

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Development of any country is directly related with the economic development. The economic development of the country in turn depends upon the capital formation and industrialization. Industrialization can be achieved through proper use of the funds and their investment in the productive sector. Scattered funds around the country can be collected through the financial intuitions. The growth of economy depends on the availability of funds to finance the increased needs. Private, domestic and public investment can be the major contributor to economic growth and employment generation in the developing countries. For the economic development of any country, public participation plays a vital role. If the people are rich and aware, people will have enough and be interested to invest. This will play a vital role in the economic growth of the country.

The relationship between stock market development and economic growth has received renewed attention of academicians and policy makers in the present decade both in the developed and developing countries as a result of the emerging equity market phenomenon and of the need to provide liquidity for privatization – linked equity issues. The growing importance of stock markets in the developing countries has opened up many avenues for research in the relationship between financial development and economic growth, with focus on developmental role of stock markets.

Securities markets facilitate the exchange of financial assets by bringing together buyers and sellers of securities. Securities markets provide an effective way of raising money for business enterprises and government and at the same time provide an investment opportunity for individuals and institutions. Securities markets have both theoretical and practical perspectives. Securities markets provide value and significance to the financial assets. Practically, the activities of

buying and selling securities on the securities markets are extremely important for the allocation of capital within economies. The securities markets serve as a reliable guide to the performance of companies, and thereby promoting efficiency.

1.1.1 Present Status of Nepalese Stock Market

Nepalese capital market is in a very early stage of development. The paucity of the capital has been the main cause for slow development. Nepal launched planned economic development more than four decades ago. Recently, Nepal has adopted the path of economic development through liberalization. However, any strategy for development requires a steady supply of medium to long-term capital funds for productive investment. For the mobilization of invest able resources, capital market is an important intermediary through which effective bridging of the deficit units and surplus units can be ensured. Capital market institutions are engaged in mobilization of savings from surplus units and deploy funds into the deficit funds for the productive investment. However, there are various inconsistencies and hindrances that exist on the way to run the market smoothly.

Equity market has shown impressive recovery from the sharp fall in 1994 with the lag effect elongated till late 1998. At present, it has been performing more strongly than in the earlier years. The improvement in the equity market has been attributed to various factors including good prospect of corporate earnings and broader household participation in the stock market. Investors not only rely on the statement of the brokers, but they also have a concern over the financial information of the concerned company. Therefore, the shares of companies with better prospects of dividend, capital increment and growth have normally higher prices in the stock market. At present, the stock market in Nepal has witnessed its strength surprisingly, and this has raised hopes for sustained growth of corporate undertakings.

Up to FY 2007/08 the financial sector in Nepal included 25 commercial banks, 78 finance companies, 58 development banks, 17 insurance companies, 44 non-government micro-credit institutions etc. In addition, there is one Employee

Provident Fund, one Credit Guarantee and Deposit Insurance Corporation and one Citizen Investment Trust. During this period some discernible improvements took place in the stock market. In 1993, Securities Board Nepal (SEBON) was established with the objectives to regulate, supervise and monitor the security market. Similarly, the Securities Exchange Centre was converted into Nepal Stock Exchange Limited (NEPSE) with the objectives to provide secondary market for securities transaction. An open out cry system was introduced by NEPSE for securities transaction, where the investors were allowed to deal in securities only through licensed brokers.

The equity market activities grow with the development and reform in the financial sector. Over the past 15 years the stock market of Nepal has made some progress. For example, between the fiscal year 1994/95 and 2007/08, the number of listed companies in NEPSE increased more than two-fold from 62 to 142.

1.1.2 Nepal Stock Exchange (NEPSE)

The history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the company Act in 1951, the first issue of Government Bond in 1964 and the establishment of Securities Exchange Centre Ltd. in 1978 were other significant development resulting to capital markets.

Securities Exchange Centre was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was only the capital market institutions undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services.

Nepal Government, under programme initiated to reform capital market, converted Securities Exchange Centre into Nepal Stock Exchange in 1993.

Nepal Stock Exchange, in short NEPSE, is a non-profit making organization, operating under Securities Exchange Act, 1983.

The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as broker, market makers etc.

NEPSE opened its trading floor on 13th January 1994 through licensed members.

Nepal Government, Nepal Rastra Bank, Nepal Industrial Development Corporation and Licensed Members are the shareholders of the NEPSE.

Trading Days and Hours

NEPSE has fixed stock trading days and hour during which the numbers are allowed to enter the floor to make the transactions as tabulated below:

Table 1
Stock Trading Days and Hours

Trading Days	Trading Hours	Type of Trading
Sunday - Thursday	12 a.m. – 3 p.m.	Regular
Friday	12 a.m. – 3 p.m.	Odd lot

Source: NEPSE Annual Report 2007/08

Board Lot

NEPSE has fixed the board lot of 10 shares if the face value is Rs. 100 or 100 shares if the face value is Rs. 10. The transactions on regular trading should be done on at least one board lot. The transaction of less than 10 shares is permitted only on odd lot trading hours.

Settlement

NEPSE has adopted a T+3 system, which mean that settlement of transaction should be done within **1** working day following the transactions day. Settlement will be carried out on the basis of paper verses payment.

Brokerage

The rate brokerage on equity transactions ranges from 0.5 percent to 1 percent depending on the traded amount.

1.1.3 Securities Board Nepal (SEBON)

SEBON was established as an apex regulator of the securities market in Nepal by Nepal Government on June 7, 1993, under the Securities Exchange Act, 1983. The main objective of SEBON is to regularize and manage the securities market and protect investors' rights.

As per the securities rules and regulations, following are the major functions of SEBON:

- Frame policies and programmers required in securities market and advice Nepal Government in this aspect.
- Register securities and grant issue approval.
- Provide license to corporate bodies to operate stock exchange business.
- Provide license to operate securities businesses.
- Supervise and monitor stock exchange and securities businesspersons.
- Conduct research, study and awareness programmers regarding securities market.

A board composed of seven members including a Chairman governs SEBON. The board has representatives from various institutions of the government as well as private sector. The Chairman of SEBON is appointed by Nepal Government for the tenure of four years. Other members of the Board include representatives one

each from Ministry of Finance, Ministry of Law, Justice and Parliamentary Affairs, Ministry of Industries, Commerce and Supplies, Nepal Rastra Bank (the central bank), Federation of Nepalese Chambers of Commerce and Industries and Nepal Chartered Accountants' Association.

SEBON, in order to implement its policies and programs effectively, has two departments, six divisions and ten sections in its organizations structure. Each department is headed by deputy director and each division by officer. Presently, there are 41 staffs in SEBON including chairman, two directors, five deputy directors, nine officers, seven assistants, seven support staffs and messenger and ten Deputation on Contract Basis. (www.sebonp.com)

1.2 Focus of the Study

In Nepal, there has been a huge amount of unutilized saving funds with public due to the lack of wider investment opportunities that provide good return. Most of the public investors are not well knowledgeable about the stock market, its rules and regulation, real financial strength and weakness of different financial companies. And they cannot well analyze and interpret the real problem and prospects of the Nepalese's stock market according to the available data and information. Hence, this study may provide real condition of the Nepalese's stock market and to encourage to involve the investment in stock market. Furthermore, the potential investors can take better decisions based on the findings of the study.

1.3 Statement of the Problem

The relationship between financial development and economic growth, with focus on developmental role of stock markets, has been in debate for some time in the past. Empirical studies suggest that financial development does matter and stock markets do spur economic growth. Unfortunately, in Nepal, despite a history of about half a decade of planned economic activities to develop real sector of the country, little attention was paid to the development of financial sector. Over the past one and half decade, financial sector, despite many problems has developed

significantly in Nepal. However, most of the developments were confined to the banking sector. Stock market has mutually remained stalled because of the low priority in the government's financial reform policies.

Various measures of stock market development indicate that 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 invest in securities according to their risk-return preference. Similarly, firms shun it because stock market is less reliable source of raising funds for them. Due to this financial system in Nepal has remained basically bank-dominated.

Stock exchanges in many countries have a long history of more than one century. These stock exchanges have faced so many ups and downs during this period including sacking of brokers. We must note that just ten years period is not sufficient to make a history of a stock exchange but the Nepal Stock Exchange Ltd. (NEPSE) has created a history. All the features of a stock exchange have been applied and the possible happenings in a secondary market have already taken place during this short span of period. The big bullish period, the long bearish period, the unprecedented market capitalization, the quite fail market driven by innocent and honest market intermediaries, the quite unfair market driven by unfair practices, the rumour driven market, the big changes in ownership of joint venture banks, the addition and subtraction is the listed companies, etc. are some of the key events in the history of the Nepalese stock market.

There are changes in the NEPSE since the inception of open out cry system of trading in 1993. The Automated Trading System (ATS), an internationally compatible trading system was inaugurated by the Former Finance Minister Dr. Ram Sharan Mahat on 24 August 2007. The noted changes are the shifting of the office from a rented house to owned house, the introduction of computer hardware and software systems in the clearance, appointment of two brokers as member of

NEPSE's Board of Directors, the shifting from T+5 system of settlement to T+3 system and changes in rules and regulations in favour of the market, etc.

However, it can be argued that the most needed changes which are fundamental for development of a stock exchange are still to be introduced. Some of these have been categorically out listed:

This present study is carried out to answer the following research questions:

- What are the problems of Nepalese stock market?
- What are the prospects of Nepalese stock market?
- Is growth rate of Nepalese stock market satisfactory?
- Are people satisfied from the information provided by NEPSE and SEBON?

1.4 Objectives of the Study

Objective of the study are guidelines by which the study can be conducted in a systematic manner. The main objective of the study is to examine and analyze the problem and Prospects of Stock Market Growth in Nepal. The specific objectives of this study are follows:

- To examine the pace of stock market growth in Nepal.
- To analyze the trend of Nepalese stock market.
- To evaluate the problems and prospects of Nepalese stock market.
- To examine the various components for the good governance of primary and secondary market.

1.5 Importance of the Study

Securities market in Nepal, till the recent past, had all the characteristics of an underdeveloped economy. It was characterized by the absence of professional promoters, underwriting agencies, market intermediaries, organized market,

regulatory bodies, and rules and regulations. However after the restoration of democracy in 1990, a trend towards an organized stock market can be marked with numerous developments in the Nepalese securities market, removing its earlier deficiencies.

This study helps us to find out different problems and prospects of stock market growth in Nepal. The importance of the study can be summarized as below:

- The operation of NEPSE and its role towards greasing out the stock trading in Nepal.
- The trend of securities market in Nepal.
- The country's policies towards financial markets.
- The views of potential investors and government and other financial institutions about the related organizations.
- The need of different policies, regulatory acts and amendments to develop market efficiency.

1.6 Limitations of the Study

It is not a comprehensive study. There are some limitations of the study. Lack of experiences, time, limited budget and up to date information are the main limitations of the study. Apart from this some more limitation are presented below:

- The subject of the study is only “Growth, Problems and Prospects of Nepalese Stock Market”.
- Up to 14 years (1994/95 to 2007/08) period data are collected for the analysis purpose.
- The study covers only the past and present state of stock market in Nepal, hence does not make any prediction about the future.

1.7 Organization of the Study

The study is divided into following chapters:

- Introduction
- Review of Literature
- Research Methodology
- Presentation and Analysis of Data
- Summary, Conclusions and Recommendations.

The first chapter is about the introduction, focus of the study, problem of the study, objective of the study, importance of the study and limitations of the study.

The second chapter is concentrated upon review of literature. This chapter is subdivided into various sections such as conceptual framework, review from different studies: review from related studies and review of previous master's thesis.

The third chapter provides the methodology adopted in the research. It comprises research design, sources of data, methods of analysis and its descriptive presentation

The fourth chapter is the presentation and analysis of data by using appropriate tools.

The last chapter gives the summary, conclusions and different recommendations regarding it.

CHAPTER – II

REVIEW OF LITERATURE

This chapter will be devoted to review some of the existing literature concerning the stock market in Nepal and abroad. In this regard, various books, journals and articles concerned to this topic have been reviewed.

2.1 Conceptual Framework

2.1.1 Capital Market

The capital market is concerned with long-term finance. Broadly it consists of a series of the channels through which the savings of the community are made available for industrial and commercial enterprises and authorities. It is concerned with those private savings, individual as well as corporate, that are turned into investments through new capital issues and also new public load floated by the government, the semi-government bodies. In capital market, demand for funds comes from agriculture, industry, trade and government while the supply of fund comes from individual or corporate savings, institutional investor and surplus of governments.

