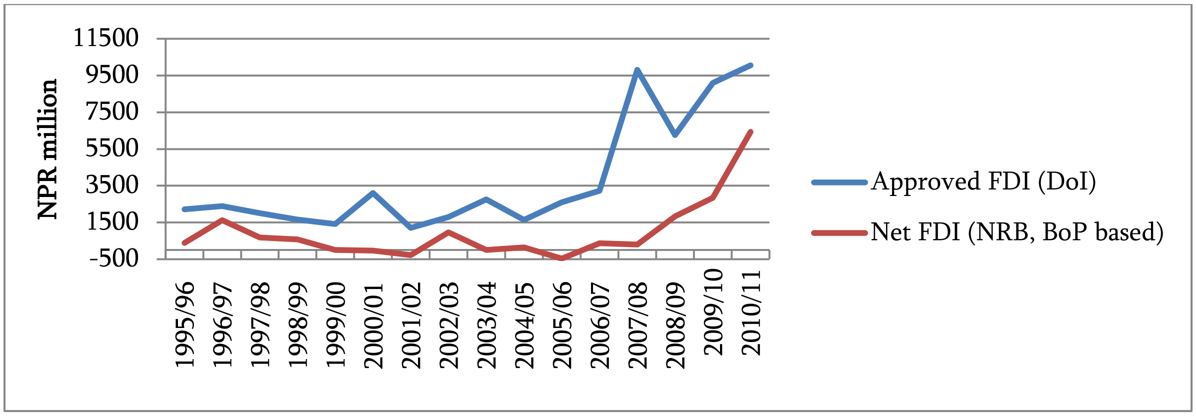
According to World Investment Report, FDI in particular suffered a setback in the recent past due to global financial crisis, followed by ongoing debt crisis. The report reveals that although global FDI flows exceeded the pre-crisis average in 2011, reaching $1.5 trillion, they still remained some 23% below their 2007 peak (UNCTAD 2012: 2). South Asia, buoyed by 31% growth of FDI into the largest economy of the region (India), witnessed a robust growth of 23 percent in 2011 in FDI inflow compared to the previous year. However, Nepal remains one of the worst performers in the region despite robust growth of 123% and 9% attained in the past two years, according to the UNCTAD data,[4]Nepal ranks the lowest in the region in terms of FDI potential index, i.e., 175 out of 182 countries ranked globally (UNCTAD 2012).

However, if we look at the country-level data for FDI approval as provided in Figure 1, the picture looks less bleak, in particular from 2006/07 onwards, which coincided with the end of armed conflict. FDI receipt figures, which are extracted Nepal Rastra Bank (NRB) – the Central Bank of Nepal tends to follow the figures of FDI approval, extracted from the Department of Industry (DOI) source. Although there is a wide variation between the two, with FDI approval posting relatively better performance compared to FDI inflow, both the figures have shown improvement in the recent past (Figure 1). During the period of armed conflict (1995/96 – 2005/06), FDI inflow was not only low, but also erratic, with two years 2001/02 and 2005/06 witnessing net negative FDI inflow.

[3] This section draws on the author's contribution to the European Report on Development: Nepal Case study prepared jointly by Pandey, Adhikari and Sijapati (2012).

[4] These data differ from the data on FDI approval complied by the Department of Industry of the Government of Nepal and the data on FDI receipt drawn from Nepal Rastra Bank (Central Bank) source, as we will show later.

Figure 1: FDI approved and realized (1995/96 – 2010/11), NPR million



Source: Author's calculations based on DOI (2011) and NRB (various issues).

For a country with low capital base, the contribution of FDI in terms of gross fixed capital formation (GFCF) is seen as an indicator to judge the development implication of FDI. Based on UNCTAD figures, FDI/GFCF ratio has improved in the case of Nepal reaching 2.5%, which is the highest ever recorded. However, this figure is much lower than other neighbouring countries in South Asia such as the Maldives (72.4), India (6.4 percent), Pakistan (5.3 percent) and Bangladesh (4 percent).[5]

2.2 Opportunities and challenges

The idea that the recent surge is FDI has brightened the prospects for attracting more FDI has found traction among bureaucrats (see Ghimire and Poudel 2012),[6] multilateral institutions (see Afram and Del Pero 2012) and researchers (see Adhikari 2012).[7]However, these commentators also seem to converge on the fact that Nepal faces enormous challenges not only to attract FDI in a sustained manner but also to make FDI work for country's development. The discussion below provides an idea of those opportunities and challenges – both real as well as potential.

2.2.1 Opportunities for expanding investment

Overall opportunities can be divided into three clusters, namely: comparative advantage, market size, and policy initiatives.

Comparative advantage

The resource endowment that constitutes a major comparative advantage for a country plays an important role in predicting the flow of FDI. While this model is true from neoclassical standpoint particularly in the context of international trade (see, for example, Qiu 2003), we conjecture that it

[5] Pandey, Adhikari and Sijapati (2012).
[6]Ghimire and Poudel (2012).
[7]Adhikari (2012).

should apply to FDI established with predominantly targeting domestic as well as regional markets as well. Although there are different opinions about Nepal's comparative advantage, based on several published reports and a survey conducted in June-July 2012,[8] we have prepared a list of sectors in which Nepal has comparative advantage as well as investment potentials elsewhere (Pandey, Adhikari and Sijapati 2012). Out of 18 sectors/sub-sectors identified by the study, seven sectors/sub-sectors fall into category I (very high investment potential) of which four are agriculture-related sectors/sub-sector. Eleven other sectors/sub-sectors fall into category II (high investment potential), of which three sectors belong to agricultural sector. We shall return to this issue in the next section.

Market size

Although the size of Nepalese market is considered relatively small compared to populous neighbours such as Bangladesh, China, India and Pakistan, it is still a market of 27 million people with growing middle class. According to a study conducted by the Asian Development Bank (2010), based on a 2004 survey, Nepal had a middle and upper-class population of 23.36% (earning between US$ 2 and US$ 20 per day) with a combined income of US$ 10.72 billion in 2005 purchasing power parity (PPP) dollars. This figure has markedly increased now because going by the CBS data, annual income of the richest 20% of the population has increased from NPR 40,486 in 2004 to NPR 94,149 in 2011, a growth of 133% (CBS 2011). Based on these figures, our 'back of an envelope' calculation shows that richest 20 percent population in the country had a combined income of US$ 7.26 billion in 2011. Although this is not disposable income, it shows that Nepal has a huge purchasing power. Moreover, the volume of Nepal's imports having reached close to US$ 6 billion in 2011/2012[9] also provides an indication of its purchasing power.

Moreover, by virtue of the various trade integration arrangements Nepal has entered into, the market size of Nepal is not restricted to geographical boundary of the country. Being a member of the World Trade Organization (WTO), Agreement on South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC)[10] mean that goods or services from Nepal have a very wide market access.[11] Better still, Indo-Nepal Trade Treaty, last renewed in 2009, provides zero tariff access to almost all products manufactured in Nepal (except for some products in the negative list including alcohol, tobacco and perfumes of non-contracting party origin) (SAWTEE 2012).

[8] These studies/reports are: an export diversification study (SAWTEE/AAN 2007); export potential assessment study (ITC 2007); Trade Policy (MoCS 2009); a report on foreign investment opportunity (MoI and MOCS 2009); and Nepal Trade Integration Study (MoCS 2010). Note that the MoI and MoCS (2009) report is unique in the sense that that it includes prospects for FDI targeting both domestic as well as export markets.

[9] See TEPC (2012) for further details.

[10] However, this initiative has not been moving as fast as was initially envisaged.

[11] See Adhikari and Kharel (2011) and Ghimire and Poudel (2012).

Furthermore, being a least developed country (LDC) Nepal enjoys duty-free quota free market access in most OECD countries, except the USA and Japan, as well in some of the South–South trading partners such as China, Turkey and Egypt. At the same time Nepal is currently negotiating a free-trade agreement with Bangladesh, which has agreed to provide zero-tariff market access to selected agricultural products to Nepal,[12] and it has also signed a Trade and Investment Framework Agreement with the USA, which would, in all likelihood, be eventually converted into a bilateral trade agreement.[13] Probably due to these favourable market access arrangements, Nepal is considered the country having the third-best indicator on margin of preference in destination markets' among 132 countries included in the most recent Global Enabling Trade Report (World Economic Forum 2012).[14] This shows that Nepal offers tremendous prospects for using trade-investment nexus.

One of the reasons for a number of Indian companies to have established their presence in Nepal after the onset of economic liberalization in Nepal and in particular after the signing of a relatively more favourable Indo-Nepal Trade Treaty in 1996 was precisely to tap the vast Indian market. Although Indian authorities are notorious for imposing (often arbitrary and non-transparent) non-tariff barriers on Nepalese exports to their market (see, for example, SAWTEE 2012),[15] the incidence of such barriers tends to be lower when the exporting company is their own company (Adhikari 2012).

Policy initiatives

Although the pace of reform has definitely been slow because of the nagging post-conflict transitional phase that the country is experiencing, reforms have paid off. For example, paying taxes and obtaining business permits in Nepal are becoming less complex (Afram and Del Pedro 2012). Moreover, three recent developments in the policy arena are likely to provide much needed shot in the arm for attracting investment – both local and foreign – in general and in the hydroelectricity sector in particular.

