

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Financial system is a set of international arrangements through which financial surplus in the economy are mobilized from surplus units and transferred to the deficit units. Financial system facilitates resources, transfer and mobilizes savings to the productive sectors thereby contributing to the economic development. The financial system is the total flow of resources in the economy as made possible for active participation of the network of financial intermediaries creating the inflows and outflows of funds. A financial system is a composition of various institutions, markets, instruments, regulations and laws. Financial institutions, financial markets and financial instruments are the main components of the financial system.

1.1.1 Study of Financial Instruments

A financial instrument refers to the stock, bond, debenture and other financial assets those represent the right of the holder to receive future prospective benefits under the terms and conditions provided in the instrument(s). Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buy and sell orders that flow from investors' demand and supply preferences determine the price of securities in the security market. Since securities market is the major component of capital market it is the need of today to address the investor's preferences as to the financial assets those are transacted in such markets. This study is a small attempt towards the end.

Financial instruments are the main medium through which each of the markets discussed above deals. Securities market cannot remain aloof what kind of securities are dealt in securities market. Speaking another way, securities market and its status are determined by

the securities that are transacted in the securities market. On the other the depth and breadth of financial instruments are highly dominated by investors preferences. Due to this very reason, this study attempts to identify the factors that influence investors while making investment decision so far as the matter of investing in financial instruments is concerned. To which securities investors give more priority, what the reasons are those mainly attract the investors to invest in a particular security, why they prefer one security over other(s) etc. are the issues to be addressed here in the study. Further, this study also strives to address whether or not the Nepalese investors are compensated rightly as per the risk they bear.

1.1.2 Financial Market

Financial Market is the place where the financial instruments like share, bond and debenture are traded. “A financial market is a market for creation and exchange of financial assets if you buy or sell financial assets, you will participate in financial market in some way or other” (Prassanna, 2002:24). In other words, the financial market is a mechanism which brings together buyers and sellers of financial assets in order to facilitate trading. It facilitates the transaction of financial assets like deposits, loan, bonds, securities, stocks, cheques, bills etc. Financial market refers to all the activities of financial institutions those transact on financial assets and liabilities.

Financial markets can be divided into money markets and capital markets. Money markets are the markets for debt securities with maturities of less than one year. Money markets basically involve the trading of short securities. Money markets are sometimes classified as organized and unorganized markets. The organized or formal money markets provide and institutional mechanism for the transactions of short-term securities and commercial banks, Finance companies and other savings/credit unions are the players in the money market. Local merchants, indigenous bankers and relatives come under the informal sector or unorganized sector.

1.1.3 Capital Market

Capital market is an important part of financial market. The market in which long term financial instruments, such as equities and bonds, are raised and traded is capital market. Capital market securities include such marketable debt securities with long term financial instruments, such as equities and bonds, are raised and traded is capital market.

Capital market securities include such marketable debt securities with maturities of a year or more and equity securities. Most of associated markets come under the scope of capital market. In fact, capital market deals with longer term and relatively riskier securities. All those who needed longer-term funds depend on capital market. Likewise, business and industries issue shares and other securities to raise funds from capital market. In the context of Nepal, capital market is slowly growing as well as improving. Growth of capital market has made it possible for the public limited companies to raise the long term capital by issuing shares and other industrial bonds to the investing public. In short, capital market is playing very significant role to enhance the country's financial sector because it is more diverse than those found in money market. Capital market is further classified into stock market, Money lenders, and Local Businessmen etc.

Investors feel that the first observation is the most important observation as an action to be taken to develop present state of Nepalese security market. The observation states that to accelerate present state of the Nepalese securities market the access of the securities services, institutional capacity and services not only in capital city are the most. The security services are bounded in the capital city only and this needs to be corrected by expanding the services in outskirts too that propels all the people in the country to participate in the investment activities that may result into the more developed security market.

Next thing investors actively concerned over are amendment and strict implementation of current status of Nepalese security market. The Securities Ordinance 2005 has been enacted for the effective securities market regulations system. For the implementation of the ordinance, the necessary arrangement of legal provisions in line with international practices

and the development of fair, dynamic and credible securities market is a challenging task. Company Ordinance, 2005 has provisioned trustee for the issuance of institutional debenture. However, in the absence of regulatory mechanism for the trustee another regulatory framework, there is a need for separate Trust Act to promote joint venture investment, securities depository and other trustee work for the mobilization of financial resources from financial market. Although the ordinance on securities, 2005 has authorized Securities Exchange Board for the regulation of the securities market, it has not provided autonomy related to employee and financial activities. It is necessary for the autonomy related to employee and financial activities. It is necessary for the autonomy and capacity building of the board. It has to be immediately equipped with resources and manpower.

1.1.4 History of Nepalese Securities Market and Financial Instruments in Nepal

The history of securities market in Nepal started with the flotation of share by Biratnagar Jute Mill Limited and Nepal Bank Limited in 1937 under Company Act 1936. At that time the participation on the ownership restricted mostly to Rana family. After the introduction of the Company Act in 1964, the government issued first Government bond in 1964 and the establishment of Securities Exchange Center Ltd. In 1976 were become another significant development relating to capital markets. Securities Exchange Center was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Nepal Government, under a program initiated to reform capital markets converted Securities Exchange Center into Nepal Stock Exchange in 1993. Nepal Stock Exchange converted its open cry system into online trading system from 24th august, 2007. Investors can make transaction from brokerage firms. But, the security services are bounded in the capital city only and this needs to be corrected by expanding its service outside the Kathmandu Valley. Central Depository System (CDS) could be another important development in Nepalese stock market which was address during budget speech of fiscal year 2066/067 B.S.

Historical development of financial instrument in Nepalese Security Market can be presented as below:

Table 1.1
Historical Development of Financial Instruments in Nepal

S. No.	Instrument	Name of Company	Date of Issue	Amount (in Rs.)	Issue Manager
1	Share	Biratnagar Jute Mills	1937 AD	-	-
2	Right Share	Nepal Finance and Saving Co. Ltd.	01/12/1995	2 million	-
3	Debenture	Shreeram Sugar Mills Ltd.	20/11/1997	93 million	NCML
4	Preferred stock	Necon Air Ltd.	10/01/1994	14 million	CIT
5	Convertible preferred stock	Everest Bank	05/07/2007	40 million	CIT
6	Mutual Fund	NIDC Capital Markets Ltd	28/07/1993	100 million	NCML
7	Government Bond	-	1964	-	-

1.2 Statement of the Problem

Financial market and institutions have undergone significant changes in recent years. Technology, innovation, deregulation, competition and global financial crises have driven transformation. Changes in information and computer technologies have fostered the growth of new financial instruments and products and the development of new and creative way to hedge and manage risks in a globalize environment occurred that changes the scope, size and activities of financial institutions. The financial market plays a key role of facilitating the flow of funds from individual units to business, government and household as well. The financial institutions in relation to financial market are the key players serving the role of intermediaries to determine the flow of funds in financial system. Financial institutions and markets serve the purpose of both the savers and users of the funds. Thus, there is a growing prospectus of financial market, financial institutions and financial instruments in a developing nation like Nepal.

In context of Nepal, there is a very short history of financial institutions, financial instruments and its markets but it is slowly developing according to the needs of the economy although they are not sophisticated as in the market of the advanced countries. There is a growing awareness among the Nepalese investors regarding the financial system, financial markets and its instruments. Despite this fact, the security market is taking its ride on a slow pace is, of course, affected by the investors' awareness. In this context, it is relevant to address the investors' preferences towards the financial instruments where they invest their surplus savings. Investors are said to be the backbone of economic development. Therefore the investors should be encouraged to make investments in securities market by creating congenial investment environment and providing varieties of financial instrument.

Components of primary markets help to raise funds. They can act as facilitator as well as governing body. Wide variety of financial instruments available for investment indicates developed security markets. Study mainly focused on the development of financial instruments and components of primary markets. This study is mainly deals with following questions:

-) What is the present situation and growth pattern of financial instruments?
-) What is the growth pattern of primary market components in Nepalese securities market?
-) Which financial instruments investors prefer more?
-) What is the attitude of individual and institutional investors towards the transaction of securities?
-) Which features of common stock are more significant in influencing investor?
-) Which investment sector do investors prefer more?
-) What are the main objectives of investment in common stock?
-) What are the shortcoming of debenture and preferred stock investment in Nepalese securities market?
-) Are there significant differences among choices of different types of bonds between individual and institutional investors?

- J Which factors affects the choice of security?
- J What is the reason for preferring government securities?
- J Do investors analyze risk and return involved in a security while investing?
- J Are investors aware of general issues concerning the securities market?
- J What are the grievances of investors against concern authorities i.e. issuer company, stock exchange etc.
- J What are the necessary actions to make progress in security market?
- J Which component of primary market is playing vital role?
- J Do the numbers of mutual fund be increased?
- J Is there any prospects of new financial instruments in Nepalese Security Market ?

1.3 Objectives of the Study

The main objective of the study is to analyze the development of financial instruments and primary market components in Nepalese Securities Market. The specific objective of this study can be outlined as follows:

- J To examine the growth pattern of long term financial instruments like equity shares, debentures, preferred stocks, and government bond, etc.
- J To identify the growth trend of primary market's components in term of public issued offered, numbers of public issued company etc.
- J To examine the investors' preferences and attitudes towards the financial instruments.
- J To identify the most popular sector for investment among Nepalese investors and factors that influence investors to invest in different types of securities.
- J To assess investor's grievances against concern authorities i.e. Issuer Company, and stock exchange, etc.
- J To identify the most important component of primary markets.
- J To examine the prospects of new financial instruments in the Nepalese Security Market.

1.4 Significance of the Study

The main objective of the study is to focus on the role of financial instruments in the development of Nepalese capital market although the role of every investor will have not well knowledge about the real financial instruments. Financial sector in the economic development of nation remained controversial for same time; recent theories in finance suggest that stock markets do promote long term growth. Development of capital markets in any country requires political and economic stability and growth oriented policies as pre – condition. At the first stage instruments price rise and the investors gradually gain confidence in the capital market.

The market is dominated by individual investors and most of them are not making informed investment decision rather driven by markets rumors. Information helps investors to decide whether or not to invest in the instruments of certain company. In order to complete the role of institutional investor, adequate instruments are required. The role of institutional investor in the capital market is known to add up new instruments through collective investment schemes, play role in stabilization of the securities prices, make rational analysis of information and pressurize the issuer for the regular flow of credible information.

This research is very useful to all the parties like security businesspersons, market makers, brokers, companies and investors etc. who are directly or indirectly involved in the stock market because it provides the guidelines to the stock market and potential investors to make investment decisions. Issuer Company may also take the advantage of the study by examining the investors' psychology towards the investment in different financial instruments.

The investors are the sovereigns of security market so their needs and desires must be identified so that they can rightly be rewarded for the sacrifice from their part. Academicians, research scholars, students and policy makers may be benefited from this study as it tends to gives some practical insights that can be very useful to turn the theoretical knowledge into practical field.

1.5 Limitations of the Study

This study is subject to some constraints. Some of the unavoidable hindrances that come in this study are as follows:

-) This research is mainly based on primary data as well as secondary sources of data. However only limited components of primary market are included under secondary data analysis.
-) The reality of the study fully depends on the reliability of the collected secondary data and information collected from questionnaires survey, which are duly filled by the respondents.
-) Out of the total investors and concern authorities related to the Nepalese capital market only 112 respondents are included in this study and the respondents are only from Kathmandu valley. The sampling technique can affect the result.
-) There may be so many financial instruments only equity shares, preference shares, debentures, and government bond are considered in this study.
-) The study covers past and present state of the stock market and investors in Nepal.
-) Only selected statistical tools have been employed in this study.

1.6 Organization of the Study

The study has been divided into five chapters, each devoted to some aspects of the development of financial instruments and primary market components in Nepalese capital market. This scientific division of the study helps anyone to achieve their goals by devoting a little time. These five chapters are as follows:

Chapter I: Introduction:

This chapter includes the introductory matter which describes the background of the study, statement of problem, objective of the study, significance of the study, limitation of the study and organization of the study.

Chapter II: Review of Literature:

This chapter deals with the review of available literature. It includes conceptual framework, review of previous studies like book, reports, article journal, previous thesis etc. It helps to discover the gap between past studies and current problems.

Chapter III: Research Methodology:

This chapter incorporates the research methodology used in the study, which includes research design, population and sample, nature and sources of data collection procedure, data processing procedures and analysis and description of key variables, etc. This chapter produces an attractive way to facilitate the analysis of relevant data to achieve pre-stated objectives.

Chapter IV: Presentation and Analysis of Data:

This chapter deals with the analysis of data collected from different sources. The collected data has been analysis using various statistical tools. This chapter also includes major findings of the study. This chapter produces an attractive way to facilitate the analysis of relevant data to achieve pre-stated objectives.

Chapter V: Summary, Conclusion and Recommendation:

This chapter includes summary, conclusion and recommendations or suggestions for further improvement.

Bibliography and appendixes have been included at the end of the study.

CHAPTER – II

REVIEW OF LITERATURE

Review of literature means reviewing past research studies or other relevant proposition in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. It is an integral and mandatory process in research works. The main reason for the full review of research in the past is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas for developing a research design. There are significant importances of review of literature:

-) To identify the problem,
-) To determined the methodology for research work,
-) To draw the scope of studies,
-) To avoid unintentional replication of previous studies, and
-) To interpret the significance of researcher's results in a precise manner.

This chapter is related to examine and review of some related books, articles, published and unpublished different business journals, bulletins, magazines, articles, newspapers, websites and major findings of previous studies of the relevant fields are included in precise manner.

This chapter has been divided into the following parts:

- a. Conceptual framework.
- b. Review of related studies:
 -) Review of thesis
 -) Review of articles and journals
- c. Research gap.

2.1 Conceptual Framework

2.1.1 Financial Instruments

Securities means shares, stock, debenture etc. issued by a corporate body or a certificate relating to unit saving scheme or group saving scheme issued by any corporate body in

accordance with the prevailing laws or negotiable certificate of deposit or treasury bill issued by Government and it includes the securities issued under full guarantee of the Government or securities as prescribed by government by a notification publishes in the Nepal Gazette or receipts relating to deposits of securities as well as rights and interest relating to securities.

Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buy and sell orders that flow from investor's demand and supply preferences determine the price of securities in deficit and surplus units of society. The common stock, preferred stock, debentures and government securities are mainly used in terms of securities in Nepal. The preferred stock and debentures are not commonly used in Nepal. Basically the common stocks are traded through NEPSE. Government securities are also important securities, which are issued by government through Nepal Rastra Bank. The major financial instruments in Nepal are:

- A. Common Stock
- B. Debt:
 -) Debenture
 -) Subordinate debenture
 -) Mortgage bonds
 -) Income bonds
- C. Floating Rate Notes
- D. Equipment Trust Certificates
- E. Equity-Linked Debt
- F. Preferred Stock
- G. Government Securities:
 -) Treasury bills
 -) Development bonds
 -) National Saving bonds
 -) Citizen Saving Certificate

J Special bonds

A. Common stock

Common stock represents an ownership position in firm. The holders of common stock are the owner of the firm, have the voting power that among other things elects the board of directors, and have a right to claim the earnings of the firm after all expenses and obligation have been paid; but they also run the risk of receiving nothing if earning are insufficient to cover the obligations.

Common stockholders hope to receive a return based on two sources dividends and capital gains. Dividends are received only if the company earns sufficient money and the board of directors deems it proper to declare dividends. Capital gain arises from advancement in the market price of the common stock, which is generally associated with a growth in per share earnings because earnings often grow smoothly over time. Common stock has no maturity date at which a fixed value will be realized.

The common stockholders of a corporation are its residual owners; their claim to income and assets comes after creditors and preferred stockholder have been paid in full. As a result, stockholder's return on investment is less certain than the return to a lender or to a preferred stockholder is not bounded on the upside as are returns to the others (Prasanna, 1994:24).

When a company needs capital for expansion, it sells shares to the public. Most companies issue million numbers of shares so each share represents only a tiny piece of company. These shares are also transferable (Fisher, 2002: 2).

Advantages of common stock can be summarized as follows:

-) Common stock provides ownership of the firm.
-) It provides control power
-) Purchase of common stock gives the following rights to stockholders:
 -) Voting right
 -) Participation in general meeting

-) Right getting information
-) Electing as a board of director
-) Participation in the profit and loss of the company
-) Transferring shares
-) Proxy representation

The disadvantages of holding common stock are as follows:

-) It is more risky than other securities
-) The rights may not be exercised in his/her best interest as individual investor represents very small proportion of total shares.
-) As an owner of firm, investor of common stock should bear legal responsibility,
-) On liquidation, holders of common stock are last in the priority of claims. Therefore, the portion of capital they contribute provides a cushion for creditors, if losses occur on dissolution.

B. Debt

Debt instrument can be bought or sold between two parties and has basic terms defined, such as notional amount (amount borrowed), interest rate and maturity/renewal date. The holders of a company's long-term debt, of course, are creditors. Generally, they cannot exercise to control over the company and do not have a voice in management. If any condition mentioned in debts contract, then these holders may be able to exert some influence on the direction of the company. Holders of long-term debt do not participate in the residual earnings of the company; instead, their return is fixed. The debt instrument has a specific maturity, whereas a share of common or preferred stock does not in liquidation, the claim of debt holder is before that of preferred and common stockholders. Depending on the nature of the debt instrument, however, there may be difference in the claim among the various creditors of a company (Vane Horne, 2000:211).

Debenture

The term debenture usually applies to the unsecured bonds of a corporation. Investor looks to the earning power of the corporation because these general credit bonds are not secured by specific property. In the event of liquidation; the holder becomes a general creditor. Although the bonds are unsecured, debenture holders are protected by the restrictions imposed in the indenture, particularly the negative pledge clause, which precludes the corporation from pledging its assets to other creditors (Vane Horne, 2000:513).

Subordinate debentures

Subordinated debentures represent debt that ranks behind debt senior to these debentures with respect to the claim on assets. At the time of liquidation, subordinated debenture holders usually receive settlement only but all senior creditors are paid the full amount owed by them. These holders still would rank a head of preferred stockholders in the event of liquidation. The existence of subordinated debentures may work to the advantage of senior holders, because senior holders are able to assume the claims of the subordinate debenture holders (Vane Horne, 2000: 513)

Mortgage Bonds

A mortgage bond issue is separated by a lien on specific assets of the corporation-usually fixed assets. The specific property securing the bonds is described in detail in the mortgage, which is the legal document giving the bondholder a lien on the property. As with other secure lending arrangements, the market value of the collateral shows the market value of the bond issue by a reasonable margin of safety (Vane Horne, 2000: 513).