An ideal capital market where funds are available at reasonable rate of return for any proposition which offers a prospective yield sufficient to make borrowing worthwhile, given rate of return for any proposition which offers a prospective yield sufficient to make borrowing worthwhile gives the roles rates of interest. (Shakespeare, 2001: 97-99)

The capital market serves as a link between supplies and uses of finance. It is a mechanism for the mobilization of public savings and channelling 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 sellers of

securities and all those agencies and institutions, which assist the sale, and resale of corporate securities (Gupta, 1978: 325).

2.1.2 Securities Markets

Holders of stocks and bonds may decide to obtain cash for their investments by selling their securities to other investors. Similarly, others in the economy have cash to invest and are desirous of buying stocks and bonds. The problem is to bring together the order of prospective sellers and prospective buyers so that an exchange of securities for cash may take place. An efficient system whereby investors can convert their securities into cash quickly and at or near the current market price makes investors more ready to put their savings into stocks and bonds (Bradley, 1963: 303).

So far as securities market is concerned, it is important constituent of capital market. It has a wide term embracing the buyers and sellers of securities and all the agencies and institutions that assist the sale and resale of corporate securities (Rugh, 1966: 50).

Securities are traded in a market called securities markets. Although securities markets are concentrated in few locations, they refer more to mechanism, rather than to place, designed to facilitate the exchange of securities by bringing buyers and sellers of securities together. In other words, people and organizations wanting to borrow money are brought together with those having surplus funds in the securities markets. Securities, such as equities, short and long-term debt instruments, derivatives etc. are the products that are traded in the markets, institutions such as investment bankers and securities firms, securities issuing institutions such as government and corporate bodies and participants of the securities markets. Securities markets' major function is to provide line between savings and investment thereby facilitating the creation of new wealth (Baral, 1999: 8-9).

Nepal stock exchange has defined the securities market in the following ways “The securities market is the place where a large number of financial securities (shares, bonds, debentures etc) is traded according to prescribed rules (Investors Guide, 1978: 11).

2.1.3 Primary Market

The primary markets are media through which new financial assets are issued or generated. They are the media through which the demanders and suppliers of today’s funds, the creators and acceptors of financial claims meet. In these primary markets, financial assets are created and exchanged, satisfying in the part the financial needs of both demanders and suppliers of today’s fund. At present concept, it is the market of direct issuance of government securities. The primary market of country is dominated by the government securities due to the existence of insignificant new issue market for industrial securities.

The primary securities market includes all transactions that result in the accumulation of financial capital by firms, government or individuals to be used in the consumption or real capital investment. The participants in this process are many and valued, but an important segment, includes the money brokers who acts as a middleman in the process of exchanging securities for fund. These brokers provide invaluable services. Their principal role is to assist in the pooling of the funds by the creation of security forms that will appeal to the ultimate investors (Nancy and Richardson, 1984: 147).

Primary markets are distinguished by the flow of funds between the market participants. Instead of trading between investors as in the secondary markets, participants in the primary market buy their assets directly from the source of the asset. Once the securities begin to trade among individuals, business, government or financial institutions, savers and investors, they become part of the secondary market (Nancy and Richardson, 1984: 146).

2.1.4 Secondary Market

The secondary financial markets are the markets where many already outstanding financial assets are traded from old to new owners. The secondary market provides “liquidity” for financial assets making them more attractive. So secondary market is a place where the securities once sold are purchased and repurchased to provide liquidity to the government securities and the secondary market is operated by Securities Exchange Centre. The trading of government securities in secondary market is very thin because of limited distributors of the securities. Securities Exchange Centre in order to promote the market, used to support the market even involving itself in buying and selling activities, if necessary. The secondary market ever operated in the country was on DBs. The SEC initiated the secondary market in the fiscal year 1975 – 76, since then the volume traded in generally increasing year by year (Pradhan, 1997: 5).

Secondary markets are markets for existing assets, which are currently traded between Investors. It is this market that creates the price and allows for liquidity. If secondary markets did not exist, investors would have no place to sell their assets. Without liquidity, many people would not invest at all (Geoffrey, 1983: 25).

Secondary (Indirect) securities markets allow outstanding securities to be traded from old to new owners. The advantage of secondary market is to provide liquidity or cash and investment opportunities to investor and to make certain assets more attractive to buyers and sellers secondary market comprises the stock exchange, the over-the-counter market (Rimal, 1994).

The **over-the-counter** (OTC) exchange is not an organization but an intangible market for the purchasers and sellers of securities not listed by the organized exchanges. A sophisticated telecommunication network lists active traders in this market. The prices at which securities are traded “over-the-counter” are determined by competitive bids and negotiation. The OTC, in addition to create a

resale market for outstanding securities, is a primary market in which new public issues are sold (Gitman, 1988: 30).

The over-the-counter market is broader in scope than stock exchanges. It will be recalled that stock exchanges limit their activities to trading in securities already issued. In contrast, the over-the-counter market handles both securities already issued and new securities being sold to the public whereas the stock exchanges are auction markets, the over-the-counter market is primarily a negotiated markets that is, buyer and seller may haggle over prices before the transaction is completed. Dealers in the over-the-counter market buy securities with the hope of being able to resell them at a higher price. This process resembles any merchandising activity in which the trader buys goods in the hope of reselling them at a higher price (Bradley, 1963: 310).

Securities with the following characteristics tend to be traded in the over-the-counter market: securities of companies with a small capitalization; securities of companies which are owned by a few holders; securities of governments and their subdivisions; and securities which are purchased in large blocks (such as government securities) by banks, life insurance companies, and other large investors (Bradley, 1963: 311).

2.1.5 Stock Brokers

A broker acts as a middleman who matches buying and selling order, thereby securing both buyers and sellers. A broker does not take title to the securities involved in the transaction. A commission is charged by the broker for his assistance in consummating the transaction (Bradley, 1963: 304).

A stockbroker, as a member of stock exchange and sub-broker as any person who acts on behalf of stock broker as an agent or otherwise assisting the investors in buying, selling on dealing in securities through such brokers (Bhatta, 1997: 23).

Conditions for Granting of Certificates to Stockbrokers

The rules stipulate the registration is necessary for acting as broker or sub-broker.

The conditions for grant of a certificate of registration to act as stock brokers are:

- a) He holds the membership of a Stock Exchange Act.
- b) He shall abide by the rules, regulations and buy-laws of the Sock Exchange of which he is a member.
- c) He shall pay the amount of fees for registration.

A stockbroker is expected to maintain high standards of integrity, promptitude, and fairness in the conduct of his business. He is expected to exercise due to skill, diligence, and comply with statutory requirements and not to indulge in manipulations and practices.

➤ **Commission Broker:**

Almost all members act as commission brokers. The commission broker executes on the floor of the exchange buying and selling orders placed by his constituents to whom he renders contracts containing a charge for commission at rates not exceeding the official scale of brokerage.

➤ **Floor Broker:**

The floor brokers, not large in number, are officially attached to other member. The floor broker executes order for any members and receives as his compensation a share of the brokerage charge by the commission broker to his constituents.

Floor brokers may be described as brokers. They are simply members of the exchange not brokers for a member firm. At peak activity periods, they will accept orders from other broker, execute them, and receive part of the commission in return. Floor brokers are useful in that they present backlogs

of orders, and they allow many firms to operate with fewer exchange memberships than would be needed without their services.

➤ **Security Dealer:**

A dealer buys securities at one price and expects to sell them at a higher price (Bradley, 1963: 304).

Dealers trade solely for themselves and are prohibited from handling public orders. Since dealers have access on the floor and can own securities on their own name. They benefit from buying at low and selling at high prices. The benefit of the dealers to the market is that their buy and sells actions added up liquidity of the securities.

Obviously, when an OTC broker receives an order for a security in which a market is not maintained, they may act as both broker and dealer in executing the trade. However, this does not eliminate the obligation to obtain the best price for the customer (Raju, 2000: 66).

➤ **Market Makers:**

Market makers, also known as specialists, facilitate the trading of securities by maintaining inventory in particular securities. They are similar to dealer in many ways except that they always stand ready to buy and sell securities at their bid and asked price for which they are market makers (Joshi, 2001: 28).

The market maker is any company or corporate body which deals in securities at the Stock Exchange in its own name or under its name on the basis of a pledge to provide liquidity to the securities issued by NG, as well as to the securities listed at the Stock Exchange by concluding necessary contracts with the concerned corporate bodies or to the securities of at least three corporate bodies, and not to let to occur improper instability in the

prices of such securities, shall be granted membership of securities market maker.

Price and Trading Procedure

The shares price is determined in the floor by the interaction of market forces i.e. demand and supply. The price is determined by the point of equilibrium between supply and demand, the shifting of this balance results in incessant adjusting of price in search of the ever-changing new equilibrium. Then market price moves upward and downward independently.

There are many reasons that causes the stock price fluctuation, major of them are economic, non-economic and market factors.

One basis for the determination of stock prices is dividends. Dividends are strongly influenced by the earning power of the enterprises. There is a very close correlation between corporate earnings and dividends. Earning power, in turn, is strongly influenced by changing economic trends, which are closely related to interest rates. In this way, the most fundamental factor in stock price fluctuations lies in changes in corporate earnings, which, together with interest rates and business cycle trends, contribute to making up the economic factors influencing stock price.

The next major influencing factors are non-economic factors, including changes in political conditions, such as war or administrative changes, changes in the weather and other natural conditions, and changes in cultural conditions, such as technological advances and the like.

Market factors, or internal factors of the market, consisting of the tone of the market and supply – demand relations, may be cited as the third category that influences the stock prices. The tone of the market is a phenomenon of excessive expectations which takes the form of over-estimating the intrinsic value of stock when stock price is high because of business prosperity while underestimating its

value at the time of market decline. The relationships of supply-demand are reflected directly in the volume of transactions, but there is also considerable effect from the actions of institutional investors, margin transactions, etc. Although margin transactions increase purchases when stock price is going up, once the price begins to fall they become a selling factor and accelerate price decline. The practice of margin finance has not been introduced, so far, in Nepal (Sharma, 1996: 64).

The buying and selling of securities takes place in the floor of the Nepal Stock Exchange Limited. The transactions are carried out only through licensed brokers and market makers. However, brokers cannot transact shares in their own account. Market makers are not allowed to do transaction on behalf of other investors. In the floor, trading is carried out on “open out cry system”. Each broker’s representative should be present in the floor and participate through written bids and offers. The trading reports are published after the floor is closed (Sharma, 1996: 64).

2.1.6 Stock Exchange

The stock exchange provides an organized market place for the investors to pay and sell securities freely. The market for these securities is an almost perfectly competitive one because a large number of sellers and buyers participate. The shares listed, however, are not really, homogeneous like a commodity in a perfectly competitive market (Joshi, 2002: 33).

In the stock exchange, there is an active bidding and a two-way auction trading takes place. The bargains that struck the fairest price are determined by the basic laws of supply and demand. The stock exchange provides an auction market in which numbers of stock exchange participate to ensure continuity of the price and liquidity to investors (Panta, 2000: 93).

In contrast to the bond market, the stock market is basically a securities market. The aggregate amount of new common stock issued by co-operations every year is

small compared to the trading on the organized exchanges – Nepal Stock Exchange, New York Stock Exchange, The American Stock Exchange, The Regional Exchanges and the over-the-counter market.

Stock exchange is the most highly centralized and visible institution where already issued securities are brought and sold for investment and speculative purpose. It provides facilities of trading of listed financial securities.

The establishment of the Securities Exchange Centre (SEC) in 1976 was the first attempt made by the government for the institutional development of the stock market in Nepal although the flotation of shares by Nepal Bank Ltd (NBL) and Biratnagar Jute Mills Ltd. (BJM) had begun in 1937 under the Company Act, 1936. The SEC managed five public issues, important medium to allow investment opportunities to the public, made by the corporate bodies till FY 1983/84.

Only from 1984, the floor was opened for secondary trading of shares to provide the liquidity for the already issued shares. It availed the liquidity to the shares of 16 stocks with paid up capital of Rs. 307.32 million, market capitalization of Rs. 318.67 million and 9852 shareholders till FY 1985/86.

Securities Exchange does not directly buy or sell securities; rather, they provide trading floors on which a continuous auction market is conducted. To transact business on the trading floor of an exchange, an individual must be member, that is, a seat on the exchange must be purchased. Individual or institutional investors who place orders to buy or sell the securities listed on an exchange may not be present when their orders are executed. Rather, they must be transmitting their orders to an exchange member – usually a commission broker, - who sees that they are carried out (Jacob, 1984: 155).