First, the GoN has announced 2012/2013 as Nepal Investment Year (NIY), with a target of attracting US$ 1 billion worth of FDI in a year (Paudel 2012). This figure is definitely quite ambitious because, even going by the approved investment data, Nepal will have to attract seven times more FDI than it did in 2010/11. However, this has sent a strong signal to the market that the government is serious about promoting FDI in the country.[16]

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[12]Thapa (2012).

[13] See SAWTEE (2011).

[14] Nepal's score was 67.9/100 against the country with the highest score Malawai (93.8/100) and the second highest score of Mauritious (72.4/100), respectively.

[15] SAWTEE (2012)

[16] Some stakeholders have raised doubt about the success of this initiative in the recent past, in particular because the present care taker government was not able to bring full-fledged budget, and there is policy fluidity due to the possibility of elections taking place in the near future.

Second, in order to provide fast-track approval for mega projects – both local and foreign – and facilitate their foray into the Nepalese business scene, the government has established Investment Board, chaired by the Prime Minister. The Board plans to offer one-window solution whereby investors who enter its office should be able to get all their issues resolved in one place, i.e. registration, licensing, immigration issues, and bill clearance to even acquiring a mobile SIM card.[17]

Third, in order to provide financing to medium to higher size hydro-electricity projects (in excess of 25 MW) and construction of transmission and distribution lines, the government established the Hydropower Investment and Development Company in 2011 with participation of the Central Bank and other public institutions. Although the company started its operation with effect from 30 July 2012, in the initial stage it is planning to lend to hydro-power projects as a part of consortium financing together with other banks and financial institution in the country.

Apart from these initiatives taken at the national level, the GoN has recently signed Bilateral Investment Protection and Promotion Agreement (BIPPA) and Double Tax Avoidance Agreement (DTAA) with India, which has the largest stake in Nepal in terms of FDI. Although these agreements alone may not help in attracting FDI and they are no substitute for better investment climate,[18] these are still important in the sense that they do send some positive message to the foreign investors that their investment would be protected in the host country and they have a legal recourse should there be a problem.[19] Moreover, Nepal is actively engaged in the negotiations of the investment protection and promotion agreement within the SAFTA. Once signed, this can help Nepal send positive signal to the investors from other countries in the region, besides India about its commitment to protect and promote investments from the region.

2.2.2 Challenges to attract and leverage investment for development

While there are some typical challenges that each post-conflict LDC like Nepal faces in terms of attracting and retaining investment, Nepal faces certain peculiar constraints that are neither common nor explained by any theory. These challenges can be broadly divided into four categories: a) political and governance-related; b) legal, institutional and policy-related; c) infrastructure-related; and d) resource-related.

Political and governance-related

An enterprise survey conducted in Nepal in 2009 shows that political instability is considered the major to severe obstacle constraining investment climate by 90% of the respondents, while 70% of them thought that this was the major obstacle (IFC 2009). At the same time 'corruption', which is a

[17] See http://www.whynepal.com/entrepreneurship/what-is-investment-board-nepal-ceo-radhesh-pant-answers/ (accessed 31 July 2012).
[18] See, for example, Yackee (2010).
[19]Adhikari (2012)

proxy for governance, is considered major to severe obstacle by 21% of the respondents, although none felt that this was the major obstacle (ibid.). Lengthening of political transition has deterred Nepali as well as foreign investors from making investment in Nepal due to the uncertainty this creates.[20] This sentiment has become widespread particularly after the failure of the government to write a new constitution, which was expected to chart a new political course for the country to move towards a credible development trajectory.[21] While political environment as a problem has also been highlighted by the recently released Nepal Economic Outlook (IIDS 2012: 27), failure to promulgate the new constitution means that even local investors are shelving their investment plans and holding back on their commitments for the time being. In a situation like this it would be imprudent to assume that foreign investors will substantially increase their investment.[22]

The attendant fallout has been a constant deterioration in quality of governance indicators, which creates uncertainty and undermines business competitiveness,[23] and perpetuates the culture of impunity. One of the extreme examples of this latter tendency is the state seizure by interest groups, which can go to any extent to declare strikes combining violence with extremism, to get their demands met. The organizers of these strikes are either oblivious of the costs of their actions to the economy in general and production loss as well as the signal they send to investors, or they are simply emboldened by impunity that has become a norm than exception.[24] What is surprising is that these kinds of activities are either considered perfectly legitimate not only by the strike organizers but also by public at large, or at least condoned by the latter.[25]

<u>Legal, institutional and policy-related</u>

Overlapping and often contradictory laws and institutional arrangements, differing priorities of the various agencies of the government coupled with serious gap between policies and their actual implementation on the ground are collectively responsible for the deterioration in the quality of investment climate in Nepal. Although these are not highlighted explicitly as the obstacles by the IFC enterprise survey, they are discussed in other literature and are confirmed as serious problems by

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[20] See, for example, Ghimire and Poudel (2012).
[21] See, for example, Poudel (2012).
[22] See, for example, Poudel (2012).
[23] See, for example, Ghimire and Poudel (2012).
[24] See The Himalayan Times (nd)
[25]One of the reasons for this is the demonstration effect created by the UCPN-Maoist party, the single largest party in the recently dissolved Constituent Assembly and its sister organization, which have used strikes as their arsenal to draw the attention of the governments in the past. As if this was not enough, donation and extortion rises with the formation of each new political party, with the private sector getting jittery each time a party splits. "Politics of intimidation has caused the business houses to panic" writes Himalayan Times in its editorial suggesting that such as tendency will have a telling impact on investment prospects of the country." See The Himalayan Times (2012), cited from Pandey, Adhikari and Sijapati (2012).

experts and stakeholders.[26] For example, an Implementation Evaluation of Foreign Direct Investment Policy in Nepal commissioned by the Economic Policy Network – a joint initiative of Ministry of Finance and Asian Development Bank – reveals that the fiscal incentives including income tax relief provided by the Foreign Investment and Technology Transfer Act, 1992 and Industrial Enterprises Act, 1992 are nullified by the provisions of the amended Revenue Act and New Income Tax Act.[27]

These problems are mainly due to differing priorities of the different agencies within the government with officials from other ministries not prepared to 'own' the idea that increased foreign investment is indeed good for the economy, and there is a feeling that it is the sole responsibility of the Ministry of Industry or Department of Industry to attract and retain foreign investors. For example, Ministry of Finance is singularly concerned about revenue generation with its Department of Internal Revenue and Department of Customs both remaining uncooperative while providing fiscal incentives to the foreign investors.

Regarding the institutional arrangement, although the one-window policy has been around for more than a decade and DOI was responsible for providing a 'one-stop facility' to all the foreign investors, this has never been the practice, because all that DOI can do is to make recommendations. The foreign investor is obliged to visit the Department of Immigration to get a visa, Ministry of Environment for conducting Environmental Impact Assessment (EIA) or Initial Environmental Examination (IEE) and Department of Revenue/Customs for obtaining fiscal incentives/exemptions promised by various laws. Now with the establishment of the Investment Board, there have been discussions going on as to whether it offers a one-window facility to the foreign investors or it is simply 'one more window' (*ibid.*).

The problems on the policy side are twofold. First, there is no policy stability in the country, which is partly because of the prolonged political conflict. Second, even those sound policies that have been formulated are seldom implemented.[28] This predicament is aptly captured by Rana and Pradhan (2005:3) when they suggest that 'Government listens but no actions are taken'. The gap between policy and implementation is due to a combination factors as highlighted in a study focusing on South Asian LDCs, including Nepal. First, policy itself could be faulty, if the implementation is lacking even after repeated attempts. Second, public officials choose not to implement some policies, either because the policies are top-down or externally driven and the public officials do not 'own' them or because they do not have the 'capacity' to do so (Adhikari 2011).

<u>Infrastructure-related</u>

[26] See Pandey, Adhikari and Sijapati (2012) for further details.

[27] Similarly, there is duty draw back facility to those who export their products, but they have to face many difficulties in getting such facility and even if they get, they get the same after a long wait. Sometimes they are given Government Bond instead of cash, which may be of no value to the foreign investors. See Rana and Pradhan (2005).

[28] Ghimire and Poudel (2012:17)

The IFC enterprise survey finds that two major infrastructure-related constraints are electricity and transport, with 57% of the enterprise surveyed suggesting electricity as the major to very severe obstacle and 16% finding this as the most important obstacle.[29] The corresponding figures for transport were much lower, at 25% and 2% respectively (IFC 2009). However, other studies find both of these as the major constraints,[30] which is vindicated by the interviews conducted with stakeholders and experts for a recent study conducted by the author.[31] Both the factors dampens investors' confidence and deters them from making or retaining, let along increasing investment in Nepal because they severely erode the competitiveness of the enterprises due to higher transaction cost they inflict on industries.[32] In the context of transport costs, it can only magnify the impact of the land-locked and difficult geographical terrain.