Income Bonds

Income bonds provide that interest must be paid only when the earnings of the firms are sufficient to meet the interest obligations. The principal, however, must be paid at the due date. Thus the interest itself is not a fixed charge. Income bonds, historically, have been issued because a firm has been in financial difficulties and its history suggests that it may be

unable to meet a substantial level of fixed charges in the future. More generally, however, income bonds simply provide flexibility to the firm in the event that earnings do not cover the amount of interest that would otherwise have to be paid. Income bonds are like preferred stock in that the firm will not be default if current payments on the obligations are not made. They have an additional advantage over preferred stock that the interest is a deductible expense for corporate income tax computations, while the dividends on preferred stock are not.

The main characteristic and distinct advantage of the income bond is that interest is payable only if the company achieves earnings. Since earnings calculations are subject to differing interpretations, the indenture if the income bonds carefully define income and expenses. If it did not, litigation might result. Some income bonds are cumulative indefinitely (if interest is not paid, it accumulates, and it must be paid at some future date); others are cumulative for the first three to five years, after which they become non-cumulative.

Income bonds usually contain sinking fund provisions to provide for their retirement. Generally, sinking funds holders receive payment range between $\frac{1}{2}$ and 1 percent of the face amount of the original issue annually. Because the sinking fund payment requirements are typically contingent on earnings, a fixed cash drain on the company is avoided. Typically, income bondholders do not have voting rights when the bonds are issued. Sometimes, bondholders are given the right to elect some specified number of directors if interest is not paid for a certain number of years (Weston and Copeland, 1990:967).

C) Floating-Rate Notes

When inflation forces interest rates to high levels, borrowers are reluctant to commit themselves to long-term debt. Yield curves are typically inverted at such times, with short-term interest rates than long-term. One factor is that borrowers would rather pay a premium for short-term funds then lock themselves into high long-term rates for two or three decades.

Two risks are faced by those who defer long-term borrowing in hope that interest rates will soon fall. First, there is no assurance that rates will not rise even higher and remain unexpectedly high levels for an indefinite period. If long-term rates rise to 15 percent, for example, debt that looked expensive at 123 percent will seem like a bargain to a borrower who passed it up in the hope of waiting out the rates of crisis. Second, the short-term money may simply become unavailable.

D. Equipment Trust Certificates

Although equipment trusts financing is a form of lease financing. The certificates themselves represent an intermediate to long-term fixed income investment. This method of financing is used by railroads to finance the acquisition of rolling stock (Vane Horne, 2000: 514).

E. Equity-Linked Debt

Sometimes the investors in the debt instruments of a company are given an option on common stock. With debt warrants, the debt holder has an option to purchase the common stock of the company and he or she continues to hold the instrument more attractive. A convertible bond is one that may be exchanged, at the option of the holder, into a certain numbers of shares of common stock of the corporation. The number of shares into which bond is convertible, is specified in the bond indenture, and these shares remain un-issued until actual conversion (Vane Horne, 2000: 514).

Purchasing of debt provides the followings advantages and disadvantages to debt holders:

From the viewpoint of long-term debt holders, debt is less risky than preferred or common stock, has limited advantages in regard to income, and is weak in regard to control. To elaborate:

-) In the area of risk, debt is favorable (relative to preferred pr common stock) because it gives the holder priority both in earnings and in liquidation. Debt also has a definite maturity and is protected by the covenants of the indenture.

- J In the area of income, the bondholder has a fixed return, except in the case of income bonds or floating rate notes. Interest payments are not contingent on the company's level of earnings or current market rates of interest. However, debt does not participate in any superior earnings of the company, and gains are limited in magnitude. Bondholders actually suffer during inflationary periods. A 20-year, 6-percent bond pays \$ 60 of interest each year. Under inflation, the purchasing power of this \$60 is eroded, causing a loss in real value to the bondholder. Frequently, long term debt is callable. If bonds are called, the investor receives their invested funds.
- J In the area of control, the bondholder usually does not have the right to vote. However, if the bonds go into default, then bondholders, in effect, take control of the company (Weston and Copeland, 1992: 969).

F. Preferred Stock

Preferred stocks have fixed dividend and right of acquiring principal before common stock at the time of liquidation. "Preferred Stock is said to be a "Hybrid" security because it has features of both common stock and bonds. Preferred stocks are preferred with respect to assets and dividends. In the event of liquidation, preferred stockholders have a claim on available assets before the common-stockholders. Furthermore, preferred stockholders get their stated dividend before common stockholders can receive and dividends (Vane Horne, 2000: 515).

Preferred stock provides the following advantages to the investor (Weston and Copeland, 1992:969).

It provides reasonably steady income.

Preferred stockholders have a preference over common stockholders in liquidation; numerous examples can be cited where the preference position of holders of preferred stock saved them from losses incurred by holders of common stock. Many corporations (for example, insurance companies) like to hold preferred stock as investment because 70 or 80 percent of the dividends received on these shares is not taxable.

Preferred stock also has some disadvantages to investors:

-) Although the holders of preferred stock bear a substantial portion of ownership risk, their returns are limited.
-) Price fluctuations in preferred stock may be greater than those in bonds; yields on bonds are sometimes higher than those on preferred stock.
-) The stockholders have no legally enforceable right to dividends.
-) Accrued dividends are seldom settled in cash comparable to the amount of the obligation that has been incurred.

G. Government Securities

Government issues various types of securities to fulfill and undertake the development works under the deficit budget and raises scattered funds from public. These securities are assumed to be less risky as compared with external debt. Government issues securities internally and externally, the main source of internal debt is government bonds. In case of Nepal, NRB has been actively issuing various government securities. It is one of the most important issuance of the government to maintain the deficit budgetary system of Nepal. The Government Securities, which are issued by NRB, are described in brief below.

Treasury Bills

It is the short-term government bond. It is issued to fulfill deficit budgetary system in Nepal. It normally matures in 91 days while some securities mature in 365 days. It is issued to collect scattered funds and to mobilize it in productive sector and conduct fiscal and monetary policies. It is issued on the basis of auction so that any individuals and institutions can invest in Treasury Bills.

Development Bonds

NRB has been issuing development bonds in Nepal. It is a long-term government bond. It has normally five years maturity period. The security holders can use it as collateral if they need money immediately. Institutional and individual investors purchase it. It has fixed and

minimum interest percentage. The securities holders normally obtains 90 percent amount of total value if they keeps them on collateral. The income from these bonds is taxable.

National Saving Bonds

It is a long –term government bond. It has normally 5 years maturity period. Individuals, organization and financial institution purchase this bond expect commercial banks. In this bond, interest is paid semi-annual basis. It can be purchased as a promissory note. Principal is refunded after its maturity period. It has fixed interest rate, which can be sold easily from one person to another in the market. It can be used as collateral as in the case of Development Bonds.

Citizen saving certificate

It is also a long-term government bond. It has normally 5 years maturity period. It has fixed interest rate which is paid semi-annual basis. It cannot be used as collateral. Individual and institutional purchase can buy this bond. It is a taxable bond.

Special Bonds

This type of bond is issued on special occasions when government falls short of funds. The government can issue special bonds to those parties to whom government has to make payment. The holder can use it as collateral.

2.1.2 Financial Markets

Financial markets provide a forum in which suppliers of loans and investment can transact business directly. The loans and investment of institution are made without the direct knowledge of the suppliers of fund (savers), suppliers in the financial markets know where their funds are being lent or invested. The two key financial markets are the money market and the capital market. Transaction in short- term debt instruments or marketable securities take place in the money market. Long-term securities (bond and stocks) are traded in the capital market (Gitman, 1988:30).

All securities, whether in the money or capital markets, are initially issued in the primary market. This is the only market in which the company or government is directly involved in the transaction and receives direct benefit from the issue—that is, the company actually receives the proceeds from the sale of securities. Once the securities begin to trade among individual, business, government or financial institution savers and investors, they become part of the secondary market. The primary market is where new securities are sold. The secondary market can be viewed as a “used” or “pre-owned” securities market. (Securities Board)

2.1.3 The Money Market vs. Capital Market

Money market is that type of market where securities with maturity period less than one year are traded and created. Capital market is that type of market where long-term securities are traded and created.

2.1.3.1 Money Market

The money market is created by a financial relationship between suppliers and demand market of short-term funds, which have maturities of one year or less. The money market is not an actual organization housed in some certain location, such as a stock market, although the majority of money market transactions are made in marketable securities, which are short-term debt instruments, such as treasury bills, commercial paper, and negotiable certificates of deposit issued by government, business, and financial institutions respectively.

The money market exists because certain individuals, businesses, government, and financial institutions have temporarily idle funds that they wish to place in some type of liquid asset or short-term, interest-earning instrument. At the same time, other individuals, businesses, governments, and financial institutions find themselves in need of seasonal or temporary financing. The money market thus brings together these suppliers and demand markets of short-term liquid funds.

Relative market capitalization and the number of listed companies can measure stock market size. The market capitalization ratio is determined by dividing the value of all shares listed on a national exchange by the host country's gross domestic product (World Bank, 1995).

2.1.3.2 Capital Market

Capital market refers to the links between lenders and borrowers of funds, arranging of funds-transfer process to seek each other's benefit. Lenders and borrowers come together in the capital market. Capital market play effective financial intermediary role to activate both primary and secondary market through the use of various long term capital market instruments like common stock, bonds, preferred stock, convertible issues and many more like that. The participants in the capital market are small business, large business, and government. Funds flowing into the capital market are available by lenders for terms longer than those flowing in the money market.

Capital market consists of the various suppliers and users of long term finance. As it is differentiated from the money market which embraces short-term finance. The capital market serves as a link between suppliers and users of finance. It is a mechanism for the mobilization of public savings and channeling them in productive investment. In this way, an important constituent of the capital market is the securities market. It has a wide term embracing the buyers and the sellers of securities and all those agencies and institutions which assist the sale and resale of corporate securities (Gupta, 1978:88).

The capital market is a financial relationship created by a number of institutions and arrangements that allows the suppliers and demanders of long term funds-funds with maturities of more than one year-to make transactions. Included among long-term funds are securities issue of business and government. The backbone of the capital market is formed by the various securities exchanges that provide a forum for debt and equity transactions. The

smooth functioning of the capital market, which is enhanced through the activities of investment bankers, is important to the long-run growth of business (Gitman, 1988:170).

Some organizations and individuals have more money than they currently need, and are thus, often described as lenders. Others need many more than they have and are required to borrow from others, and are thus called as borrowers. It would be reasonable to suppose that surplus units and deficit units would be aware of each other's existence and that the surplus unit would be willing to allow the deficit unit to use their surplus to their mutual advantages. To protect the interests of both, an exchange would take place with somewhat understanding. Such an exchange may be called direct external finance and internal finance. The indirect external finance involves a third unit, usually called financial intermediary that accepts money from surplus units and release to deficit units. The other type of finance is that where the financing is carried out within the same economic unit. Capital market includes:

-) Activities relating to the organization, distribution and trading of securities
-) Organization which facilitates this activities
-) Individuals and institutions which buy and sell securities and
-) Rules, regulations, customs and practices that control the organization and conduct business in the market.

2.1.4 Primary Market vs. Secondary Market

The capital market may be studied under two headings i.e. Primary Market and Secondary Market.

2.1.4.1 Primary Market

The Primary market is concerned with the floatation of shares and distribution of shares to the general public. It consists of companies issuing securities to the buyer of new securities and various intermediaries that help in the disposal of new securities. Issue managers, underwriters, stock brokers, stock exchange etc. are the important constituents of the new issue market. Stock exchange provides facilities of trading in listed securities. It is the market

where various securities are brought and sold for investment or speculative purpose. So that is concerns with the sale of new issued securities in the market. But it is one of the most integral parts of the new issue market and the change of one certainly affects the others.

Primary markets are absolutely vital to capitalistic economics if they are to function properly, since they serve to channel funds from savers to borrowers. Furthermore, they provide an important locative function by channeling the funds to those who can make the best use, the most productive. In fact, the primary function of a capital market is to allocate resources optimally. A security market with the lowest possible prices for transactions services.

There are three ways in which a company may raise capital in the primary market.

I. Public Issue-

This involves sale of securities to the public. It is by the most important mode of issuing securities.

II. Right Issue-

This is a method of raising further funds from existing shareholders by offering additional securities to them on a preemptive basis. It involves the offer of additional shares to existing shareholders. These are offered in proportion of existing shareholdings. Each existing shareholder receives one right for each share owned. The right states the terms of the option to purchase new shares, specifying the number of shares required to purchase each new share, the subscription price for new share, and the expiry date of the option.

III. Private Placement

It involves selling securities privately to a single investor or to a small group of investors. In the United States private offerings are made under an exemption from SEC registration. Section 4(2) of the Securities Act of 1933 allows the unregistered sale of securities by an issue so long as it is not a public offering. In general, the provisions set forth in Section 4 (2) require that private placements be sold to a limited number of sophisticated investors who are buying for investment purposes.

These right issue and private placement are primary issue but these are not public issue.

2.1.4.2 Secondary Market

The secondary capital market deals with those securities that are already issued in an initial public offering in the primary market. Typically, the secondary markets are those where previously issued securities are purchased and sold.

In the secondary capital market, the securities are generally sold by and transferred from one investor to another. Hence, the secondary capital market needs to be highly liquid in nature. A high transparency for the secondary market trading is also required. With the advancement of the technology, the trading concept in secondary market has changed substantially. In the earlier days, the investors needed to meet at fixed place in order to carry out the transactions. But now trading in secondary capital market has become much easier for the investors.

2.1.4.3 Relationship between Primary & Secondary market

The primary market and the secondary market have a symbiotic relationship. While the primary market creates long term securities, the secondary market provides liquidity through marketability of those institutions.

Fresh capital issues are influenced by the level and trend in stock prices at the time of issue. Actually, new activity in the primary market adds depth to the secondary market by enlarging the supply of instruments for trading and investment in the secondary market. Stock prices in turners are influenced by the large size and bunching of new issues. Besides, primary and secondary market is indispensable ingredients of the capital market and is the basis to meet the financial requirements of corporate bodies.

2.1.5 Historical Background of Nepalese Primary Market

There is no longer historical development period of capital market in Nepal. The vanshavalies and chronicles have very little to say regarding how government of that time look on the relationship between economic development and capital market. The political negligence and

fundamental economic domination could be responsible for having no historical base for the growth of capital market.

During the Rana regime, this is said to be most dark ages in the history of Nepal, the irresponsible habit of promoting self-interest in disregard to larger interest of the society as a whole created total bankruptcy in nation's financial resources. The ideas of promoting investment, technological innovation and industrial development were not given priorities. As a result of the exploitative mentality, the capital markets were not developed.

During the Rana regime no effort was made for change or development. They had a closed economy. Thus, through there was some development it was not due to the will of the rulers but only because of the time. But during the period of Juddha Samsher, an idea to develop capital market in the interest of Rana family was managed through a part of potential Indian investors. Company act was promulgated and numbers of public limited companies were formed under the sole monopoly of Rana family. Anyhow capital market got signals of development under the permit of Ranas share concentration investment policy. At the same time, Tejarath was found to facilitate loans to government employees. After a war, number of industries collapsed one after another in such a way that there was a serious set back on the growth of capital markets. Some new hopes came under the new era of elected government but it was soon put into dustbin through political changes of inefficiency.

Afterwards, the Panchayat government came to further economic development by various slogans of people's participation, regionalism, basic needs, industrial development, trade promotion, resource mobilization etc. There were so many proposals to develop capital market. But Securities Marketing Center was found only during 1970 AD to start the capital market development. Immediately after that, Securities Exchange Act was passed by Rastriya Panchayat to facilitate securities transactions. The name of the center has been changed to Securities Exchange Center.

For the first time in 1937 AD Nepal Bank Ltd as a commercial bank was established by the initiative of Udyog Parishad. The main objective of this institution was to raise habit of savings and turns these into investment. It has been helping a lot in promoting of industries and commercial development of the country. Later on another commercial bank named Rastriya Banijya Bank was established in 1964 AD. After the adoption of liberalized economy in the country these financial institutions are responsible for mobilizing the public deposits to business enterprises by offering attractive interest rates and by providing better and reliable services to the depositors.

In the context of the development of capital market, Nepal Industrial Development Corporation (NIDC) has also played a vital role. This corporation was established in 1961 AD. The main objective was to develop industries in modern way to provide necessary financial and technical help, to provide loan, and facilities to the industrialization in the private sector. Since its establishment, the fixed capital needs of the companies have been met by NIDC and provides up to 85 percent of the fixed capital needs of industrial organization. Besides granting direct long-term loans it also participates in the issue equity shares of industrial enterprises, and gives guarantees on industrial loan provided by commercial banks. The immense activities done by NIDC can be great to help foster the capital market in Nepal. One thing essential for the rapid growth of capital market is to persuade business firms to convert themselves into public limited companies. Companies requiring large amount of funds should be asked to raise at least a part of their financial needs by issuing shares in the market.

The commercial fact faced by the economy is the lack of public confidence in enterprises. The confidence of investors in business can be enhanced if NIDC and commercial banks & other financial institutions underwrite the shares issued by public companies.

Employee's Provident Fund, which was established in 1962 AD, also cannot be neglected since it has contributed a lot in the growth of capital market. It has been mobilizing the

employee's savings to commercial banks, from where the funds find their way to business enterprises investment in the government's development bond and at the same time providing loan to various corporations are some other activities undertaken.

Securities Exchange Center (SEC) was established in 1976 AD, to promote the public savings and to mobilize capital funds for industrial investments. In a real sense, the establishment of this center has made possible the development of capital market in Nepal because prior to this there was no special institution in Nepal dealing with securities. This center managed to issue public shares and debentures of 23 corporate bodies for raising about Rs. 500 million from Public.

Securities Exchange Center has issued the Shares of the following companies (NEPSE, pp.16-17).

Table 2.1**List of Companies of Public Issue Offered by SEC**

S. No.	Name of Company	Issue Subscription
1.	Rastriya Beema Sansthan	Under Subscribed
2.	Nepal Battery Co. Ltd	Over Subscribed
3.	Nepal Arab Bank Ltd	Over Subscribed
4.	Nepal Byapar Co. (Narayani) Ltd.	Under Subscribed
5.	Nepal Lube Oil Ltd	Over Subscribed
6.	Nepal Industrial Development Corporation	Under Subscribed
7.	Himal Cement Company	Under Subscribed
8.	Nepal Indosuez Bank Ltd.	Over Subscribed
9.	Nepal Grindlays Bank Ltd	Over Subscribed
10.	Bottlers Nepal Ltd.	Over Subscribed
11.	Nepal United Company Ltd.	Under Subscribed
12.	Indreni Soyabean Udyog Ltd	Under Subscribed
13.	Nepal Life & General Insurance Company	Over Subscribed
14.	Bottlers Nepal (Tarai) Ltd.	Over Subscribed
15.	Butwal Spinning Mills Pvt. Ltd.	Under Subscribed
16.	Nepal Metal Company Ltd.	Under Subscribed
17.	Seti Cigarette Factory Ltd.	Over Subscribed
18.	Gorakhkali Rubber Udyog Ltd.	Over Subscribed
19.	Jyoti Spinning Mill Ltd. a. Ordinary Shares b. Preference Shares	Under Subscribed
20.	Arun Vanaspati Udyog	Over Subscribed
21.	Nepal Trading Ltd.	Over Subscribed
22.	Nepal Finance & Saving Company Ltd	Over Subscribed
23.	Himalayan Bank Ltd	Over Subscribed

New issue managed by the Securities Exchange Centre of Rastriya Beema Sansthan, Nepal Bayapur Comapany (Narayani) Ltd; Nepal Industrial Development Corporation. Himal Cement Company Ltd. Seti Cigarette Factory Ltd. is under subscribed and others are over subscribed.