The stock market is the only institution to mobilize substantial portion of public activity and the public share volume in other markets. This suggests that individual investors recognized the opportunities in these other markets and pursue

them. Also, in some cases, institutional investors are restricted from these markets because the stock is often too small to meet their criteria or legal requirements. As will be seen in other markets, - the AMEX and the over-the-counter market have out performed the NYSE in recent years in New York. Individual investors may know exactly what they are doing by not being the major force on the NYSE.

Some parallels exist between the stock market and the bond market in terms of trading. As we know that although the market for U.S. government and the agency bonds are active, liquid markets, the corporate and the municipal sectors are much less so, at least, for the average investors. In case of stocks, the New York Stock Exchange (NYSE) is a very active, liquid market, with trades occurring smoothly within a carefully monitored framework. Prices may fluctuate sharply as a result of changes in investors expectations, but such changes are orderly and investors can buy or sell with reasonable confidence that the prices are “fair” (i.e. represent orderly transactions within a monitored environment).

The American Stock Exchange is designed to imitate the NYSE, and thus has similar trading procedures. The role of specialist is initially the same as on the NYSE, although the capital requirements are smaller. Active stocks are usually assigned to specialist firm that may have several partners at the post to handle orders. Certain trading policies are different because of the relatively “thin” supply of shares for many AMEX stocks.

In over-the counter market, the corporations being traded may range from very large (e.g. Food Lion Supermarkets and Coors Bell) to very small firms unknown to most investors; the market for particular shares may be very active or very inactive. Bid – ask spreads may range from 1/8 points or more. The small investors can trade in the OTC market more easily than in the corporate or municipal bond markets, investing only a few hundred dollars or less. The OTC market is of increasing importance and continues to enhance its position relative to the organized exchanges. But in Nepal, OTC is not practiced yet.

The extent of active stock market trading by individual investors should depend on several factors. One is their knowledge. Do they understand how stock is valued, traded and managed? A second factor is their belief about the relationship between a security value and its price. Are the two usually identical, and if not, can a typical investor expect to the difference? And the third factor is the trade-offs to be made between direct investing and indirect investing through the purchase of investment company share.

2.2 Review of Related Studies

Vast numbers of research studies have been performed internationally on the stock market. The scholars create books under so many years of practice. So, it is considered here to put scholars' view in regards with the investors' protection. What have they spelled out and in what way investors should be protected in the capital market is picked-up from the books like below:

Prof. M.K. Shrestha in his book "Shareholder's Democracy and AGM Feedback" has focused various issues related to protection of shareholder's expectation. "Success of companies directly depends on the protection of their owners. But how can this be accomplished is main question. Thus, it is necessary to develop a possible guidance for enhancing the efficiency for public limited companies to contribute directly in the growth of national economy on one hand and ensuring handsome return to the shareholders on the other hand to make their investment meaningful and worthwhile. At present, the overall shareholders' democracy in terms of the protection of their interest is basically focused on the payment of satisfactory dividend and the maximization of shareholders' wealth by appreciating the value of shares they hold" (Shrestha, 1992: 92).

The movement of degree of response in new issue market is significantly and positively related with the movement in price, liquidity and cost of capital in the secondary segment of the market (Sharma, 1996: 36).

Share price is a function of information; the continuous flow of information is precondition for the orderly function of the market (Joshi, 1996: 38).

The prices, turnover of stocks increased tremendously after the opening of the trading floor. Even prices of stocks with huge accumulate losses and the companies established only a couple of month back went up and up which is not conducive for the healthy growth of market. Such unnatural high prices are accounted for the poor transparency and the pouring of large number of people without having a minimum knowledge on shares in the market (Joshi, 1996: 39).

It may be appropriate to mention at this stage that the expansion and the growth of the stock market have a direct correlation with the overall growth and expansion of the private sector in the Nepali Economy. If the private sector is to assume a lead role in future economic development, it is necessary to provide a ready source of capital to sustain such efforts. An important component of the capital markets is the stock exchange, which performs a pivotal role in channelling individual as well as industrial savings in the private sector (Peiris, 1992: 131).

Dr. R.S. Mahat in his book “Capital Market, Financial Flows and Industrial Finance in Nepal” (1981) has said, “There is absence of secondary market to ensure liquidity to the securities on demand. Any attempt to stimulate investment in industrial sources would naturally depend on the extent to which the securities are saleable in the market. Only the existence of a Stock Exchange can enable the security holders to sell their securities for cash and purchase alternate securities if they wish. In Nepal, in the absence of such a stock market, an industrial security is an illiquid form of asset, even more illiquid than the real estate for all practical purpose”.

The investors are losing faith on the performance of share market since companies are not providing timely and adequate disclosure of information and the continuous violence of shareholders’ rights by the company management. This is responsible for losing faith of general public to buy and sell shares of such companies (Shrestha, 1996: 32).

In the book “The Stock Market: Theories and Evidence” by James H. Lorie, Peter Dodd and Mary Hamilton Kimpion, mainly two points about the stock prices markets and investors are following:

1. The first that it is relatively easy for the individual investors to make substantial returns by investing according to some simple rules so that he can make prediction about the market mechanism and its growth prospects.
2. The second point is that the individual investors is manipulated or exploited by the financial institutions to such extent that investing in the common stock is intolerably hazardous. This means, the simple rules regarding the prediction of market mechanism whether it is growing or not, for investments cannot be expected to produce extra ordinary returns. Nor is the small individual investor at substantial disadvantage as compared with the professional investors or the financial institutions.

This book helps to evaluate the security price in primary and in secondary market. The use of formal models and empirical inquiry has provided new knowledge and has cast light on the validity of some old and new theories of securities valuation in the recent market condition. So that one can show the condition either the market is in growth form or in declining stage and the share price condition in the point of simple investors are clearly analyzed.

Henderson has analyzed in his book “New issue market and finance for industry” that the new issue market has three important functions; they are origination, understanding, underwriting and distribution. The NIM (New Issue Market) facilitates the capital market to raise long-term funds. Industries, new issues are further classified as “initial” issues and “further” issues. Initial capital can be raised only through equity or preference shares. When existing companies raise issues it is called “further” capital. Such organization can raise debentures (Henderson, 1951: 24). The interplay of these functions helps to transfer resources from the resource of surplus funds to those who require these funds in ultimate users of these funds.

According to the journal of SEB named as “Meeting the Challenges ahead (2054-2069): clearly defined the policy development regarding to the growth of the market. As an apex regulatory body for the Nepalese Securities Market. The securities board has adopted following set of strategies policies to handle the strategic issues that are inhibiting the growth and development of the market. These policies consist of:

- Improvement in the statutory and regulatory framework of the capital market.
- Development of widely participated capital market. Improvement in the securities board’s institutional capacity.

SEBO has also made some improvements in the statutory and regulatory framework of the capital market. Such improvements contribute to the development of capital market in the following ways:-

- Bring clear demarcation in the role and responsibilities borne by the securities board and other regulatory agencies i.e. stock exchange, NRB, ORC etc.
- Reduce the duplication in the role and responsibilities of Board and other regulatory agencies.
- Show the ways of coordination between the services Board and other regulatory agencies.
- Promote public confidence in the regulatory system and market structure.
- Introduce a system of recognizing self-regulatory bodies by encouraging them to share and take responsibilities in certain areas.
- Establish securities board as a central market regulator and rest in with wider investigation and enforcement power.
- Empower the securities board to audit the registered corporate bodies, mutual funds, as custodians and clearing houses in relation to their financial reporting issues.
- Promote the development of ‘full-survive’ securities house and,

- Gives focused attentions for the establishment and up grading of necessary legislative infrastructure to address on going needs.

Nepalese capital market offers a wide range of financial services and instruments. It also has to provide the opportunity for a large number of investors to participate directly or through mutual savings schemes. While implementing this policy the securities board:

- Advises the government regarding the development of a secondary market for government securities and the opening of foreign portfolio investment.
- Coordinates with NRB to formulate prudential standards for the primary issue as well as secondary trading of government bonds.
- Studies the possibility of introducing as over the counter exchange system and brings in the concept of introducing broker in order to facilitate easy entry and exit process for the benefit of investors.

Articles are not full research framework for giving complete direction to the concerned authorities however it gives cooperation to the researcher. So it is taken into the account for the literature review that how many persons have written so many articles in favour of the protection of investors in the capital market of Nepal is reviewed here.

“Capital market is a crucial element in the national economy. Its role in reinvigorating and boosting the economic activities in the country holds significant. The strategic plan released by security board can, to a great extent, energize the investors by increasing investor interest in it. Security market experience both boom and decline soon after the beginning of securities trading through brokers’ members in the stock exchange floor. Though the market started to function quickly boosting the prices of shares to an unexpected level, it could not sustained.

There is an urgent need for proficient development of the market standard and information dissemination system focused mainly on corporate financial

disclosure practices and transparency, corporate accounting and auditing securities markets regulation and corporate governance. To implement the above, Security Board has a great responsibility as to reviewing and developing regulatory standards to make them a relevant with the need of issuers, investors along with promoting efficient capital formation.” (Business Age, April 1999: 15)

Share investment has traditionally been guided by the investors’ return. Most earnings of investors here have been in the form of dividend rather than capital gains, though high dividend are often seen, in corporate finance theory as a wasteful investment destination, with other stock market participants hardly making profit and even if they did failing to meet investor’s expectations, demand for shares of commercial banks outpaced supply and their prices boomed.

Now the latest slums 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, refusing investor’s allegations of the market manipulation and insiders’ trading of last February, discreetly claimed that Nepalese Stock Market is in a nascent stage. And that, investment are made more on an impulse, rather than market study and credit rating.” (Business age, June 2001:25)

“Investors were enlightened and they started inquiring about company’s financial health and further prospect before buying or selling shares. People turned to price-earning multiples; NEPSE indexes informed trading became sort of a norm when stock market entered 1995. Many that could not cope with the system of intelligent speculation left the ground. As a result the number of buyers gradually came down and so did the prices.” (The Kathmandu Post, May 18, 1996: 2)

“There are many loopholes in our Stock-Exchange Act. Investors feel insecure here. A few years back there was a company called Nimrod Pharmaceutical Company that floated in shares, but where are they now? Similarly, it has been more than a year that Bansbari Leather has allotted its shares, but why didn’t the company list its shares in the market? It has been three years that Gorkhkali

Rubber Udhog hasn't called for its AGM. Government remained silent in all these cases. This is why the general public as well as the institutional buyers are not feeling secure investing in stock market." (Business age, January 2000:25)

Mr. Radhe Shyam Pradhan (1993) has conducted a research, "Stock Market Behaviour in Small Capital Market: A Case of Nepal". For the study, he collected the data of 17 enterprises from the year 1986 to 1990. Using statistical tools like regression model. His objectives of the study were to assess the stock market behaviour in Nepal, to examine the relationship of market equity, market value to book value, price earnings and dividends with liquidity, profitability, leverage, assets turnover and interest coverage.

Conclusion of his research was: The stock with larger ratio of dividend per share to market price per share have lower leverage ratio., The leverage ratio of dividends per share to market price per share has higher liquidity, There is positive relationship between the ratios of dividends per share and interest coverage. Assets turnover, earning and interest coverage are more variable for the stocks paying higher dividends.

Prof. Manohar Krishna Shrestha in an article "ISDDC" Bulletin (Volume 8 July 1982 – June 1983) has brought certain policy issues related to stock market development such as lack of suitable financing planning, negligence of working capital management, deviation between turnover and return on net working capital. At the end, he has also made some suggestive measures to over conform the above policy issues viz. identification of needed funds, developments of management information system, positive attitude towards risk and profit and determination of right combination of short-term and long-term sources of fund to finance working capital.

"ADB experts have seen many obstacles to the growth of capital market. This includes low level of investor's confidence, disclosure of poor and manipulated financial information, weak enforcement of regulation, absence of institutional investors, lack of diversity in range of financial instruments and the scope of

active participation for the various intermediaries limited by vertical barriers.”
(The Rising Nepal, January 20th 2001: 4)

According to the IMF staff country report “A well functioning capital market is important for Nepal to support the efficient channelling of private savings to investment and facilitate the transaction to direct monetary control. Headway has been made through various reforms since the late 1980’s while the capital market is still in the early stage of development with many structural weaknesses.”

In country economic review, Nepal: ADB recommends efforts to mobilize domestic resources more efficiently in order to develop capital market (Primary plus Secondary market included) including “major tax reforms and further measures to improve efficiency in the financial sectors as well as revitalize the capital market.”

In the paper “Privatization principle and practice” Donaldson David and J. Wagle, Dillip M, writes “There is a symbolic link between privatization and capital market. In most of the cases, privatization represents the first time that private voices are heard on SOE Boards. Indeed, for many, a change in the whole legal structure of company governance is a necessary first step. Borrowings from banks tend to become more commercial and less the result of political pressure. Often new firms of finance are lapsed on domestic and international capital markets for the first time. At the same, a large privatization program often has a dramatic effect in capital market development adding greatly to stock and variety of corporate assets available to public.”

