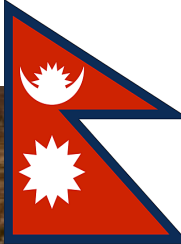
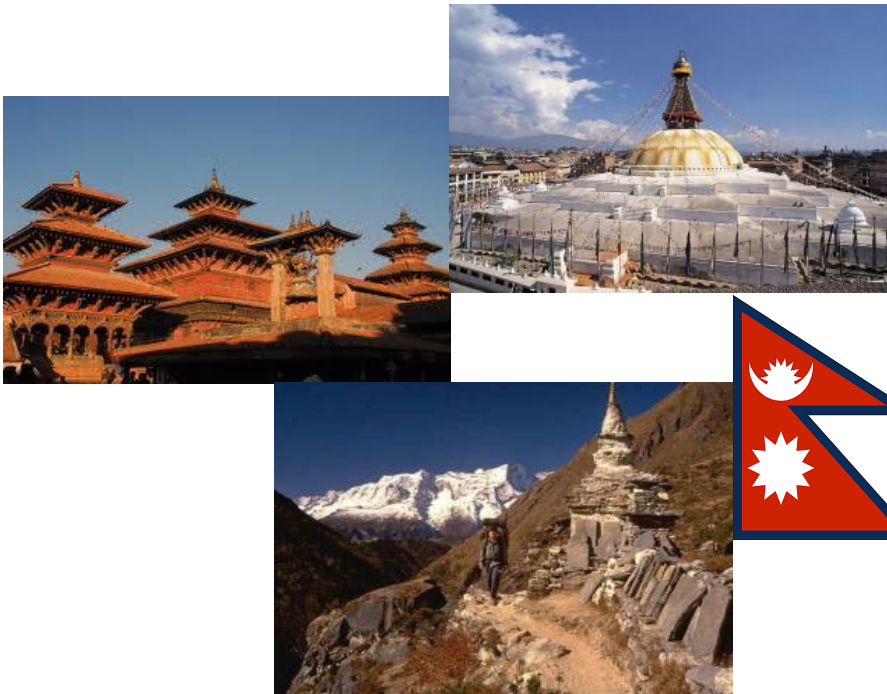


Tourism Cluster in Nepal

Microeconomics of Competitiveness



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Executive Summary

As a poor developing nation¹ that emerged from a decade of Maoist insurgency, Nepal faces a set of social, economic and political challenges and opportunities. Its national business environment has suffered from difficult internal geography, regional isolation, closed economy, and political instability. We recommend that Nepal focus on trade, infrastructure and governance to boost its over-all economy. The tourism cluster, although small, presents a more positive potential than other clusters in contributing to Nepal's growth. The natural endowments and cultural heritage of Nepal provide a solid foundation for tourism cluster's development. We argue that a vicious cycle plagues this cluster. Specifically, poor marketing has led to inability to capture higher-value demand. This low-value demand has limited the incentives for new investments in infrastructure, discouraging innovation and adoption of best practices. Nepal's government, industry and institutions for collaboration must break the vicious cycle to enable tourism in Nepal to become more competitive and to emerge as a leading cluster driving Nepal's over-all economy.

¹ Nepal ranks 152 out of 168 in terms of GDP per capita, according to World Bank 2009 data

I Nepal Country Analysis

1. Country Background

Nepal borders India in the South and China in the North. 29.4 million Nepalis live in a country, which is the size of the US State Arkansas. Socially, the country is diverse with 103 castes and ethnic groups and 92 living languages. It is also youthful, considering that 50% of its population are below 21 years. Economically, Nepal has GDP of \$7.3 billion and GDP/capital of \$254. Agriculture, which comprises 1/3 of the GDP, employs 2/3 of the population. The growth rate is 3.5% and quarter of its population is below the poverty line of \$2/day.

Politically, the country has maintained a unitary and centralized structure for the last six decades until it became a federal republic in May 2008. In Nepal's multiparty system, Nepali Congress, Nepal Communist Party – United Marxist Leninist, Nepal Community Party – Maoists and Madhesi Jana Adhikhar Forum are the four largest parties in the current Constituent Assembly. The new constitution to be promulgated in May 2011 will outline the new federal and decentralized structure, paying particular attention to the striking social and economic variance.

2. Overall Economic Performance

2.1 Balance Sheet

Nepal's set of assets and liabilities points to numerous economic and political challenges. On the assets side, the nation is endowed with breath-taking landscapes –mountains, lakes, and national parks. In fact, eight of world's ten tallest mountains in the world, including Mt. Everest, are in Nepal. At the same time, Nepal has world's second largest water resources after Brazil, opening tremendous possibilities for hydroelectricity. Similarly, the cultural heritage of Nepal is

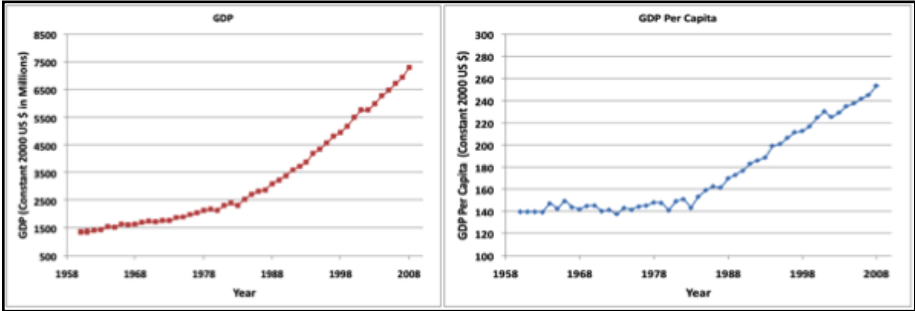
distinguished – Lord Buddha was born in Nepal; the country has never been colonized and maintains its rich traditions; some even cite Kathmandu, with a wide collection of Hindu temples, as a walking museum.

On the other hand, the country lists in the bottom 20% in the world in UN’s human development indices. Education was illegal in the country until 1951, when the century-long autocratic regime fell and the first public high school was established. After short-lived democracy in the late 1950s, monarchy was in place for the next four decades. In 1991, democracy was reinstated and Nepal liberalized its economic policies along with India. The ensuing growth, however, did not benefit the economically marginalized; a Maoist insurgency advocating for decentralization and equality began in 1996. A peace treaty was finally signed between the major political parties in 2006. In 2008, Nepal became the world youngest federal republic. However, socio-economic inequalities still remains the central issue in uniting the nation.

While Nepal’s mountains distinguish Nepal in terms of its natural beauty, they also create a difficult terrain in the country, making exchange of ideas and resources difficult. At the same time, the nation is land-locked with limited access to India’s seaports.

2.2 Poverty Level

Figure 1. Prosperity Level in Nepal



Nepal’s citizens remain the poorest in the South Asia region. As depicted in Figure 1, the early 1980s marked

a growth in the economy; this resulted primarily from growth of the private sector and FDIs; in addition, local governance was strengthened in the country².

Table 1. Comparison of Nepal's Economy in South Asia

2008 Indicators	Nepal	Bangladesh	Bhutan	South Asia
GDP/capita (constant 2000 US\$)	254	462	1247	673
GDP (constant 2000 US \$ million)	7,304	73,939	856	148,600
Growth rate (%)	5.4	6.2	13.8	5.6
National Inflation Average	11	9	8	-

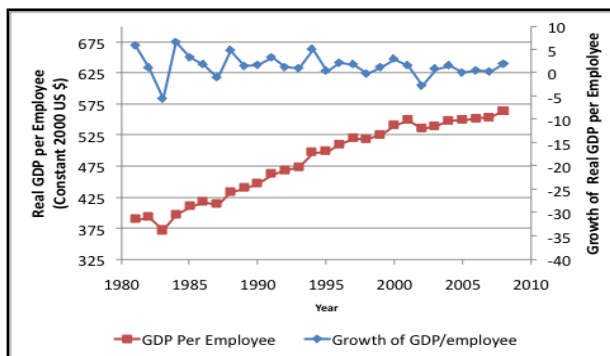
However, today, as seen from Table 1, the GDP per capita of Nepal is about half that of the next

poorest country, Bangladesh, one fourth that of a country with similar mountainous terrains, Bhutan, and the lowest in South Asia³. In understanding such low levels of economic prosperity, we probed four intermediate indicators – labor productivity, inequality, trade and FDI.