Although the problem of electricity shortages is not likely to be resolved soon, the alternative is to invest in captive generators, which are very expensive to run due to rising prices of fossil fuel. To add to their woes, the public sector monopoly, Nepal Oil Corporation, remains incapable of supplying diesel in a timely manner due to the losses it has sustained in the supply of fuels. When there is a shortage of fuel, it is not possible to operate the industry any more, although some resort to purchasing fuels from the black market.

The underdeveloped nature of Nepal's transport sector coupled with dilapidated roads is highlighted by a number of global reports, including but not limited to, Enabling Trade Report (WEF 2012a); Global Competitiveness Report (WEF 2012b) and Logistics Performance Indicators (World Bank 2012). Like in many other indicators of competitiveness, Nepal ranks the lowest in the South Asia region in terms of transport indicators. The reasons for Nepal's transport network to remain inadequate, unreliable, and expensive, as identified by a study conducted by ADB/DFID/ILO (2009), are: a) under-developed road network; b) insufficient funding for maintaining and rehabilitating the network and for constructing new road infrastructure; c) insufficient alternate transport routes; and d) limited supply of trucks and prevalence of cartels known as a 'syndicate' system.

Resource-related

Although there are several problems that the investors face under this category, we focus on three key resources, namely human, financial and technological. As far as human resource constraints are concerned, four different issues are prominent. First, Nepal does not have enough educated people with the skills required for sectors in which FDIs flow the most. The more skilled workers have already migrated abroad in search of greener pastures. Second, while most industries are already operating below capacity due to electricity and other problems, industrialists are now suggesting that

[29] See also Adhikari and Sapkota (2012); Viswanathan (2102)

[30] See ADB/DFID/ILO (2009); Adhikari (2011); SAWTEE (2012); Ghimire and Poudel (2012).

[31]See Pandey, Adhikari and Sijapati (2012).

[32] See Ghimire and Poudel (2012:18)

they scale down their production further due to the acute shortage of skilled workers.[33] Third, labour shortages have pushed up wages to the extent that Nepal has the highest wage overhead in South Asia.[34] Finally, the remaining workers are heavily unionized and apt to demand higher wages and facilities without making commensurate increases in productivity.[35] They are politically motivated and operate more as wings of their political parties than as workers concerned about enhancing productivity, letting business survive in the fiercely competitive market and waiting to reap rewards later, let alone struggling for the emancipation of workers.

As for access to finance, IFC (2009) finds that only 74% of the firms have a bank account and 39 percent have a line of credit or a loan from a financial institution. It also states that most firms rely on internal funds to finance the bulk of their investments and their working capital needs.[36] Three years on, some improvement in the situation is shown by Doing Business Report (World Bank 2012). However, it is still a bit nuanced and has to be understood differently depending on the size and origin of the company. While there is little problem in terms of access to finance (in particular obtaining credit from banks) for relatively large companies and companies of foreign origin, according to a survey of SMEs conducted in 2011, it is highly restricted in the case of micro, small and medium enterprises (Sharma and Khadka 2011).[37] According to the survey, the major reasons for the reluctance of these enterprises to obtain loan from banks are in the following order: high interest rate; collateral-related problems; and lengthy and burdensome process (ibid: 71).

Finally, on the issue of technology, Nepal's record on generation, acquisition, adaptation and application of technology leaves much to be desired. The country lags behind other South Asian countries in the various indicators of technological advancement (such as technological readiness, production process sophistication and innovation) as measured by Global Competitiveness Report (WEF 2012).If we take the registration of intellectual property as the indicators for innovation, Nepali enterprises as well as individuals have a long way to go. For example, even 46 years after the enactment of the Patent, Design and Trademark Act, 1965, only 68 patents have been registered, of which only 32 are owned by Nepali nationals. Similarly, 72 designs have been registered with the Department of Industry, of which 17 belong to nationals and the remaining 55 belong to foreigners (Adhikari and Sapkota 2012).

3. Rationale for promoting agriculture-related sector in Nepal

The salience of agricultural sector for the Nepalese economy and need to promote this sector cannot be underestimated due to several reasons. First, the share of agriculture to national gross domestic

[33] Himalayan Times (2012).
[34] SAWTEE (2012) based on IMF World Economic Outlook Database.
[35]See, for example, Shakya (2009); Viswanathan (2012).
[36]IFC (2009).
[37]Sharma and Khadka (2011).

product (GDP) has recently increased to 35 after declining ever since the onset of industrial development in the country (MoF 2012). Of late, due to relatively better performance of the agricultural sector and deteriorating performance of manufacturing sector (although this is not something to cheer about), agricultural sector is becoming more important for the Nepalese economy. Another related issue is that two-third of economically active population of the country are engaged in agricultural sector for their livelihoods. Most agriculture households, which are in rural areas, are smallholders[38] practicing subsistence farming with only small portion of farms using modern production methods and technologies (ANSAB 2011).Since poverty in rural areas is much higher (35 percent) than in urban areas (10 percent), the objective of inclusive economic growth, which the Government of Nepal appears to be promoting – particularly after the end of internal conflict– can be achieved only through the development of the agricultural sector. Indeed, as argued by Sharma (2009), the central challenge for poverty and inequality reduction is to increase agricultural growth by shoring up investment in the sector (Sharma 2009).

Second, due to the agro-climatic variations Nepal offers prospects for diverse agricultural practices (Samriddi 2011). In a recent paper prepared for South Asian Analysis Group, Jha (2012) notes Nepal being a unique country having all the three regions – the plains (Terai), hills and the mountains, many of the plants or crops grown in any part of the world could be produced in the country. Citing the example of DNPL, which has already been "reaping dividends from investment" in this sector, he makes a strong case for attracting investment in agricultural and herbal sector. This could be one of the reasons for viewing agriculture as a sector in which Nepal has comparative advantage (besides hydro-electricity and tourism). This is proven by the fact that ten out of 14 products enlisted by Trade Policy 2009 as "thrust areas" and seven out of 12 products identified for export expansion by Nepal Trade Integration Strategy 2010 are agricultural products.[39] Based on these documents prepared by the Ministry of Commerce and Supplies (MoCS 2009, 2010), along with a report on investment potential also produced by MoCS in collaboration with the Ministry of Industry (MoI and MOCS 2009), a study prepared by the International Trade Centre (2007), and two recent studies conducted by SAWTEE (2012a, 2012b), several agriculture-related products/sectors listed in Table 1 seem to hold tremendous export as well as investment potentials.

[38]About 45 percent of the farming households have less than 0.5 hectares (ha) of land and are amongst the poorest. See ANSAB (2011).

[39] This document, prepared as a part of the Diagnostic Trade Integration Strategy (DTIS) under the Enhanced Integrated Framework (EIF), is considered the blueprint for the expansion and diversification of Nepalese exports.

Table 1: List of agricultural sectors/sub-sectors with trade and investment potentials

Product/sub-sector	ITC assessment	Trade Policy	Investment potential study	NTIS	SAWTEE studies
Tea	√	√	√	√	√
Coffee		√	√		√
Cardamom	√	√		√	√
Ginger	√	√	√	√	√
Garlic			√		
Vegetable/seeds		√	√		√
Pulses/lentils	√	√		√	√
Honey		√		√	
Floriculture		√	√		
Herbs and essential oils	√	√		√	√
Horticulture		√	√		√
Noodles				√	
Livestock, dairy			√		
Aquaculture			√		
Animal feed			√		
Oilseed			√		
Leather	√		√		

Source: Author's compilation based on ITC (2007); MoCS (2009); MoI and MoCS (2009) and MoCS (2010); SAWTEE (2012a, 2012b).

Third, of all the sectors in which FDI has been attracted, agriculture is the sector in which development spin off measured by the twin criteria of domestic value addition and employment opportunities is the highest. While investment in manufacturing or services sectors should also be promoted because they provide reasonable employment opportunity and help in structural transformation of the country, it is the FDI in agriculture sector which contributes most to inclusive development of the country. One can discuss this with the examples of readymade garment and orthodox tea. While the former uses, on an average, more than 60 percent imported inputs and often fails to meet the value added criteria for being eligible to export under the Generalized System of Preferences scheme or free trade agreement, almost 100% value addition takes places in the country in the case of tea (except for packaging materials for which foreign inputs may have been used).

Moreover, employment in garment sector (which otherwise provides decent employment potential due to labour intensive nature of production process) pales in significance while compared to orthodox tea sector. This is because in the garment sector the employment is generated only in the processing stage (cutting, sewing, ironing, packing and exporting), in tea sector employment is provided from the very beginning of the process (cloning of plants, plantation, application of organic manure, harvesting, drying, blending and packaging). Orthodox tea, as opposed to conventional cut, trimmed and curled (CTC) tea, provides even higher share of employment opportunities not least because 67 percent of the total producers of the former are small holder farmers, while the remainder is produced by organized tea states.[40] This means that the contribution of orthodox tea in helping the government in achieving the objectives of inclusive growth in much higher than garment sector, or any other manufacturing sector for that matter.