Investors in the past years do nothing for the upliftment of the market. “NEPSE Parisuchak” is declining since the last years about more than two cores. If this will happen for few more years Nepalese share market may face great problem regarding the primary and secondary market.

“The current downtrend in share market is not so easy to recover unless strong regulatory measures are not enforced. The honeymoon days of share market exist

no more but there are still market players who have honeymoon days as they have built 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 one of the strong measures to revive the share market in future.

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 short 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.

The revival of the share market requires minimum fulfilment of the responsibilities and accountabilities among company management to the shareholder. 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.”

“The shareholders should be more conscious of rights given by the company Act 2021. The shareholders, under section 14(1), (2), (3), of the Act, have a legal right to file a suit or initiate a legal proceeding against the company or any person in the district court of the concerned department if their rights provided in the act are violated. The jurisdictions of the district court and the concerned demarcated have been demarcated clearly in section 146(2) of the Act. This definitely implies that the shareholders must come forward and seek legal remedies for their grievances against the company’s high handedness and undemocratic ruling.” (The Kathmandu Post, July 25th, 1994: 2)

“Investors were enlightened and they started inquiring about company’s financial health, future prospects etc. before buying or selling shares. People turned to Price-Earning Multiples, NEPSE, indexes etc. Informed trading became sort of a norm when stock market entered 1995. Many who could not cope with the system of intelligent speculation left the ground. As a result the number of buyers gradually came down and did the price” (The Rising Nepal, April 25th, 1996: 4).

“Our small investors need to be educated on the working of the stock exchange. In this task the role of Nepal Stock Exchange and the government and probably also that of the centres, which manage share issues of companies, becomes evident. In addition, stock exchange watchers feel that the government should revise its stock market rules to take account of the various aspects of stock market including loopholes in order to prevent share market profilers from fleecing the public. The companies whose shares are listed in the stock exchange should make to follow certain rules in order to inform the public of the state of financial health of the companies” (The Rising Nepal, January 20th, 1995: 4)

According to the Nepalese Stock Market, An Introduction, “These days the interest of the investors is gradually fading away. Investors have been discouraged with the shares market running at a snail’s pace. There is no room for satisfaction for investors. Although the country has adopted the liberal market policies to revive the economy, it has not been applied into concrete actions in Nepalese context. Brokers have been reporting since long about Nepal’s stock market position, however, no action has been taken from the government. The government has not been able to regulate the companies, and the corporate culture is also not being developed among companies.”

“It is said that people have started pouring their money into the stock market due to shrinking size of interest rates on the deposits at commercial banks. Experts are of the view that public response towards stock market will continue to pick up for some time” (The Rising Nepal, September 3rd, 1999: 4).

In its early start, share market proved highly optimistic within a period of six months due to favourable conditions of political stability, economic liberalization, strong commitment of better and prospective return by company management active role of brokers and the market makers, relaxation of control on the operation of the stock exchange by the concerned authorities and growing condition of the investors. There has been a remarkable rise in NEPSE index. But, later on there has been a continuous downtrend in share market due to frequent change in government, poor performance of companies, unfair share market practices and loss of investors' confidence in share market. As a result of these unfavourable developments, share market entered an era of worst bearish trend resulting from tremendous fall in NEPSE index. In order to revive the downtrend in share market, various reformative measures are urgently necessary to curb on unfair share market practices through the development of comprehensive and transparent stock exchange guidelines by the concerned authorities. The existing company management has to reorient its positive attitude towards investors and shareholders by improving the quality of timely reporting and providing the expected return to win the losing confidence of shareholders. Investors should be self-conscious in the selection of brokers for trading in securities and organize themselves to be active to protect their rights. All these will help in the revival of share market to make it more active by attracting the investing public. (Shrestha, 1996: 10-13) 2004: 2).

The study conducted by Bary Borsworth on Industrial Production and Prices of common stock, 1953-1975 has revealed that the stock market and economic activity move in similar cyclical patterns. This fundamental relationship shows that stock prices are meaningful in the sense of reflecting real economic variables (Borsworth, 1975: 78).

The study conducted by the U.S. Department of Commerce on stock prices and the business cycle, 1948-84 has found that the general correspondence between stock prices and business cycle, where weighted moving average of a stock price index

is mapped against the peaks and troughs of business cycle since 1948. The market has reflected all the recessions in the economy since 1948 (Kimpton, 1985: 54).

The indicators of stock market development reflect the development of an economy. It is important to predict the course of the national economy because economic activity affects corporate profits, investor attitudes and expectations and ultimately security prices. The key for the analyst is that overall economic activity manifests itself in the behaviour of stock price or the stock market. This linkage between economic activity and the stock market is critical (Fisher and Jordan, 1990: 125).

There are two important aspects of capital market, namely, the raising of funds in the form of shares and debentures and trading in the securities already issued by companies. While the first aspect is obviously is much more important from the point of view of economic growth, the second aspect is also of considerable importance. In fact, if facilities for transfer of existing securities are abundant, the raising of new capital is considered assisted for the buyer of a new issue of security is confident that whenever he wants to get cash he can find a buyer without much difficulty. This aspect is called the liquidity of the stock market. Thus, the liquidity of the stock market affects the raising of new capital from the market (Kunt & Levine, 1996: 89).

A number of studies on the relationship between stock prices and the national economy have found that changes in the stock market tend to precede changes in business conditions by an average of about four months. As a result, the stock price index is major component of the index of leading economic indicators, which consistently provides a warning about changes in economic activity (Lorie, 1985; Dodd, 1985; Kimpton, 1985: 78).

E. Fama and G.W. Schwert found in their joint study that government bonds, Treasury bills and real estate compensate somewhat for unexpected inflation. The surprising result, however, is that common stock returns are negatively correlated with both expected and unexpected inflation. Rather than being compensated for

inflation, investors in common stocks have been penalized (Fama & Schwert, 1975: 99).

Ross Levine, a Senior Economist in the Finance and Private Sector Department Division of the World Bank's Policy Research Department, has mentioned in his article that stock markets may affect economic activity through the creation of liquidity. Many profitable investments require a long-term commitment of capital, but investors are often reluctant to relinquish control of their savings for long periods. Liquid equity markets make investment less risky – and more cheaply if they need access to their savings or want to alter their portfolios. At the same time, companies enjoy permanent access to capital raised through equity issues. By facilitating long-term, more profitable investments, liquid market improves the allocation of capital and enhances prospects for long-term economic growth. Further, by making investment less risky and more profitable, stock market liquidity can also lead to more investment (Levine, 1996: 35).

Ross Levine, at his same study, has found that stock market liquidity rather than stock market size and volatility of the stock market matters for growth. He has shown that with taking examples of 38 countries with more liquid stock markets in 1976 grew faster than those economics with less liquid stock market in 1976 between 1976 and 1993. Thus, stock market liquidity helps to forecast economic growth. He has used three measures of stock market liquidity, viz. value traded ratio turnover and the value-traded ratio divided by stock price volatility. The study has revealed that countries that had more liquid stock markets in 1976 enjoyed both faster rates of capital formation and greater productivity over the next 18 years, because liquid stock markets encourage more investment (Levine, 1996: 52).

Kersi D. Doodha has shown the causal connection between deficit finance, money supply, and the general level of price and the share prices. The relationship being positive and in the same direction, it can be deducted that, *ceteris paribus*, if the deficit finance is low, money supply increase will be small, the general price level

will be little and, therefore, the growth in stock market prices will be small (Doodha, 1962: 352).

However, there are various researches performed on the stock market liquidity and its effect on long-term economic growth. Levine & Zeroos have mentioned in his article that increased liquidity can deter growth through at least three channels. First by increasing the returns to investment, greater stock market liquidity may reduce saving rates through income and substitution effects. Second, by reducing the uncertainty associated with investment, greater stock market volatility may reduce saving rates because of the ambiguous effects on uncertainty on savings. While less uncertainty makes an investment more attractive to risk-averse agents, less uncertainty also lowers demand for precautionary savings. Thus, the ultimate impact of lower uncertainty on saving rates produced by greater stock market liquidity is uncertain. Third, stock market liquidity may adversely affect corporate governance; very liquid markets may encourage investor myopia. Because, more liquid markets make it easy for dissatisfied investors to sell quickly, liquid markets weaken investor's commitment and reduce investor's incentives to exert corporate control by overseeing managers and monitoring firm performance and potential. According to this view, enhanced stock market liquidity may actually hurt economic growth (Levine & Zeroos, 1996: 89).

Demirgic – Kunt and Levine find that across countries the level of stock market development is positively correlated with the development of financial intermediaries. Thus, stock markets and financial institutions are generally complements; they grow simultaneously (Kunt, Levine, 1996).

Levine and Zeroos examine the empirical relationship between measures of stock market development and long-run growth rates. After controlling for the initial level of GDP per capital, initial investment in human capital, political stability, the level of banking development and measures of monetary, fiscal and exchange rate policy, the predetermine component of stock market development remains positively and significantly with long-run economic growth.

Donald E. Fischer and Ronald J. Jordan have distinguished investment from speculation in SM by the time horizon of the investors; and often by the risk-return characteristics of the investment. The true investor is interested to seek a good rate of return for a relatively long period of time. The true speculator seeks opportunities of very large returns to earn rather quickly. Thus, the same stock can be purchased as a speculation or as investment, depending on the motivation of purchaser (Fischer & Jordan, 1990: 128).

Donald E. Fischer and Ronald J. Jordan further say that investments generally involve real assets and financial assets, real assets are tangible while financial assets are pieces of paper representing an indirect claim on real assets held by someone else. Financial assets are liquid, so that they can be sold to acquire real assets. Thus they encourage investment in financial assets through the stock market (Fischer & Jordan, 1990: 129).

“Common stock represents an ownership position. The holders of common stock are the owners of the firm, have the voting power that among other things elects the board of directors, and have a right to the earnings of the firm after all expenses and obligations have been paid but they also run the risk of receiving nothing if earnings are insufficient to cover all obligations” (Donald E. Fischer and Ronald J. Jordan, 1990: 129).

No specific research studies have been available regarding the impact of stock market on economic development and vice versa in the Nepalese Context. However, some articles, books, dissertations etc. related to stock market are consulted and reviewed.

Review of Regulation of Capital Market and Intermediaries

a) Policy Framework for Capital Market Development:

The economic institutional and regulatory framework provides the underpinnings for capital market development. At the early stage of an emerging market

economy, it is important that the Government create the right policy environment to facilitate the creation of a critical mass of financial instruments, issuers, and investors. Government can also create incentives for capital mobilization, remove impediments to private sector development, educate investors, and provide basic legal and regulatory reforms. Until now, Nepal's capital market development has to reach its full potential for several reasons, including:

- Unfavourable macroeconomic conditions.
- Political uncertainty.
- Low investor confidence.
- Distortions in the tax system.
- Slow pace of privatization.
- Inadequate institutional investor base.
- No local venture capital firms.
- Misallocation of savings to bank deposits and Government securities.
- Inadequate disclosure to investors.
- Weak legal underpinnings for the securities market regulation and enforcement.
- Restrictions on foreign portfolio investment.

Legal reforms must provide for securities, law with adequate regulatory and enforcement powers to the Government regulator. In Nepal, legal reforms are also necessary in order to harmonize the Securities Exchange Act with the Company Act, Banking and Finance Company Act and Ordinance. Each of these acts as well as the Provident Fund Act and the Insurance Act has a significant impact on the development of the capital market, the securities industry, and institutional investment.

In most emerging capital markets, the securities commission has a legal mandate to facilitate capital market development. Government policies must facilitate rather than impede capital market development. In particular, sound macroeconomic policy can lay the foundation for the development of long-term capital market instruments. Tax policy should encourage long-term investment

through the capital market. In Nepal, the overall policy environment has not been conducive to the development of the capital market even though the Government has taken concrete steps to encourage the creation and development of the stock exchange and legal framework.