2.3 Labor Productivity

Nepal's labor productivity is remarkably low, as shown in Figure 2, and about one-third that of South Asia². The growth rate of labor productivity in the last decade has hovered around 0-2%. Low levels of education and technology in Nepal can help in understanding such poor performance.

Figure 2. Labor Productivity in Nepal



2.3.1 Education

The public expenditure on education in Nepal is severely lacking. While the 3.8% of GDP that is

² World Bank Development Indicators 2008

³ Tradingeconomics.com

spent on education, only 0.9% of the population is enrolled. In addition, total public expenditure on tertiary education is merely 0.4% of GDP. Most of the universities and colleges are lacking in administrative and faculty capacity⁴. In several of the 567 colleges, most professors have only Bachelors or Masters degree.

2.3.2 Technology

Table 2. Technological Penetration in Nepal

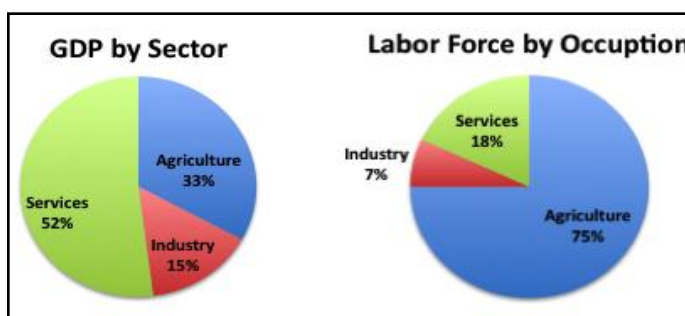
ICT Technology Indicator	Value
Fixed Broadband (users per 100)	0.03
Internet (users per 100)	1.73
Mobile Cell phone subscription (per 100)	14.58
Telephone Lines (per 100)	2.79

As shown in Table 2, the penetration of Information and Communications Technology (ICT) in Nepal is low. Only 2 out of 100 and 3 out of 100 Nepalis have access to Internet and telephone lines respectively⁵. Technology availability is concentrated in the urban areas. In the last two years, blackouts for as long as 18 hours per day severely limited any activity in the country. Also, Nepal’s difficult geography makes ICT pervasiveness difficult.

2.4 Economic inequality

While agriculture comprises 1/3 of Nepal’s GDP, 2/3 of the population is occupied in this sector (Figure 3). As a result, an average agricultural

Figure 3. Nepal’s Economy by Sector and Occupation



worker earns about 1/5 that of those in services or industrial sectors. In the last two decades inequality has risen remarkably. The top 10% of the citizens held 20.1% of income in 1985 and

⁴ Bhuban Bajracharya, “Study of Education Sector Financing in Nepal,” Final Report of the DANIDA Basic and Primary Education Program II, March 2003

⁵ www.tradingeconomics.com

in 2004, the number increased to 37.7%⁶. The Gini coefficient also increased from 38 in 1996 to 47% in 2004. Such high inequality and the ensuing socio-economic marginalization of the poor have resulted in the decade-long Maoist insurgency and political instability in the country.

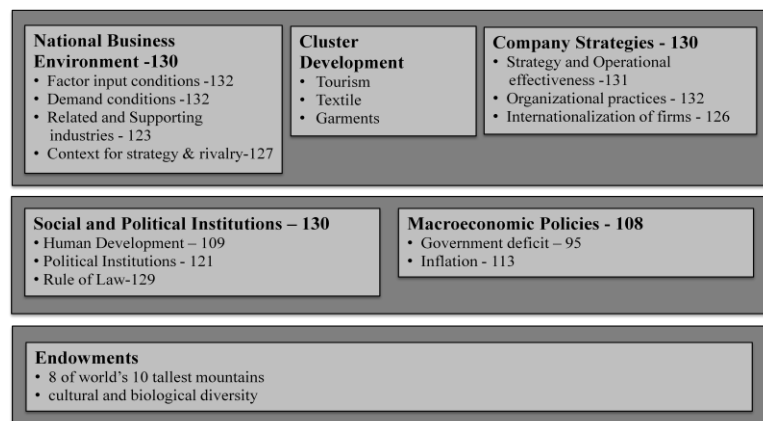
2.5 Trade and FDI

In 1997, FDI peaked due to liberalization policies. During the same period, the net trade was also highest. However, since the Maoist insurgency in 1996, FDI and trade balance have declined severely. Political instability and lack of rule of law has discouraged industrialists and investors since the rate of returns were low and uncertain.

2.6 Nepal's Competitiveness

Given the low performance in various development areas, not surprisingly, Nepal ranked 114 out of 139 in the global competitiveness index. In fact, as depicted in Figure 4, in each of the three layers and sub-categories within them, Nepal ranks poorly⁷.

Figure 4. Global Competitiveness of Nepal in MOC Framework



3. National Business Environment

This section will first examine the national business environment of Nepal using the diamond model, which provides a framework to examine the four key factors that determine competitiveness of a nation's business environment. Based on the analysis, the underlying

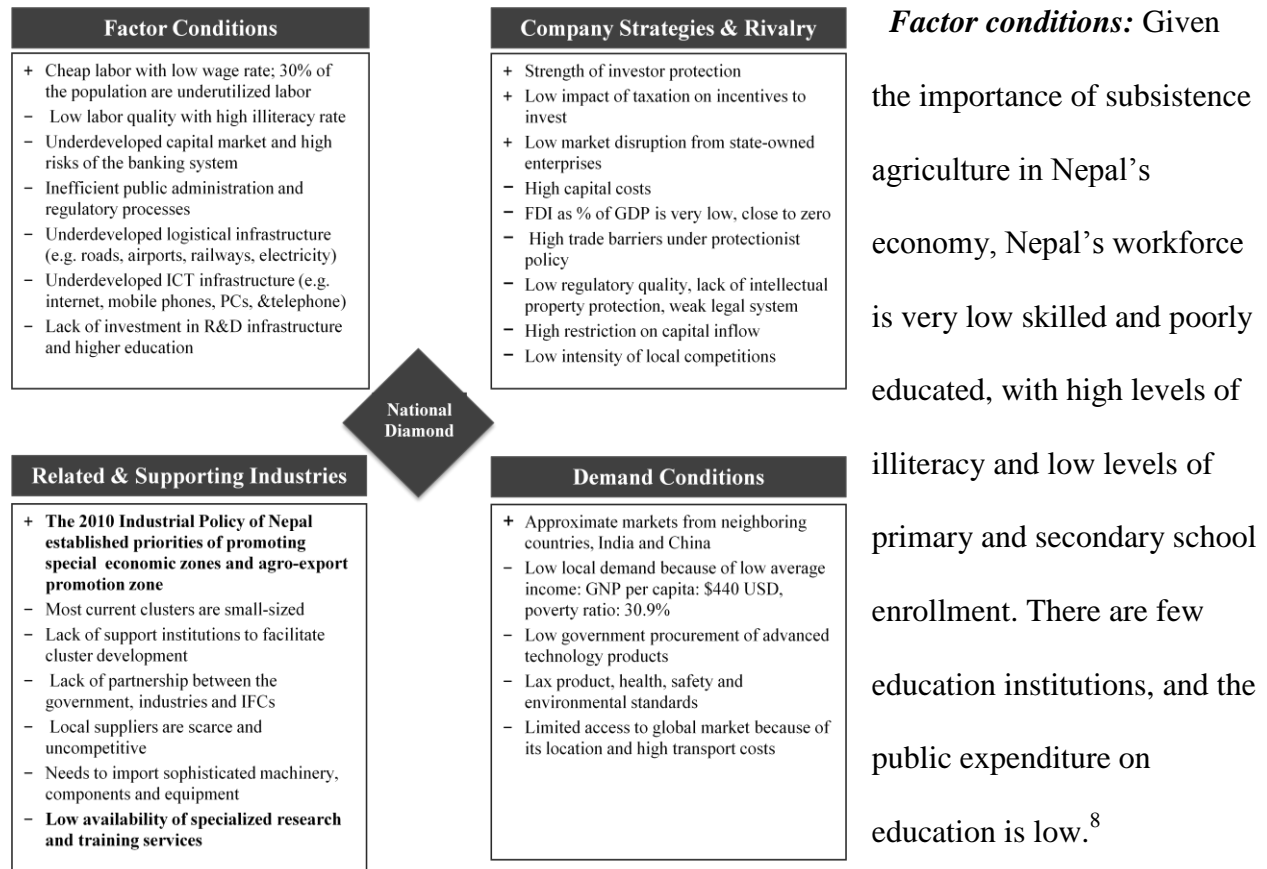
⁶ United Nations Development Program, 1976-2004