Fourth, even in the context of FDI, the contribution of agricultural FDI to employment is higher than any other FDIs in Nepal. In order to find this, based on the Department of Industry data for approved FDIs, we have recently computed the sectoral composition of FDI (Figure 2 upper-left panel) which shows that of the total FDIs approved till 2010/11 the share of agricultural sector is the lowest (1 percent) as opposed to investment in other sectors such as manufacturing (38 percent), energy-based (21 percent) and services (19 percent).[41] Then we calculate the share in employment generated by approved FDIs by sectors (Figure 2 upper-right panel), which shows that contribution of agricultural FDI is merely 2 percent compared to sector such as manufacturing (50 percent), services (21 percent) and tourism (14 percent), although agriculture does relatively better given the percentage share of FDIs coming into the sector.

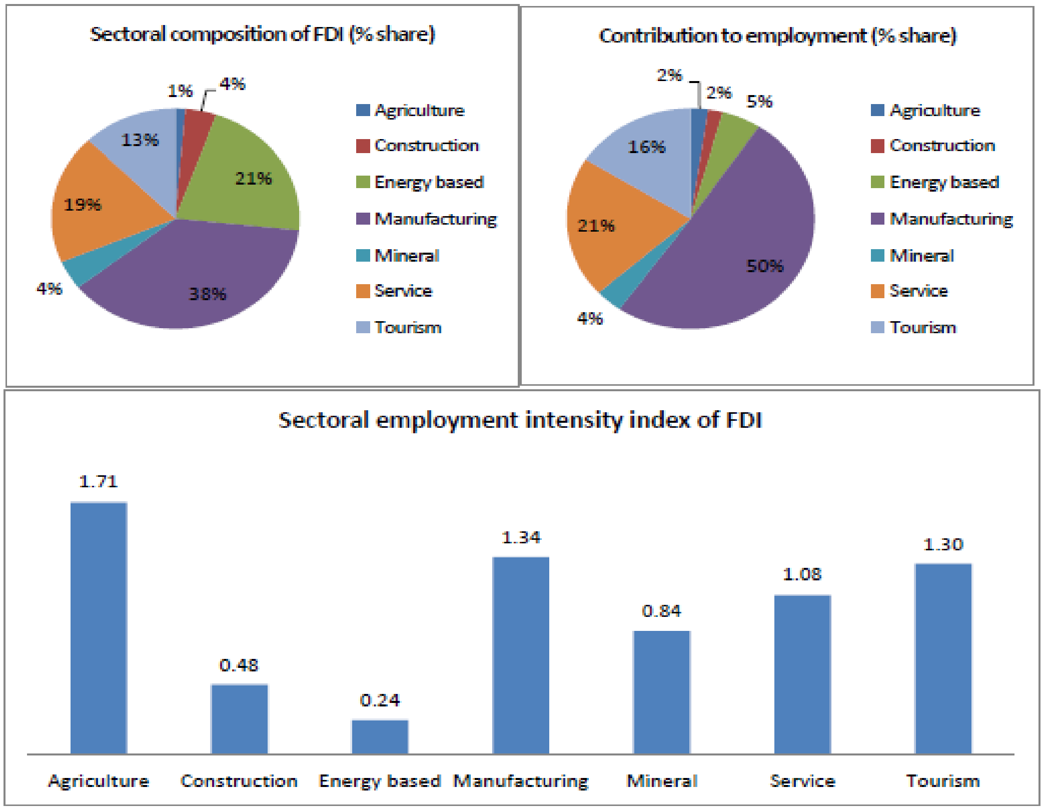
These two figures help us calculate what we call "employment intensity index of FDI" which is the main purpose of this exercise. This is done by dividing the percentage share of employment (proposed to be) generated by FDI by the percentage share of the amount of (approved) FDI (Figure 2 lower panel). The results show that FDI in agriculture sector tends to have the highest intensity (1.71), followed by manufacturing (1.34) and services (1.3), whereas energy-based and construction sectors with indices of 0.24 and 0.48 have the lowest and second lowest employment intensity respectively.[42] This shows that per dollar of FDI in agriculture is worth more than per dollar FDI in any other sector in terms of potential employment opportunity, which has a major policy implication for development policy. However, above conclusion should be considered as tentative at best because the figures included in the analysis are approved and prospective investment and employment and not the realized ones. This is because Department of Industry does not have data for the actual inflow of FDI and number of people employed in each establishment because it does not have the monitoring apparatus in place.

Figure 2: Sectoral composition of FDI, employment share (in percentge) and employment intensity index based on cumulative FDI data up to 2010/11

[40] See ANSAB (2011) for further details.

[41] See Pandey, Adhikari and Sijapati (2012) for further details.

[42] The indices are provided up to two decimal points for the sake of accuracy whereas shares of various sectors in FDI value and employment have been rounded up.



Source: Pandey, Adhikari and Sijapati (2012).

4. Indian investment in agriculture-related sector in Nepal

As briefly noted above, India is the single largest foreign investor in Nepal. There are several factors responsible for this, some of which deserve elaboration.

First, Nepal and India have had a *de facto* Customs Union type of arrangement particularly since 1950, when treaties of Peace and Friendship and Trade and Commerce were signed between the two countries. At that time, Nepal's dependence on India for its external economic relations was so high that 90 percent of Nepal's trade were conducted with India (SAWTEE 2012a). However, the investment relation expanded between these two countries in the aftermath of economic liberalization initiated in both the countries, which paved the way for Nepal to welcome FDI in general and Indian investment in particular, the process of which was hastened due to relaxation on the movement of investment out of the country on the Indian side of the border.However, it was the signing of the most liberal trade treaty between the two neighbouring countries in 1996 that led to increased investment from India into Nepal to take advantage of the zero tariff market access available in the Indian market without any rules of origin requirement. During this period all kinds of investment flowed in – both genuine FDIs as well as investment made by "fly-by-night" investors who wanted to make quick profit due to tariff differential prevalent between the two countries and shift location as the differential disappeared (Adhikari 2009).

Second, due to open border it is thought easier to export goods manufactured in one country into the other without much problem. Although this was true to some extent, the fact that the two countries having open border do not face non-tariff barriers (NTBs) and customs-related irritants has proven to be a myth at least in the context of India and Nepal.[43]However, these problems have been found to be less severe in the case of ventures in which Indian companieshave relatively high stakes. This is probably because Indian companies are more apt in working their way through the Indian bureaucracy including quarantine offices, customs and security agencies better. Another plausible reason is that these authorities tend to take softer approach to these companies because they tend to think that those are their "own" companies, whereas ventures owned purely by Nepalese and any other foreign investors are often viewed with suspicion.[44] Another related issue is that there is no visa restriction for the movement of people between two countries, which has definitely played a role in increased business contact as well as flow of FDI from India to Nepal. The reverse is not true because the Central Bank of Nepal does not allow any Nepalese to make investment abroad.

Third, due to similarities in culture and language and existence of cross border relationship – blood as well conjugal –establishment and operation of business in Nepal becomes an easier proposition for

[43] See SAWTEE (2012a) for further details.

[44] See Adhikari (2012). This argument was echoed by Dr. Prakash Chandra Lohani, who chaired the session in which the author made the presentation. Dr. Lohani happens to be a former minister in-charge of various portfolios including Finance, Foreign Affairs, Commerce and Agriculture in different periods.

Indian businesspeople. Moreover, cultural similarities mean that the consumers' tastes and preferences tend to be similar. Therefore, products manufactured in one country can be marketed in another country without having to incur extra costs. One such glaring example is that cost of advertising Indian products in Nepal is extremely low because most Indian television channels, magazines and newspapers that advertise their products can derive the benefit of exposing the content to the Nepalese consumers free of costs as these media are freely available in Nepal. Even when Nepalese television media is used all they need to do is todub the content into Nepali or English language.

Fourth, and probably more important than other reasons mentioned above, is that Nepali currency is pegged to Indian currency and the latter is freely convertible through any bank in Nepal. This is not the case if the Indian investments were made in other South Asian countries such as Bangladesh and Sri Lanka, where the Indian currency must be changed into convertible currency before converting them into the local currency and vice versa thus creating uncertainty particularly in the present context of highly volatile currency rates. To add to Indian investors' confidence, the exchange rate of 1 India Rupee to 1.60 Nepali Rupees, last fixed in 1993, has not changed in the past two decades. This gives some kind of predictability to the Indian investors investing in Nepal in that the value of their currency would not be changed abruptly. Although Bhutan has even more favourable currency arrangements with India, with the exchange rate of the currency being 1:1, Nepalese market is 45 times bigger than the former and hence more attractive for Indian investors.

Despite the favourable prospects, Indian investment in the Nepalese agricultural sector has been extremely limited, apart from the investment made by DNPL, which will be discussed extensively in the next section. For example, ever since the systematic recording of FDI was done by the Department of Industry, only seven Indian investments in agricultural sector were approved, which represents a meager1.26 percent of all the Indian investments approved till 2010/2011 (Table 2).

Table2: Indian investment in Nepal, cumulative figure upto 2010/2011

Sector	Number of industry	Total project cost (NPR 'million)	Total fixed cost (NPR million)	Foreign investment (NPR million)	Employment
Agriculture	7	793	343	417	784
Construction	17	2,246	1,614	1,876	830
Energy	12	8,336	9,810	5,147	1222
Manufacturing	296	29,493	21,023	14,687	36142
Mineral	6	4,477	3,633	2,261	1521
Service	112	12,355	10,016	6,485	11,781
Tourism	51	5,025	4,679	1,517	4,127
Total	501	62,725	51,119	32,390	56,407

Source: DOI (2011):57.