In Nepal, the main impediments have been the following: (i) tax policy that discourages investment in capital market instruments issued by the private sector; (ii) the channelling of most savings to state-owned banks, and Government debt; (iii) institutional arrangements that seem to discourage contractual savings and institutional investment flows into the capital market; and (iv) lack of investors confidence in the stock market since many listed companies do not trade on a regular basis, or hold annual meetings and provide disclosure information to investors on a timely basis. Also there is a need for a strategic plan to link privatization policy to the growth and development of the capital market.

b) Regulation of Capital Market and Intermediaries:

The main regulators of the capital markets and intermediaries providing broker and dealer services to the primary and secondary markets are the Securities Board (SEBO), Nepal Rastra Bank (NRB) and the Nepal Stock Exchange (NEPSE), a self-regulatory organization under the Securities Exchange Act, as amended. The NRB is responsible for the supervision of securities market intermediaries (other than brokers) while the Securities Board is responsible for the supervision of the NEPSE, the registration and supervision of stock brokers and the granting of licenses to finance companies and others acting as issue manager, underwriter, market-maker, or portfolio manager. In many countries insurance companies have established subsidiaries to provide money management services or to engage in capital market activities normally provided by a securities broker-dealer. In Nepal, there is a need to establish a regulatory body to supervise private provident funds.

Under the Finance Company Act and the Banking Act, the NRB supervises and regulates finance companies and commercial banks. In Nepal, these organizations are also permitted to provide investment banking type services. In this regard, it is

noteworthy that the risks associated with investment banking activities are quite different from those associated with commercial banking or the quasi-banking functions performed by deposit-taking finance companies. In obtaining a license from the Securities Board, however, certain minimum capital requirements must be met by anyone proposing to act as issue manager, underwriter, market maker, portfolio manager, or stockbroker.

The Securities Board (SEBO) of Nepal was established in 1993, under the 1992 Amendments to the Securities Exchange Act of 1983. Under the Securities Investment Trust Act of 1997, the Securities Board is also responsible for the registration and supervision of investment funds. Under a new Securities Exchange Act, as proposed, NEPSE would function as a self-regulatory organization under the oversight of the Securities Board. Under the Securities Exchange Act, the Securities Board also has a clear mandate to promote the development of the capital market.

Under the current regulatory scheme, the supervision of finance companies and commercial banks acting as underwriting, issue manager, market-maker or portfolio manager are supervised by the NRB, including the administration of prudential standards, financial reporting, off-site monitoring, and on-site inspections for compliance with applicable rules and regulations. The NRB of course, is also responsible for the overall supervision of commercial banks and finance companies, including their activities in the markets for Treasury Bills and Government securities. At the present time, the Securities Board does not participate in the NRB's program to inspect and monitor the financial conditions of finance companies and commercial banks that are licensed to conduct capital market activities. In view of the difference in risk associated with deposit-taking institution and capital market activities, it would be desirable for the Securities Board to participate in the supervisory program for financial institutions licensed by the Securities Board to conduct capital market activities.

The Board of Directors of the NEPSE consists of seven members. The Chairman of the Board is an official of the Ministry of Finance. Two Board members

represent NRB Bank and one member is appointed by Nepal Industrial Development Corporation. Two licensed stockbroker members of the Exchange also serve on the Board of Directors. Finally the General Manager of the NEPSE is a member of the Board.

The Securities Board must be in a position to intervene in the event that the stock exchange is not performing its self-regulatory functions in accordance with the Securities Exchange Act, or otherwise engage in activities requiring enforcement action. If the main Government regulator is too closely identified with the day-to-day operations of a stock exchange, this could erode public confidence in the event of the demise of a listed company, member firm, or other market failure.

While the NEPSE is expected to perform self-regulatory functions, the existing securities law (as amended) and regulations do not clearly define the regulatory, supervisory, and enforcement functions of the stock exchange and the Securities Board. Thus, it is not surprising that self-regulation has not developed to any significant extent. Also, the NEPSE does not have the necessary committee structure to carry out basic self-regulatory functions. The bye-laws of the exchange are not adequate for this purpose and there is a need to develop procedural manuals that can provide staff guidance to formalize the self-regulatory process.

At the present time, the Privatization Act of 1994 governs the privatization process in Nepal. Prior to the passage of the Act, the privatization process was defined in the Government Policy Paper on Privatization (1991). In Nepal, the form and methods of privatization are specified in the Privatization Act with policy direction to the process provided by a high level Privatization Committee.

Under the Privatization Act, several methods of privatization are provided for: (i) sale of shares to the general public, employees, workers, and other interested parties; (ii) formation of a co-operative; (iii) selling the assets of an enterprise; (iv) leasing the assets of an enterprise; (v) seeking private management of a public enterprises (vi) or by other methods seemed appropriate by the Committee. The

Act also specifies the factors that should be taken into account for the purpose of evaluating proposals submitted to the Government by interested parties following the announcement of a proposed privatization.

Section 15A of the Securities Exchange Act required a listed company to submit annually to the Securities Board and to NEPSE its balance sheet, profit and loss account and directors' report within four months from the end of its financial year. An interim report is also required to be submitted to both within 60 days after the expiry of each six months period.

Rule 23A (1) of the Securities Exchange Regulation requires a company, before listing, to enter into a listing Agreement with NEPSE in which the company has to give various undertakings including an undertaking concerning the continuing disclosure obligations of listed companies; NEPSE must notify the Securities Board of the entering into of the Listing Agreement [Rule 23A(2)]. The form of the agreement is prescribed by Schedule 1 of NEPSE Securities Listing Bye-Laws and specifies 46 items relating to disclosure obligations. Bye-Laws 15 also prescribes information which listed companies must provide to NEPSE immediately; all of the 15 items so prescribed are repeated, verbatim in most cases, in the Listing Agreement.

In order to make informed decisions, investors must have access to accurate and timely information. This is often not the case in Nepal. While banks, finance companies and insurance companies are perceived to provide meaningful information to investors on a timely basis, disclosure to investors is not adequate for many non-financial listed companies. Some financial market professionals have suggested it, leaders of private industry and independent authorities that a major reason why financial information is not presented correctly in disclosure documents is that the system of tax collection works against it. The lack of accurate and timely information is cited as an important reason why investors to a considerable extent have lost confidence in the stock market. In some instances, companies listed on the exchange may have ceased operations or at least are in

non-compliance with reporting requirements to the stock exchange, Registrar of Companies and the Securities Board.

2.3 Review of Thesis

There are many thesis written by various researchers in past years. Among them some thesis are reviewed here for analysis of literature.

Bharat Prasad Bhatta (1997) has also conducted research on the topic “Dynamics of Stock Market in Nepal”, The study was carried out by primary as well as secondary data from 1990 to 1998.

The objectives of the research were as follows:

- To analyze the trend of the Nepalese stock market.
- To diagnose and compare sector-wise financial status of the stocks in Nepalese stock market.
- To analyze the market share prices of Nepalese stock market.
- To find out the impact of secondary on primary market and vice versa.
- To recommend for the improvement of stock market in Nepal.

He has found his studies were the stock market and economic activities move in 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. 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 the 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 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 sector.

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 resource mobilization to finance the productive enterprises in Nepalese economy.

Surya Chandra Shrestha (1999) has conducted research on “Stock Price Behaviour in Nepal”; this study aims to examine the efficiency of the stock market in Nepal. He analyzed only 30 listed companies.

The main objectives of the study were:

- To examine the serial correlation of the successive daily price changes of the individual stocks.
- To determine whether the sequence of price changes is consistent with changes of the series of random numbers expected under the independent Bernoulli process.
- To determine the efficiency of the stock market through the theoretical model of efficient market hypothesis in the Nepalese stock market.
- To provide feedback policy input towards institutional development of efficient market.

He finally concluded that the NEPSE is not efficient in pricing shares even in its weak form. He had used autocorrelation and run test to detect the dependence among the stock price series. The outcomes of both the models were found to be similar and rejecting the null hypothesis that the successive price changes is

independent. Though his research was not based on the total market return movement, the result drawn from analyzing the movement of major stocks traded in the market can be generalized for efficiency level of overall NEPSE. Moreover this research work with the analysis of total market return and banking sector stock return will be useful to verify his findings as well.

Mukti Aryal (1999) has conducted research on “The General Behavior of Stock Market.” On the basis of run tests and serial correlation, it seems that the independent assumption of random walk model in stock prices is rejected by the collected sample data of 21 companies at least as a description of price behaviour in Nepal Stock Exchange.

The specific objectives of this study were:

- To discuss theoretically the movements of stock market prices as predicated by the random walk model.
- To develop the empirical probability distribution of successive price changes of an individual common stock and a stock market as a whole.
- To examine whether the successive price changes of stocks market are independent to each other or not.

His research revealed NEPSE to be an inefficient market. He performed a test of weak form efficiency by examining whether the stock price behaviour follow a random walk or not. He concluded that the knowledge of past is useful in predicting the future movements of stock market prices. Therefore, investors on the floor of the exchanges for securities can make higher than expected profits in the future based solely on the historical prices series under the existing trading mechanisms than they would be under buy and hold strategy.

Dhakpa Gela Sherpa (2001) has conducted research on “Corporate Information Disclosure and its Effect on Share Price”. The primary objectives of this study were to obtain an insight on corporate information disclosure with special reference to Nepalese stock market and its listed companies.

The main objectives of the study were:

- To highlight the corporate disclosure practice in Nepal.
- To identify the extent of disclosure of each of the item of information and to develop the information disclosure index.
- To check the quality of corporate disclosure of Nepalese listed companies measured by company characteristic namely asset size, number of shares outstanding and earning margin.
- To see the relationship between corporate information disclosure and stock prices.

His research study began with the construction of disclosure index for which he collected 59 informational items, classified according to their importance and calculated mean value after the collection of primary data. Thereafter, he selected 33 listed companies, used their annual reports and calculated disclosure scores, which was followed by use of various statistical tools like regression, correlation etc. to attain the mentioned objectives.

From the detail analysis, he found that most of companies do not disclose adequate and qualitative information on their annual reports, and most of disclosed information consisted of only relationship between disclosure scores and variables like earning margin, asset size etc. The important finding of his research is that there is positive relationship between market price of share and disclosure score. In other words, the company having greater disclosure score had the higher prices of stock.

Jyoti Joshi (2003) has conducted research on “Role of Nepal Stock Exchange in the secondary Market” she using the secondary data from 1996/97 to 2002/02.

The main objectives of this study were:

- To assess the past and present behaviour of business operation in the Nepal Stock Exchange Market.
- To forecast the future trends of business and economic activity in the NEPSE in terms of quality, value and volume.

- To prescribe ways and means by which secondary market would be more effective and meaningful.

The basic conclusions of her study were:

NEPSE should introduce digital technology and online marketing in its trading procedure, the rules and regulations should be up to date. Privatization process needs to be carried out effectively in order to develop Nepalese stock market.

Tax system should be reformed which should encourage and stimulate capital formation.

Risi Khanal (2003) has prepared the thesis on “Growth, Problems and Prospects of Nepalese Stock Market”. Using the secondary data from 1993/94 to 2001/2002.

The main objectives of his study were:

- Tax system should be reformed which should encourage and stimulate capital formation.
- To examine the investors’ awareness,
- To examine the stock broker’s and other related institution performance,
- To analyze sector wise financial performance of NEPSE,
- To observe the coordination among SEBON, NEPSE and Rastra Bank.

In this study, Khanal concluded that the development of stock market in Nepal so far cannot be considered satisfactory. This is evident from the facts and figures available in the stock market performance. But there is enough long-term liquidity in the market. Again he added that the stock market and economic activity move in similar direction. They influence each other. Nepal Stock Exchange is the only one institution in the country to regulate and control the financial system of a country. The official stock market in Nepal, NEPSE is ten years old. It means it is in infant stage thus equity market and related institutions are still in their infancy stage.

Deepak Paudel (2005) entitled “Stock price behavior of commercial banks in NEPSE” with the objective to examine monthly closing price of 6 listed

commercial banks during the period of three consecutive years from 2002 to 2004. He used correlation coefficient, regression analysis, and run test and auto correlation

The main objectives of his study were:

- To find out Nepalese people's awareness of the securities investment.
- To identify the stock market participation trend in Nepal
- To study and examine the major investment influencing factors.
- To provide some useful suggestions regarding stock market participation.

He found in his study that successive price changes were correlated with previous price series. He also found that most of the stocks did not follow random walk hypothesis. The present stock prices were dependent to the historical prices. The EPS was the most affecting factor for the price change of the stock. Most of the investors wanted to invest in the shares of commercial banks because the fluctuation in NEPSE index was due to the transaction of commercial bank shares. There were serious limitations in the study. Data used in this study, monthly closing price of stocks not enough to predict the behavior of share prices.

Sarada Mainali (2006) has conducted research on "A Study on Share Price Behaviour of Listed Companies".

The main objectives of this study were:

- To analyze the behavior of stock price of Listed Companies.
- To examine the stock price trend and volume of stock traded on the secondary market.
- To identify the factors affecting stock price.
- To analyze the investors' view regarding the decision on stock investment.