⁷ International Cluster Competitiveness Project. Institute for Strategy and Competitiveness.

reasons that constraint Nepal’s business environment will be explored. Finally, specific policy recommendations will be provided on improving the national business environment.

3.1 National diamond analysis

Figure 5. Analysis of National Business Environment



Government spending on research and technology is small, limiting the capacity of technology improvement and innovation. Infrastructures like roads and airways are highly undeveloped in Nepal, with less than half of the population having road access and the distribution of current road networks highly unequal. Also, Nepal has the lowest number of telephone subscriber in South Asia. Access to energy is limited, with approximately 27% of the private sector value lost due to electricity outages.⁹ Capital is hard to access because of liquidity constraints and lack of

⁸ World Bank Development Indicators 2010

⁹ World Bank Development Indicators 2010

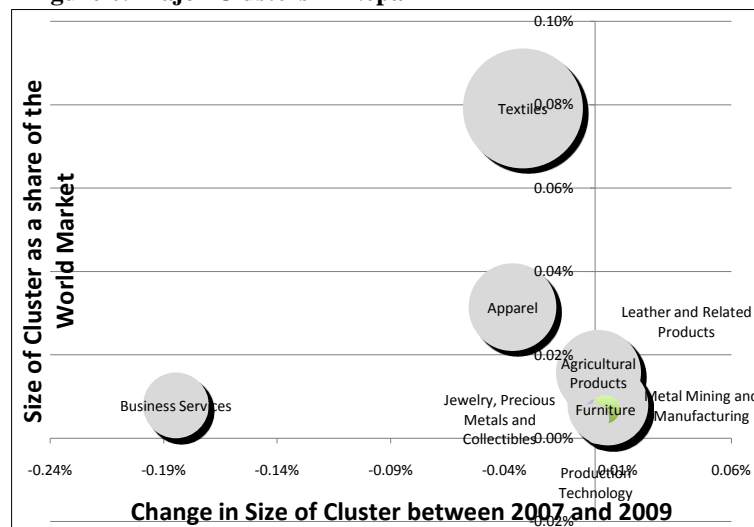
sophistication in Nepal’s capital markets. The banking system carries high credit and liquidity risks, creating vulnerabilities of Nepal’s financial system.¹⁰

Demand conditions: Lack of sophisticated domestic demand has constrained the development of Nepal’s domestic market, resulting in slow growth in productivity and innovation. The national income level is low and poverty is prevalent, which has led to limited purchasing power of the population. The GNI per capita of Nepal is only \$1,180 USD (based on purchasing power parity) in 2009 and the poverty ratio is as high as 30.9%, with both indicators among the worst both at the world and regional levels.¹¹ Government procurement is constrained by limited revenues.¹²

Related and supporting

industries: Currently, cluster development in Nepal is very preliminary. Most clusters of Nepal are small-sized and none of them is competitive in the world market. The top three

Figure 6. Major Clusters in Nepal



largest clusters are textile, apparel and agricultural products, with the textile cluster accounting for 0.08% of the world market.¹³ Due to the financial crisis of 2008, most of the clusters have been shrinking, especially the business services cluster. Specifically, tourism cluster, one of Nepal’s most promising areas for foreign exchange income, only takes an ignorable share in the

¹⁰ Nepal: Selected Issues. International Monetary Fund. July 2010. IMF Country Report No. 10/184

¹¹ IMF data and statistics

¹² World Bank Development Indicators 2010

¹³ International Cluster Competitiveness Project. Institute for Strategy and Competitiveness.

world market.¹⁴ Intermediate institutions like industry associations play an important role in promoting cross-sector/industry cooperation and implementing specialized research and training, but there are very few such institutions in Nepal. Partnership between the government, industries and IFCs is rare and ineffective. Local suppliers are scarce and uncompetitive, and sophisticated machinery and equipment has to be imported from abroad.

Context for strategy and rivalries: FDI as a percentage of Nepal’s GDP has come down to almost zero in recent years. Given the domestic capital constraints, this further limits investors’ access to capital and results in high capital costs.¹⁵ There are high trade barriers under the protectionist policy, and Nepal’s total trade volume have been declining in the past years.¹⁶ The administrative capacity of the government is weak, leading to low regulatory quality. The domestic legal system is weak, with ineffective intellectual property protection.¹⁷ The existence of a large number of small and medium firms has limited the intensity of local competitions.

3.2 Why is Nepal’s national business environment so unproductive?

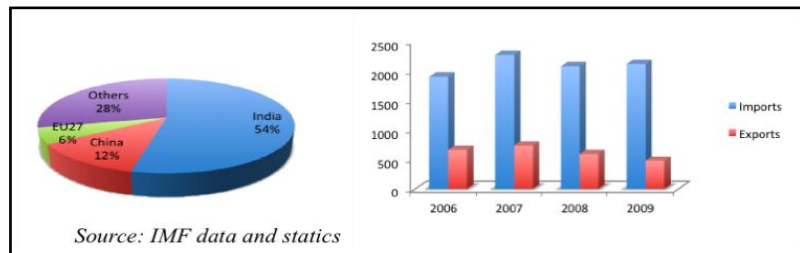
Four constraints explain the low productivity of Nepal’s business environment:

1.) Closed economy:

Nepal’s volume of trade is small and grows slowly

(Figure 7). The share of trade

Figure 7. Major Trade Partners (2009) and Volume of Trade (2006-09)



in GDP is below the regional average and average of low-income countries. In 2009, exports of

¹⁴ Based on our calculation, the total value of Nepal’s tourism cluster is equal to 0.0003% of the overall value of the world tourism market.

¹⁵ World Bank Development Indicators 2010

¹⁶ Nepal Trade Brief. The World Bank. 2009. World Trade Indicators, 2009/10.