However, it needs to be noted that the agricultural FDI from India in the above table, for some reason, does not consider certain investment in agro processing sectors such as tea, dairy, ice cream and bakery as agricultural investment, but they are categorized under manufacturing. Even after accounting for these investments, this may not significantly alter the percentage of agricultural FDI from India in total FDIs.

5. Indian Investment in agro-processing Industry: A case of Dabur Nepal Ltd.

As noted above, apart from DNPL, there are very few Indian investments made in agro-processing sector. The idea of establishing DNPL was mooted when some senior officials of the parent company in India visited Nepal in 1990, when India was still a closed economy while Nepal was creating favourable and welcoming environment for luring FDIs into its shores. Nepal provided a very good manufacturing base for export to India with favourable customs and tax rules, according to Udanyan Ganguly, former CEO of DNPL and present regional business head of Dabur India overseeing Nepal, Bangladesh and Sri Lanka (Ganguly 2008).

When the company was established in Nepal, with the parent company holding 82 percent and the Nepalese promoters holding 18 percent shares (Pro Public 2007), it was in for a long haul. This is proven, among others, by the fact that it has firmly placed itself on the ground in Nepal, where it has not only established its processing plants but also initiated several projects, which are interwoven with the social and economic fabric of the country. The company considers Nepal as a very important investment as well as an important production base (Mathema 2008). It operates greenhouse projects for medicinal plants in various parts of the country and has provided direct and indirect employment opportunities to a number of farmers and workers, while contributing to the commercial yet sustainable use of local resources. However, the company has, at times, been criticized for allegedly flouting government rules, importing inputs from South America and thereby retaining limited value addition in the region (Pro Public 2007) as well as supplying sub-standard products and falsifying date of manufacture (Business Standard 2010; Times of India 2011).

One of the objectives of the paper is to analyze the contribution (or otherwise) of Indian agro-processing industry in general and that of DNPL in particular to the Nepalese society and the economy. In the context of the empirical evidence pointing that benefit of FDIs to the society as well as economy of the host country is at best ambiguous, we need to ground our micro analysis on some kind of framework. We, therefore, choose the contributions (or lack thereof) made by the company in the following spheres for our analysis: a) employment opportunity; b) export revenue; c) government revenue; d) linkage with local economy; e) sustainability; f) technology; and g) corporate citizenship.

5.1 Employment opportunity

Although no official data is available, estimates put direct employment figure at 5,000 and indirect at 25,000 (Mathema 2008) on farms and 1,000 direct employment in the factory (Indian Express 2011).Since the above figures were dated, we wanted to confirm this from the company sources, which declined to officially provide any information. However, an official from the company, in the condition of anonymity, confirmed that the company has provided direct employment to nearly 2,000 workers and indirect employment to nearly 20,000 people.[45]

5.4 Export revenue

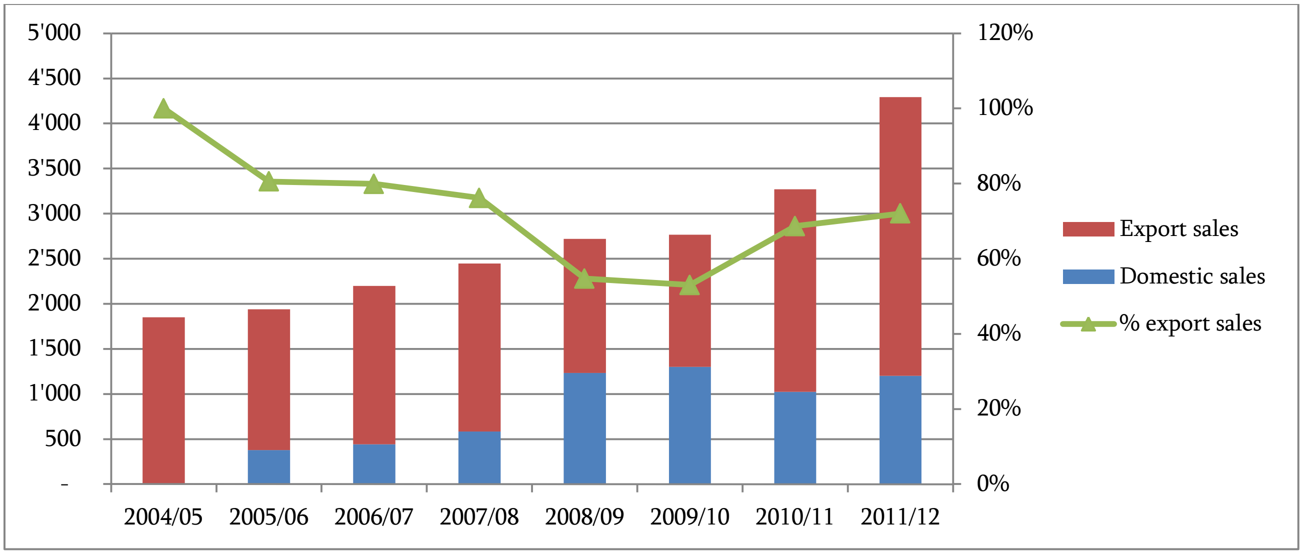
Nepal's merchandise trade deficit has been ballooning since 2002 due to a confluence of factors including revision of Nepal-India trade agreement, gradual phasing out of textiles and clothing quotas at the multilateral level and supply-side constraints (SAWTEE 2012a). As per the preliminary estimates for the fiscal year 2011/2012 recently released by the Trade and Export Promotion Centre, import export ratio has worsened from 6.7:1 from 6.2:1 a year earlier, despite a favourable export growth of 14.8 percent achieved during the year (TEPC 2012).

Although the trade deficit is currently being financed by remittance incomes, the sustainability of such flow is questionable given the fact that such incomes depend on many exogenous factors. In such a milieu, every Rupee of export income matters and the role of DNPL's, one of the largest contributors to merchandize exports of the country, cannot be under-estimated. This is because DNPL was primarily established with the objective of processing agricultural and forest products in Nepal and exporting them to the Indian market, and it has lived upto this expectation on that count. Since 2005/06 onwards, it has even started catering to the domestic market, thereby substituting imports and helping Nepal, at the very least, save its precious foreign currency. Figure 3 provides the details of the export revenue, domestic revenue and total revenue of DNPL between 2005 and 2012 (as of 31 March each year, when the company's book is closed). In the figure while sales revenues (in INR million) are shown in left-hand vertical axis, export sales as percentage of total sales are shown in right-hand vertical axis.

As can be seen from the figure, although the company has started catering to the domestic market since 2005/06 it still focuses predominantly on export market for generating its revenue. This can be seen from the fact that the export revenue, which was gradually reduced to 53 percent in 2009/10, has picked up since to reach 72 percent in 2011/12, which means domestic sales, despite being quite sizeable in value terms, accounts for merely 28 percent of the total sales of DNPL as of 2011/12.

Figure 3: Shares of domestic and export sales of DNPL (INR million) and percentage

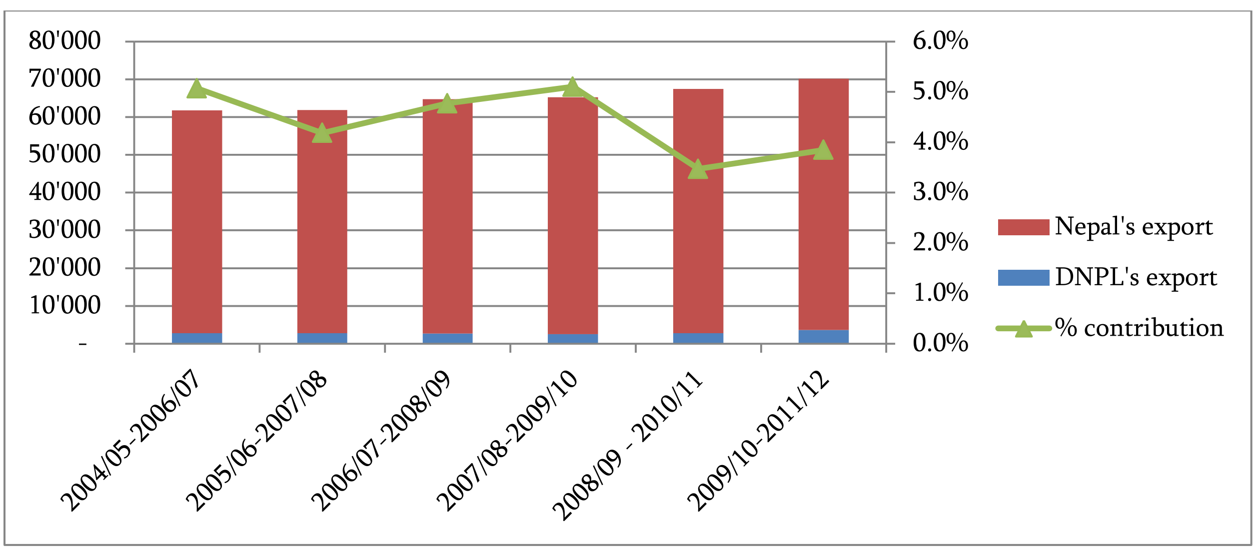
[45] Information received from the company resource on 30 September 2012.