In her study, Mainali concluded that Share trading system in share market is still uncivilized even in this IT age. Though the volume to trading has increased the number of brokers has not increased. Therefore, for the systematic operation of the share market, the number of brokers should be increased according to the volume of trading. Similarly, the automation system has to be put in to practice to make

the share market effective and competitive.

The public investors should not directly invest their savings in shares haphazardly. They should at least analyze or get suggestions from experts about financial position and the level of risk prior to taking and investment decisions. Because of the persistence in the stock price movements professional traders either institutional or individual can beat the market. Thus it is suggestions that the investors should be alert to exploit the opportunities

Overall, the previous studies in stock market support the idea that Nepalese stock market is not efficient even in the weak form hypothesis. Nepalese investors are not efficient enough to recognize potential for excess return.

2.4 Research Gap

There is a gap between the previous research and this research. Previous researches were conducted only on the growth and size of the stock market. They were analyzed only on the basis of secondary data analysis. Few of the previous research were concerned with problems of stock market. However, they were not analyzed taking such variables like sufficiency of legal rules and regulations, availability of information, provision to attack institutional investors etc. To do this research, the researcher does not find the any previous research on the topic of prospects of Nepalese stock market. So to fulfill this gap this present study is conducted both analyzing the secondary data and primary data. The growth of stock market are analyzed using both secondary data and primary data analysis as well as analyzing over the 14 years data.. The problem and prospects of Nepalese stock market are analyzed on the basis of only primary data analysis using the Likert scale method.

There have been several researches done before in Stock Market. All of those researches have many useful findings and their own limitations. Like, Aryal conducted a study in 1995 in Share Price Behaviour based on twenty-one sample stocks. The time period was only five years from the beginning day of organized

Stock Market for five years period. Now it is out of date. Till date market has experienced many ups and downs. Likewise, Shrestha in 1999 carried out a study based on data of randomly selected thirty stocks out of all listed securities mostly started from the commencing day of organized trading system on NEPSE. His study covers the period from 13th January 1994 to Mid July 1998. However, his study implies technical concept but not emphasis has been given on fundamentalism. His study remains silent to say whether the trading with the help of past information could earn profit in both bull and bear market. Likewise, likewise, Khanal concluded that the development of stock market in Nepal so far can not be considered satisfactory. Mainali has carried out another study in Share price behaviour in 2006 but her study only selected finance companies,.

These researches are helpful in different areas. The findings of pervious researches are equally important. The main focus of the research will be to analyze the performance, growth and downfalls of the Stock Market. This will help to analyze whether the Stock Market is in increasing trend or in decreasing trend. By analyzing these aspects, focuses can be set on the weakness. So, that in future these weaknesses can be turned into the strength of the Stock Market. This will help to make the existence of the Stock Market more robust. Further more, by being able to point out the weakness; more investors can be made to contribute for the growth of Stock Market.

CHAPTER – III

RESEARCH METHODOLOGY

3.1 Introduction

Research means to search or study about a phenomenon. Generally research is an effort to search new fact, knowledge and principle in scientific ways. Research is the process of a systematic in –depth study or search of any particular topic, subject or area of investigation backed by the collection, complication, presentation and interpretation of relevant details or data. Methodology refers to the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind it. So that research methodology is a systematic way of conducting the research in an effective and practical so that it can explain how the research is done.

Therefore this chapter highlights the research methodology used for the study of “Growth, Problem and Prospects of Nepalese Stock Market”. In this regard, this chapter explains not only talk of the research methods but also consider the logic behind the methods, which are used in the context of our research. This chapter consists of the research design, population, sampling procedure and sources and analysis of data.

3.2 Research Design

Research design is a plan or way for the study that give a direction for the collection and analysis of data. In other words, research design is the arrangement of collections and analysis of data in a systematic way. It is concerned with various steps to collect the data for analysis and procedures for acquiring the information including from which sources and by what procedure it is obtained.

This research is based on secondary data and primary data analysis. Hence, descriptive and analytical research design has been used to conduct the study of

growth, problems and prospects of Nepalese stock market. It deals with the stock market on the basis of available information.

3.3 Population and Sample

The analysis of stock market, its growth, problems and prospects depends on the total number of 142 companies listed in the Nepal Stock Exchange as on the end of 2008 and major economic indicator (GDP, Inflation, Turnover etc) are taken as total population. Moreover, the companies that are in existence and doing share transactions in NEPSE and the factor that affects the present economic growth are considered as the sample of the study. The required data have been collected from the various sources; but mainly from the annual reports of securities exchange board, Nepal covering a period of 1993/94 to 2007/08. Therefore, all the companies listed in the stock exchange are taken as samples.

3.4 Sources of Data

The main place of data was the central office of Nepal Stock Exchange (NEPSE), Securities Board office, Thapathali, Kathmandu and Economic Survey published by Ministry of Finance. The main source of data is annual report of the SEBON. Besides annual report, various bulletins available and useful to the study are also taken into consideration. The research is mainly based on the secondary data. The required data will be collected through the corporate office of the security Board of Nepal.

Primary Data

The primary data are collected through questionnaire and informal interview of concerned persons like staff of SEBON, share broker, and investors. All together 50 copies of questionnaires were distributed to the persons and institution irrespective of their professions and nature of activities

Table 2
Collection of Primary Data

Sector	Population	Sample
Stock Brokers	23	7
SEBON Staffs	41	5
Investors (Attendance in Agrawal Securities and in Primo Securities, June 2009)	61	38
Total	125	50

Secondary Data

The secondary source of data are the annual report of the Security Board Nepal, different books from library, periodicals, newspaper cuttings, company's magazines etc. Guidelines and unpublished thesis, research work that directly related to the financial performance and stock market would form secondary data for the purpose of this study. Significant information are also collected from Internet and various websites like www.nepalstock.com, www.sebonp.com etc.

3.5 Data Collection Technique

To collect the secondary data, published materials are viewed in various spots such as books by different authors, unpublished thesis reports, journals, Internet web sites, online library, AGM reports of listed companies, NEPSE, SEBON etc. To collect these secondary data, the researchers visited campus library of SDC, TU central library, SEBON library. On the other hand, the primary data collected through scheduled questionnaire.

3.6 Data Processing

Data so obtained have no meaning unless they are arranged and presented in a systematic way. Data processing technique is one of the most important parts of the research study. The researcher should adopt that data processing technique to process the information and data which is suitable and feasible according to nature

and objects of the research study. The available information and data should be present in different way, which can easily be understood by the general public. In this study, the required available data and information are shown in figures. The computation has been done with the help of calculator and computer.

3.7 Analysis of Data

Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic. This study is mostly based on the analysis of secondary and primary data with the help of different statistical tools like Diagrammatic presentation and mean. The empirical result has been extracted in this study by using annual data of listed companies from 1994/95 to 2007/08.

Data Analysis Variables

- Gross Domestic Product (GDP)
- Issue Approval
- Public Issue
- Issue Manager
- Stock Broker
- Paid-up Value, Turnover and Market Capitalization

3.8 Tools of Data Analysis

On the basis of secondary and primary data collected from the trading report, published books, journal and questionnaire with different financial and non-financial expert and staff as well as officers of NEPSE and SEBON were done, so effective analysis of data could be done on effective manner. To draw the conclusion by analyzing the collected data simple statistical tool are used as follows:

3.8.1 Diagrams and Graphs

Diagrams and graphs are visual aids that give a bird's eye view of a set of numerical data that show the information in a way that enables us to make comparison between two or more than sets of data.

3.8.2 Market Index

Market indexes are used to determine the relationship between historical price movements and economic variables and to determine the systematic risk for individual securities and portfolios. The index is taken as a measuring tool whether the performance of stock market is good or not. This clearly focuses on the price of stocks that is increasing or decreasing in the market. Because the prices of stocks go up and down in a particular period compared to the previous period as disclosed by index. The highest index suggests the increase in market price of the stocks and implies the better performance of companies and vice-versa. Thus, the NEPSE index shows the behaviour of stock prices in the capital market.

The computation formula for price index is as follows:

$$\text{Each day's index} = \frac{\text{Each day's total market value}}{\text{Base day's total market value}} \times 100$$

$$P_{01} = \frac{\sum P_1 \times Q_1}{\sum P_0 \times Q_0} \times 100$$

Where,

P_0 = Base Market Price

P_{01} = NEPSE Price Index

P_1 = Today's Stock Price

Q_1 = Listed Shares (i.e. no. of Shares outstanding)

Q_0 = Base Listed Shares.

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

4.1 Background

This chapter is basically focused upon the analysis of data collected from different secondary sources. It will reveal the development of Nepalese stock market in terms of turnover, issued – capital, paid-up capital, contribution of market capitalization to GDP etc. comparing with different years. With reference to various readings and review of literature in the preceding chapters, effort is made to analyze and diagnose the recent Nepalese Stock Market Development. Different tables and diagrams are drawn to make the result more simple and understandable.

The relevant information and data are collected from Nepal Stock Exchange (NEPSE), Security Board (SEBON) and from different books and articles. All companies listed in stock market (NEPSE) are taken as a sample and appropriate statistical and financial tool have been used to perform the analysis.

Group-Wise Description of Listed Companies

Table 3

Group-Wise Description of Listed Companies

S.N.	Sector	No. of Listed Co. Group-wise	Percentage
1.	Commercial Banks	17	11.98
2.	Development Banks	23	16.19
3.	Finance Companies	55	38.75
4.	Insurance Companies	17	11.98
5.	Hotels	4	2.81
6.	Manufacturing and Processing	18	12.67
7.	Trading	4	2.81
8.	Hydro Power	3	2.11
9.	Others	1	0.70
Total		142	100.00

Source: Annual Report of NEPSE 2007/08

Figure 1

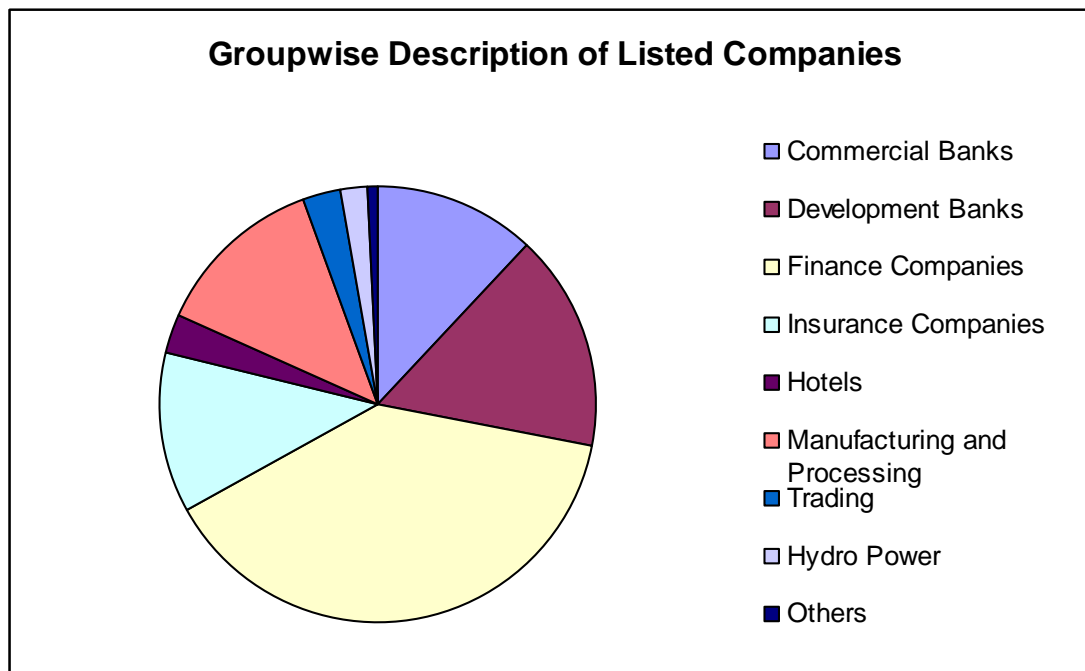


Table 3 and Figure 1 represents that 142 companies listed in NEPSE in this fiscal year 2007/08, 38.75 Percent 55 finance companies are listed out of 142 listed companies and only 4 Hotels and only 1 in Others companies are listed in NEPSE. The number of listed companies in the FY 2007/08 reached 148 with the listing of 13 new companies. However, the number of listed of companies at the end of the fiscal year came down to 142 with the delisting of five companies and merger of two.