¹⁷ The Worldwide Governance Indicators (WGI) project. The World Bank.

goods and services only accounted for 16% of the total GDP. Moreover, Nepal's exports are mainly labor-intensive manufacturing and agricultural products, and services' share in total exports has dropped greatly in recent years. However, the diversification of export base has improved largely.¹⁸ Also, Nepal's export markets are highly concentrated. India and China are Nepal's main trading partners, and together they account for about 2/3 of accounts for over 50% of Nepal's imports and exports.¹⁹ Nepal's protectionist trade policy has created high trade barriers. For example, the import-weighted tariff average is much higher than the regional level and the duty-free imports only account for less than 2% of total imports.²⁰

2). *External isolation:* Nepal's adverse geographic location has hindered its access to global market and caused high dependency on neighboring countries. According to the Human Development Report in 2002, 9 of the 11 countries with the lowest Human Development Index are landlocked.²¹ Currently, landlocked between India and China, Nepal has limited access to global market, and being far from major markets has resulted in high overland transport costs, especially for manufacturing exports. Nepal's economy is highly dependent on India and China in trade and commerce. On one side, Nepal faces very high dependency on infrastructure, political relation and stability of Nepal's sole transit neighbor, India.²² On the other hand, neighboring China in Tibet has increased transport costs to enter the Chinese market, which potentially will bring Nepal a large export market and new sources of FDI.²³

¹⁸ Nepal Trade Brief. The World Bank. 2009. World Trade Indicators, 2009/10.

¹⁹ IMF Data and Statistics. Exports and Imports (Nepal)

²⁰ Nepal Trade Brief. The World Bank. 2009. World Trade Indicators, 2009/10.

²¹ Human Development Report 2002. The United Nations Development Programme.

²² Faye, McArthur, Sachs and Snow. 2004. The Challenges Facing Landlocked Developing Countries. Journal of Human Development, Vol. 5, No 1, March 2004.

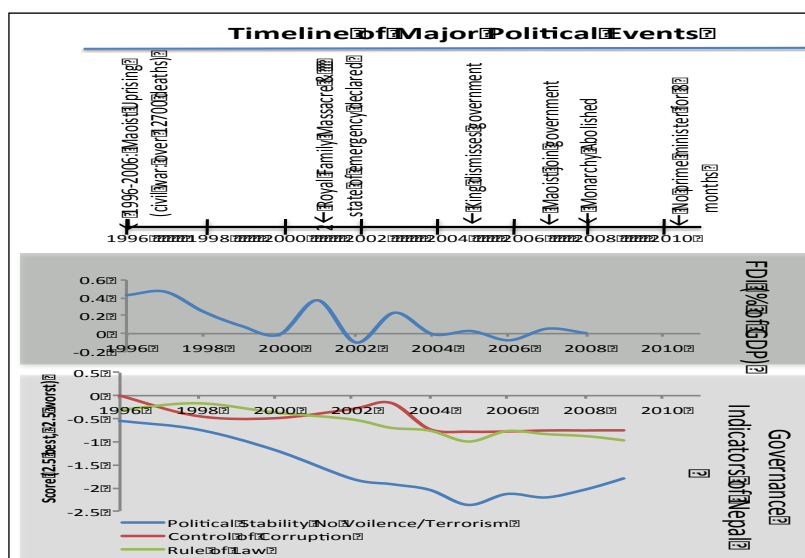
²³ With the railway connecting Lhasa and Khasa to be completed in 2013, the bottleneck of expanding trade and commerce between the two countries is expected to be removed.

3). **Difficult internal geography:** Nepal's has a challenging internal geography. Including the Himalayas, mountains and hills cover 83% of Nepal. Building roads in mountainous areas is costlier and requires a higher technology relative to building roads in flatlands. This has resulted in low levels of infrastructure. Currently only 32% of the rural Nepali population has access to road networks within a 2 km walking distance²⁴. This difficult terrain as well as the resultant lack of infrastructure makes trading, communicating and exchanging knowledge among different communities difficult. Lack of trade has resulted in subsistence farming, which usually does not benefit from specialization and economies of scale. Lack of trade and communication of products available in other parts of the country leads to low demand sophistication and low demand conditions and best practices and solutions to problems are not shared. This leads to not just inefficiencies but also lower productivity as well as inequality between regions.

4). **Political risks:** Nepal had historically been a small peaceful country. The royal family massacre in 2001 and the Maoist movement from 1996 to 2006 were two events that destabilized the country and pushed it

towards a spiral of political instability. In 2006, a peace treaty was signed legalizing the Maoist. In 2008, the monarchy was abolished and Maoist won the election of 2008. The events of the

Figure 8. Major Political Events in Nepal 1996-2010



²⁴<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/EXTSARREGTOPTRANSPORT/0,,contentMDK:20694202~pagePK:34004173~piPK:34003707~theSitePK:579598,00.html>

last decade have led to growing concerns about political risk among the foreign investors. According to the Enterprise survey²⁵, over 60% of the businesses in Nepal identifies political instability as the biggest constraint to doing business in Nepal. The FDI in Nepal, which was at low levels to begin with, slumped during the Civil war years falling to 0.007% of GDP in 2008. Nepal also ranks very low on political stability, corruption as well as rule of law (Figure 8). The weak rule of law has led to a large number of strikes in Nepal. The lack of strong judicial system to protect investors only adds to this perception of risk.

3.3 What is the role of non-private sector players in addressing these constraints?

3.3.1 Government

Significant shifts in macroeconomic policy have taken place during the past decades, but due to the lack of capacity and resources, very few policies succeeded in transforming the economy or increasing its competitive.²⁶ In the late 1980s, liberalization of the trade and industrial regime began. From 1991 to 1994, the new democratically elected government began implementing a broad set of reforms, including market-oriented growth and social sector investments. Good progress was made toward the objectives of these policies, but the subsequent political instability and upheavals slowed advancement of the reform agenda. In 1994, the incumbent government lost support and five successive coalition or minority governments slowed advancement of the reform agenda. From 2002 to 2007, the target of the Tenth Plan/Poverty Reduction Strategy was hard to meet because of macroeconomic instability. In 2008, with stability restored, the Three-Year (2008-2010) Interim Development Plan outlined government priorities, including ensuring peace, inclusive growth, reducing poverty and expanding social services.

²⁵ <http://www.enterprisesurveys.org/documents/EnterpriseSurveys/Reports/Nepal-2009.pdf>

²⁶ Nepal: Country Assistance Evaluation. 1999. The World Bank. Report No. 19850.

3.3.2 International development organizations

Multinational organizations such as the World Bank and ADB have played a big role of introducing projects in different sectors in Nepal. The World Bank has been involved in irrigation, road and telecommunication infrastructure, education, governance, access to water, trade and poverty issues. Nepal was one of the founding members of the Asian Development Bank (ADB) and has received over \$2.47 Billion of loans from the ADB. ADB has also provided around \$500 M worth of investment grants and \$138 M worth of technical assistance. Opinions are divided on the impact of foreign aid to Nepal. Though foreign aid has brought in skills, knowledge and funds to improve important sectors such as health and education, many fear that the inflow of foreign aid to Nepal has led to a high level of dependence on the foreign aid and has hindered innovation.

4. Recommendations for Nepal Country Analysis

The analysis of the macroeconomic situation and the business climate of Nepal have identified some underlying problems. Our recommendation focuses on these four underlying problems:

1). Open up markets to India and China: The low levels of trade and the challenging geographical location can both be addressed by opening up the markets: (1) Open up dialogue with India and China about free trade agreement. Ministry of Trade (MOT); (2) Reduce trade barriers and tariffs. MOT; (3) Diversify the trade portfolio between Nepal-China and Nepal-India trade. MOT; (4) Shift from Import substitution to export promotion strategy. MOT and National Planning Commission (NPC)

2). Move towards Globalization: Being a small landlocked country, Nepal has been slow to globalize. Nepal should integrate in the global economy by encouraging FDI: (1) Broaden the

outlook to countries other than India, China and other biggest trade partners; (2) Encourage collaboration, strategic trade deals, Joint Ventures, and knowledge sharing between the industries in other country and industries in Nepal. The diplomatic missions; (3) Encourage the industrial, trade and commerce group IFCs to participate in international conferences and collaborate with similar IFCs in other countries. FNCCI²⁷.