In 1993 AD, remarkable development took place in the capital market. Under a program initiated to reform the capital market the Securities Exchange Center was converted into the Nepal Stock Exchange in order to increase marketability to government bonds and corporate securities. Nepal stock Exchange opened its trading floor in 13th January, 1994 providing membership to 5 market makers and 25 brokers. The brokers are permitted to act as intermediaries in buying and selling of shares of listed companies. At present, there are 23 brokers. The number of listed companies increased from 63 in 1992/93 to 99 in 1994/95 and the market value from 4,000 millions to 12,963 millions respectively. After opening the trading floor to brokers and market makers the total annual turnover rose from 70 million in 1992/93 to 1,052 million in 1994/95 (SEBO/N).

The earliest records of securities dealing in Nepal are meager and obscure. In those days, there was no remarkable movement or industrial development. Still it is on the rudimentary stage. No attempts were made to mobilize private savings and use them to productive sector. There were no media or market mechanism that facilitated the transfer of funds from surplus spending. Except for a brief period starting from 1963 AD until the end of the Second World War, no attempt was made to collect funds for the industries through the floatation of securities. It is specially the stocks in the market. In the absence of the development of corporate security market, the securities floated in the market are the government securities. Through them the government assembles the funds directly from the surplus spending units via the financial intermediaries. So far the government has the virtual monopoly over the security market. The resort to security market by the government has been in the form of borrowing. It is through the insurance of mainly the development bonds to meet the budgetary expenses. The first series of development bond was floated on Feb 12, 1964. It carried 6%

rate of interest and had the maturity period of 5 years. Since then the government has been floating the development bonds each year. Till now it has floated 26 issues of such bonds. The interest rate was ranging from 5% to 15.5% and with the maturity period varying the fiscal year 1965/66 amounted to Rs. 7.5 million. In 1970-71 it was equivalent to Rs. 3 million and it reached Rs. 300 million in 1976-77. From the very beginning of SMC, over the counter market for government bond was started. Despite resistance due to the level of awareness about financial assets from investors, it was able to carry transactions of government bond with turnover of Rs. 787 million in 1992-93 as against Rs. 372 million in 1980-81.

Securities Board Nepal acronym SEBO/N was established on May 26, 1993 after the first amendment in the Securities Exchange Act became effective. The same Act mandated SEBO/N to act as a securities market regulator and developer. Accordingly, Securities Exchange Centre (SEC), a government enterprise previously acting as a socio market operator and regulator, was restructured into present form of Nepal Stock Exchange. Another major event of restructuring was the creation of the SEBO/N as a separate government regulator. The securities market witnessed interesting ups and downs from its establishment to date. SEBO/N's regulatory interventions were targeted to discipline the market and consolidate its position as central securities market regulator.

2.1.6 Components of Primary Markets:

Components of primary markets are those institutions which are directly and indirectly involved in public issue process. There are many organizations involved during this process. They can be presented as below:

Figure 2.1
Components of Primary Markets

A. Issuing Company

Issuing company is the company which raises funds from the general public through the process of public offering. The purpose of public offerings is for the collection of funds from general public by the company as per its requirement. The company seeking for public offerings could be a completely new company (initial public offerings), a new company set by the existing company (initial public offerings) or by existing listed company (successive public offerings).

As per Company Act, only public companies are liable to go for public offerings. The Act specifically states that private companies are not allowed to sell their share and debentures in the free market.

NRB has made mandatory that financial institutions must go for common stock public offerings within two years of operation commencement. NRB has also set minimum percentage of equity holding to be offered to the public shareholders. For bank and financial institutions minimum shares to be hold by promoter is 51 percent. In case of insurance and hydro power companies, there is a controversy rule regarding public and promoter share for such companies, going into public signifies the need of funds for the company rather than the obligation.

The Provisions and Conditions for Securities Registration and Issue, 2063 has set the guidelines that before going into public offerings, issuing company should take into consideration that,

a. If the issuing company is industrial institutions:

-) The institution has bought the land or made other provisions in which necessary infrastructure like factory; office buildings, go-down etc. are already build in or made necessary arrangements for it.
-) Necessary technology has been selected for which spare parts of machineries needed have been bought. If not, LC has been opened to buy the necessary technologies.
-) Estimated budget has been proposed for the project to be implemented and for which if loans are required, such agreements are already made.
-) In the absence of long-term loan agreement, issue securities are underwritten.
-) Necessary approvals according to the existing Act have been taken.

b. If the issuing company is financial institutions:

-) According to the nature of the business, required infrastructures are installed.

-) Approval has been taken under the Company Ordinance 2063.
-) For commencing other activities, authority, and approval from governing bodies based on existing Act has been taken.

B. Merchant Bankers:

Merchant bankers are intermediaries which work as mediators in the fund mobilization for the general public to the business groups. The funds are raised from the hypothetical market that comprises widely spread fund surplus groups, mainly the general public, concentrated fund deficient groups, and the business groups. Funds are raised under different tool names that have long-term and short-term maturity period. According to such maturity period of the tools traded, market is identified as capital market for long-term and money market for short-term tools to be traded.

The role of merchant bankers in this market is to help, create, and expand securities underwriting. They also provide additional services like advising corporations and managing investment portfolio for the needing groups.

The concept of merchant banking differs from the commercial and development banks in respect that they do not require large funds to be invested as a principle. Their sources of income are basically the service charge; they charge to their clients for playing intermediary role in the fund mobilization and their advisory role. Typically, the activities of domestically oriented investment banks can be summarized as under,

-) Securities Underwriting
-) The secondary market for securities
-) The money market
-) Corporate advisory services
-) Investment portfolio management services, and also
-) Venture capital
-) Leasing/Hire purchase

-) Other services (insurance, real estate etc.)

The role of merchant banking in managing the public offerings comes under the heading of securities underwriting. The working process of which would be described comprehensively later.

For the working of merchant banking function in Nepal, Nepal Rastra Bank (NRB) has set forth the working guidelines. Guidelines have identified working of merchant banking into two sets of functions. The first set is the non fund-based functions and the second set is fund-based functions.

Fund-based activities identified for the merchant banking are:

-) Bridging Finance
-) Underwriting
-) Project Finance
-) Venture Capital
-) Acquisition and Merger

Non fund-based activities identified for the merchant banking are:

-) Share issue management
-) Mutual Fund
-) Portfolio Management
-) Corporate Counseling
-) Project Counseling
-) Debenture Trusteeship
-) Arranging International Finance
-) Investment Advisor
-) Advising Corporate Mergers

NRB has set the directives as for non fund-based activities of merchant banking, for underwriting and for bridging finance it is not necessary to take separate approval from NRB. But, for other fund-based activities of merchant banking, it is necessary to take separate approval from NRB for different activities to be undertaken.

Under the NRB directives of per client loan advancement and facility limit provision, such loan and facility can be provided to a client up to:

-) In maximum of 25% of primary capital in fund-based activities.
-) In maximum of 50 percent of primary capital in non fund-based activities.

There are 17 merchant banks available in Nepal. They are providing issue manager, lead underwriter, register, transfer of share etc. services to other institutions.

C. Securities Board:

Securities board has been formed under the Securities Exchange Act, 2040 Clause 3. This legislation has required for the creation of an independent statutory board to be apex authority for the securities market, thus resulting into the formation of Securities Board.

The need of legislative body is for maintaining healthy and orderly development of the securities markets and to ensure adequate investor protection. Establishment of SEB is necessary to promote markets that ensure:

Fairness: The market must promote integrity in dealings, high standards of conduct and good business practice.

Efficiency: The market should with professionals and be well informed, offering high standards of service at reasonable cost.

Confidence: The market must inspire confidence in both investors and issuers to actively participate in and rely more on the securities markets.

Flexibility: The markets should be resilient, innovative and be continuously responsive to the needs of all market participants.

With the objective of providing this to the market, in accordance with the Act, the Security Exchange Bylaws 2063 has defined the work, responsibility and the authority of the Board as:

-) To work in safeguarding the interest of investors and help develop capital market.
-) To advise Nepal Government in formulating policies for the development of the capital market.
-) To implement the policies set forth by Nepal Government regarding securities exchange.
-) To supervise the work process management and working procedure of those involved in securities exchange to make issue management of securities regular and well managed.
-) To approve registration of securities and issue of securities.
-) To register the name of securities issue dealers and give them approval letter.
-) To interrogate and supervise the workings of securities exchange dealers.
-) To formulate clauses to be followed by the securities exchange market and the dealers in security exchange market.
-) To supervise, interrogate the working securities market, securities dealers and the listed companies and when necessary make needed directions or undertake necessary actions.
-) To develop and implement directives for proper management of securities market and for regular and well managed securities exchange.
-) To approve Securities Market Sub-directives.
-) To collect notices, data and prospectus from the listed companies and companies with securities registered; make above available information to the interested investors.
-) To work for the healthy, competitive, regular and managed operation of the capital market with the objective of safeguarding the interest of the investors for continuous growth of the market.

This Bylaw is the amendment of Securities Exchange Bylaws 2063.

Role of Securities Board in Issue of Securities

In its approach to manage public issues of securities, the Board will bear in mind

a. Protection of rights and interests of the investor, especially,

-) The right to adequate, true and fair information
-) The need for liquidity
-) Prompt, fair and equitable allotment
-) Easy and efficient service in allotment and transfers

b. The need to encourage corporate entities to tap the securities markets for their diverse resources needs.

The Board would endeavor to evolve market and institutional structure, a set of instruments and methods of public offerings to cater the above objectives.

The legislative provisions relating to public issues of securities may be classified under:

a. Capital control, governing issue of securities and the terms of their issues;

-) To regulate terms of issues of securities from the viewpoint of investor protection, issuers needs and overall development of the securities market; and
-) To promote sound capital structure of companies.

b. Prospectus provisions, governing the disclosure of information at the time of issue of any security;

c. Obligations of regular disclosure of financial and other information on entities making public issues;

d. Listing requirements governing traded securities;

e. Provisions governing allotment and transfer of securities.

-) Ensuring fair and equitable allotment; and
-) Promoting speedier and more efficient service in matters of allotment and transfer.

D. Office of the Registrar of Companies (ROC)

Registrar of Companies (ROC) is the governing body for any institution registered under Company Act. In its governing role, it observes and regulates any company going into public

examining whether the process of “going public” is in accordance with the rules and regulation set forth by the existing Company Act or not.

As per the Company Act 2063, public companies need to publish their prospectus before issuing securities to the public. Before publishing prospectus, one copy of the prospectus needs to be submitted to ROC. In this process, ROC approves the prospectus to be published. While approving the prospectus, ROC makes sure that important information is not missed out and unnecessary information is not mentioned. In the presence of such changes, ROC sends it back to the company for necessary changes. Upon satisfactory changes ROC grants approval to issuing company to issue the prospectus. Apart from approving the prospectus to be published by issuing company before going into public, ROC does not play other major role.

E. Stock Exchange Market:

Stock exchange has been defined as any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying and selling of or dealing in securities. The stock exchange, therefore, is the most important institution in the secondary market. In the primary market, it comes into play during primary share allotment, during issuing share in premium and when Securities Board can ask Securities Exchange Market for its opinion.

Securities Exchange Act 2063 has stated that for the operation of the stock exchange market, approval needs to be taken from the Securities Exchange Board. Any registered institution except private companies willing to do or allow others to do security transaction should get approval for securities exchange market from the securities board.

After the issue of securities to the public, the Act requires that companies be listed in the Securities Exchange Market before the floated shares can be traded in the market. Nepal Stock Exchange Limited (NEPSE) is the only stock exchange in the country.

F. Financial Institutions:

They are financial intermediaries like commercial bank, finance companies (merchant bankers), and development banks and co-operatives institutions. These institutions are established under the Company Act and Nepal Rastra Bank Directives. These financial institutions perform the role of intermediaries in the securities issue as per the authority received from the Securities Exchange Board. Financial Institutions are involved in securities issue process as:

-) Issue manager
-) Underwriters
-) Collection centers
-) Bankers to the issue

The role of financial institutions is to manage the issue process and be intermediaries in the process of transfer of funds from the investors to the issuing company. The financial institutions may also play a role of creditors to the issuing company by providing bridge finance.

Securities Issue By laws has specified required capital for intermediaries in the securities issue and transaction as,

Table 2.2
Required Capital for Intermediaries

Transaction Type	Authorized Capital ('000)	Paid-up Capital ('000)
Issue registration & issue management, Issue Underwriters	NPR, 20,000.00	NPR 10,000.00
Dealer in securities market	NPR 10,000.00	NPR 5,000.00
Market makers in securities market	NPR 10,000.00	NPR 5,000.00
Brokers in securities market	NPR 400.00	NPR 200.00
Intermediaries in securities transfer, registration etc	NPR 400.00	NPR 200.00

Sources: SEBON Annual Report

G. Nepal Rastra Bank (NRB)

Nepal Rastra Bank is the central banking authority in Nepal. It is the governing authority in setting guidelines to all the financial institution regarding its area of operation. But, in the case of public offerings, its involvement is very minimal. Its role in the issue process is only to grant financial institutions approval to be involved with different role in the issue process. Also for different fund based activities of merchant banking, approval needs to be taken from Nepal Rastra Bank.

H. Securities Dealers

Any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise. The definition of 'dealer' does not include a 'trader', that is, a person who buys and sells securities for his or her own account either individually or in a fiduciary capacity but not as part of a regular business. Individuals who buy and sell securities for themselves generally are considered traders and not dealers.

Sometimes you can easily tell if someone is a dealer. For example, a firm that advertises publicly that it makes a market in securities is obviously a dealer. Other situations can be less clear. For instance, each of the following individuals and businesses may need to register as a dealer, depending on a number of factors:

-) A person who holds himself out as being willing to buy and sell a particular security on a continuous basis;
-) A person who runs a matched book of repurchase agreements; or
-) A person who issues or originates securities that he also buys and sells.

Here are some of the questions you should ask to determine whether you are acting as a dealer:

-) Do you advertise or otherwise let others know that you are in the business of buying and selling securities?
-) Do you do business with the public (either retail or institutional)?

- J Do you make a market in, or quote prices for both purchase and sales of, one or more securities?
- J Do you participate in a “selling group” or otherwise underwrite securities?
- J Do you provide services to investors, such as handling money and securities, extending credit, or giving investment advice?
- J Do you write derivatives contracts that are securities?

A “yes” answer to any of these questions indicates that you may need to register as a dealer

Dealers can be viewed as any investors who have desired portfolio based on the opportunities he sees and on his preferences. Dealer and stock exchange specialist exists as provider of liquidity and controllers of the size of the spread. Dealer exists because they provide immediacy more cheaply than investors could provide it for themselves. Dealer faces price uncertainty of the securities, and he also faces an order arrival uncertainty, as he does not know when he will transact with the public. The importance of liquidity in the securities markets motivates strong interest in the trading behavior of dealers. Dealers seek to provide liquidity in an ongoing manner and they can influence the short run dynamics of securities prices through the trading behavior.

Securities dealers retail the primary issue of securities. They purchase from the primary markets all or some of securities issued in primary market and manage the portfolio of investors with agreement of portfolio management with the investors. Securities dealers have to make buy and sales transactions of securities in the name of either customers or themselves through brokers. The section 31 (3) of Securities Exchange Regulation 1993 defines securities dealer as who carries out in his\her name the transaction of securities presented to the stock Exchange for the transaction or by concluding an investment management contract in accordance with the prevailing laws, with the objective of managing the investment carries out the transaction of securities through a broker from the name of the investors or his\her name. Membership of securities dealers shall be provided to the corporate company only and the capital, qualification and professional experience of securities dealers are as same as those

of issue and sales managers. According to the annual report of 2006/07 of Securities Board of Nepal, there are two securities Dealer in NEPSE.

Table: 2.3
Securities Dealer Permitted for the Year, 2006/07

S.N.	Name of Company
1	Nepal Sri Lanka Merchant Bank Ltd (NSLMB), Kamaladi
2	United Finance Ltd., Darbar Marg

(Source: Annual report of SEBO/N, 2006/7)

It is noteworthy that no securities dealers have done any securities dealings till now though membership has been taken from NEPSE and SEBO. SEBO and NEPSE should notice the case of no securities dealings and explore the reasons for not happening so. Otherwise, what is worth providing securities dealership is the question of the fact. SEBON should study and make clear rule for that security dealer why they are not doing their job.

I. Issue and Sales Managers

Issue and sales managers manage the issue and sale of primary issue of securities efficiently and grant services to the issuing companies who are first, new and unspecialized in the primary issues. Investment banks or merchant banks (as one of their functions) assume the management of primary issues of securities, underwrite the primary issue at risk and collect and distribute the application for primary securities transactions etc. That is why issue and sales managers are in that sense called merchant\investment bankers.

The issue and sales managers are those who provide the pre-issue, issue and post issue services for sales management of securities to be newly issued either through public issue method or circulation method by a corporate body, make the underwriting to purchase the unsold shares on their issuance or acts relating to that [section 31(2) of Securities Exchange Regulation, 1998] capital, qualification and professional experience of issue and sales managers as enshrined in the law [section (33) of Securities Exchange Regulation 1998] are given below:

- (a) Corporate company with limited liability.
- (b) Securities business as main articles of association and the paid-up capital at least ten million rupees.
- (c) For bank and financial institutions, securities business as subsidiary objective and the paid-up capital at least fifteen million rupees.
- (d) At least two employees qualified as brokers.

The membership of issue managers shall be provided to the companies and they must comply with above criteria.

Issue and sales managers generally provides advices and counseling services, underwriting services and distributions services. The issue and sales managers provided their services from pre-issue to listing of securities at NEPSE. Services provided by Nepalese issue and sales managers are as under.

1. Pre-issue Services

The issue and sales managers negotiate issue agreements with the issuing company and provide the following pre-issue services.

-) Consultancy for determination of appropriate timing for floatation of securities.
-) Drafting prospectus on the request of issuing company.
-) Getting the approval of prospectus from company register.
-) Getting securities registered with SEBO\N and issue permission.
-) Underwriting.
-) Appointing co-issue managers and co-underwriters, depending on the size of issue.
-) Appointing bankers to issues.
-) Deciding the collection centers.
-) Drafting IPOs announcements and publishing through media.
-) Printing application forms etc.