4.1.1 Yearly Volume of Traded Stocks and NEPSE Index

Table 4
Volume of Traded Stocks and NEPSE Index

(Rs. in million)

Year	No. of Companies	No. of transactions (Shares units) '000'	Market Capitalization	Traded Total Turnover Volume '000'	Turnover Values in Rs.	Yearly NEPSE index
1997/98	101	15483	14289	1195.1	202.61	163.35
1998/99	107	15814	23508	4788	1500	216.92
1999/00	110	29136	43123.33	7674	1157	360.70
2000/01	115	46095	46349.4	4987	2344.20	348.43
2001/02	96	42028	34704	5791	1540.60	227.54
2002/03	108	69163	35240.40	2427.89	575.99	204.86
2003/04	114	85533	41424.77	6468.18	2144.27	222.04
2004/05	125	106246	61365.89	18433.55	4507.68	286.27
2005/06	135	97374	96813.74	12221.93	3451.43	386.83
2006/07	141	120510	186301.30	18147.25	8360.1	683.04
2007/08	142	150800	366247.50	28599.80	22820.80	963.36

Source: Trading Report of NEPSE 2007/08

Table 4 shows that the yearly volume and values of traded stocks are fluctuating. However, there is a sharp rise in the volume of traded stocks in fiscal year 2007/08. The major reason for the sharp rise in the trading volume in fiscal year 2007/08 may be attributed to heavy transaction of banking sectors. We can see that the significant increases in NEPSE Index in the fiscal year 2007/08 by 280.32 points.

4.2 Analysis of Turnover

Annual Turnover

Annual turnover constitutes an important indicator for measuring the nation's economic activity. It also reflects the stock market liquidity as higher the amount of trading of stock market size, the greater is the stock market liquidity.

Table 5
Monthly Turnover in 2007/08

S.N.	Month	Amount Traded (in million)
1.	July/August	1717.64
2.	August/September	1541.56
3.	September/October	2224.45
4.	October/November	937.02
5.	November/December	2732.37
6.	December/January	3230.79
7.	January/February	1281.93
8.	February/March	1876.38
9.	March/April	918.29
10.	April/May	1619.27
11.	May/June	2262.19
12.	June/July	2478.80

Figure 2

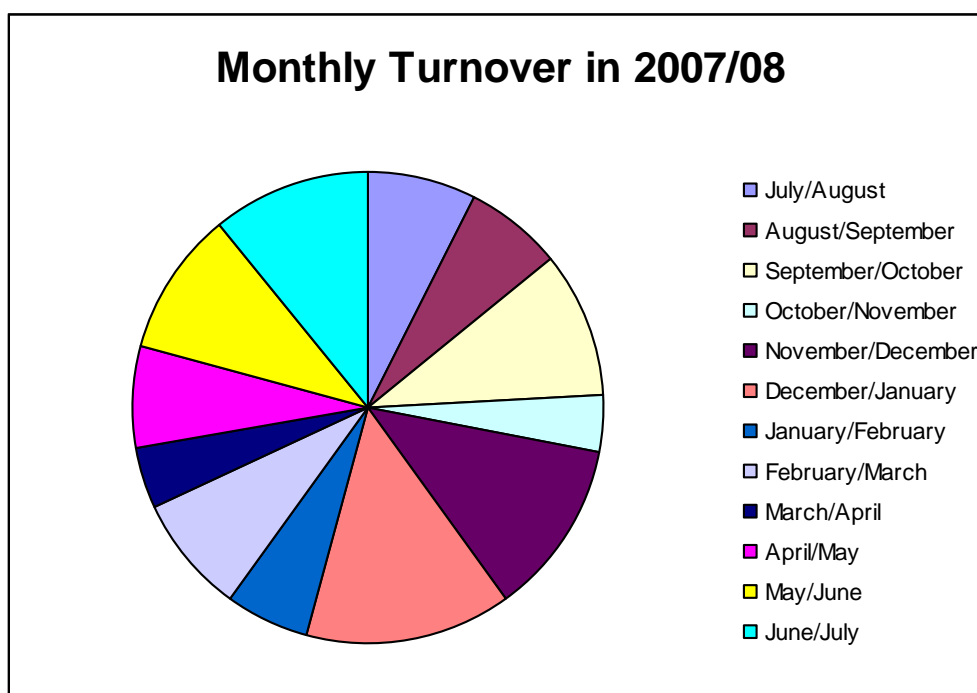


Table 5 and Figure – 2 represent that the highest amount traded in December/January in Rs 3230.79 million and the lowest is March/April Rs in 918.29 million.

4.2.1 Paid Up Value of Listed Securities

The paid-up value of listed securities in the end of this fiscal year was Rs. 294657.96 million as compared to the paid-up value of Rs. 21798.80 million in the previous year 2006/07. The paid-up value of securities in the end of this fiscal year is given below:

Table 6
Paid Up Value of Listed Securities

S.N.	Sector	Paid-up Value (Rs. in million)	Percentage
1.	Commercial Banks	146672.75	49.78
2.	Development Banks	23226.80	7.88
3.	Finance Companies	43172.76	14.67
4.	Insurance Companies	16696.98	5.66
5.	Hotels	15528.80	5.27
6.	Manufacturing and Processing	25397.35	8.61
7.	Trading	784.67	0.28
8.	Hydro Power	22686.57	7.69
9.	Others	491.28	0.16
Total		294657.96	100.00

Source: Trading Report NEPSE 2007/08

Figure 3

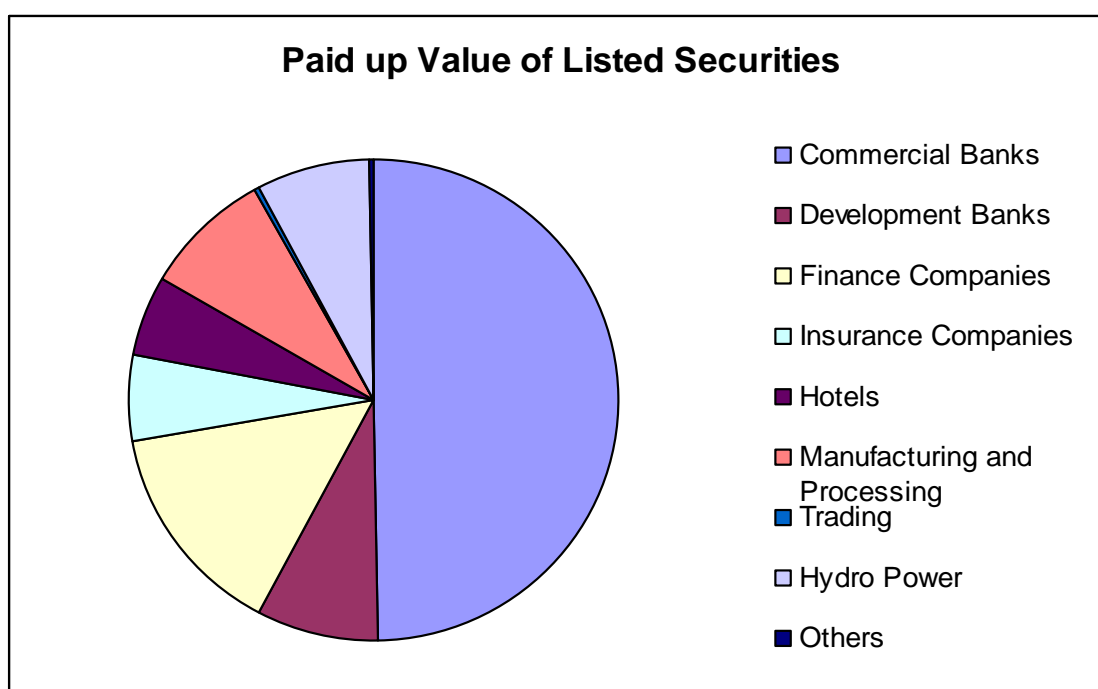


Table 6 and figure 3 shows that the huge amount of paid –up value covered by the commercial Banks. It’s Cover 49.78 percent (Rs. 146672.75 million out of Rs.

294657.96 million) and lowest paid – up values are of Others and Trading companies only 0.16 and 0.28 percentage respectively.

4.2.2 Paid Up Value of Listed Securities for Different Years

Table 7
Paid Up Value of Listed Securities for Different Years

Fiscal Year	Paid-up Value (Rs. in million)	% Increase in Paid-up Value	% of Turnover in Paid-up Capital
1994/95	2961.8	-	5.60
1995/96	3358.5	13.40	6.42
1996/97	4476.5	33.29	9.30
1997/98	4959.8	10.80	4.09
1998/99	6487.4	30.80	23.12
1999/00	7347.4	13.26	15.75
2000/01	8165.2	11.13	28.71
2001/02	9685.04	18.61	15.91
2002/03	12560.07	29.69	4.58
2003/04	13404.90	6.73	16.00
2004/05	16771.80	25.11	16.88
2005/06	19958.00	18.99	17.25
2006/07	21798.80	9.22	38.35
2007/08	294657.96	1251.71	72.45

Source: Annual Report, SEBO 2007/08 Trading Report, NEPSE 2007/08.

Figure 4

Paid up Value of Listed Securities for Different Years

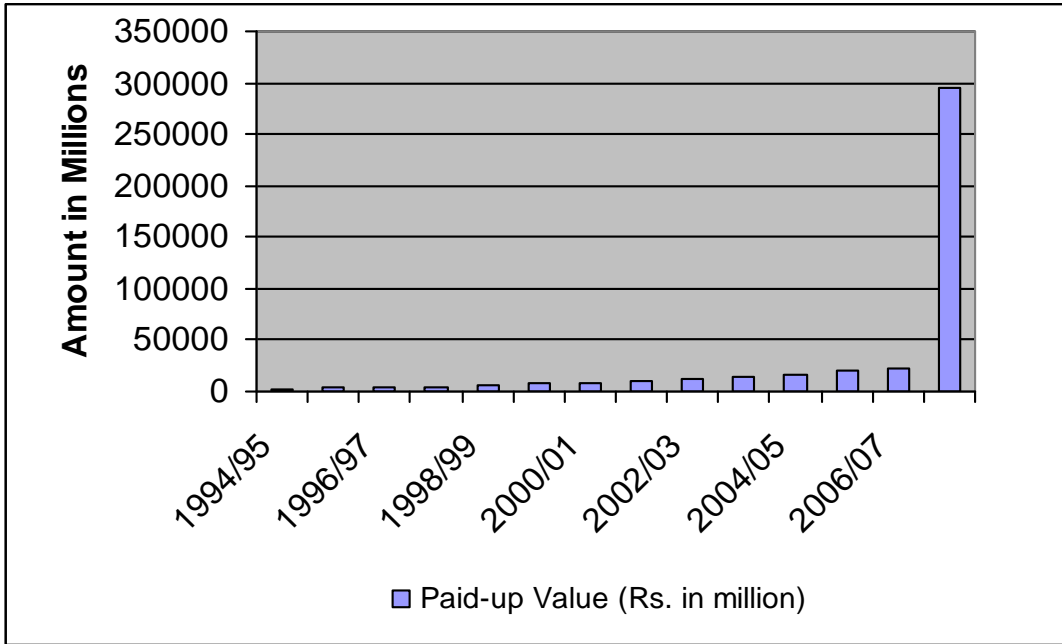
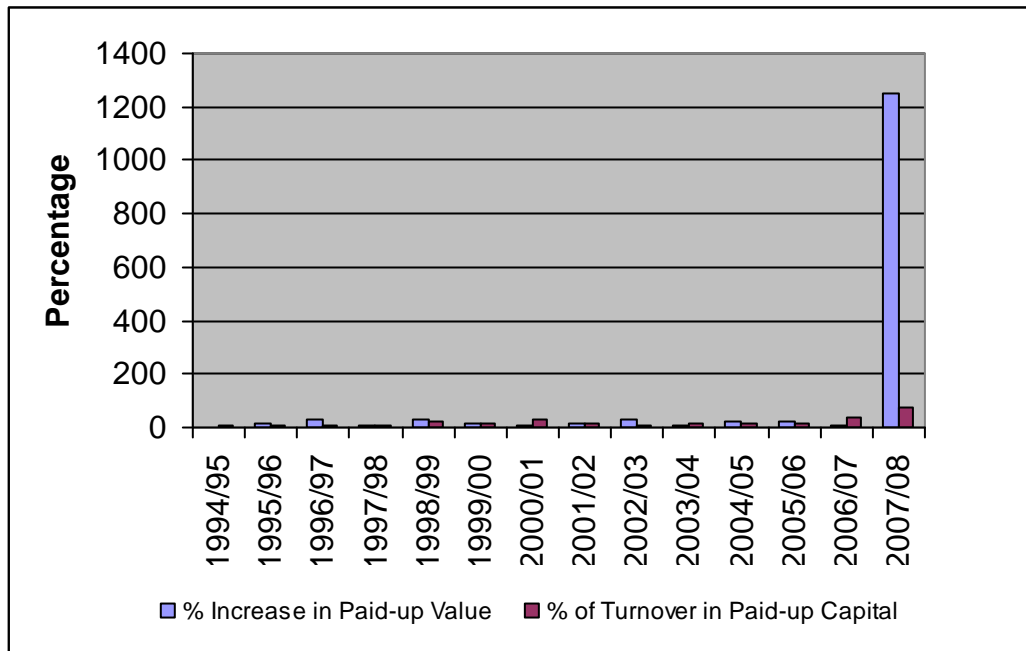


Figure 5

Percentage increase in paid-up Value & Percentage of turnover in paid-up capital



By the end of this fiscal year 2007/08, the paid-up value of listed securities increased by 1251.71 percent and reached to Rs. 294657.96 which was also the highest percentage increased in the paid-up value of listed securities from the study year 1994/95 to this fiscal year 2007/08. The lowest is in the year 2003/04 by only 6.73 percent.