3). *Improve Infrastructure:* Improving the infrastructure, which has been a binding constraint on growth, would stimulate the national demand and allow knowledge sharing and trading: (1) Create a national plan to have a strategic road network throughout the country by expanding and improving the existing roads and building new ones where necessary. Ministry of transportation and NPC; (2) Improve ICT, Ministry of Communications, Information and Technology; (3) Improve access to electricity by installing micro hydro projects, Ministry of Energy

4). *Improve Governance:* It is difficult to eliminate the political instability. However steps can be taken to address the causes of the political instability and mitigate its effects: (1) Reorganize the police force to reduce corruption and retrained to increase the capacity; (2) Reform the judicial and legal systems; (3) Strengthen the anti-corruption agency and give authority to charge and prosecute corrupt officials; (4) Focus on improving investor protection.

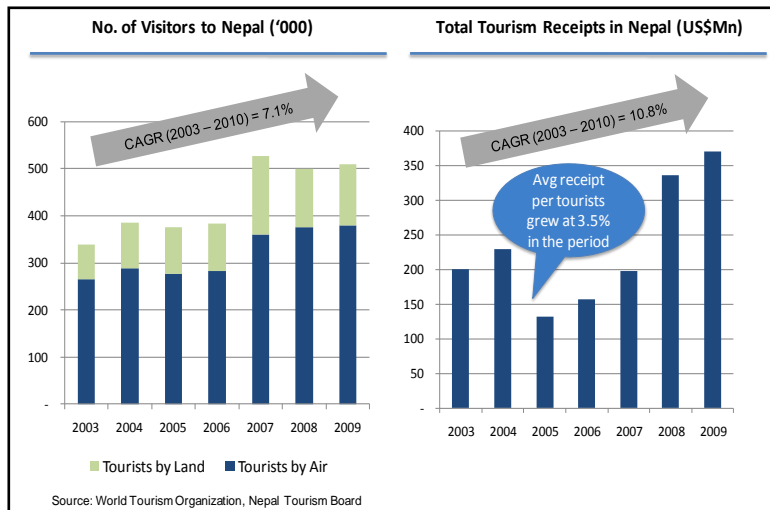
²⁷ Federation of Nepalese Chambers of Commerce and Industries.

II Nepal Tourism Cluster Analysis

1. Overview of Nepal Tourism Cluster

Nepal has very rich natural and cultural endowments for the tourism cluster. These endowments have enabled Nepal to continue to attract tourists despite its weaknesses in many dimensions. Nepal's tourism cluster has been growing both in terms of tourist number and tourism receipts in the past seven years. In 2003, the numbers of tourists arriving Nepal by land and by air were 72 thousands and 267 thousands respectively, amounting to a total of 338 thousand tourists²⁸. In 2009, the numbers of tourists arriving by land and by air were 131 thousands and 379 thousands respectively, i.e. a total of 510 thousand tourists for the year²⁹. The CAGR for tourist number between 2003 and 2009 was 7.1%. On the other hand, the total tourism receipts in Nepal have grown at a slightly higher rate, namely 10.8%. This higher growth rate has

Figure 9. Nepal Tourists Number and Receipts (2003-2009)



been driven by the rising spend per tourists, from \$592 per tourist in 2003 to \$727 per tourist in 2009. In 2009, the total tourism receipts in Nepal exceeded \$370 million³⁰. (Figure 9)

Despite the growth trend, the size of Nepal tourism cluster is

still small relative to other peer countries on an absolute scale. In terms of the total number of

²⁸ Nepal Tourism Board Statistics. World Tourism Organization Statistics.

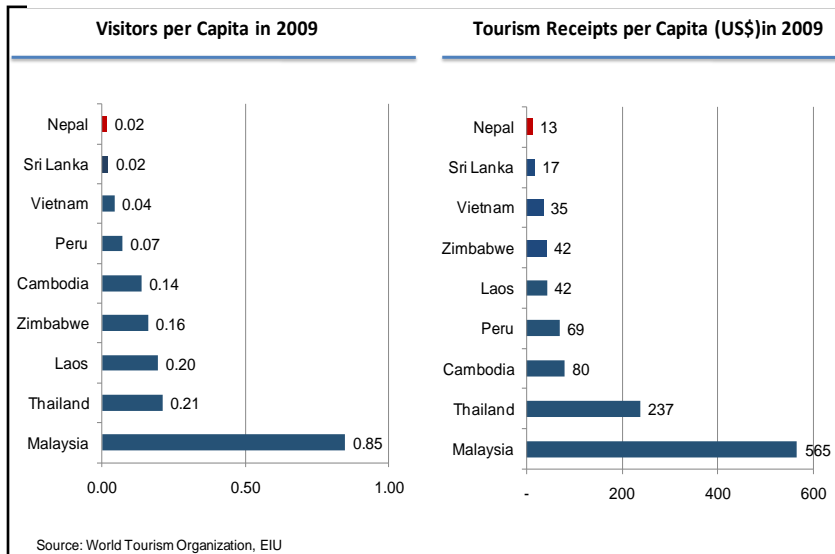
²⁹ Ibid.

³⁰ Ibid.

tourists in 2009, Nepal's number of tourists, reaching around 500 thousands, was far lower than the numbers for other Asian countries that were considered more successful in tourism (e.g. 2 million tourists for Cambodia, 3.7 million for Vietnam and 14.1 million for Thailand)³¹. Even when comparing to Zimbabwe, a landlocked and mountainous country like Nepal in Africa, Nepal's tourist number is still only a quarter of that in Zimbabwe. This same lag is also observed in terms of absolute tourism receipts. For example, Nepal's tourism receipt in 2009 was about one-third of that in Cambodia and 12% of that in Vietnam³².

Besides comparing Nepal to its peers on the absolute scale of their tourism clusters, we also compared Nepal to its peers on a relative scale by adjusting to GDP and to population of the countries. Considering tourism receipts as a percentage of GDP, Nepal is at an average level among its peers (~ 3% of GDP). This level is higher than some very successful mountain tourism countries such as Peru, on par with Vietnam, but lower than other tourism oriented peers in Asia such as 6% in Thailand.

Figure 10. Nepal Tourism Cluster vs Peers (scale to population)



Adjusting for population, Nepal is at the bottom end among its peers in terms of both tourist number and tourism receipts. The number of tourist per capita of local population is 0.02 for Nepal while the same metric for Vietnam is 0.04, for

³¹ World Tourism Organization Statistics.

³² Ibid.

Peru is 0.07 and for Thailand is 0.21. Similarly, the tourism receipts per capital for Nepal are only \$13, versus \$35 for Vietnam, \$69 for Peru and \$237 for Thailand. Hence, no matter whether we view Nepal's tourism cluster on an absolute scale or we scale it to its population, its size is still among the smallest among its peers (Figure 10). Nepal's tourism cluster is only 0.0003% of the world tourism market, so small that it cannot even be visible in the cluster map in (Error! Reference source not found.).

India ranks number 1 in terms of tourists visiting Nepal by nationality³³, then come developed countries such as Japan, UK, USA, France, and Germany. China emerges with rapid growth of tourist and is expected to move up the ranking. Purposes of visits are limited and concentrate on trekking and mountaineering. While most tourists come to Nepal for general pleasure, trekking, mountaineering and pilgrimage, most neighboring countries including India, Sri Lanka, Pakistan, and Bhutan actually provide very similar types of activities for tourists. Therefore, Nepal has not created strong differentiation against these competitors, nor has Nepal identified its special niche to provide complementary tourism offerings with its neighbors.