Source: DNPL Annual Reports (2005 – 2012)

Since direct comparison with national data is not possible because of the differences in fiscal years,[46] we take three years moving average of Nepal's exports and the exports of DNPL to gauge the contribution it has made to the merchandise exports of the country. The results shown in Figure 4 is quite illuminating in the sense that DNPL, a single company, made a mean contribution of 4.6 percent to the total exports of Nepal, which is non-trivial by any standard. While the peak contribution was 5.1 percent, the lowest contribution was 3.5 percent.

Figure 4: DNPL's contribution to Nepal's export (%)



Source: Nepal's export (TEPC) and DNPL exports (DNPL's annual reports)

[46] Nepal's national export data is calculated on the basis of Nepalese fiscal year (mid-July to mid-July), DNPL follows Indian fiscal year (April to March) for accounting purpose.

5.3 Government revenue

DNPL makes contribution to government revenue under various headings. First, although it is either entitled to duty refund or is provided with duty free facility for the import of raw materials used in exports and capital equipment, it is obliged to pay import duty for the importation of items that are not directly used in the production process (such as vehicles, air conditioners, furniture, etc.). Second, it is obliged to pay excise duty in the process and value added tax (VAT) on its imports not meant for export processing. Third, the company is also required to pay corporate income tax on its profits. Fourth, the company's staff and workers pay tax on income they earn. Fifth, company's shareholders pay tax on the dividend they receive from the company. Although it is not feasible for us to calculate all these contributions the company makes to the Government revenue, it is possible to calculate the following from the annual reports of the company:

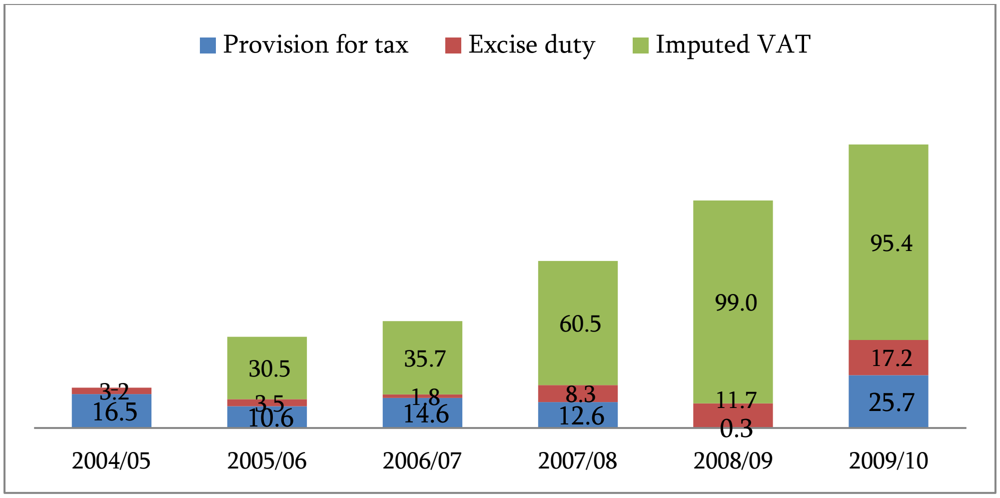
a) Corporate income tax: Although the audited financial report attached to the annual report of the company do not provide exact amount of corporate income tax paid each year, they do provide what is known as "provision for tax" which is the bare minimum the company has to pay to the government each year.

b) Excise duty: This figure is provided in the profit and loss account of the company.

c) VAT: Since the company does not provide the VAT amount anywhere in its financial statement, we imputed VAT at the rate of 10 percent in 2004/05 and at the rate of 13 percent thereafter (in line with prevailing rates applied by the Government of Nepal). In order to arrive at these figures, we took the import data from the company's financial statement, and calculated VAT by multiplying them by share of domestic sales because exports would be entitled to VAT exemption. These imputed figures, therefore, should be taken as best approximation but not as definitive.

Although it is not possible for us to calculate the tax on salary and emoluments paid to DNPL's staff due to non-availability, we attempt to capture the above three components of the company's contribution to government revenue in Figure 5. According to the figure, although the company's contribution has generally been rising in line with the growth of company's business, there was a reduction in 2008/09 both on income tax and VAT. Although income tax as well as excise duty have picked up in 2009/2010, VAT has further reduced. It also needs to be noted that these figures are available only upto 2009/10 because thereafter, possibly because of the change in accounting format, it is not possible to trace the above mentioned contributions from the company's financial statements.

Figure 5: DNPL's contribution to government revenue (INR million)

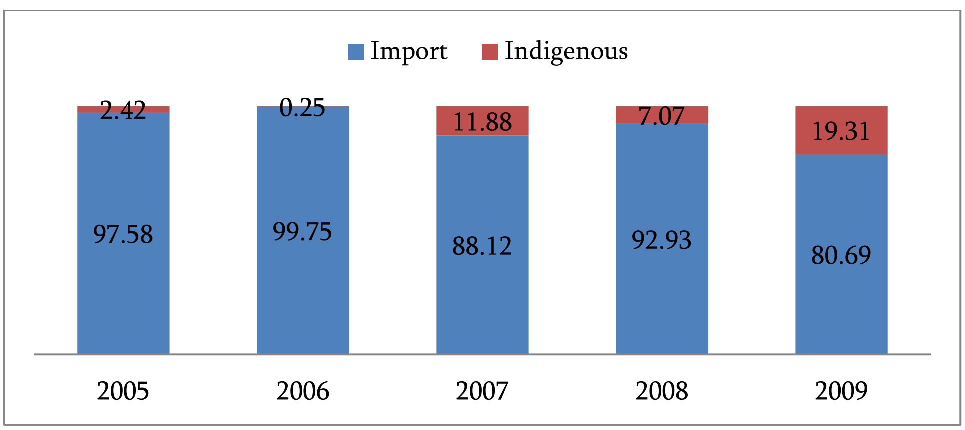


Source: DNPL Annual Reports (2005-2012)

5.4 Linkage with local economy

DNPL seems to be making efforts towards increasing indigenization. The data relating to percentage of raw materials used is not available from the year 2010 onwards, probably due to change in the reporting format of the financial report. However, available figures suggest that use of local inputs has increased from 2.42 percent in 2005 to 19.31 percent in 2009, although there have been significant variations in the mix in between these two periods, with indigenization reaching its lowest level in 2006, when it was merely 0.25 percent(Figure 6).

Figure 6:Raw materials mix of DNPL (%), 2005 – 2009



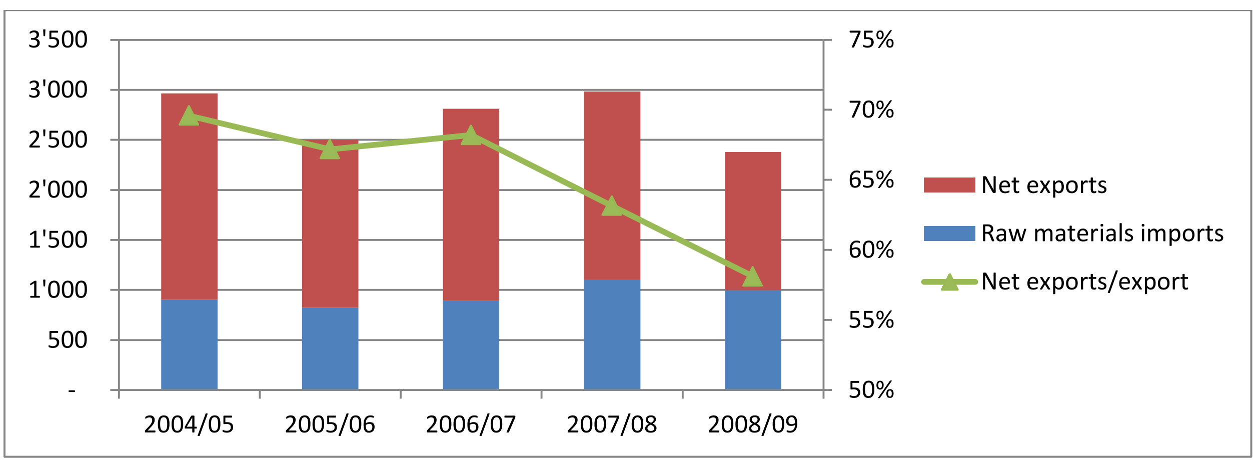
Source: Annual reports, DNPL (2005–2010).

The level of indigenization could have increased further in the past few years because the company has been operating greenhouse project for medicinal plants in Banepa, a town adjacent to Katmandu Valley with the objective of creating a sustainable source of medicinal and aromatic herbs (Mathema 2008). Since 1998, nursery in Banepa, have been involved in conservation and research into several species of endangered *ayurvedic* plants. As of 2008, Banepa alone used to produce 6 million saplings of medicinal plants per year, and these used to be distributed to 46 farmers' cooperatives in 19 districts across Nepal (Mathema 2008). Going by the increased business volume (as discussed below), one could only guesstimate that these figures might have considerably increased in the recent period.