2. Issue Services

Issue activities are the main activities of the issue and sales manager. They provide the following issue services.

-) Distributing the application and application money from the collection center and branches of the bankers to issue.
-) Collecting the application and application money from the collection center and branches of the bankers to issue.
-) Advertising IPOs on media to induce the sub-scriptions.
-) Maintaining the record of collected applications and money.
-) Determining the close date of application.

3. Post-issue Services

After primary issue at market, the issue and sales managers provide the following post-issue services.

-) In case of over subscription, allotment of securities as per the allotment of securities as per the allotment directives.
-) In case of under subscription, underwriting of securities.
-) Demanding call money and refunding.
-) Printing share certificate, writing the name and address of shareholders, authorizing share certificate and distributing to the concerned shareholders.
-) Providing the raised fund to the issuers after deducting the commission.
-) Arranging listing of securities at NEPSE.
-) Hearing and resolving grievance of investors until listing.
-) Based on the SEBO\N annual report 2006\07, there are 9 issue managers available in Nepal. Among them; two financial institutions are permitting for both issue manager and securities. Dealers and rest of are working as issue managers.

Table: 2.4

List of Issue Manager

S.N.	Name of Issue Manager
------	-----------------------

1	National finance Co. Ltd. (NPC), Newroad
2	Ace Finance Co. Ltd, Kantipath
3	NIDC capital Markets Ltd., Kamalpokhari
4	Citizen Investment Trust, Putalisadak
5	Nepal Merchant Banking and Finance Ltd, Darbarmarg
6	Nepal Finance and Saving Co. Ltd, Kamaladi
7	Nepal Share Market and Finance Ltd., Putalisadak
	Issue Managers and Securities Dealers
8	Nepal Sri Lanka Merchant Bank Ltd., Kamaladi
9	United Finance Ltd., Durbarmarga

(Source: SEBO/N annual report, 2006\07)

Issue managers are required to submit their annual reports including profit and loss account, balance sheet, cash flow statements and securities trading report to SEBO\N within three months of the expiry of the fiscal year. In this fiscal year, 2006\07, out of nine issue managers, five were involved in the issue management activities; they are Nepal Merchant Banking and Finance Ltd., Citizen Investment Trust, NIDC Capital Markets Ltd., Ace Finance Co. Ltd., and Nepal Finance and Saving Co.

J. Advertising Agents:

Advertising plays a key role in promoting the public issue. Advertising agents are those organizations which provide information to the general investors. After comparing the effectiveness and cost of each programmer with the other, a suitable advertising agency is selected in consultation with the lead manager to the issue. The advertising agencies take the responsibility of giving publicity to the issue on the suitable media. The media may be newspapers/magazines/hoardings/press release or a combination of all.

In case of Nepal, Public Issue Offer must be published at least seven working days before the new public issue in national daily newspaper, and the same rules for right offering.

2.1.7 Public Issue Process:

Securities Act 2006, Company Act 2006, regulations, by-laws, and guidelines issued under the Securities Act provide the basis legal framework for issue of securities to the public. The issuing companies should follow the provisions made by these acts, regulations, by-laws, and guidelines while issuing securities. There are ten steps of securities issue process in Nepal which can be summarized as below:

Figure2.2:
Public Issue Process

- 1. Company decision:** Under company decision, the company makes some preliminary decisions. The rupee amount of new capital required is established. The type of securities to be offered is specified. Stock, bonds, or a combination can be used. If stock is to be issued, should it offered to existing stockholders or sold directly to the general public. The basis on which to deal with the investment bankers, either by a competitive bid or a negotiated deal, is determined.
- 2. Appointment of issue manager:** The investment-banking firm must be appointed. As per the provision in Company Act, 2006, company must take services of issue manager licensed by Securities Board of Nepal (SEBON) for the public offering of securities. One can select the any one or two investment bankers.
- 3. Prospectus preparation:** After the appointment of issue manager, the issue manager prepares prospectus.
- 4. Filing with SEBON:** Prospectus, due diligence certificate of issue manager and other documents should be filed with SEBON to get the prospectus approved.
 - i. **Prospectus:** Prospectus is the important legal document to provide information about the issuing company and the securities. It includes the company's information on major functioning, capital, financial situation, management, involving promoters and directors, operational status and the future prospectus. Preparation and approval of prospectus is primary task of the public issue. Therefore the issuing company must prepare the prospectus and get approval from SEBON. The information that should be enclosed in the prospectus is prescribed by the Securities Act as well as the Company Act.
 - ii. **Due Diligence Certificate of Issue Manager:** It is the certificate issued by the issue manager stating that the issue manager has reviewed all the information contents of the prospectus and is satisfied with the content of the information.
 - iii. **Other documents:** These documents includes declaration of the company stating that it has complied with the prevailing laws of the nation applicable to it, financial statements, details of promoters and executive of the company, and details on any issues related with the company.

- iv. **Securities Registration Fee:** Issuing Company should pay fee to issue securities. The fee charged on the issue amount by the Security Board of Nepal (SEBON). The fee charge by SEBON can be summarized as below:

Table: 2.5
Securities Registration Fee

Securities	% of fee charged on Issue Amount
Share	0.20
Debenture and Bond	0.15
Mutual Bond	0.10
Other Securities	0.10

Source: www.sebonp.com.np

- 5. SEBON’S review by the Prospectus Vetting Committee (PVC) of SEBON:** In the PVC of SEBON; there are members representing SEBON, Nepal Rastra Bank, Stock Exchange, Insurance Board and Company Registrar’s Office.
- 6. Clarification/update:** Prospectus Vetting Committee can ask to clarify and update the information contain in the prospectus.
- 7. Prospectus approval by SEBON:** After careful study of the prospectus; the Prospectus Vetting Committee can give approval for the prospectus prepared by the issue manager.
- 8. Issue open and issue close:** Issue should open within 2 months of prospectus approval for minimum of four days to maximum of 15 days.
- 9. Allotment and refunding:** Allotment and refunding should be within specified time framework prescribed by rules and regulations. Present rules for allotment time framework can be summarized as under:

Table: 2.6

Allotment and Refunding Time Framework

Number of Applicants for share	Allotment with-in
Up to 100,000	40 days
100,001 - 200,000	50 days
200,001 - 300,000	60 days
300,001 above	70 days

Number of employee and percentage of public share to be distributed to employee of the issuing company:

Table: 2.7

Percentage of Public Share to be distributed to Employee

Number of employee in issuing Company	Percentage of public share to be distributed
1 -50	2
51 – 100	3
101 -200	4
201 and above	5

10. Listing to the Stock Exchange: After the allotment, refunding, and certificate distribution, Company should go for listing its securities in the Stock Exchange. Company should have to submit application in prescribed format within specified time along with certificate of incorporation, tax certificate, Memorandum of Association , Articles of Association and concerned Act, rules and regulations in the case of corporate body other than company after the incorporation and the projected B/S and PL A/C for the next three years, last three years audited financial statement, if the year of incorporation is less than three years, the B/S and A/C of investment in shares of subsidiary company or investment made in its parent company's share capital, details of share investment in any other company

other than subsidiary, the name, address, number of shares subscribed and the amount invested by shareholders having more than 5% of the share capital need to be submitted. The Company should pay listing fee and annual fee to the Stock Exchange. Present listing fee and annual fee are as follows:

Table:2.8

Listing and Annual Fee For Shares

S.No.	Issued Capital	Listing Fee	Annual Fee as per issued capital
1.	Upto Rs. 10 million	0.20% or minimum 15,000	Rs. 15,000
2.	Rs. 10 million to Rs. 50 million	0.15% or minimum 45,000	Rs. 25,000
3.	Rs. 50 million to Rs. 100 million	0.10% or minimum 75,000	Rs. 35,000
4.	Above Rs. 100 million	0.075% or minimum 100,000	Rs. 50,000

Table: 2.9

Listing and Annual Fee For Debentures and Mutual Funds

S.No.	Issued Capital	Listing Fee	Annual Fee as per issued capital
1.	Upto Rs. 10 million	0.20% or minimum 15,000	Rs. 15,000
2.	Rs. 10 million to Rs. 50 million	0.15% or minimum 45,000	Rs. 25,000
3.	Rs. 50 million to Rs. 100 million	0.10% or minimum 75,000	Rs. 35,000
4.	Above Rs. 100 million	0.075% or minimum 100,000	Rs. 50,000

Source: www.nepalstock.com

Listing the security to the Stock Exchange is the completion of public issue process. After the listing, the secondary transaction can take place. Listed Company must have to fulfill all rules

and regulation prescribed by the Stock Exchange. Stock Exchange can de-listing the security which does not fulfill its requirement.

2.2 Review of Journals and Articles

Fama (1970) in his report described, at one level, capital market is simple enough. The primary market is, where companies raise capital by issuing securities, basically either shares or bonds. The secondary market is where those same securities are traded those definitions are simple and there is nothing very complex about the mechanisms for issuing, trading or setting. Sometime the term capital market is extended to covers long-term bank loans to companies.

But at another level, the capital markets are more complex because when they function properly they are the very hubs of a free market economy. In them, all economic currents and forces meet and interact.

A healthy capital market is democratic and egalitarian. It shows no respect for class or caste. It does not acknowledge hierarchy. When the price of share price falls, it falls for all those who hold it. Financial analysis may have doctorate in math but some of the best traders of equities, and futures and options have been near a university.

A study critically examined the situation of common stock investors and the situation has not improved till now. Though the size of the shareholders population in Nepal has been growing constantly the government seems to have not taken any initiative in formulating the separate act, which protects the shareholder's rights. Thus the need of separate act regarding the protection of shareholders right is questioned.

Company and other acts relating to financial and industrial sector have provisioned rights of the shareholders as:

1. Voting right
2. Participation in general meeting
3. Right getting information

4. Electing as a board of director
5. Participation in the profit and loss of company
6. Transferring shares
7. Proxy representation

The collective rights of the shareholders are:

1. Amend the internal bylaws
2. Authorize the sales of assets
3. Enter into mergers
4. Change amount of authorize capital

Some public limited companies have floated the shares to the general public without having shareholders representation in the board. There are many such companies, which conduct the annual general meetings just to fulfill their desire and do not consider the voice of the majority of the shareholders similarly management involvement and government intervention in the board election have brought a greater setback in the voting rights of the shareholder.

ADB expert Tiwari (1996) has seen many obstacles to the growth of the capital market. This includes low level of investor's confidence, disclosure of poor and manipulated financial information, weak enforcement of regulation, absence of instructional investors, lack of diversity in range of financial instruments and the scope of active participation for the various intermediaries limited by vertical barriers.

The current downtrend in share market is not so easy to recover unless strong regularly measures are not enforced. The honeymoon days of share market exist on more but there are still unlimited financial fortunes by sharp practices that went undetected during the period of share market boom among all, the regulation of share market to control on the unfair trade practice would be done of the strong measures to revive the share market in future. In order to curb the fraudulent practices and discourage the dissemination of misleading information in the current share market of Nepal, the regulating authorities must govern the activities in the

share market. There should be immediate check on the unfair share trading practices. Wash sales should be discouraged by immediate action. Nepal Stock Exchange can form a watchdog team to investigate on the real existence of a share transaction. The present practice of share trading by mutual consent is a kind of wash sales that should be discouraged as it creates distortion in the price determined by the market forces. Such action helps in avoiding a fiction name created by several different share brokers in share transaction and also to check on the creating an illusion of rising price. Moreover, the challenge for the regulating authority is to control on the hidden establishment of share market corners and pool by some market price manipulators. Surprise inspection and secret vigilance by a professional team (without making known who are its members and advisors) can check on the functioning of the office of such price manipulators interested to corner a share market in the hope of trapping or squeezing sellers. If found dishonest in share market dealings, action should be taken against such price manipulators by imposing heavy penalties and punishment depending upon the nature of offence.

At the same time, the concerned authority has to discourage the practice of churning by the brokers since it helps broker to generate sales commissions regardless of benefits of such transaction to the client. Moreover, it is a right time for the concerned authorities to develop transparent guidelines to have strict vigilance and control on misuse of insiders should be debarred from leaking price sensitive information by imposing heavy penalties and punishment for breach of legal provision. The revival of the share market requires minimum fulfillment of the responsibilities and accountabilities among company management to be shareholder focused. Time has come for company management to respond to shareholders expectation of return from their investment in shares of companies. Management should make it a habit to change attitude to think what is good for shareholders is good for company as a whole.

Now, the latest slumps in the secondary market, despite a pretty good performance by commercial banks, make it more apparent that investment in the past was done on whim.

Even officials at the stock exchange and the securities board, refuting investor's allegations of the market manipulation and insider's trading of last February, discreetly claimed that the Nepalese stock market is in a nascent stage. And that, investment are made more on an impulse, rather than through market study and credit rating.

Share trading scandal formed the headline of major dailies of Nepal a few months ago. The news was that some of the staffs of Nepal Merchant Banking and Finance Ltd. (NMB), the share registrar of Standard Chartered Bank Nepal Ltd were involved in unauthorized sale of investors not present in the country. They were also alleged of cheating such shareholders of their dividend. As a share registrar, the company's duties were to update the shareholder's information, distribute the benefits provided by the client company to the latter's shareholders and to verify the signature of the shareholder at the time of ownership transfer of shares. But the staff forged the signatures of the company's shareholders so as to sell their shares without the knowledge of the shareholders and to claim themselves the dividend allotted to such shareholders. When the media reported this scandal, NMB blamed on of its staffs and registered a forgery case in the District Police Office, Kathmandu. The accused is learnt to be in the police custody. As stated in the news, though some other staffs also were involved in this scandal, NMB has registered the case against only one of its staff. Another of the NMB staff accused in this scandal is reported to have escaped out of the country. If such types of scandals, whether they are reported by the media or not, are repeated frequently and no attempts ate made to rectify the flaws in the system and to punish the guilty, there is not doubt that sooner or later the capital market will lose the investors.

A close study of this case brings the deficiencies of our market to the forefront. The major deficiencies are obviously lack of professionalism among the market participants and lack of interest in compliance. The issuer company cannot escape from its responsibility simply blaming the registrar. It must satisfy those investors whose share has been stolen. Nowadays, share registrars are careless. Investor can be raised on their professionalism and honesty. The stockbroker has also made a mistake by executing the share trading without identifying the

client and thus violating the codes of conduct for stockbrokers issued by Securities Board (SEBO), the regulator of the capital market in Nepal. As the code clearly states that the brokers must identify their clients, such scandal could have been avoided had the broker complied with the code. Also the regulators are equally responsible as they are not effectively monitoring the activities of securities businesspersons and taking legal action against their non-compliance under the prevailing rules and regulation. As the capital market of Nepal is still in the infant stage, the regulatory system established to systematize and regularize the securities trading still has deficiencies. This leaves scope for anyone to tame unfair benefit from the market at the cost of ordinary investors. Not only the investors are found to be irrational and concerned with short-term gains, in this scenario, we cannot expect perfect behavior from all the market participants. The major problems seen in the system are duality and ambiguities in the regulations, inadequate legal provision to control the market, lack of adequate market infrastructure, and lack of clear demarcation of duties of the regulators, poor compliance and lack of clear legal provision for taking action to address the noncompliance cases.

Pradhan and Blampaki (2004) conclude in their article investment in the capital market now has become very uncertain, sending the investors in search of avenues of more certain returns. The equity investments is considered riskier than investment in bond, preferred stock etc. The secondary market is not performing well. Various measures of stock market deployments indicate that the stock market in Nepal is underdeveloped and has failed to show impact on the overall national economy. Small market size has made it vulnerable to manipulation and price rigging. Low turnover ratio and value traded ratio to volatility, and high concentration ratio indicate that the stock market in Nepal is highly illiquid and risky. Investors tend to avoid stock market because they do not have options to it because stock market is less reliable source of raising funds for them. Investors need to be aware of the relationship of financial variables, which helps them to predict future price and earning and come with effective investment decision. In this regard a study reveals that earnings yield and cash flow yield have significant impact on dividend yield. Earning yield and cash flow yield

have significant impact on book to market value whereas; size has negative impact in dividend yield. In the case of earning yield and cash flow yield, cash flow yield has been found to be more informative than earning yield.

Capital gain yield is positively influenced by earning yield and size, whereas, the same is negatively influence by book to market value and cash flow yield. Book to market value has been found to be statistically strong in predicting capital gain yield. Similarly, total yield is positively determined by earning yield and size, whereas the same is negatively determined by book to market value and cash flow yield. Book to market value has been found to be more informative than other variable.

On the other hand investors must be careful while examining company's financial disclosures, as it is possible that while offering their securities to the public the IPO companies overstate their accounting figures to unjustly influence the investment decisions of investors.

2.3 Review of Thesis

In Nepalese context there are not sufficient studies in the field of development of financial instruments and primary market components.

Shrestha (2002) Conducted research on the topic of "Growth and Prospect to Stock Market in Nepal" tries to show the role of the capital market which has been increasing as to mobilize the saving of the nations and canalizes them into productive activities. But, the major problems in the process of development are to increase the level of saving and the channels those saving into investment that leads to economic growth. Capital market is playing a crucial role in the process of growth. In this way, the important of capital market arises as to proper allocation of accumulated savings to various economic, objective of his study were:

-) To identify the legal obstacle in the stock market development
-) To study existing transaction system

Bhatta (2003) has also conducted research on the topic “Dynamics of Stock Market in Nepal”. The objectives of the research were as follows:

-) To analyze the trend of the Nepalese stock market.
-) To diagnose and compare sectoral financial status of the stock in Nepalese stock market.
-) To analyze the market share prices of the Nepalese stock market.
-) To find out the impact of the secondary on primary market and vice versa.

He has conducted in his research as follows:

The stock market and economic activities move in the similar direction. They influence each other. The development of the former is reflected in the latter. The stock market raises and mobilizes the invest-able resources to finance the long-term large projects in the economy. The stock market therefore can be regarded as a heart of economy.

The investors are interested to invest their resources in the shares of corporate sector through the stock market in the Nepalese economy.

The investors are interested to invest their resources in the shares of corporate sector through the stock market in the Nepalese economy. It is necessary to develop the entrepreneurship and encourage the entrepreneurs to start the productive venture as soon as possible. Management capability of the entrepreneurs is a key for better performance of the firms. Government should launch programs to enhance management capability of the entrepreneurs, which may contribute to raise the return from the investment.

Development of manufacturing sector is the backbone of an economy, which in turn, assists to foster banking, finance and insurance sectors. Unfortunately, the manufacturing sector does not have a good performance in Nepalese economy. Almost all firms in this sector have a good performance in Nepalese economy. Almost all firms in this sector have a sustained loss.

The secondary aspect of the stock market is not also functioning well in Nepal. There is almost no liquidity in the stock market for shares except that of banking and some finance and insurance sectors.