2. Cluster Diamond

Analyzing the strengths and weakness of Nepal's tourism cluster using Prof. Michael E. Porter's Diamond Framework (Figure 11), under Factor Conditions, Nepal has very rich natural geographic and cultural endowments. However, Nepal lags behind on basic infrastructure across the board such as transportation and accommodation. Human resources are weak with low literacy rate and poor training to cater to tourism cluster development. Capital availability is limited to support growth of the cluster. On Demand Conditions, despite steady growth of both the number of tourists and tourism receipts, and among the highest average length of stay (12

³³ Nepal Tourism Board "Nepal's Tourism Strategic Plan 2002-2009".

days)³⁴ in Asia, the tourism base is relatively small. Also tourism growth is skewed toward low-value backpackers. Limited synergy with neighboring tourist attractions is attained, and global awareness of Nepal's uniqueness is extremely low. In Context for Strategy and Rivalry, it is encouraging that government identified tourism as a national strategic development focus and it is a competitive environment with handful of players. On the other hand, these players are individual small family businesses pursuing low cost as primary value proposition. There are no global players in presence to bring out best practices, nor coordinated marketing strategy or positioning for Nepal' tourism as a whole. In Related and Supporting Industries, indigenous handicraft and agriculture cluster present potentials for selling unique merchandise and promoting ecotourism; however, dining and retail clusters are way underdeveloped to support a growing number of tourists. Meanwhile, other supporting services in Nepal such as healthcare,

Figure 11. Cluster Diamond Analysis



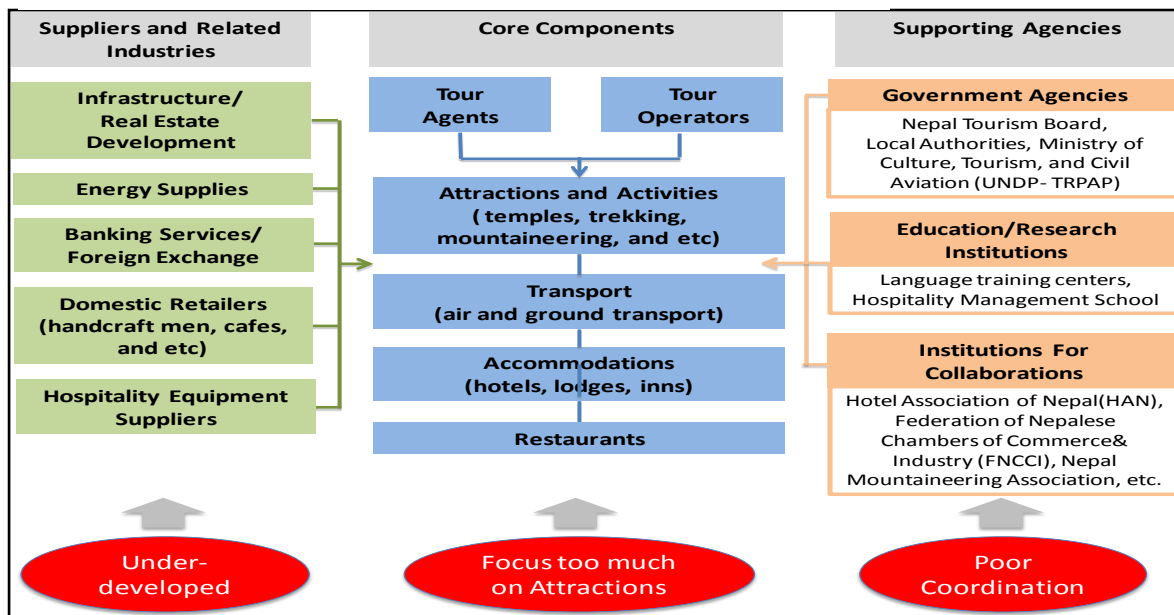
ICT, finance and etc are also far from global standards. The underdevelopment in these supporting services will add inconvenience or concerns among tourists. Overall, based on the cluster diamond analysis, although there are some bright spots in Nepal tourism clusters, e.g. good natural endowments, steady growth, dedication from

³⁴ Nepal Tourism Board statistics.

the government to develop the cluster, etc., Nepal is far below par in most of the important dimensions in the diamond. The particular areas of concern include availability of basic infrastructure, weaknesses in human capital, availability of capital, quality of incumbent players, supporting services and coordinated marketing efforts.

3. Cluster Map

Figure 12. Cluster Map



To

better understand the weak links among the players in the tourism cluster, we laid out the cluster map (Figure 12). In the map, almost all of the suppliers and related industries are too underdeveloped to sufficiently serve tourists. Supporting agencies including government bureaus and IFCs lack coordination to combine and optimize efforts and impacts. Education institutions are sparse and new with short history and little legacy. Although there have been initiatives by these agencies to upgrade Nepal’s tourism cluster, the initiatives often had only minimal impact due to poor coordination and collaboration among the agencies. Within the core components of tourism, most efforts have been oriented around attractions and activities, the strongest aspect of Nepal’s tourism. Over the years, the industry players and the government made little efforts to

upgrade other parts of the core components such as tour operators, transportation services, accommodations and restaurants. The underdevelopment of these core components has become bottlenecks and limited Nepal's ability to best leverage the advantages in attractions and activities. Furthermore, we don't see much collaboration across the chain. For example, tour agents and tour operators function separately, causing high transaction cost for tourists.

4. Vicious Cycle in Nepal Tourism

Our cluster diamond and cluster map analyses have allowed us to identify the major strengths and weaknesses of Nepal's tourism cluster. To draw further insights from the diamond framework and cluster map, we seek to understand the relationships and interdependence among the weaknesses identified for the cluster.

We believe the underdevelopment of Nepal's tourism cluster can be largely attributed to a vicious cycle that comprises four elements: 1) Poor marketing & positioning, 2) Inability to capture high-value demand, 3) Lack of incentives to support infrastructure and services, as well as 4) Poor innovation and adoption of best practices. The cycle started with poor marketing by the Nepali government, IFCs, trade associations and players. This poor marketing failed to leverage Nepal's world-class natural and cultural endowments to attract higher-end or more sophisticated tourists. The absence of such higher-end segments in turn limited the financial incentives for companies to invest in better infrastructure and tourism service offerings. Low investment level then weakened Nepal's ability to adopt innovation and best practices. These poor levels of innovation and best practices in the end constrained Nepal's options to market and differentiate itself against its global competitors.

1) Poor marketing & positioning

Historically, Nepal tourism has relied heavily on word-of-mouth of tourists as the key channel for its marketing. Based on surveys conducted by the Nepal Tourism Board, among the visitors to Nepal, 47% cited that friends and family were their most important sources of information on Nepal³⁵. The more massive media or proactive channels including advertising, TV, tour operators were only considered by 2%, 6% and 17% of the tourists respectively as their key sources of information on Nepal tourism³⁶. This result can be a potential positive as it shows that Nepal generally offers good word-of-mouth, and word-of-mouth is often the most powerful channel for viral marketing. Indeed, 96% of survey respondents are satisfied with their travel experience in Nepal³⁷. But this result also shows that imbalance does likely exist in the current marketing channel mix, and there is huge room for Nepal's government and industry players to strengthen their marketing efforts. Indeed, marketing efforts by the government and industry players have a huge advantage that word-of-mouth marketing hardly has, i.e. the ability to control and shape the message. So far, the word-of-mouth marketing has enabled Nepal to portray an image of an attractive backpacking destination to prospective tourists. But to upgrade this tourist base and bring in more tourism revenues, Nepal's government and industry players need to play a much more active role to position Nepal and deliver the country's best aspects to the global tourist community.