Back in 2008, the company claimed to have attained self-sufficiency in Akarkara (*Spilanthes acmella Murr.*), which used to be imported from Morocco (Mathema 2008) and in the latest annual report of the company it claims to have attained self-sufficiency in Sahatavari (*Asparagus racemosus*)as well (DNPL 2012:1). This has been made possible through the plantation of these plants in various parts of the country by engaging local farmers.

However, the company still imports a significant portion of its inputs from other countries, including from its home country (India) and countries as far as Brazil, Morocco and the United States. Therefore, it can be argued that one should not only look at the export revenue of DNPL, but at net exports by subtracting imports by exports. Although the export data is available for eight years' period between 2004/05 and 2011/12, data on the use of imported raw materials are available only for five years' period between 2004/05 and 2008/09. Based on available data, we calculate net exports, which are presented in Figure 7 as well as net export as a percentage of total exports. It is observed from the figure that the net export was satisfactory when it was 70 percent in 2004/05, but has significantly reduced (to 58 percent) in 2008/09 suggesting that the dependence on imported inputs has increased.

Figure 7: Exports, imports, net exports (INR million) and net export as % of total exports



Source: Annual reports, DNPL (2005–2010).

However, the figures on net exports do not tally with the claim of the company that the indigenization has been growing in the company, which is also shown in Figure 7 above. One plausible explanation for this is that company has become equally active in the domestic market. However, a detailed investigation is required to fully understand this discrepancy. This could be one of the reasons some to argue that the company could have done much more to ensure domestic value addition (Pro Public 2007).

5.5 Sustainability

DNPL has had own share of problems – first due to armed insurgency that gripped the entire nation in the decade starting from 1996, then from labour strikes after 2006 following the establishment of peace carried out by unruly trade unions, which work according to the instruction of their mother political parties. However, the company does not seem to be perturbed by such events and, if the indication of the former Country Director is anything to go by, the company is here for a long haul and is claimed to follow a different approach to what "fly-by-night" investors would do (Ganguly 2008). Therefore, a commitment for continuity itself is an indicator of sustainability – of its operation, employment, use of local resources and making contribution to other aspects of Nepalese economy.

The company in uniquely positioned to ensure environmental sustainability as well not least because the parent company itself considers environment and nature as the lifeline of its business. "With a portfolio of Ayurveda and nature-based products, **conservation of nature & natural resources is deep rooted in our organizational DNA**, and in every aspect of our ever-growing business" reads the first paragraph of the sustainability Report of the company posted on its website (emphasis in original).[47] It has made contribution towards environmental sustainability on two distinct but interrelated areas.

First, its contribution towards sustainable use of biological resources is reflected in its approach of preventing extinction of such resources which can be caused due to uncontrolled harvesting in the wild. One might argue that this is in the self-interest of the DNPL because it would be cheaper and fresher to use local inputs rather than importing them from distant places such as North Africa, North America or South America and that the company depends so much in the sustainability of the natural environment for its survival and growth. However, it should also be understood that importing inputs readily available at internationally competitive prices would be much easier than taking pain to manage greenhouse projects and coordinate its activities with several local government offices and farmers' cooperatives and thousands of farmers.

The path towards sustainability attained by DNPL started with its pioneering idea of domesticating the wild plants, engaging farmers in the cultivation of herbal and medicinal plants by providing them with saplings and buying back the final harvest and establishment of Medicinal Plants Project focusing on mountain region of the country. Under this project the company has also established satellite nursery centres at various high altitude regions like Marpha, Manang and Jumla. Where plantations of different medicinal herbs like Taxus, Akarkara and Chiraito are being done (DIL 2012: 30).

[47]http://www.dabur.com/About%20Dabur-Vision (accessed 30 September 2012).

Another important scientific landmark is the establishment of the Greenhouse Project in Banepa, 30 km east of Kathmandu, designed to produce saplings of medicinal plants under controlled environmental conditions, where the entire environment is controlled by automatic computer systems that can constantly monitor any changes within the greenhouse. Operated under DNPL's "Plants for Life" project, this greenhouse maintains the highly critical environmental parameters required for the survival of such plants. The company is also developing and supplying quality saplings of more than 20 herbs, of which eight are endangered (*ibid.*). At the same time, the company has also initiated a programme to promote herbal gardens in schools, in collaboration with International Centre for Integrated Mountain Development (ICIMOD). The idea behind this initiative is to engage school children in making herbal garden in their schools so that they can get first hand information about various plants and their usage (DNPL 2012:1-2).

Secondly, in keeping with its policy of providing sustainable source of energy for its activities, DNPL has commissioned a new 'gassifier' project to save energycosts in steam generation by using rice husk as fuel. Set up with an investment of close to INR 15 million, according to the company "this project involves modification of the existing boiler to permit dual fuel firing (furnace oil and gas) and installation of the 'gassifier' unit, piping and storage area for rice husk. This initiative – put in place in view of the rising fuel costs and the recent fuel crisis in Nepal – has already reduced the furnace oil consumption for steam generation by 50%"(DIL 2012:31). Buoyed by the success of this initiative, the company is now moving towards setting up an effluent waste treatment unit and a second gassifier (*ibid.*).

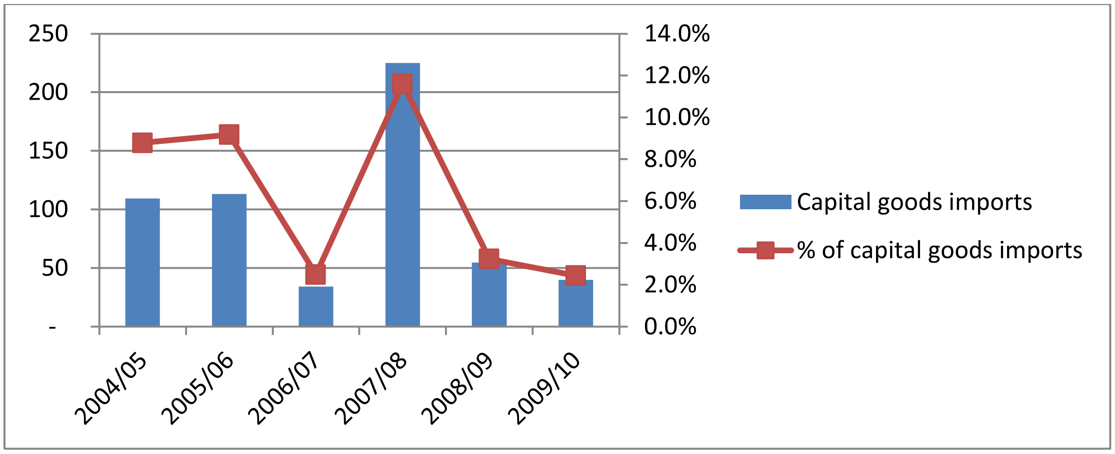
5.6 Technology

Since there is no clear cut methodology to measure the generation, acquisition, transfer and application of technology for enhancing productivity, we need to make use of various approaches to analyse this component of DNPL's contribution to the Nepalese economy. Therefore, we make use of various quantitative as well as qualitative criteria such as import of capital goods, research and development (R&D) expenditure and technological development for this aspect.

Figure 8 provides data on the imports of capital goods made by the company over the six years' period between 2004/05 and 2009/10 for which data is available, which suggests that the import of capital goods have been erratic with the same reaching its peak in 2007/08 when it was 12 percent. Following this there has been a massive decline. Although there is no clear benchmark available, to the best of our knowledge, to determine optimal import of capital goods for an agro-processing industry like DNPL, an average of 6.3 percent with the lowest figures reaching 2.4 percent in certain years may not be considered sufficient. This is because, even at the macro level, Nepal's average import of capital goods during these six years' period was 12.3 percent.[48]

[48] See Pandey, Adhikari and Sijapati (2012) for further details.

Figure 8: Imports of capital goods (INR million) and % of capital goods as total import



Similarly, the company's credential on making R&D is not very impressive. During the review period, the annual reports of year 2009 and 2010 are the only two reports which have made explicit disclosure of Technology Absorption and R&D. During both the years, the DNPL has reported "nil" or "not applicable" for specific areas in which R&D carried by the company, benefits derived from R&D, future plan of action, expenditure on R&D capital, and total R&D expenditure as a percentage of total turnover (DNLP 2009, 2010).

However, DNPL seems to have made considerable efforts towards modernization of its factory, which can be gleaned from its annual reports as well as Form B of Annexure 3 of the reports. This seems to be a regulatory requirement introduced by the Government of India. It appears that according to the form, the company is required to report on technology upgradation in every annual report. While it has included such reporting in the annual reports between 2006 and 2010, it has not done so in other years.