Although it has become late to take steps to overcome such problems of the Nepalese stock market in order to make it active and supportive, the stock market has good prospect for the mobilization to finance the productive enterprises in Nepalese economy.

Upadhyaya (2004) has conducted a study similar to the present one entitled “Investors Preference and Financial Instruments”. The main objectives of this study are:

-) To study the preferences of investors in the financial instruments.
-) To assess investors’ awareness regarding the investment decisions in selecting securities.
-) To analyze the investment trend in the security market of Nepal, and
-) To suggest some practical recommendations on the basis of the findings of the study.

He gives the following important remarks in regard to the investors’ preferences from the analysis; it seems that the Nepalese investors’ prefer common stocks when making investment decision. The common stock has the largest chunk of trading in the market. The main attraction of common stock is due to return: dividend of the company. The stocks of banking sectors have the largest amount of trading in the market or the market capitalization of common stock of banking sectors is very high. Hence, the preference of investors is on common stock of banking sector.

The investors give the second priority to the government securities because the government securities are taken as risk less investment. The Nepalese investors least prefer the preferred stocks and debenture. It was found that from the primary data, no attraction of investors is the main reasons of the Nepalese companies for not preferring to issue debenture and preferred

stock frequently. The market capitalization of the securities shows that the Nepalese security market is in development stage since the capitalization is in increasing trend.

The Nepalese investors do not seem aware in regarding investment in the security market. They don't analyze the risk and return before making any investment in any securities. They invest their money just by observing the market trend, which is very unscientific in Nepalese context because Nepalese security market is not in equilibrium. The investors are feeling the existing rules and regulations regarding sufficient and timely information from the companies where they have invested their money.

Kafle (2005) carried out a study entitled "Primary Market Development in Nepal: Issue and Challenges". His study was based on bank and financial act and security ordinance 2005. He intent to extend that Nepalese financial system is at a critical stage of transformation. Due to banking sector is being consolidated under the umbrella bank and financial institution act, the responsibility of financing long term project including infrastructure and potential hydro-electric project fall on security market which was an urgency of consolidated development of securities market would not only accommodate the present need but also contributes to the growth process through the development of equity and debt market. He also shed light the fact that newly issued securities ordinance 2005; the SEBON would be better placed to regulate the integrity of disclosures in the securities issue. Modernization of stock exchange and efficient clearing and settlement system of stock exchange and efficient clearing and settlement system of stock exchange would make primary market bounded to increase manifold, providing a reliable and sustainable alternatives for raising capital.

Timilsina, (2005) has conducted a study on the topic "A Study of the Problems and Prospects of Stock Market Growth in Nepal". By analyzing his studies, some of the major findings are as follows:

- J Stock market is in developing stage. The major portions of Nepal investors do not have sufficient knowledge about investment. NEPSE and SEBO/N DO not provide information accurate and timely. So the information provided by them is not sufficient.
- J Most of the peoples share purchasing decision without analyzing the financial performance of the company and without consulting the experts. Among the listed companies during the year 2003/04, majority are from the finance companies.
- J The number of listed securities are increasing gradually where as the numbers of transactions in NEPSE are in fluctuating manner. Growth of market day per year, average turnover in volume and value are in satisfactory level.
- J Number of issues and amount of issue approved are satisfactory.

For the efficient operations of the stock market price formation activity is one of the major concerns. To raise importance of stock market the role of broker is very important. They facilitate in the share trading activities we can't imagine that transaction of securities without the presence of brokers.

Panta (2005) Conducted research on the topic of “current Status of Share market in Nepal” the trend of the Nepalese stock market and present status of primary and secondary market as well as problems and prospects of Nepalese stock market. The findings are as follows:

- J The development of stock market primarily depends on program and their implementation.
- J In Nepal, the overall policy environment has not been conducive to the development of the stock marker therefore it is difficult to develop more efficient secondary market, trading system for both equity and debt security.
- J Restriction on foreign portfolio investment hindered market development.

- J NEPSE does not have appropriate policies and memberships are fee structure to attract members outside KTM.
- J In Nepal, banks dominate primary market in government debt instruments. OTC trading is no permitted therefore secondary market is totally inactive.
- J Lack of necessary provisions in the laws and regulation of the privatization and automatics of stock exchange as well as for the establishment of central depository of securities (CDS).

The transparency and openness of transaction, quality professional's services, adequate. Corporate financial disclosures and improved legal, regulatory and supervisory frame – are the urgent needs of Nepalese stock market.

Therefore it is important that the basic assumption in any effort for protection investors interest or boosting their confidence or developing the stock market is that business, which should be enabled to operate in an environment that remains conducive to growth and expansion but complete replication of any tailor made, as applied anywhere, may not work because the specifics in Nepalese stock market is different form other developed market.

Mahat (2006) Conducted research on the topic of “Future prospect of NEPSE in capital mobilization” is able to analyzed situation in Nepal where the industrial sector has very little access to private saving. Also be indicates the availability of industrial securities is nearly absent and the development of financial institutions that link the surplus spending units with the deficit spending ones is in the rudimentary stage.

He further concluded notwithstanding the underdevelopment state of financial institution in the country, growth of invest able funds becoming available recent years. This study also demonstrated the relatively very limited financial contribution of other financial institution to this sector but he does no indicate these factors, which help to uplift the financial contribution to the other sectors like provident fund and NIC etc.

It is acknowledged that a much greater use of resources available in the financial system of the industrial development of the country may not be very smooth and easy. He only specified the growth and potential (measures) of security market, capital market regarding primary and secondary market. It was absent to show the problems face by the NIDC and other industrial as well as financial sectors. He just shows the preliminary and basic problems of industrial sector but not in broad way. His topic was “future prospects of NEPSE in capital mobilization” but according to the topic the sufficient future prospects/measures are not available in this study but can find thin basic context. There is not indication in the relations of primary and secondary market with economic condition of country in his study. But it is able to give the theoretical version of relationship of capital market with economic growth.

The findings on the term nature of sources and uses of funds and the current ratios of various size and industry groups also do not give any ground for complacency. Some industries were found to have financed a large part of the increase in current assets with the long-term sources of funds, while for others the increase in long-term source was hardly sufficient even to finance the long-term assets formations. He was given high attention to the working capital management in Nepalese industries

Pandey (2007) Conducted research on the topic of "Public response to Primary Issue of Shares in Nepal," with the objective of: identify the problems of primary share issue market, assess the growth of primary issue market, analyze the pattern of public response to shares & find the reasons of variation. He has summarized the finding as: Public response in primary market is high due to lack of opportunities for investment in other fields. No proper investment analysis is been made. Despite this, public are attracted towards shares than other sectors, basically to increase their value of investment, be it dividend capital gain or bonus shares. It can be seen that public response to primary issues on Banking and Financial sectors is normally higher than that of the manufacturing and services sector. Major causes for poor response in the period 1995-1998 were; interest rates were higher as compared to dividend

yield, the public companies were not performing well and people did not know about the importance of investing securities. Now the response is highly positive because people are aware, money flow in the market is higher, people have seen that most companies are distributing dividends, share prices are increasing for most companies and a lack of better alternatives for investment. Now that the average interest rates have gone down, more can be obtained from investment in stock.

Bhandari (2008) studied “Structure and Efficiency of Securities Market Intermediation Service in Nepal”. In Nepalese context very few studies have been done by the individual researcher in this topic. He tried to find out the efficiency of securities market intermediation service in Nepalese Securities Market. Major finding of his study are as follows:

-) With the elapse of time, there are a lot of changes in structure of intermediaries. The total number of intermediaries is in decreasing trend over his study period and the mixture of market intermediaries are often changing. He considered ten years data for the study.
-) Number of listed companies, traded companies, paid-up capital, market capital and NEPSE index are increasing during his study periods, besides some exception. These indicators show the increasing efficiency in comparison with the earlier year.
-) Number of permitted brokers during the study periods was decreasing. Some of the brokers hold license only but not submitted financial and transaction reports to NEPSE on time.
-) Other sector of Nepalese economy have not moving except capital market in the later days, there is abnormal development in capital market only.
-) The high proportion of the investor was not satisfied with issue manager/under writing service available.
-) The market makers are not existed from 2002/03 to onwards. The main reason for the failure of the markets was the inability of the market makers to acquire a sufficient buffer stock of shares initially required by them for market making and introduced very initial stage of the security market.

) Overall his study's conclusion is that the structure of the securities market is not well defined as lack of adequate mixture of all typical market. Securities markets intermediation service is inefficient. But, interesting things is that amount and volume of share transaction, paid-up capital, market capitalization, and NEPSE index all are in increasing trends. Nepalese Security market is small in quantity and poor in quality as compared to other develop stock market.

2.4 Research Gap

Since the above mentioned studies offer limited findings and they are not exactly similar to the present study. In other words, there are not any past study available which analysis the trend and pattern of financial instruments, primary market components and their development but Nepalese capital market is in infancy stage and there are varies factors remaining to improve as compared to the developed capital market. Majority of the investors of the Nepalese capital market are making investment decision without analyzing the securities and securities related variables properly. Hence, in Nepalese securities market, to examine the exact trend and status of the primary market growth only secondary sources of date are not sufficient and complete but most of the past studies similar to this study were based on only secondary sources of data. Moreover, more extensive testing, and adjustment of necessary variables are needed in ordered to be more conclusive about the development of financial instruments and primary market components in Nepalese capital market.

This study aims to attempt to study about the growth trend and pattern of available financial instruments and primary market components in Nepalese securities market. The previous relevant literature more of less similar to this study has just reviewed to support the study and this study tries to fulfill the weakness of the past studies because the study is based on primary as well as secondary sources of data and findings have been made on the basis of analysis of collected data using various statistical tools. The present study is based on fourteen year's data of Nepalese Securities Market, which tries to achieve its objectives by analyzing secondary as well as primary source of data. Thus, the earlier studies on these issues need to be updated and validated because of the many changes taking place in Nepalese primary market. Therefore, the current study is probably a first study in this field which supplements to overcome the weakness and limitation of previous studies.

CHAPTER- III

RESEARCH METHODOLOGY

This chapter presents all the necessary steps to be followed throughout this research work in order to achieve and accomplish the objective of the study. Research methodology discussed in this chapter helps to guide the research study providing different issues and aspects. It systematically solves the various sequential steps to adopt by a researcher in studying problem with the objectives in view. This chapter is to outline the nature and sources of data, sample selection and classification of variables, techniques and steps adopted in interpreting and analyzing the data. It also focuses on how to collect required data, what is the population and sample, and what techniques to be adopted to analyze and interpret etc.

3.1 Research Design

Research design is a plan structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances (Kothari, 1994:43). The research design refers to the entire process of planning and carrying out a research study. It describes the general framework for collecting, analyzing and evaluating data after identifying: (i) what the researcher wants to know, and (ii) what has to be dealt with in order to obtain required information (Wolf and Panta, 2003:74). Current research applies analytical and descriptive techniques to evaluate and analyze the investor's preferences toward financial instruments. Therefore, current research is both analytical and descriptive. It is analytical in the sense that it uses different analytical tools to analyze the investor's preferences toward financial instruments similarly it is descriptive in the sense that it clarifies different aspects of investor's preferences toward financial instruments. As per the nature of the research primary as well as secondary data have been extensively used.

3.2 Population and Sample

All the investors those who invest in financial securities in Nepal constitute the population of the study. Total population of Nepalese investors is divided into two parts namely individual and institutional investor. The detail sample plan is based on stratified and purposive sampling. There are total 112 respondents included in this study as a sample. Out of them, 56 respondents are individual investors and remaining 56 respondents are institutional investors. This classification has been made for the purpose of analyzing the difference in the investor's opinion with respect to major aspect of investors' preferences towards financial instruments.

3.3 Nature and Source of Data and Collection Procedure

This study based on both primary and secondary data. The primary data and information are collected through questionnaire survey. Direct interview and mail questionnaire method of data collection are employed to collect primary data whereas secondary data are based on various published and unpublished sources like annual report of SEBON, journals, magazines, web sites etc.

3.4 Data Processing Procedures and Analysis

Data obtained from various sources have no meaning unless they will be arranged and presented in a systematic way. The data has been collected from primary sources (questionnaires) and different secondary sources in raw forms, which are verified, simplified, classified and tabulated form for the purpose of analysis. Different statistical tools and technique are used while analyzing the data.

3.4.1 Statistical Tools:

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of the collected data. It is an essential tool to measure the relationship of two or more variables. "Statistical analysis is one particular language, which describes the data and makes possible to talk about the relations and the difference of the variables." (Gupta S.P., 1997:21). The main statistical tools which will be used to analyze the data are as follows:

i) Median values

The median is the middle value of the given distribution. Median is defined as 'the value of the variable which divides the group into two equal parts, one part comprising of all the values greater than and the other part comprising of all valueless than median.' Thus, the median divides the whole distribution into lower 50% and upper 50% of the values. Thus, the median is different from mean as the median describes the 'position' of the variable in the distribution. For calculating the median, first of all find, $N/2$, identify the class- interval corresponding to this in c.f., then use the following expression,

$$Md = L + \frac{N/2 - \sum cf}{f}$$

Where,

Md = median

L = lower limit of the median class

c.f = c.f. preceding the median class

f = frequency of the selected class

N = total number of observation

ii) Chi-square Test

Chi-square, symbolically written as χ^2 , is a statistical measure used in the context of sampling analysis for comparing a variance to a theoretical variance. As a non-parametric test, it can be used to determine if categorical data shows dependency or the two classifications are independent. It can also be used to make comparisons between theoretical populations and actual data when categories are used. Thus, the chi-square test is applicable in large number of problems. In fact, chi-square test is used to test the goodness of fit, the significance of association between two attributes, and the homogeneity or the significance of population variance. In this study chi-square test is utilized to test the significance of association between two attributes. Chi-square is calculated utilizing the formula below:

$$\chi^2 = \sum \frac{(O-E)^2}{E}$$

Where,

$$E = \frac{RT \mid CT}{N}$$

RT = Row total,

CT = Column total,

χ^2 = Value of Chi Square

O = Observed Frequency,

E = Expected Frequency,

N = Grand total

iii) Arithmetic Mean

Arithmetic mean is the average return over periods. Arithmetic mean of a given set of observation is their sum divided by the number of observations. To illustrate it, let's suppose that $X_1, X_2, X_3, \dots, X_n$ denote return of given 'n' number of respondents and \bar{X} is the arithmetic mean of the given observation. It is calculated by,

$$\bar{X} = \frac{X_1 + X_2 + X_3 + \dots + X_n}{n} \quad \text{or,} \quad \bar{X} = \frac{\sum X}{n}$$

Where,

\bar{X} = Arithmetic mean,

$X_1 + X_2 + X_3 + \dots + X_n$ = Set of observations

n = Total number of observations

$\sum X$ = Sum of given observations

iv) T-test

If we draw a large number of small samples i.e.($n < 30$) and compute the mean for each sample and then plot the frequency distribution of these mean, the resulting sampling distribution would be t-test. On these study sample are taken only for 14 years i.e. ($14 < 30$). Some assumptions of the t-test are as follows:

- i) The parent population from which samples are drawn is normally distributed.
- ii) The two samples are random and independent each other.

iii) The population and variances are equal and unknown.

v) Multiple Bar-diagrams and Graphs

Diagrams and graphs are visual aids which give a bird's eye view of a set of numerical data which show the information in a way that enables us to make comparison between two or more than two sets of data. Diagrams are in different types. Out of these various types of diagram one of the most important form of diagrammatic presentation of data is multiple bar diagram which is used in cases where multiple characteristics of the same set of data have to be presented and analyze.

vi) Pie- diagram

A pie- diagram is a widely use, it is generally used for diagrammatic presentation of the values differing widely in magnitude. In this method all the given data are converted into 360 degree as the angel of a circle is 360 degree.

vii) Percentage

Percentage is one of the most useful tools for the comparison of two quantities or variables. Simply, the word percentage means per hundred. In other words, the fraction with 100 as its denominator is known as a percentage and the numerator of this fraction is known as rate of percent.

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

This chapter presents the analysis of primary and secondary data that are collected by using different techniques. It is related to the presentation and analysis of data collected from various sources. This chapter also related to a number of closely related operations, which are performed with the purpose of summarizing the collected data and organizing these in such manner that they answer the research questions. The chapter includes main three parts. The first part deals with the presentation and analysis of secondary data while the second part deals with analysis of primary data which mainly focuses on investor's preferences, reason for preferring one security over others, level of satisfaction they enjoy by buying security and grievances of investors against different institution and the last part deals with the major findings of the study.

4.1 Presentation and Analysis of Secondary Data

The sources of data, which are collected from secondary sources and are also secondary nature, are called secondary data. Thus, this chapter relates to analysis and interpretation of secondary data.

4.1.1 Amount of Public Issue Offered

Securities Exchange Act provisioned that any company which come for IPO must get issue approval from security board of Nepal prior to make their offer to public. Since first year of SEBON operation, FY 1993/94, it has given issue approval to 259 issues amounting Rs.21855.05 million till FY 2007/08 (SEBON, 2008: 30). As Securities Regulation provisioned, the company which got issue approval may commit their offer any time within two months from the date of issue approval. The amount of issue approved and the actual amount issued in a fiscal year may vary. Hence, for better result the study is focused on actual amount of issued in the fiscal year rather than the amount approved by the SEBON in that fiscal year. Amount of public issues offered during the study period along with its growing rates have been given in Table 4.1

Table 4.1
Amount of Public Issues

Fiscal Year	Amount of Public issue(Rs.)	Annual Growth Rates (%)
1993/94	244.4	-
1994/95	173.96	-28.82
1995/96	293.74	68.85
1996/97	332.2	13.09
1997/98	462.36	39.18
1998/99	258	-44.2
1999/00	326.86	26.7
2000/01	410.49	25.58
2001/02	1441.33	251.24
2002/03	556.54	-61.39
2003/04	1027.5	84.62
2004/05	1626.82	58.52
2005/06	2443.28	50.19
2006/07	2295.5	-6.01
2007/08	9961.85	333.97
Total	21855.05	

Source: SEBON Annual Report 2007/08

Figure 4.1
Amount of public issue

As shown in the figure 4.1, it is seen that the amount of public issue offered has been in rising trend during study period. From table 4.1, since first year of SEBON operation the amount of public issue have been fluctuating trend. In FY 1993/94 issue worth Rs.244.40 million were offered to the public. The amount decreased to Rs.173.96 million in FY 1994/95. After that the amount of public issue showed rising trend although only for few years. It rose to Rs.293.74 million in FY 1995/96, Rs.332.20 million in 1996/97, and Rs462.36 in FY 1997/98. It again dropped to Rs.258 million in FY 1998/99 only to rise again in FY 1999/00 to reach 326.86 million. It continued to rise in two subsequent years i.e. FY 2000/01 and FY 2001/02 and reached Rs.410.49 and Rs.1441.33 million respectively. However, it dropped substantially in the following year i.e. FY 2002/03 and marked just Rs.556.54 million. But the year proved to be the end of falling trend, as the amount of issue offered showed continuously rising trend in the subsequent fiscal years. The amount of public issues was recorded Rs.1027.50 million in FY 2003/04, Rs.1626.82 million in FY 2004/05, Rs.2443.28 million in FY 2005/06, Rs.2295.5 million in FY 2006/07 and Rs.9961.85 million in FY 2007/08. While the lowest amount of public issue was Rs.173.96 million in FY 1994/95 and the highest amount of public issue was Rs.9961.85 in FY 2007/08. The total public issue during the study

period was Rs.21855.05 million.