At the moment, the efforts of these agencies and players were plainly ineffective. For example, the Nepal Tourism Board (NTB) has actually been offering helpful content to tourists, in the sense that 84% of the tourists who visited the NTB's website found it useful. Yet, only

³⁵ Nepal Tourism Board Visitors Survey.

³⁶ Ibid.

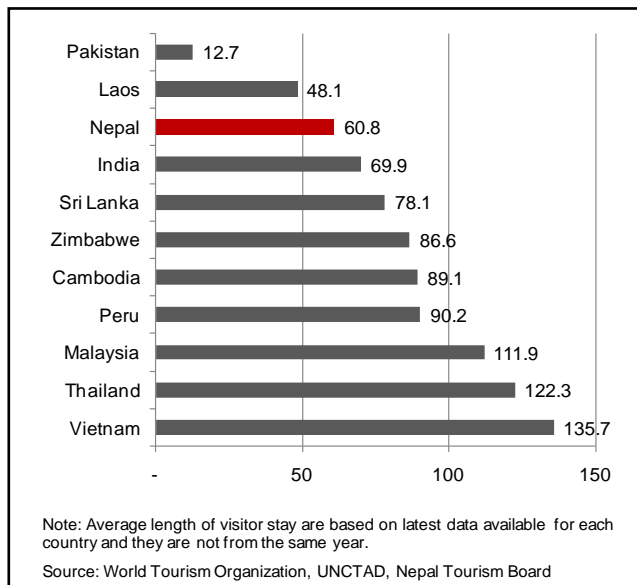
³⁷ Ibid.

11% of all visitors to Nepal had visited the NTB’s website prior to the visit³⁸. This anecdote shows that the NTB is unable to draw traffic to the quality content it provides. Similarly, 89% of visitors surveyed have never heard of NTB’s slogan for Nepal, “Once is not enough”, but 80% of the visitors believe the slogan represents Nepal well³⁹.

2) Inability to capture high-value demand

Given Nepal’s rich endowments and its high level of satisfaction among tourists, we believe Nepal’s government, IFCs and industry players have the basis to re-position and re-market Nepal for more premium demand. Some ideas for re-positioning include premium skiing, premium mountaineering, adventure travel such as mountain flight, exclusive mountain resorts, etc. However, only minimal marketing efforts have been made so far towards this end of up-selling Nepal. Although healthy growth has been seen in tourist number from Nepal’s rapidly

Figure 13 Average Spending per Visitor per Day in 2009



developing neighbors such as India and China, the growth in tourists from the more developed nations has been stalled. For example, the tourist numbers from China and India grew at 20.5% and 5.0% respectively between 2001 and 2010. Yet during the same period, tourists from the US and the UK only grew at a 1.6% and 1.0% respectively. In addition, the majority of tourists to Nepal

still remain as low-value backpackers and pilgrims. For example, 89% of the visitors find

³⁸ Nepal Tourism Board Visitor Survey.

³⁹ Ibid.

“visiting temples” as the most important activity but only 3% sees “mountain flight” as the most important activity. As you can see in the chart to the left, on average a tourist spends only \$61 per day in Nepal. This level is among the lowest among its peers, and is much lower than the \$90 per day in Peru and \$122 per day in Thailand⁴⁰. Based on some interviews, some tourists can spend less than \$50 to stay in Nepal’s hotels for a week. This example demonstrates the limited value capture from the current tourist base of Nepal (**Error! Reference source not found.**).

Of course, Nepal should try to maintain its attractiveness to these low-value tourists as these tourists provide the core of Nepal’s tourism. But we believe this maintenance of the core does not imply that premium positioning cannot be offered simultaneously. Many countries, by separating their resorts to different regions of the countries, have been able to cater to both low-end and high-end tourists. Examples include Thailand, Indonesia, Italy, etc.

3) *Lack of incentives to support infrastructure and services*

The low-value demand and hence poor value capture results in the lack of incentives for companies or even local government to invest needed infrastructure and services to support tourism. Under infrastructure category, Nepal ranked beyond 100 on every attribute except air transportation. (Figure 14) 80% of hotels in Nepal are non-star hotels and there is no international hotel chain operates in Nepal⁴¹.

Figure 14. Competitiveness Rank- Infrastructure

Nepal		India	
Air Transport Infrastructure			
Quality of air transport infrastructure	114	Quality of air transport infrastructure	86
Available seat kilometers, domestic*	62	Available seat kilometers, domestic*	8
Available seat kilometers, international*	84	Available seat kilometers, international*	16
Departures per 1,000 population*	114	Departures per 1,000 population*	109
Airport density*	61	Airport density*	130
Number of operating airlines*	74	Number of operating airlines*	16
International air transport network	112	International air transport network	47
Ground Transport Infrastructure			
Quality of railroad infrastructure	111	Quality of roads	87
Quality of port infrastructure	107	Quality of railroad infrastructure	21
Quality of ground transport network	103	Quality of port infrastructure	93
Road density*	96	Quality of ground transport network	52
		Road density*	32
Tourism Infrastructure			
Hotel rooms*	116	Hotel rooms*	123
Presence of major car rental companies*	122	Presence of major car rental companies*	1
ATMs accepting Visa cards*	116	ATMs accepting Visa cards*	99
ICT Infrastructure			
Extent of business Internet use	121	Extent of business Internet use	41
Internet users*	120	Internet users*	99
Telephone lines*	111	Telephone lines*	108
Broadband Internet subscribers*	109	Broadband Internet subscribers*	94
Mobile telephone subscribers*	130	Mobile telephone subscribers*	120

Source: World Economic Forum 2009 Travel & Tourism competitiveness Report

in

⁴⁰ World Tourism Organization. UNCTAD. Nepal Tourism Board.

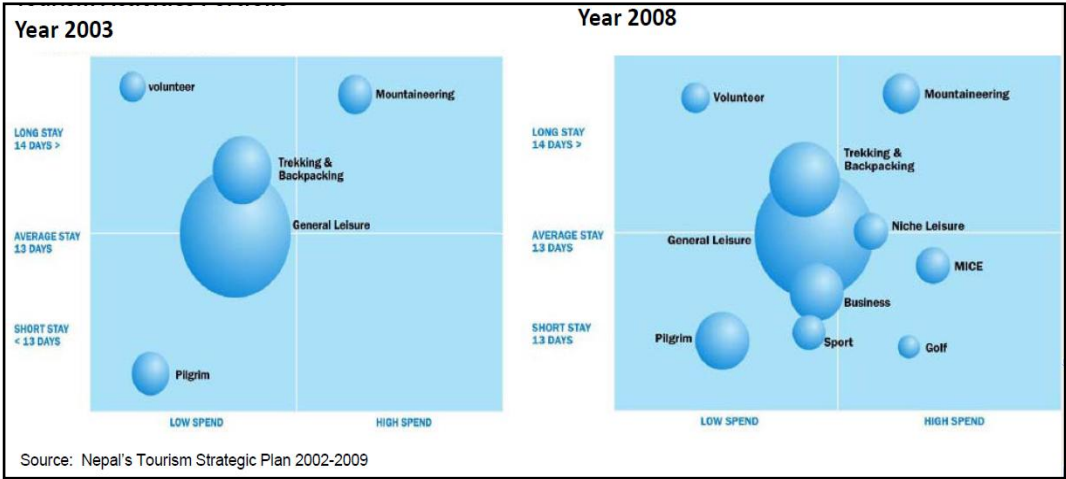
⁴¹ Nepal Tourism Sector Analysis by Asia Invest division of EuropeAid Cooperation Office.