The company has separately reported major technological developments under the rubric modernization/development. As reported in 2005, the company installed a new packing line for packing 1 litre and 330 ml fruit juices in a new flex pack (DNPL 2005), while in 2006, as the report indicates, the company introduced new pack of herbal toothpaste and invested in automation of the toothpaste manufacturing plant, which contributed to increased packing capacity (DNPL 2006). Similarly, certain energy-related technological upgradation was highlighted in its 2007 report (DNPL 2007), and installing juice and glucose filling plants as well as introducing new blending line and packing facilities, according to its annual report for 2008 (DNPL 2008). In 2009, the company has reported modest achievement in upgradation of laboratory equipment (DNPL 2009), whereas the gassifire plant, discussed above, which was installed for better operational efficiency and reduced cost of boiler operation as well as enhanced environmental sustainability was highlighted as a major technological development in the 2010 report (DNPL 2010). Finally, both the 2011 as well as 2012 annual reports emphasized that the company invested in capital modernization and expansion projects (DNPL 2011, 2012).

5.7 Corporate citizenship

Despite some good initiatives taken by the company to discharge its obligations as a good corporate citizen, particularly its positive contributions in several areas as highlighted above, the company has failed to live upto the expectations of some of the stakeholders on a number of counts. These stakeholders are government, shareholders and customers.

In the past eight-year period, the company declared interim dividend of 40 per cent in March 2005, and refrained from declaring any dividend between the respective financial year end of 2006 and 2008 "in view of future business plans under considerations". During the financial year ending 2009 to 2012, the company did not declare any dividend on account of "low profit for the year". On the one hand not declaring any dividend is good in the sense that plowing back of profits in the company make the company stronger, and a multinational company like DNPL reinvesting in the country rather than repatriating profit should be seen in a positive light. On the other hand, not declaring the dividend on the ground of "low profit for the year", particularly from 2009 onwards is something difficult to comprehend. The company is the market leader on FMCG as well as one of the largest exporters of the country and it is witnessing a healthy growth in its turnover. It has been granted several fiscal incentives by the government including duty exemptions. Despite all this, the company failing to earn adequate profit and being able to declare dividend remains something of a mystery.

Although it is difficult to find an industry benchmark for the profit as well as dividend, its competitor Unilever Nepal Ltd. (UNL), which has only achieved close to 2/3rd turnover compared to DNPL has proposed 680 percent dividend for the fiscal year 2011/12. This has been made possible because the company earned a net profit of NPR 735 million during the year.[49] While there is a difference between the public limited company such as UNL and private limited company such as DNPL in terms of disclosure requirement as well as transparency, the reluctance of DNPL staff even in disclosing the sales figures, which can be downloaded from its parent company's website and such a positive aspect as the employment provided by the company gives reasons to suspect why the company is trying to maintain opacity. The shareholders of the company, after all, are not making investment with philanthropic motive. Under normal circumstances, being unable to receive any dividend, not even equivalent to the opportunity costs of their capital, in the past seven years on one pretext or the other should led to agitation against the company or its management, but that is not happening. The reason for their silence is not fully known, but this is something that requires a further investigation.

[49] See Himalayan Times (2012).

Another corporate responsibility is to comply with the existing laws and regulations of the country in which the company operates. However, a study done by Pro Public (2007:15) seems to suggest the company has not done enough to comply with these legal norms. The following text from the report is worth noting:

a) According to the Company, after the termination of the agreement to collect 800 metric tonnes of Loth Salla (*Taxus baccata)* leaves annually, it has been fulfilling the need of such leaves through plantation in its nursery. Such a huge quantity of leaves being provided by the plantation is questionable. Besides, there are allegations that the Company has been collecting the leaves from forests in other districts, whereas there is no agreement that allows DNPL to carry out such activity.

b) The Company has a leasehold arrangement with the government authority in Mustang District. But due to the inaccessibility of the agreement, whether the Company has been complying with the terms and conditions set out in the agreement is unknown.

c) Saplings of Kutaki (*Piccorrhiza kurroa)* were found in Banepa Nursery. However, the source from where DNPL had accessed it initially could not be known. Even the source from where the Company had accessed Loth Salla for plantation in its nursery was not disclosed.

The above text does not establish that the company is flouting the laws and rules of the country, but does raise some concerns, which need to be further investigated before reaching any conclusion.

A third issue relates to the protection of consumers' interests, in which DNPL has allegedly been less careful than what is expected of such a company of international repute, although the company denies the charges. First, it was alleged that the Real juice – a popular brand of the company – was adulterated as some inedible substances were found in the juice packet. Second, controversy even brewed over the issue of the company reportedly post-dating some of the juice packets before dispatching them to the market prompting the Commission for Investigation of Abuse of Authority (CIAA) – the anti corruption watchdog of the country – to raid its factory.[50]

Conclusion

We have seen that the FDI has a major role to play in the development of any given country, although it is not the cure all. The growing significance of trade and investment nexus as exemplified by the East Asian countries, provide a testimony to the strength of the linkage that any developing country in general and LDCs in particular would be inclined to accept without much reservation. This has given rise to the growth of efficiency-seeking investment, although resource-seeking investments, particularly agricultural ones, would continue to carve out a niche for themselves.

[50] See Business Standard (2010)

The paper shows Nepal is the worst performer in South Asia (and one of the worst ones in the world) in terms of attracting FDI. This is despite the fact that the country has achieved impressive growth both in terms of FDI commitment (represented by approval) as well as FDI inflow (represented by actual investment made) in particular after the end of the armed insurgency in 2005/06. It then argues that due to confluence of factors including unfavourable political climate, trade union activism, lack of policy instability and competition from other relatively favourable destinations for FDI means that Nepal is unable to attract much FDI into the country. This is despite the fact that Nepal has unique comparative advantage on the production of certain goods and services, it enjoys one of the most favourable market access conditions in the world and it has, of late, made some valiant strides in terms of policy initiatives to attract FDIs.

The paper then discusses the rationale for promoting agriculture-related sector, in particular agriculture sector in Nepal despite the limited role played by it in terms of helping the country achieve structural transformation. It then makes a plea that given the development spin off that the agricultural sector offers and the role it would play in helping a country like Nepal achieve its avowed objective of inclusive growth, the development of agricultural sector be kept at the centre stage of policy discourse. This is more so in the context of the fact that Nepal possesses comparative advantage as well as investment potentials in several agricultural sectors and offers unique topography suited to the production and export of select agricultural products – some in raw forms while others in processed forms. The paper also shows that it is the agricultural sector that has the highest employment intensity of all.

This is followed by a general discussion around the salience of Indian investment for the country like Nepal as well a brief investigation relating to the reason for Indian FDI to occupy a lion's share of overall FDI flow in the country. It then finds out that agriculture represents the least preferred sector in the eyes of Indian investors representing a measly 1.26 percent of the total FDI proposed by the Indian investors and only 7 out of 501 FDIs registered with the Department of Industry being categorized under agricultural sector. Although there is some discrepancy in reporting in the sense that some of the purely agricultural sectors are not included in this classification, the fact remains that Indian investment in agricultural sector is the lowest.

The paper then delves into the issue of Indian investment in Nepal's agro-processing sector taking DNPL as the case study. In the context of the empirical evidence pointing that benefit of FDIs to the society as well as economy of the host country is at best ambiguous, the papers groundsits micro analysis on the following factors: a) employment opportunity; b) export revenue; c) government's revenue; d) linkage with local economy; e) sustainability; f) technology; g) corporate citizenship, to find out the contribution made by the company in the socio-economic and environmental spheres. It was found that the company has provided reasonably good employment opportunities (upto 2,000 direct and 20,000 indirect), generated almost close to 5 percent of the total merchandize export revenue for the country, established close linkage with the local economy as well as helped in environmental sustainability. However, the company has not made significant contribution to the national treasury and has made very limited contribution in the area of technological advancement despite the significant potentials in both the areas. Finally, going by the available information, it was found that company has, at least in part, failed to live upto the expectation of some of the key stakeholders – in particular the government, shareholders and consumers – and there is a lot that the company could do to establish itself as a good corporate citizen.

It must be admitted, that, on the balance, positive contribution of the company outweighs the negative, and with some improvement in the modality of operation coupled with commitment to technological development and efforts towards enhancing transparency of operation, the company could prove to be a highly useful business venture for the country. The final question then is what needs to be done to replicate this model in any other South Asian countries?

Based on the discussions made above, it needs to be emphasized that there is no need to replicate this type of industry elsewhere in the region due to two main reasons. First, in the context of growing regional integration, it would be better to promote specialization by each country on select sectors and Nepal is well-positioned to host a company like DNPL not least because of its topography, climatic conditions, proximity with the vast Indian market and a deeper level of integration between the two neighbouring countries. Second, the wealth of knowledge and experience gained by DNPL in Nepal could be utilized to further strengthen the presence of the company in the country rather than starting anew in any other country.

That being said, this type of model is worth replicating in other countries in the region as long as the host country offers the kind of attributes that Nepal has been able to offer to DNPL. For example, there is a potential for Indian investors to invest in leather processing industry in Bangladesh in which the latter has comparative advantage.[51] However, taking a cue from DNPL and building on other positive aspects, any such investment should take the issues of technological development, contributions to government revenue and maintaining an image of good corporate citizenship seriously so as to make maximum positive contributions towards the socio-economic and environmental spheres of the host nation.

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[51] See Raihan, Adhikari and Adhikari (2007) for further details.

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