4.1.2 Number of Public Issues Offered

The number of public Offerings another to identify the exact number of offers made by various listed companies to the general public in each fiscal years.

Table 4.2
Number of Public Issues

Fiscal Year	Amount of Issue	No. of issue	Average size	Annual growth rate (%)
1993/94	244.4	16	15.28	0
1994/95	173.96	10	17.4	13.87
1995/96	293.74	12	24.48	40.69
1996/97	332.2	5	66.44	171.4
1997/98	462.36	12	38.53	-42.01
1998/99	258	5	51.6	33.92
1999/00	326.86	6	54.48	5.58
2000/01	410.49	9	45.16	-17.11
2001/02	1441.33	12	120.12	165.99
2002/03	556.54	18	30.92	74.26
2003/04	1027.5	14	73.39	137.35
2004/05	1626.82	14	116.2	58.33
2005/06	2443.28	29	84.25	-27.5
2006/07	2295.5	34	67.51	-19.87
2007/08	9961.85	63	158.12	134.21
Total	21855.05	259	84.38	

Source: SEBON Annual Report 2007/08

Figure 4.2
Number of Public Issue

Table 4.2 shows that the number of public issue offered during the study period has been fluctuating during various fiscal years but has been in increasing trend. Table 4.2 revealed the number of issues offered in each FY during the study period. Likewise the amount of public issue, the number of issue offered in a FY also had not any consistent trend on the study period. During the entire study period the lowest numbers of public issue offered in a Year were 5 which belong to FY 1996/97 and FY 1998/99. The highest number of issues offered during FY 2007/08. The average size of issue offered in each FY has also been in fluctuating trend. Average size of issue offered was smallest in FY 1993/94 and largest in FY 2007/08.

4.1.3 Sector-Wise Number of Publicly Issued Company

Issuing company should list their issues in NEPSE for trading. Since opening of NEPSE in FY 1993/94, 159 companies have already been listed where, out of these, 17 companies had de-listed from trading floor of NEPSE. So at the end of FY 2007/08, there were 142 companies listed in NEPSE.

Table 4.3
Publicly Issued Companies

S.N.	Sector	No of Public Issue	Paid up value (in million)	%
1	Banking	17	14667.3	49.78
2	Finance	55	2322.7	7.88
3	Insurance	17	4317.3	14.56
4	Development Banks	23	1669.7	5.67
5	Manufacturing and Processing	18	2539.7	8.62
6	Trading	4	78.4	0.27
7	Hotel	4	1552.9	5.27
8	Other	4	2337.8	7.87
Total		142	29845.8	100

Source: SEBON Annual Report 2007/08

Total paid up value of these listed securities by the end of fiscal year 2007/08 reached Rs.29845.80 million which was Rs.21798.80 million in last fiscal year (2006/07). The most intriguing aspect of this total paid up capital the contribution from financial sector that includes commercial banks, development banks, finance companies and insurance companies is very high.

Figure 4.3
Sector wise Public Issue

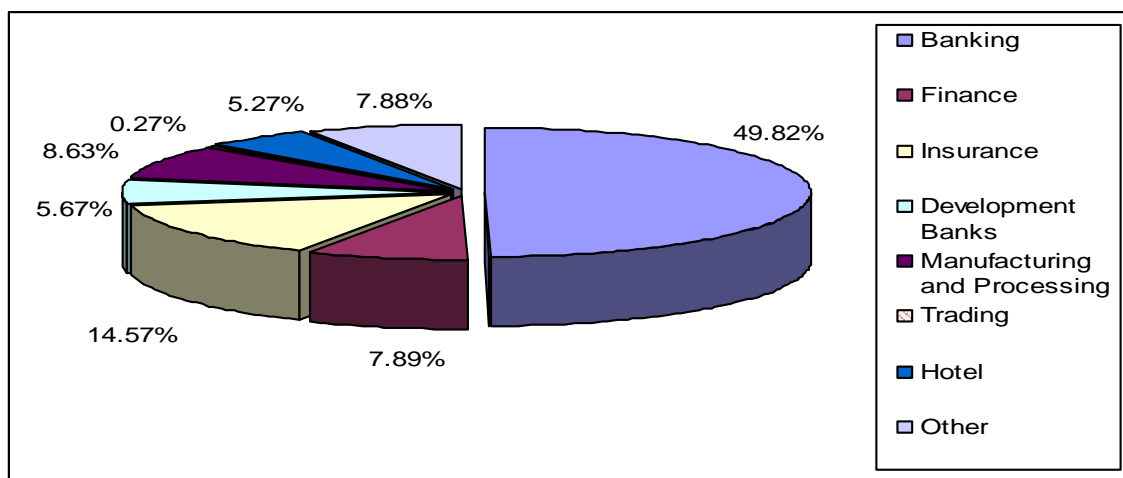


Table 4.3 shows, out of 142 listed companies, 112 companies belong to financial sector. From paid-up value perspective commercial banks occupies 49.82 percent (17) Development bank have 5.67 percent (23), Finance companies accounts for 7.88 percent (55) and insurance companies have 14.57 percent (17), altogether financial sector they accounting for 77.89 percent. On other hand manufacturing and processing sector despite being third largest sector (in term of listed companies) account for only 8.62 percent. Similarly, trading, hotel and other sector account for 0.29 percent, 5.27 percent and 7.87 percent of total paid up value respectively. Together as non-financial sector they account for 22.21 percent of total paid up value.

4.1.4 Public Issue from Financial and Non-financial Sector

Listed companies of NEPSE can be divided into Finance sector and Non-finance sector Finance sector mainly includes companies from commercial banks, development banks, finance companies and insurance while non-finance companies includes the companies from manufacturing and processing companies, trading companies, hotels and others (SEBON, 2006 Sept. 26). Table 4.5 reveals the public issues from finance and non-finance sector during the study period.

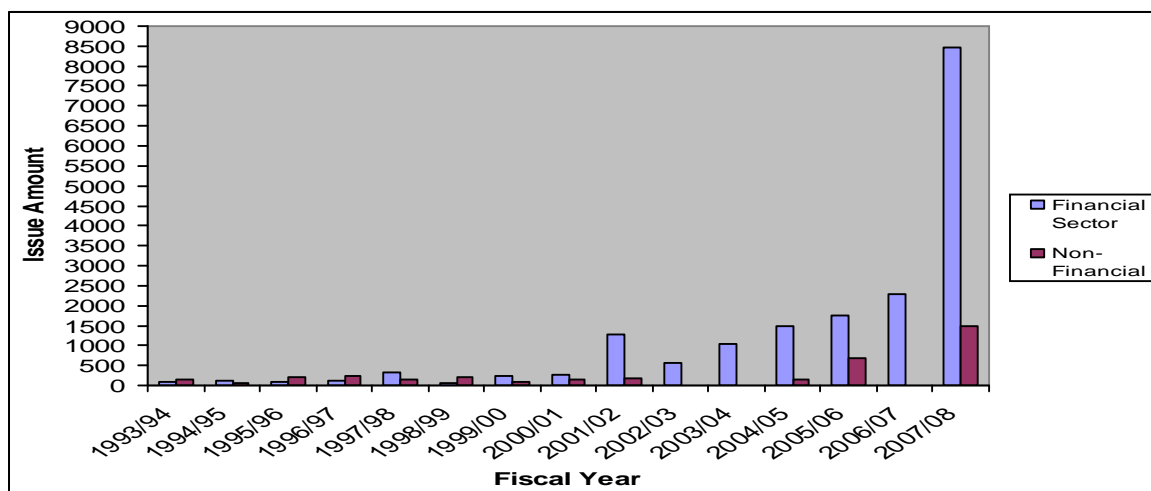
Table 4.4
Public Issue from Finance and Non-finance Sector

Sector	Finance			Non-finance			Total	
	Year	No. of Issue	Amount (Rs. in million)	Annual Growth (%)	No. of Issue	Amount (Rs. in million)	Annual Growth (%)	No. of Issue
1993/94	6	87.8	-	10	156.6	-	16	244.4
1994/95	6	120	36.67	4	54	-65.52	10	173.96
1995/96	8	95.1	-20.75	4	198.6	267.78	12	293.74
1996/97	4	107	12.51	1	225.2	13.39	5	332.2
1997/98	9	315.5	194.85	3	146.9	-34.77	12	462.36
1998/99	3	58	-81.62	2	200	36.15	5	258
1999/00	5	237.3	309.14	1	89.6	-55.20	6	326.86
2000/01	8	260.5	9.73	1	150	67.41	9	410.49
2001/02	11	1267.9	386.72	1	173.5	15.67	12	1441.33
2002/03	18	556.5	-56.11	0	0	-100	18	556.54
2003/04	14	1027.5	84.64	0	0	0	14	1027.5
2004/05	13	1486.8	44.7	1	140	0	14	1626.82
2005/06	27	1759.4	18.33	2	683.9	388.50	29	2443.28
2006/07	34	2295.50	28.42	0	0	-100	34	2295.5
2007/08	62	8461.85	268.60	1	1500	0	63	9961.85
Total	228	18136.65		31	3718.03		259	21855.05
Average	15.2	1209.11		2.067	247.87		17.27	1457.003

Source: SEBON Annual Report 07/08

Figure 4.4

Public Issues from Finance and Non-finance Sector



From Table 4.5 revealed that total of 259 public issues was made from finance and non-financial sector during the study period. Out of this, total of 228 (88.03 percent) offers came from financial sector whereas rest 31 (11.79 percent) from non-financial sector. It means 88.0 percent public offers are from financial sector and rest 11.79 percent from non-financial sector. During the study period total of Rs. 21855.05 million issued to public. Out of it Rs.18136.65 million (82.98 percent) came from financial sector. Similarly, contribution from non-financial sector is Rs. 3718.03 million which is 17.02 percent of total.

On an average, there are approximately 15 offers from financial sector during each Fiscal Year, while approximately just 2 from non-financial sector. Similarly, on an average public issue of Rs.1209.11 m came from financial sector while Rs.247.88 m from non-financial sector. These figures clearly show that the financial sector is dominant force of Nepalese IPO market. From the table it is clearly seen that financial sector were growing at 35.60 percent per year during the study period while non-financial sector were growing only at 16.26 percent per year.

The highest growth rate in financial sector was 386.72 percent in FY 2001/02 whereas in non-financial sector was 388.50 percent in 2005/06.

Result of t-test

T-test deals with the small samples for testing hypothesis concerning population means, difference between two population means, as observed sample correlation coefficient etc. To test where the issue between Finance and Non-finance Sector are differing or not t-test is performed. Since there are Finance and Non-finance sector and yearly 15 years are taken as the number of observation. The overall results these calculations are as follows:

Table 4.5
T-test result of Finance and Non-Finance Sector Issues

Total no. of Observations	Calculated t-value	Degree of Freedom	Tabulated t-value	Result	Decision
15	1.73	28	1.70	Tab-t<Cal-t	Ho is rejected

The t-test for difference between two normal populations having the same means and equal population variances or there is significant difference between population means from which the sample are drawn. For this, t-test is done at 5% level of significant (one tailed test). From the table it is seen that calculated t-value is greater than the tabulated t-value, so null hypothesis (Ho) is rejected at 28 degree of freedom. This implies that issue amount from financial sector is not equal with non-financial sector and it is noted that primary market is concentrated to financial sector than Non-financial sector.

4.1.5 Instrument-Wise Public Issues

Likewise many other emerging markets, Nepalese market also provides limited variety of investment instruments which mainly includes common stock, preferences shares, convertible preference shares, right shares, and debenture .

Table 4.6
Instrument wise Issue

Fiscal Year	Ordinary Share		Right Share		Debenture		Preference Share*		Total	
	No of issue	Amount (in m.)	No of issue	Amount (in m.)	No of issue	Amt. (in m.)	No of issue	Amt. (in m.)	No of issue	Amount (in m.)
1993/94	14	227.9	-	-	-	-	2	16.5	16	244.4
1994/95	10	173.96	-	-	-	-	-	-	10	173.96
1995/96	10	224.74	2	69	-	-	-	-	12	293.74
1996/97	2	57	3	265.2	-	-	-	-	5	332.20
1997/98	8	119.4	3	259.96	1	93	-	-	12	462.36
1998/99	3	148	1	30	-	-	1	80	5	258.00
1999/00	3	202.3	3	124.6	-	-	-	-	6	326.90
2000/01	7	278.7	2	131.8	-	-	-	-	9	410.50
2001/02	5	319.5	5	621.9	1	360	1	140	12	1441.40
2002/03	14	394.3	4	162.2	-	-	-	-	18	556.50
2003/04	10	657.5	3	70	1	300	-	-	14	1027.5
2004/05	7	1231.78	6	94.93	1	300	-	-	14	1626.71
2005/06	14	579.8	11	1013.5	4	850	-	-	29	2443.30
2006/07	15	380.3	17	1265.3	1	250	1	400	34	2295.6
2007/08	16	984.8	42	6087.1	5	2950	-	-	63	9961.90
Total	138	5919.98	102	10205.49	14	5103	5	636.5	259	2154.97
%	53.27	27.08	39.38	46.70	5.41	23.34	1.93	2.90	100	100

Source: SEBON Annual Report 2007/08

*Note: Convertible preferred stock also treated as ordinary preferred stock during the study.

Table 4.6 shows out of 259 offers during the sample period, 138 issues were ordinary shares, which is 53.27 percent of the total issue offered during the period. Similarly, 102 issues were right shares, which is 39.38 percent of total issue. Also 14 issues were debentures (5.41 percent) and 5 issues were preference share (1.93 percent). Hence, from

number of issues offered perspective, ordinary share was the most preferred instrument for issuing company, followed by right share, debenture and preference share respectively.

Figure 4.5
Instrument Wise Public Issue (On the basis of Total Amount)

From issued amount perspective right share emerges as most used financial instrument with 46.70 percent of total issued amount. Second most used instrument was ordinary share occupying 27.08 percent of total amount followed by debenture 23.34 percent and preferred stock (2.90 percent) respectively.

This study clearly showed that NEPSE Stock Market is highly dependent on few financial instrument likely ordinary share and right share.

4.2 Presentation and Analysis of Primary Data

This part deals with the analysis of primary data collected from questionnaire survey. This part tries to analysis the investors (both individual and institutional) attitudes towards the developments and growth pattern of financial instruments and primary market components in Nepalese Security Market. It also tries to attempt the investors' grievances towards the different parties of the security market and level of investors' awareness.

4.2.1 Analysis of Investor's Preferences and Type of Securities

An important issue in Nepalese capital market is to know what kinds of securities investors prefer most. Another issue is to identify whether the tendency of the institutional and individual investor related to each other or not. This is tested by the use of null hypothesis. The table 4.7 shows the investors preference on different types of securities. Rank one indicates the most preferable securities and rank five represents the least preferable securities.

Table 4.7
Status of investor's preference and type of securities

Type of security	Rank					Mean	Overall rank
	1	2	3	4	5		
Common stock	53	43	13	2	1	1.71	1
Preferred stock	5	19	40	20	28	3.42	4
Debentures/Bonds	12	25	16	50	9	3.17	3
Government Bonds	42	25	5	30	10	2.47	2

Source: Field Survey, 2009, Kathmandu

Table 4.7 shows that common stock is the security that is most preferred by the investors, followed by government bonds, debentures and preferred stock respectively. From the table it is clear that mean values of common stock, preferred stock, debentures and government bonds are 1.71, 3.42, 3.17 and 2.47 respectively. These mean values indicate the concentrations of respondents are of common stock.

4.2.2 Attitude of Investor towards Transacting on Securities

Table 4.8 shows the information of the results of the two types of investors i.e. individual and institutional and their responses to the statement they would like or dislike transacting on the each of the given securities. Total numbers of each of the responses on each security according to investors' category are presented in the table 4.8

Table 4.8

Attitude of investor towards transacting on securities

Type of securities	Responses	Type of investor		%	Calculated 2	Result
		Individual	Institutional			
Common stock	Like	45	47	82.14	0.243	Ho is accepted
	Dislike	11	9	17.86		
Preferred stock	Like	15	11	23.21	0.801	Ho is accepted
	Dislike	41	45	76.79		
Debentures/Bonds	Like	43	36	70.54	2.105	Ho is accepted
	Dislike	13	20	29.46		
Government Bonds	Like	48	42	80.36	2.036	Ho is accepted
	Dislike	8	14	19.64		

Source: Field Survey, 2009, Kathmandu, and Appendix - 1

Note: i) Tabulated value of 2 at .05 level of significance for 1 d.f. is 3.84

Table 4.8 shows, calculated value of 2 for Common Stock, Preferred Stock, Debenture/Bonds and Government Bonds are 0.243, 0.801, 2.105 and 2.036 respectively which all are less than table value (3.84) therefore null hypothesis is accepted. It shows there is no significance difference between the views of individual and institutional investors. Common stock is the most preferred security but the preferred stock is the least preferred securities among Nepalese Security investors.

4.2.3 Analysis of Relative Important Features of Common Stock

Respondents indicate following features of common stock to rate as per the features' importance to investors. The results of the responses of the respondents are as follows:

Table 4.9**Importance features of common stock as viewed by the respondents**

S.N	Features of common stock	Rank										Mean	Overall Rank
		1	2	3	4	5	6	7	8	9	10		
1	Power to exercise rights	9	12	15	18	9	10	15	17	4	3	5.02	4
2	Participation in management	13	14	7	10	12	11	25	7	8	5	5.19	5
3	Sense of ownership	3	2	8	9	6	5	10	45	20	4	6.94	6
4	Participation in earnings	45	15	4	5	8	2	10	7	3	13	3.95	3
5	Bulk transaction	21	23	13	19	7	5	10	11	-	3	3.88	2
6	Marketability	21	25	11	13	15	17	1	2	6	1	3.75	1

Source: Field Survey, 2009, Kathmandu

The table 4.9 shows that various important features of common stock viewed by the respondents. The main reason to prefer common stock is marketability. Next to this, bulk transaction is the second feature of common stock in terms of the perceived importance of Nepalese investors. Sense of ownership is the least important feature of common stock for the transaction.