Compared to India, where some attributes such as presence of rental companies, road density, and extent of business internet use are still competitive, Nepal is much less accessible to tourists. The insufficient infrastructure not only limits the capacity to absorb tourists but also suppresses the average receipt per tourist. Therefore, the poor basic infrastructure comes back to constrain cluster development.

4) Poor innovation and adoption of best practices

Weak innovation fails to capture high-spend and long-stay segments. In 2003, the biggest segment is general leisure, followed by trekking& backpacking and mountaineering. Four out of five segments fall in low-spend side, regardless of length of stay (Figure 15). In 2008, more segments emerged but most are small and unable to generate high receipts. The most lucrative mountaineering segment had not grown at all over the five years period. General leisure and trekking still make the largest two segments but without significant increase on spending nor length of stay. Medical tourism or eco-tourism that could leverage other related clusters in Nepal did not appear to capture high-spend and long-stay space. Overall, weak innovation and lack of adoption of best practices leave much value to be created and captured.

Figure 15. Tourism Activity Portfolio



5. Can Nepal capture part of Bhutan's tourism?

Leveraging Bhutan's tourism is actually a smart and sound strategy-position Nepal as a more affordable complementary option that offers the similar experience of Bhutan should be feasible. First of all, Bhutan⁴² government sets the policy of considering only high-end tourist arrivals and mandating daily tariff. On high season (total 9 months out of a year), tourists have to pay USD\$200 per person per night and enjoy a package covering accommodation, all meals, all travel with a licensed tour guide, all internal transport, and camping equipment for trekking tours. These high-end tourists are exactly what Nepal needs most to break the vicious cycle as discussed in previous paragraphs. Secondly, the flight from Paro³, the only international airport at Bhutan, to Kathmandu, Nepal is one of the most exciting ones as the aircraft passes over 4 of the 5 highest mountains in the world. Even though Druk Air, the Bhutan national airline, flies to other destinations including Bangkok in Thailand, Delhi, Kolkata, Bodh Gaya in India, Dacca in Bangladesh, the flight to Nepal is no doubt a distinctive must-do. Therefore, making Nepal a complementary site to extend and continue the trip and experience of Bhutan is highly attractive. Nepal will, in a sense, adopt the high-end tourists who visited Bhutan. However, how much Nepal could capitalize on these high-end tourists largely depends on how much improvement could be made on top of its existing infrastructure and services.

6. Recommendations for Nepal Tourism Cluster

The underdevelopment of Nepal tourism cluster can be largely attributed to the vicious cycle described above. Hence, we believe the most relevant recommendations for Nepal tourism cluster will be measures that can counteract each step of the vicious cycle. Below we will structure our recommendations based on how they can address each of the four step of the cycle.

⁴² Tourism Council of Bhutan <http://www.tourism.gov.bt/>

1) Improve marketing and positioning of Nepal

Recommendations to improve marketing and positioning are twofold. First, Nepal must improve the global tourism community's perceptions of the country. Because of limited global news coverage on Nepal and the Maoist insurgency in the past decade, Nepal is still associated with concerns of risks and safety. Prospective tourists generally know little about Nepal and sometimes this ignorance about the country can lead to fear and uneasiness among tourists. Second, Nepal's governments, IFCs and players in tourism need to have a clearer vision of what Nepal tourism can be and be more coordinated in their marketing efforts. As we saw from earlier analysis, Nepal has a lot to offer for tourists but it needs to better communicate all these value propositions to prospective tourists. Some specific measures that Nepal tourism cluster can consider include (owners of measures in parentheses):

- Dispel safety and risk concerns in major tourism magazines and websites (Nepal Tourism Board, Nepal Ministry of Tourism)
- Explore ways to upgrade Nepal's positioning among tourists (Nepal Tourism Board, Nepal Ministry of Tourism, Trade Associations, Leading Players in Cluster)
- Identify complementarities with tourism offerings in neighboring countries (Nepal Tourism Board, Nepal Ministry of Tourism, Trade Associations, Leading Players in Cluster)
- Align with all key stakeholders on coordinated marketing plans (Nepal Tourism Board, Nepal Ministry of Tourism, Trade Associations, Leading Players in Cluster)
- Participate in global tourism forums and conferences (Nepal Tourism Board, Nepal Ministry of Tourism, Trade Associations, Leading Players in Cluster)

- Leverage more mass-media means (e.g. TV advertising) to increase awareness of Nepal among tourists (Nepal Tourism Board, Nepal Ministry of Tourism)
- Encourage partnership among players along the tourism value chain, e.g. hotels partnering with tour operators to promote attractions (Nepal Tourism Board, Nepal Ministry of Tourism, Trade Associations, Leading Players in Cluster)

2) Serve more higher-value demand

Serving more higher-value demand requires better variety of tourism attractions that can capture values. Rather than rely on the most basic experience of natural and cultural endowments, higher-value products or services can be created to enrich the tourist experience and capture extra value through the same endowments. Some specific measures include:

- Introduce new mountain-based tourist activities that can give more unique experience to tourists while generating more revenue for the cluster. Examples include skiing, paragliding, mountain flight, premium mountain resorts, rafting, etc. (Trade associations, Leading players)
- Introduce new cultural-based tourist activities that capture extra values from pilgrims. Examples include meditation tourism, re-experiencing the Buddha's journey, etc. (Trade associations, Leading players in cluster)

3) Improve Infrastructure and Create Incentives for Continual Improvement

In utopia, the government can invest in all required infrastructure without worrying about the return on capital or payback period. Yet in reality, the key challenge in improving infrastructure is often capital constraint. Hence, the most important consideration that Nepal's government should have is to prioritize its investments. The government must know what

infrastructure leads to bottlenecks in the system. It must also distinguish between infrastructures that the government must itself invest versus infrastructures that the government can expect some private players to participate. For example, railway is more likely to require the government's direct investment whereas hotels can potentially be invested by private players.

Some specific measures include:

- Invest in transportation systems including airports, railways and roads to connect different tourist resorts in Nepal. These investments are in line with those required in Country level. (Nepal Ministry of Tourism, Nepal Government)
- Invest in ICT infrastructure to allow better connectivity between Nepal and the rest of the world. These investments are in line with those required in Country level. (Nepal Ministry of Tourism, Nepal Government)
- Develop tourism-oriented schools and curriculums to train talent for the tourism cluster (Nepal Ministry of Tourism, Nepal Government)
- Provide subsidies (e.g. land, tax breaks, etc.) or co-investments to attract foreign players to develop hotels, resorts as well as other facilities for higher-end tourism in Nepal (Nepal Ministry of Tourism, Nepal Government, Private Sector)
- Provide low-cost financing for local tourism players to grow their business (Nepal Ministry of Tourism, Nepal Government, Private Sector)

4) Introduce and adopt innovative best practices

We believe competition and information access are the keys to innovation and best practice adoption. At the moment, Nepal tourism market is already quite competitive with lots of players. Thus what is lacking is the quality of the competition, i.e. the presence of leading

players to facilitate more constructive competition (as opposed to cost competition). Some specific measures include:

- Invite world-class players in tourism to participate in Nepal's tourism cluster (Nepal Tourism Board, Nepal Ministry of Tourism)
- Organize experience-sharing workshops with leading tourism players in other countries to allow local Nepali players to learn (Nepal Tourism Board, Nepal Ministry of Tourism, Private Sector)
- Encourage partnerships along the value chain to generate new ideas and facilitate collaboration (Nepal Tourism Board, Nepal Ministry of Tourism, Private Sector)
- Encourage consolidation of some of the subscale players. Although competition is good in general, having too many mom-and-pop players are also suboptimal as they lack the efficient scale to improve their business models (Nepal Ministry of Tourism, Private Sector)

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