4.2.4 Analysis of Investment Sectors and Investor's Attitude

There are different industrial sectors in which one can invest but the choices are different. Investors' attitude about the investment determines by various factors. The table 4.10 shows the investors attitudes towards different sectors.

Table 4.10**Investment sectors and investor's attitude**

S.N	Industrial sector	Rank										Mean	Rank
		1	2	3	4	5	6	7	8	9	10		
1	Bank	58	25	7	5	6	4	7	-	-	-	2.25	1
2	Finance	17	23	21	19	18	2	4	3	3	2	3.60	2
3	Hotel	10	22	17	16	7	9	11	11	6	3	4.53	3
4	Manufacturing and Processing company	5	22	13	18	6	9	12	5	8	14	5.18	6
5	Insurance Company	6	9	20	21	18	17	8	4	3	6	4.78	4
6	Trading Company	7	5	30	15	12	7	9	15	5	7	5.06	5
7	Others	9	6	4	18	-	-	21	-	18	36	6.91	7

Source: Field Survey, 2009, Kathmandu

The table 4.10 shows that the most attractive sector for Nepalese investors is banking sector which has mean value 2.25 and rank position is one. Likewise Finance, Hotel, Insurance, Trading, Manufacturing and processing, and other sector are most to least priority sector of the Nepalese Security investor.

4.2.5 Investment Objectives of the Investors

Investment objective is the foundation of investment on the basis of which investor's makes a decision regarding selection of security, evaluation of the performance and time horizon of investment etc. The investment objective of investors is not only a basis to identify investor's investment psychology but also a milestone to set investment related policies and to set price and other features of securities. The main psychological reason behind investing is to obtain certain investment objectives.

Table 4.11

Investment objectives of investors as viewed by investors

Investment Objectives	Rank				Mean	Overall rank
	1	2	3	4		
High return	51	44	12	5	1.74	1
Less risk	21	31	27	33	2.64	3
Marketability	35	12	36	29	2.53	2
Social status	5	25	37	45	3.09	4

Source: Sample Survey, 2009, Kathmandu

Table 4.11 shows the investors' investment objective, their ranking position and mean value. Rank one indicates the highly preferable investment objective to invest and rank 4 prefers the less priority ranking. High return is the main objectives of investment but social status is the least important objectives of investment for the Nepalese Security investors.

4.2.6 Shortcomings of Debentures and Preferred Stock Investment

Debentures and preferred stock are not used as common stock in Nepalese market Moreover the tendency of this is same for both the institutional and individual investors. What are such reasons that get the Nepalese investors feel so alienated with debt security is a question to be analyzed here onwards. The answer of this perhaps will be the solution in itself to correct the problems that has been apparent in Nepalese bond market.

Table 4.12
Problems in investing in debt and preferred stock

S.No	Statements	Rank					Mean	Overall ranking
		1	2	3	4	5		
1.	No provision of handsome return that compensates the perceived risk of investors.	44	19	14	18	17	2.51	4
2.	These financial instruments provide only certain return.	35	40	22	13	2	2.17	2
3.	Overburden of legal formalities	21	17	21	12	41	3.31	6
4.	Due to the lack of professional practices	33	15	14	32	18	2.88	5
5.	Lack of marketability and liquidity.	45	19	6	31	11	2.50	3
6.	No legal protection in favor of investors	6	18	20	24	44	3.73	7
7.	Due to the lack of wide varieties in these kinds of securities.	51	34	10	9	8	2.01	1

Source: Field Survey, 2009. Kathmandu

Table 4.12 shows debt and preferred is the least demanding securities for the Nepalese Security investor. The lack of wide varieties in these kinds of security is the main reason behind it but no legal protection in favor of investor is the least affecting one.

4.2.7 Investor's Preference on Bond Investment

Of course bond market is not as in the height as stock market. However there are so many types of bonds that meet the investors' need and get them propel to invest in these securities but what is such bond that can win the investor's psychology is the main question to be addressed. Investors are given the bond option having following alternative features and asked which of these they like most. The results of their views are provided in table 4.13.

Table 4.13
Preference of alternative bonds

Observations	Number of respondents					
	Institutional	%	Individual	%	Total	%
Bond that gets you participates in profits and or loss (income bond).	9	8.04	6	5.36	15	13.39
Bond that adjusts promised interest rate according to the rate in the market (floating rate).	16	14.29	7	6.25	23	20.54
Bond that is pledged against the firm's assets (mortgaged bond).	13	11.61	26	23.21	39	34.82
Simple debt that pays regular interest (simple interest).	18	16.07	17	15.18	35	31.25
Calculated value of χ^2	8.4836					

Source: Field Survey, 2009, Kathmandu. and Appendix – 1

Note: i) Tabulated t value of χ^2 at .05 level of significance for 3 d.f. is 7.82

Table 4.13 shows mortgage bond is the most favored bond followed by simple interest bond, floating rate bond and income bond. The result of the survey has also been presented in figure below. It shows that out of the total respondents 39 (34.82 percent), 35 (31.25 percent), 23 (20.56 percent) and 15 (13.39 percent) respondents are in favor of mortgage, simple interest, floating rate and income bond respectively. This shows that firms should not only issue bond of traditional nature but they should also add some feature(s) in bond to pull bond market up to an inspiring level.

Calculated value (8.4836) of chi-square is higher than table value (7.82), therefore, null hypothesis is accepted. So, there is significance difference between views of individual investors and institutional investors. Institutional investors prefers simple interest bond but

individual investors prefer mortgage bond. These preferences are also shown in figure 4.6 below.

Figure 4.6
Preference of investors towards different kinds of bond

4.2.8 Factor Affecting Choice of Security

Factors those affect or determine the choice of security may be innumerable depending upon the status of security market in the country and investor's psychology. As a matter of fact nothing can fully explain the determining factors those affect the choice of the investors in buying security notwithstanding here an attempt has been made to identify some of the important factors that may affect their choice. Given the following important four factors influencing the choice of security investors are asked to rate these giving 1 for most influencing to 5 for least influencing factor. The results of their rating are appeared as follows:

Table 4.14
Factor Affecting Choice of Security

Factors	Rank					Mean	Overall rank
	1	2	3	4	5		
Return pattern	22	65	15	6	4	2.15	2
Availability	12	30	34	21	15	2.97	3

Company's overall performance	77	16	12	2	5	1.59	1
Rumors	1	1	24	43	43	4.13	4

Source: Sample Survey, 2009, Kathmandu

Table 4.14 shows Company's overall performance is the most affecting factor for the choice of security which ranked one. Likewise, return pattern, availability, and rumors are the most to least affecting factor for the choice of security in the Nepalese Security Market.

4.2.9 Reason for Preferring Government Securities

As per the analysis investors are inclined more towards government bonds than corporate bonds and preferred stock. In course of identifying the reason for preferring government security following analysis is performed and presented. On the other way, it is the need to identify what are such features of government security that make the investors prefer the security. As an attempt towards that end following alternative features of government bonds are presented and asked to rate these as per their importance giving 1 to most important and 5 to least important.

Table 4.15

Reason for preferring government security

Factors affecting choice of security	Rank					Mean	Overall rank
	1	2	3	4	5		
Risk Free	78	15	9	1	9	1.64	1
Advantage for construction	12	42	15	12	31	3.07	2
Protection against malpractices	8	20	27	33	24	3.40	3
Less legal formalities	1	16	37	15	43	3.74	5
Stable return	13	19	24	20	36	3.42	4

Source: Sample Survey, 2009, Kathmandu

Table 4.15 shows that government security is preferred security by the Nepalese Security investor because of risk free character of it. Likewise advantages for construction of portfolio, protection against malpractices, stable return, and less legal formalities are the most to the least affecting factor for preferring government security by the Nepalese Security investors.

4.2.10 Analysis of Risk and Return While Investment

Whether the Nepalese investors are fully aware of the risk and return or not are analyzed here or do the investors tend to adopt any particular method of analyzing risk and return of the security before investing in or not is the question to be addressed here in this section. Following is the result of survey conducted to identify behavior of investors in this regard.

Table 4.16
Investors performing risk and return analysis

Response	No. of respondents				Total	%
	Individual	%	Institutional	%		
Yes	25	22.32	37	33.04	62	55.36
No	16	14.29	15	13.39	31	27.68
Don't Know	15	13.39	4	3.57	19	16.96
Total	56	50	56	50	112	100
Value of t_2	8.72					

Source: Field Survey, 2009, Kathmandu

Note: i) Tabulated value of t_2 at .05 level of significance for 4 d.f. is 9.49.

Table 4.16 shows out of the total respondents, there are more of institutional investors (i.e. 33.04 percent) performing risk and return analysis while investing in securities. Like wise investors who don't perform risk and return are 31 as opposed to those who perform. Investors having no idea as to this are 19. This is also presented in the figure 4.7.

Figure 4.7
Investors' tendency to perform risk and return analysis

The calculated value (8.72) of F_2 that is less than table value (9.49) of F_2 at 0.05 level of significance and 4 percentage degree of freedom. This indicates that the tendency of individual and institutional investors do not differ significantly to perform risk and return analysis while investing in securities.

4.2.11 Investor's Grievances Against Issuer Companies

Issuer Company is the major component of primary market. There are so many grievances of the investors who purchase share from primary market against Issuer Company.

Table 4.17
Primary market investor's grievances towards Issuer Company

Nature of grievances	No. of respondents with the grievances	Percentage (%)
Issuer Company does not provide the prospectus/security/purchase application form	-	-
Company wants to influence unduly through prospectus and other advertisements	65	58.04
Company does not provide the article of association, memorandum of association and other related documents for detail perusal.	11	9.82
Company rejects to receive the share application form duly filled by the investor.	-	-
Irregularities while allocating the security to the investors.	36	32.14
Total	112	100

Source: Field Survey, 2009, Kathmandu

Table 4.17 shows most of the respondent complaint as to the company's tendency to influence unduly to the investors through different type of source of information having their reach. And some of the respondents also dissatisfied with the process of allocating shares to the investors. Other 11 have complained that company does not provide necessary documents for detail perusal.

4.2.12 Investors Grievances against Nepal Stock Exchange

Security Exchange Company is the sole organization that regulates and looks after the functioning of other security related companies. The type and nature of grievances of the respondents are provided in the table 4.18.

Respondents have different complain against Security Exchange. The complaint is that they do not inform to market as to the price sensitive information and financial statements. Further respondents complain that the company cannot make up to date information as to the information relating to the membership, listing of securities and transaction etc.

Table 4.18
Investor’s grievances against Nepal Stock Exchange

Nature of grievances	No. of respondents with the grievances	Percentage (%)
Stock exchange does not inform to market as to the price sensitive information and financial statements.	97	86.61
Stock exchange does not provide the necessary information of the sold/purchased share.	-	-
It does not provide information relating to the membership, listing of securities and transactions etc.	15	13.39
Total	112	100

Source: Field Survey, 2009, Kathmandu

4.2.13 Necessary Actions to Accelerate State of Security Market

Transactions of securities and overall situation of security market is in developing phase and need to be accelerated. With a view to identify actions that possibly help to upgrade the present state of security market; following type of actions are identified and asked to rate these as per their necessity and urgency in the context of Nepalese security market. The results of their rankings are appeared in the table 4.19

Table 4.19

Necessary actions to accelerate state of security market as viewed by respondents

Observations	Rank					Mean	Overall Rank
	1	2	3	4	5		
1. Expansion of activities beyond capital city.	45	35	18	6	8	2.08	1
2. Arrangements for the involvement of Employee's Provident Fund, Citizen's Investment Trust, and Mutual Fund in security market	22	27	40	20	3	2.60	3
3. Sufficient Publicity	12	7	8	39	46	3.89	4
4. Amendment and strict implementation of rules and regulations	33	43	30	3	3	2.11	2

Source: Field Survey, 2009, Kathmandu

Table 4.19 shows that expansion of activities beyond capital city is the most important suggestion to accelerate present state of Nepalese Security Market.

4.2.14 Component playing vital role in the Primary Market

There are mainly eight components of the primary market but which component is playing the main role in the primary market is the focus of the study. To identify the role of each component, different responses on the basis of ranking were collected from the various respondents. Rank one is the highly important component and rank eight indicates the least preferable component.

Table 4.20**Component playing vital role in the primary market**

Components of Security Market	Rank					Mean	Overall rank
	1	2	3	4	5		
a) Issuing Company	25	29	17	11	30	2.93	7
b) Registrar of Company	10	17	35	20	30	3.38	13
c) Merchant/Investment Bankers	33	44	20	7	8	2.22	2
d) Nepal Rastra Bank	20	15	20	30	27	3.26	9
e) Financial Institution	19	30	27	16	20	2.89	6
f) SEBON	43	24	4	31	10	2.47	3
g) NEPSE	22	43	16	11	20	2.68	5
h) Issue and Sales Manager	54	42	13	2	1	1.70	1
i) Adverting Agent	12	20	35	15	30	3.28	10
j) Collection Centers	27	35	27	14	9	2.49	4
k) Under writer	18	19	30	16	29	3.17	8
l) Dealer	12	19	23	38	20	3.31	11
m) Insurance Board	11	17	36	18	30	3.35	12

Source: Field Survey, 2009, Kathmandu, and Appendix - 2

(Note: Financial institution involves issue manager, underwriter, collection center, and bankers to the issue but during the study they have been analyzed separately to identify the individual role.)

Table 4.20, shows the most important component of the primary market is the issue manager and sales manager. Likewise, Merchant/investment Banker, Security Board of Nepal (SEBON), Collection Centres, Nepal Stock Exchange (NEPSE), Financial Institutions, Issuing Company, Underwriter, Nepal Rastra Bank (NRB), Advertising Agents, Dealer,

Insurance Board, and Registrar of Company (ROC) have most to least important role in the primary market of Nepal.

4.2.15 Need of Mutual Fund

Market price of blue chip securities is very high. Small investor can not afford these types of securities. They are unable to construct optimal portfolio and bearing high risk. These difficulties of small investor gave rise to the concept of mutual fund. Views of 112 sample investor have been collected to access the need of mutual fund in Nepalese Security Market.

Table 4.21
Need of Mutual Fund

Response	No. of respondents				Total	%
	Individual	%	Institutional	%		
Yes	27	24.11	38	33.93	65	58.04
No	14	12.50	14	12.50	28	25
Don't Know	15	13.39	4	3.57	19	16.96
Total	56	50	56	50	112	100
Value of χ^2	8.23					

Source: Field Survey, 2009, Kathmandu

Note: i) Tabulated t value of χ^2 at .05 level of significance for 4 d.f. is 9.49.

Table 4.21 shows, 58.04 percent of respondents are at the side of increment in the number of mutual fund, 25 percent of respondents are against its increment but 16.96 percent of respondents have no idea.

Chi-square test shows there is no significant difference between views of individual investors and institutional investor because calculated value (8.23) of chi-square is lower than its table value (9.49).

Responses of different respondents presented in the diagram as blow:

Figure 4.8
Need of Mutual Fund

Figure 4.8 shows, high number of respondents feel there is need of increment the number of mutual fund in the Nepalese Security Market.

4.2.16 Prospect of Derivative Securities in Nepalese Security Market:

There are limited numbers of financial instrument available in Nepalese Security Market. Derivative securities are those type of securities whose income are depends upon the income of underlying assets which is also unavailable for Nepalese investors. Views of 112 have been collected to access the need of derivative securities in Nepalese Security Market.

Table 4.22
Prospect of Derivative Securities in Nepalese Securities Market

Response	No. of respondents				Total	%
	Individual	%	Institutional	%		
Yes	30	26.79	40	35.71	70	62.50
No	7	6.25	10	8.93	17	15.18
Don't Know	19	16.96	6	5.36	25	22.32
Total	56	50	56	50	112	100
Value of 2	8.72					

Source: Field Survey, 2009, Kathmandu

Table 4.21 shows, 62.50 percent of respondents are in favor of launching derivative securities in Nepalese Security Market, 15.18 percent of respondents are against with such views, but 22.32 percent of respondents are not familiar with the term of derivative securities or they are undecided.

Chi-square test shows there is no significant difference between views of individual investors and institutional investor because calculated value (8.23) of chi-square is lower than its table value (9.49).

Responses of different respondent presented in the diagram as blow:

Figure 4.9

Prospect of Derivative Securities

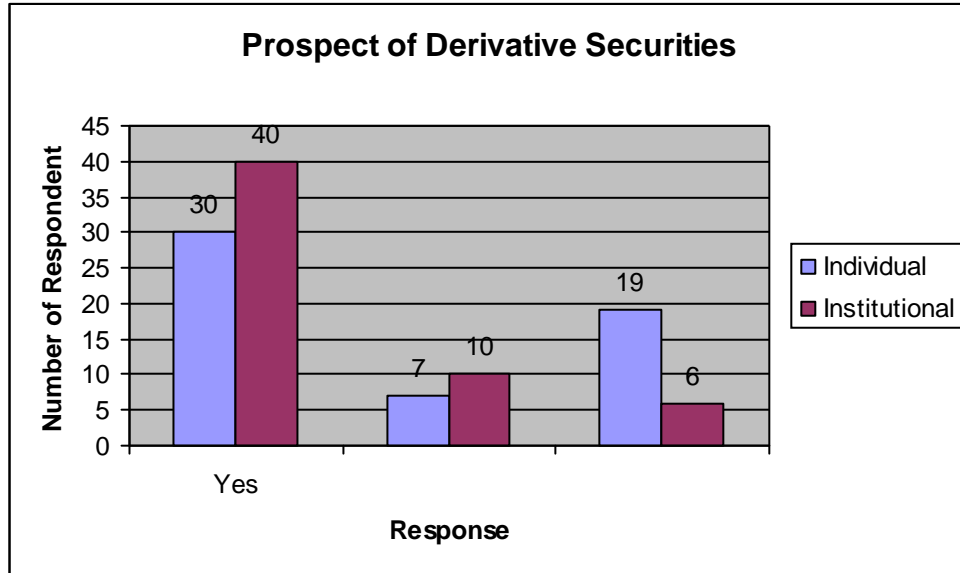


Figure 4.9 shows high portion of respondents are in favor of derivative securities.

4.3 Major Findings of the Study

Major finding of the study have been divided into two sections. Section one presents the major findings of secondary data analysis, whereas section two presents the findings of primary data analysis.

4.3.1 Major finding of Secondary Data Analysis:

The major findings of secondary data analysis are as follows:

- J The highest amount of public issue during study period was Rs.9961.85 which belongs to FY 2007/08 whereas the lowest amount was Rs.173.96 in FY1994/95. The overall trend of the public issue was fluctuated. But in the later year amount of the public issue increased in comparison with the former years.
- J The highest number of public issue during study period was 63 which belongs to FY 2007/08 whereas the lowest number of public issue was 5 which belongs to FY 1998/99.
- J Among the various sectors; the banking sector contributes the highest with 49.78 percent of the total public issue whereas trading sector contributes 0.27 percent during the study period.
- J During the study period, finance sector issued the highest public issue with 55 public issues but in term of paid-up capital banking sector issued the highest amount of public issue of Rs. 14,667.3 million which covers 49.78 percent of the total public issue.
- J Financial sector's average number of public issue was 15.2 but non-financial sector had only 2.067. Financial sector's average amount of public issue was Rs. 1209.11 million but the non-financial sector issued only Rs.247.87.
- J Ordinary shares, preference shares, debentures and right shares are major financial instruments of Nepalese Securities Market. Ordinary shares cover 46.69 percent of total public issue which is the highest one.

4.3.2 Major Findings of Primary Data Analysis:

The major findings of primary data analysis are as follows:

- J With respect to investors' preference, common stock is the highest preferable but preferred stock is the least preferable security.
- J Regarding the attitude of investor towards transacting on securities, common stock is the most preferable but preferred stock is the least preferable one. Chi-square test shows there is no significance difference between the views of individual investor and institutional investor.
- J Regarding relative importance features of common stock, investors highly prefers common stock because of its marketability.
- J With respect to investment sector and investor's attitude, banking sector is the most preferable but other sector is the least preferable sector.
- J Regarding investment objectives of the investors, high return is the main objective but social status is the least affecting objective.
- J Regarding shortcoming of debentures and preferred stock investment, lack of wide varieties in these kinds of security is the most affecting but no legal protection in favor of investors in the least one.
- J With respect to investor's preference on bond investment, mortgage bond is the most preferred but chi-square test shows there is significance difference between the view of individual investors and institutional investors. Institutional investors prefers simple interest bond but individual investors prefer mortgage bond.
- J Regarding factors affecting choice of security, Company's overall performance is the most affecting factor but rumors is the least affecting factor.
- J Regarding the reason for preferring government securities, risk free characteristic is the most important reason whereas less legal formalities is the least one.
- J With respect to analysis of risk and return while investment, 55.36 percent of total respondents make risk and return analysis before investment. Chi-square test shows

there is no significance difference between the views of individual investors and institutional investors.

- J Regarding investor's grievances against issuer companies, out of total respondents; 58.04 percent of investors complain that company wants to influence unduly through prospectus and other advertisements.
- J Regarding investor's grievances against Security Exchange, 86.61 percent of total respondents complain stock exchange does not inform to market to the price sensitive information and financial statements.
- J With respect to necessary actions to accelerate state of security market, majority of respondents suggest to expand the activities beyond capital city.
- J With respect to component playing vital role in the primary market, issue and sales manager plays the most important role but registrar of company (ROC) has the least important role.
- J Regarding need of mutual fund, 58.04 percent of total respondents are at the side of increment in the number of mutual fund. Chi-square test shows there is no significance difference between the views of individual investors and institutional investors.
- J Regarding prospect of derivative securities in Nepalese security, 62.20 percent of total respondent suggest to introduce derivative security in the Nepalese Security Market. Chi-square test shows there is no significance difference between the views of individual investors and institutional investors.

CHAPTER – V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Financial instrument refers to the stock, bond, debenture and other financial assets those represent the right of the holder to receive future prospective benefits under the terms and conditions provided in the instrument(s) which are traded in the financial market with the help of financial intermediaries. Capital and securities market are the important parts of the financial markets. Nepalese financial markets are in developing stage. Gradually the investors' awareness, participation and interest in the financial market are increasing. Most of the financial instruments are actively traded in Nepalese Security Markets. But, derivative instruments like options, futures are not still trading in Nepalese Security Market.

Components of primary market like Issue Manager, Merchant/investment Banker, Security Board of Nepal (SEBON), Collection Centres, Nepal Stock Exchange (NEPSE), Financial Institutions, Issuing Company, Underwriter, Nepal Rastra Bank (NRB), Advertising Agents, Dealer, Insurance Board, and Registrar of Company (ROC) plays the vital role in issue of new securities. Without these components, the primary market is meaningless. Similarly, the financial instruments like bond, common stock, preferred stock, listed government securities are traded on the secondary market. Developed financial market is essential for development of national economy. A primary market is a part of financial market. Financial markets contribution to the national economy express in different ways like transaction amount, number of listed companies, number of issue, NEPSE index, profit amount, turnover, GDP, etc. Nepalese security markets are dominated by banking sector.

The main objective of the study is to analyze the development of financial instruments and primary market components in Nepalese Securities Market. Its specific objectives are to examine the growth pattern of long term financial instruments like equity shares, debentures,

preferred stocks, and government bond, to identify the growth trend of primary market's components in term of public issued offered, numbers of public issued company, to examine the investors' preferences and attitudes towards the financial instruments, to identify the most popular sector for investment among Nepalese investors and factors that influence investors to invest in different types of securities, to assess investor's grievances against concern authorities i.e. Issuer Company, and stock exchange, to identify the most important component of primary markets, and to examine the prospects of new financial instruments in the Nepalese Security Market.

Books, Articles and past master's research works are reviewed in this research. This research is based on primary as well as secondary data. With regard to secondary data, fourteenth years data have been collected for the study. Primary data has been collected from one hundred and twelve sample respondents. Out of them, fifty-six are individual investor and the same from the institutional investors. Primary and secondary data have been analyzed with the different financial and statistical tools.

5.2 Conclusion

Nepalese security market is in developing stage. The amount of public issue and its number are in increasing trends. There are so many financial instruments available for the Nepalese investor but derivative securities are still have not been introduced to them. Banking sector is dominating other sector and finance sector has been issued large number of public issue than non-financial sector. Ordinary shares cover the high portion of the public issue. Institutional investor prefers simple interest bond but individual investor prefer mortgage bond which is result of the chi-square test also. Nepalese investors analyze the overall company's performance to choose security for investment. Majority of respondent are in favor of introducing derivative securities and increasing the number of mutual fund. Respondents suggest to broaden the access of the securities services, professionalism of the stock market and traders, institutional capacity and services beyond the capital city to develop security market in Nepal. [Components](#) of primary market like issue and sales manager,

investment/merchant bankers, and Security board of Nepal (SEBON) have been playing vital role. Nepalese financial instruments are not developed at all and the components of primary markets have not been playing the effective role equally.

5.3 Recommendations

Nepalese investors have limited choice of financial instruments and the components of primary market are not playing their role in an efficient manner. With the help of finding of the study and the literature review some recommendations can be forwarded to the stakeholders of the market. They are follows:

-) Banking and finance sectors cover high portion of the public issue, for the overall development of the nation increment of the public issue is desirable in other sector also.
-) During the study period, issuing companies have issued common stock highly. They should issue other financial instrument to make easy to construct portfolio.
-) Investors focus only on common stock, they should invest their fund in other financial instruments to reduce the risk.
-) Investor prefers to invest security with high return. So, issuing company should issue such type of securities.
-) Issuing company should issue debenture and preferred stock with wide varieties.
-) Respondents complain issuing company wants to influence unduly through prospectus and other advertisements. Concerned authority should give attention regarding this issue.
-) Stock exchange has not been providing related information and financial statement. Stock exchange should address this complain.
-) Area and activities of security market should expand beyond the capital city for the development of Security Market.
-) All the components of primary market should act effectively.
-) Number of mutual fund should be increased to give access of blue chip stock.

) Concern parties should introduce derivative securities to provide choice for investment.

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APPENDIX-I

RESEARCH QUESTIONNAIRE

I hereby request you to fill up the questionnaire designed for proposed survey of the surveyor. The precious views and opinions from your side will be helpful for facilitating the research entitled “Development of Financial Instruments and Primary Market Components in Nepalese Securities Market”. The views expressed by you here in the questionnaire will be used for the research purpose only and kept confidential.

I) For individual investor only :

Name (Optional) :

Address :

Qualification :

Occupation :

II) For institutional investors only :

Name (Optional) :

Address :

Qualification :

Occupation :

.....X.....X.....

1. Please consider the following financial instruments in Nepalese security market, Place a number that best describe your preference on a scale of 1 to 5 on the line before each of these securities.

1 2 3 4 5

Most preferred

Least preferred

1. Common stock
2. Preferred stock
3. Debentures/Bonds
4. Government Bonds

2. Do you like to transaction of following securities? (Please make a tick(v) mark)

Type of securities	Like	Dislike
a) Common Stock		
b) Preferred Stock		
C) Debentures/Bonds		
d) Government Bonds		

3. Following are the some of the features of common stock. Please rank in order of their following importance to you.

1. Power to exercise rights..... ()
2. Participation in management..... ()
3. Sense of ownership..... ()
4. Participation in earnings..... ()
5. Bulk transaction..... ()

- 6. Marketability..... ()
- 7. Others (please specify) ()

4. Following are the eight industrial sectors. In your opinion, which of the sectors is attractive so far as the matter of investing in securities is concerned? Please rank in order of their attractiveness as per the given scheme.

More attractive		Least attractive
1	2 3	4 5

- 1. Bank..... ()
- 2. Development bank..... ()
- 3. Finance..... ()
- 4. Hotel ()
- 5. Manufacturing and Processing Company..... ()
- 6. Insurance Company ()
- 7. Trading Company ()
- 8. Others..... ()

5. Which of the followings best matches with your investment purposes? Please rank in order of their importance to you.

1. High return..... ()
2. Less risk..... ()
3. Marketability..... ()
4. Social status..... ()
5. Other (please specify) ()

6. In Nepalese capital market, financial instruments except common stock have not been used frequently. How far do you agree/disagree with the following reasons of not using debt and preferred stock as frequently a common stock? Please make a tick mark as the appropriate number as per the following scheme:

1= strongly agree, 2= agree, 3= don't know, 4= disagree, 5= strongly disagree

S. No	Statements	1	2	3	4	5
1	No provision of handsome return that compensates the perceived risk of investors.					
2	These financial instruments provides only certain return					
3	Overburden of legal formalities					
4	Due to the lack of professional practices.					
5	Lack of marketability and liquidity					
6	No legal protection on favor of investors					
7	Due to the lack of wide varieties in these kinds of securities					

7. Followings are some descriptions about different types of bonds. Which bond(s) do you prefer most? Please rank in order of their importance (If you prefer bond).

1. Bond that gets you participates in profit and loss. ()
2. Bond that adjusts promised interest rate according to the rate in the market. ()
3. Bond that is pledged against the firm's assets ()
4. Simple debt that pay regular interest. ()

8. Which of the following factors, in your opinion, is the most important factor to select securities to invest in? Please rank in order of their importance.

1. Return pattern..... ()
2. Availability..... ()
3. Company's overall performance..... ()
4. Rumors..... ()
5. Others (please specify)

9. What may be the main attraction of government securities? Please rank in order of their importance.

1. Risk free/safe..... ()
2. Advantages for portfolio construction..... ()
3. High interest rate..... ()
4. Less legal formalities..... ()
5. Protection against mal practices..... ()
6. Others (Please specify) ()

10. When making investment decision, do you think, it is necessary to make risk and return analysis? Please make a tick mark in the box.

Yes

2. No

3. Don't know

11. Following are the subject matter of grievances against Issuer Company that issues security in the primary market. Please make a tick mark on the subject matter related to you.

1. Issuer Company does not provide the prospectus/security purchase application form.
2. Company wants to influence unduly through prospectus and other advertisements.
3. Company does not provide the article of association, memorandum of association and other related documents for detail perusal.
4. Company rejects to receive the share application form duly filled by the investor.
5. Irregularities while allocating the security to the investors.
6. Others (please specify)

12. Following are the subject matter of grievances against Nepal Stock Exchange. Please make a tick mark on the subject matter related to you.

- 1 Stock exchange does not inform to market as to the price sensitive information and financial statements.
- 2 Stock exchange does not provide the necessary information of the sold/purchase share.
- 3 It does not provide information relating to the membership, listing of securities and transactions etc.
- 4 Other (please specify).....
.....

13. Following are some of the observations that can be done to develop security market in Nepal. Please rank in order of their importance.

1. The access of the securities services, professionalism of the stock market and traders, institutional capacity and services not only in capital city.
2. Making clear- cut arrangements for regulations concerning the involvement of Employee's Provident Fund, Citizen's Investment Trust, construction, extractive and IT sector and Mutual Fund in security market.
3. Sufficient publicity as to the security and security market.
4. Amendment and strict implementation of current rules and regulations.
5. Others (Please Specify).

14. Which component plays vital role in primary market?

- a) Issuing Company
- b) Registrar of Companies (ROC)
- c) Merchant/Investment Bankers
- d) Nepal Rastra Bank
- e) Financial Institutions
- f) Security Board of Nepal (SEBON)
- g) Nepal Stock Exchange (NEPSE)
- h) Issue and Sales Managers
- i) Advertising Agents
- j) Collection Centers
- k) Underwriters
- l) Dealer
- m) Insurance Board

15. Should the number of Mutual Fund Company be increased?

- a) Yes b) No c) No idea

16. Is there any prospect of derivative securities in Nepalese Security market?

- a) Yes b) No c) No idea

THANK YOU FOR YOUR KIND COOPERATION.

Appendix - 1

The following hypothesis is set to test for the chi-square (χ^2) of the whole document.

Null Hypothesis (H_0):

There is no significance difference among the view of respondent group (i.e. no difference)

Alternative Hypothesis (H_1):

There is significance difference among the views of respondent group (i.e. difference).

Where,

S = Significant

NS = Not significant

Decision Criteria

) If calculated value of chi-square is greater than its tabulated value, that is significant and H_1 is accepted.

) If calculated value of chi-square is lesser than its tabulated value, that is not significant and H_0 is accepted.

Q.N.2 Do you like to transaction of following securities?

Common Stock:

Setting of Hypothesis

Null hypothesis (H_0): There is no significant difference among the views of the respondent group.

Alternative hypothesis (H_1): There is significant difference among the views of the respondent group

The test of Statistics

Under H_0 is given by

$$(t^2) = \frac{\sum(O-E)^2}{E}$$

Where, $O =$ Observed frequency

$E =$ Expected

Expected frequency is calculated by

$$\frac{RT \times CT}{N}$$

Where,

$RT =$ Row total

$CT =$ Column total

$N =$ Row and Column total

Calculation of Expected Frequency

$$(1, 1) = \frac{RT \times CT}{N} = \frac{92 \mid 56}{112} = 46$$

$$(1, 2) = \frac{92 \mid 56}{112} = 46$$

$$(2, 1) = \frac{20 \mid 56}{112} = 10$$

$$(2, 2) = \frac{20 \mid 56}{112} = 10$$

Calculation Example of Chi-Square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	45	46	0.02173913
(1,2)	47	46	0.02173913
(2,1)	11	10	0.1
(2,2)	9	10	0.1
			$\sum(O-E)^2/E = 0.24347826$

$$\begin{aligned}
 \text{Degree of freedom (d. f.)} &= R-1 \times C-1 \\
 &= 2-1 \times 2-1 \\
 &= 1
 \end{aligned}$$

Result and Conclusion

Since, the calculated value of chi-square (χ^2) 0.2435 is lesser than the tabulated value 3.841, it is not significant and H_0 is accepted. That means the preference of two types of investors do not differ and are similar as regards the attitude of transacting common stock among them.

Preferred Stock:

Computing the Value of chi-square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	15	13	0.307692308
(1,2)	11	13	0.307692308
(2,1)	41	13	0.093023256
(2,2)	45	13	0.093023256
			$\Sigma(O-E)^2/E = 0.801431127$

$$\begin{aligned}
 \text{Degree of freedom (d.f.)} &= R-1 \times C-1 \\
 &= 2-1 \times 2-1 \\
 &= 1
 \end{aligned}$$

Result and Conclusion

Since, the calculated value of chi-square (χ^2) 0.801431127 is lesser than the tabulated value 3.841, it is not significant and H_0 is accepted. That means the preference of two types of investors do not differ and are similar as regards the attitude of transacting Preferred stock among them.

Debentures/Bonds:

Computing the Value of chi-square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	43	39.50	0.310126582
(1,2)	36	39.50	0.310126582

(2,1)	13	16.50	0.742424242
(2,2)	20	16.50	0.742424242
			$\Sigma(O-E)^2/E = 2.105101649$

Government Bonds:

Computing the Value of chi-square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	48	45	0.2
(1,2)	42	45	0.2
(2,1)	8	11	0.818181818
(2,2)	14	11	0.818181818
			$\Sigma(O-E)^2/E = 2.0363636$

Q. No. 7 Followings are some descriptions about different types of bonds. Which bond(s) do you prefer most? Please rank in order of their importance (If you prefer bond).

5. Bond that gets you participates in profit and loss. ()
6. Bond that adjusts promised interest rate according to the rate in the market. ()
7. Bond that is pledged against the firm's assets ()
8. Simple debt that pay regular interest. ()

Computing the Value of chi-square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	9	7.5	0.3
(1,2)	6	7.5	0.3
(2,1)	16	11.5	1.760869565
(2,2)	7	11.5	1.760869565

(3,1)	13	19.5	2.166666667
(3,2)	26	19.5	2.166666667
(4,1)	18	17.5	0.014285714
(4,2)	17	17.5	0.014285714
			$\Sigma(O-E)^2/E = 8.483643892$

10. When making investment decision, do you think, it is necessary to make risk and return analysis? Please make a tick mark in the box.

Yes

2. No

3. Don't know

Computing the Value of chi-square (χ^2)

Row, Column	O	E	$(O-E)^2/E$
(1,1)	25	31	1.161290323
(1,2)	37	31	1.161290323
(2,1)	16	15.50	0.016129032
(2,2)	15	15.50	0.016129032
(3,1)	15	9.5	3.184210526
(3,2)	4	9.5	3.184210426
			$\Sigma(O-E)^2/E = 8.723259762$

Appendix - 2

Component playing vital role in the primary market

Components of Security Market	Rank					Mean	Overall rank
	1	2	3	4	5		
a) Issuing Company	25	29	17	11	30	2.93*	7
b) Registrar of Company	10	17	35	20	30	3.38	13
c) Merchant/Investment Bankers	33	44	20	7	8	2.22	2
d) Nepal Rastra Bank	20	15	20	30	27	3.26	9
e) Financial Institution	19	30	27	16	20	2.89	6
f) SEBON	43	24	4	31	10	2.47	3
g) NEPSE	22	43	16	11	20	2.68	5
h) Issue and Sales Manager	54	42	13	2	1	1.70	1
i) Adverting Agent	12	20	35	15	30	3.28	10
j) Collection Centers	27	35	27	14	9	2.49	4
k) Under writer	18	19	30	16	29	3.17	8
l) Dealer	12	19	23	38	20	3.31	11
m) Insurance Board	11	17	36	18	30	3.35	12

Note: 1,2,3,4 and 5 indicate weights.

$$* \text{ Mean} = \frac{1 | 25 \Gamma 2 | 29 \Gamma 3 | 17 \Gamma 4 | 11 \Gamma 5 | 30}{25 \Gamma 29 \Gamma 17 \Gamma 11 \Gamma 30} \times 2.9286$$