The percentage of turnover on paid-up capital is highest in the fiscal year 2007/08 with 72.45 percent and lowest in the fiscal year 1997/98 with 4.09 percent. The percentage of turnover was 5.60 percent in the fiscal year 1994/95.

4.2.3 Market Capitalization

The market capitalization value of listed securities in the end of this fiscal year 2007/08 is Rs. 366247.50 million. The market capitalization value was Rs. 186301.30 million in the last year.

Table 8
Market Capitalization

S.N.	Sector	Market Capitalization Value (Rs. in million)	Percentage
1.	Commercial Banks	259970	70.99
2.	Development Banks	17995	4.92
3.	Finance Companies	37680	10.29
4.	Insurance Companies	11245	3.07
5.	Hotels	4800	1.31
6.	Manufacturing and Processing	7510	2.05
7.	Trading	1170	0.31
8.	Hydro- Power	25865	7.06
8.	Others	11.60	0.003
Total		366247.50	100

Source: Trading Report NEPSE 2007/08

Figure 6
Market Capitalization of Listed Securities

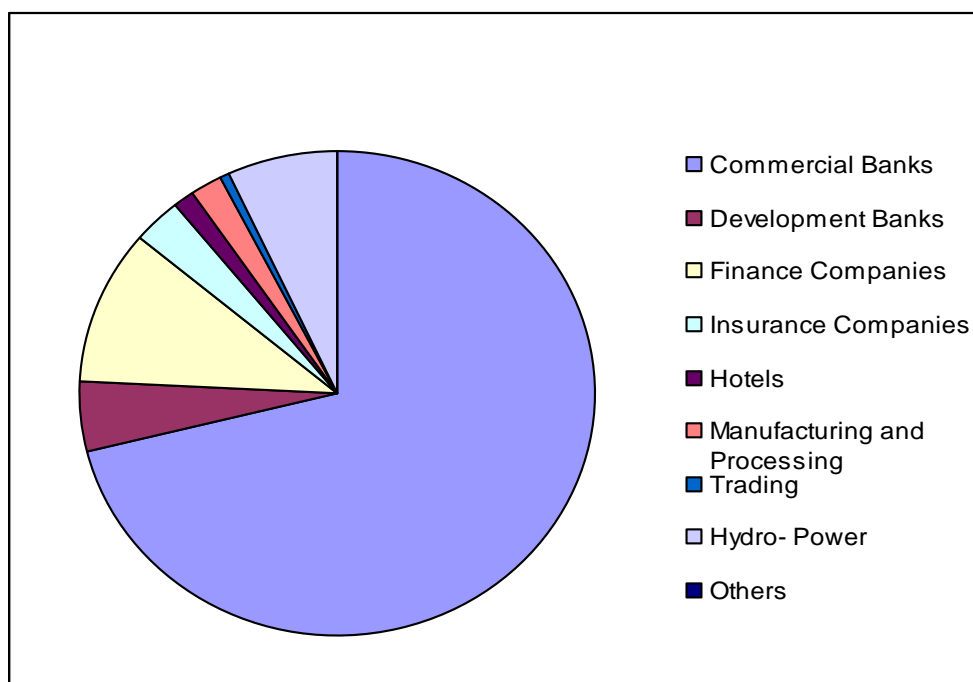


Table 8 and the Figure 6 represents that the highest market capitalization by commercial banks and it's covered the 70.99 percent (259970 million out of 366247.50 million) .Here the lowest market capitalization by Others sector and it's covered only 0.003 percent.

4.2.4 Analysis of Market Capitalization

Table 9
Market Capitalization in NEPSE

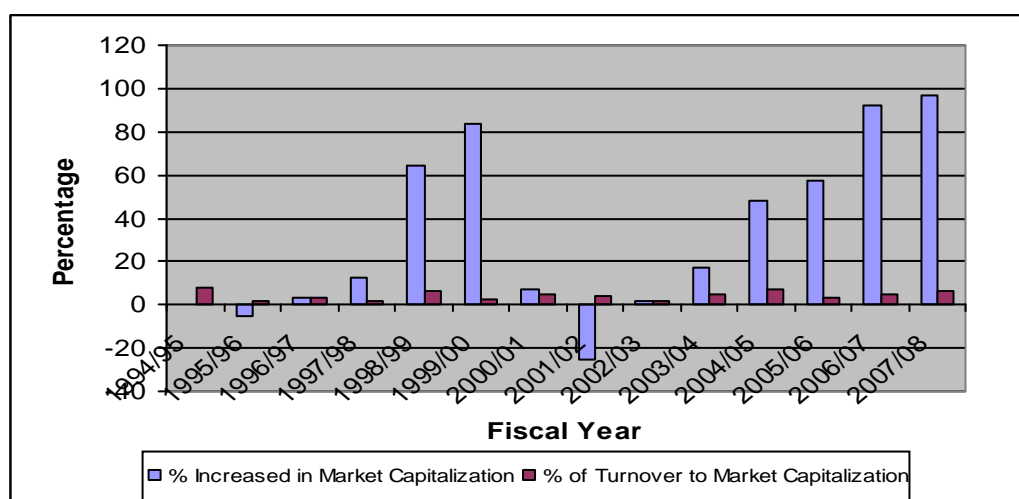
Fiscal Year	Market Capitalization (Rs. in million)	% Increased in Market Capitalization	% of Turnover to Market Capitalization
1994/95	12963	-	8.13
1995/96	12295	-5.15	1.75
1996/97	12698	3.28	3.28
1997/98	14289	12.53	1.42

Fiscal Year	Market Capitalization (Rs. in million)	% Increased in Market Capitalization	% of Turnover to Market Capitalization
1998/99	23508	64.52	6.38
1999/00	43123.3	83.44	2.68
2000/01	46349.4	7.48	5.06
2001/02	34703.87	-25.12	4.44
2002/03	3520.40	1.55	1.63
2003/04	41424.77	17.55	5.18
2004/05	61365.89	48.13	7.35
2005/06	96813.74	57.76	3.57
2006/07	186301.3	92.43	4.48
2007/08	366247.50	96.58	6.23

Source: Annual Report, SEBO 2007/08 Trading Report, NEPSE 2007/08.

The market capitalization of listed securities in the fiscal year 2007/08 is Rs. 366247.50 million. It is increased by 96.58 percent from the fiscal year 2006/07 which was Rs. 186301.30 million. The market capitalization was decreased by -25.12 percent in the fiscal year 2001/02. The highest increase in market capitalization rate is 96.58 in the fiscal year 2007/08.

Figure 7
% increased in Market Capitalization & % of Turnover to Market Capitalization



4.2.5 Analysis of the Growth Trend of Stock Market Indicator

Table 10

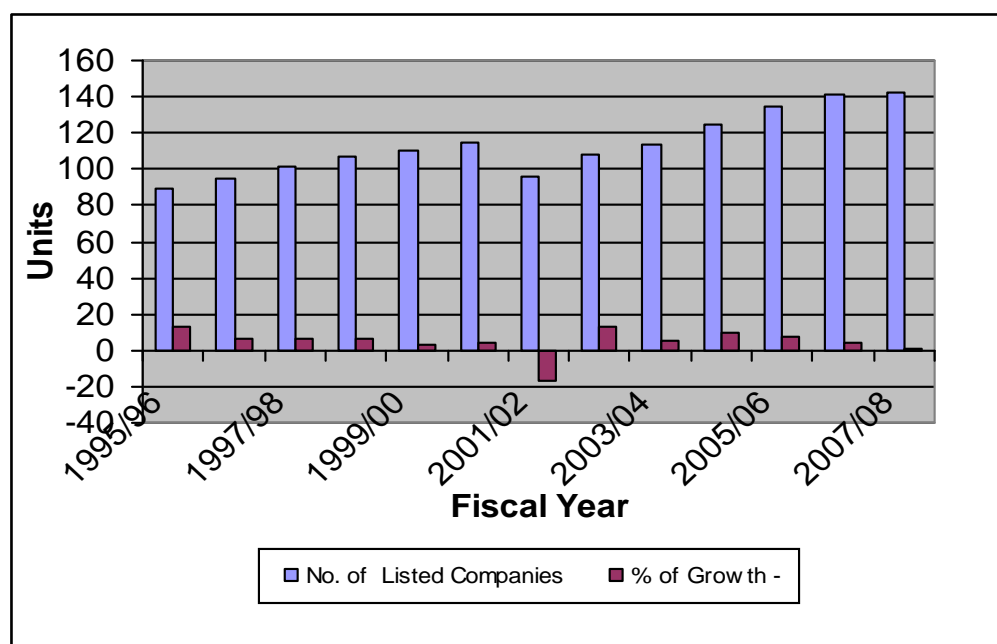
Stock Market Indicator

Fiscal Year	No. of Listed Companies	% of Growth	No. of Traded Company	% of Growth	No. of Share Traded '000'	% of Growth
1994/95	79	-	53	-	3901	-
1995/96	89	12.66	59	11.32	2954	-24.28
1996/97	95	6.74	67	13.56	9443	219.67
1997/98	101	6.32	68	1.49	1195	-87.35
1998/99	107	5.94	69	1.47	4857	306.44
1999/00	110	2.80	69	0	7674	58
2000/01	115	4.55	67	-2.90	4989	-34.99
2001/02	96	-16.52	69	3.00	6005	20.36
2002/03	108	12.5	81	15.94	2428	-59.57
2003/04	114	5.56	92	15	6468	166.39
2004/05	125	9.64	102	10.86	18434	184.98
2005/06	135	8.00	110	7.54	12221	-33.70
2006/07	141	4.25	116	5.45	18147	48.49
2007/08	142	0.70	136	17.24	28599	57.59

Source: Annual Report, SEBO 2007/08

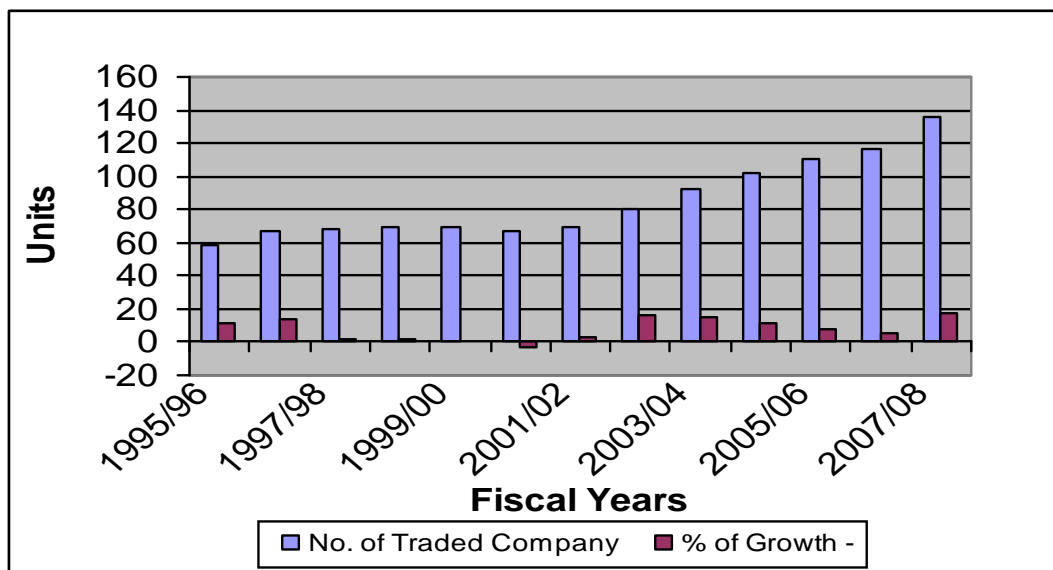
Figure 8

Number of Listed Companies in NEPSE & % of Growth



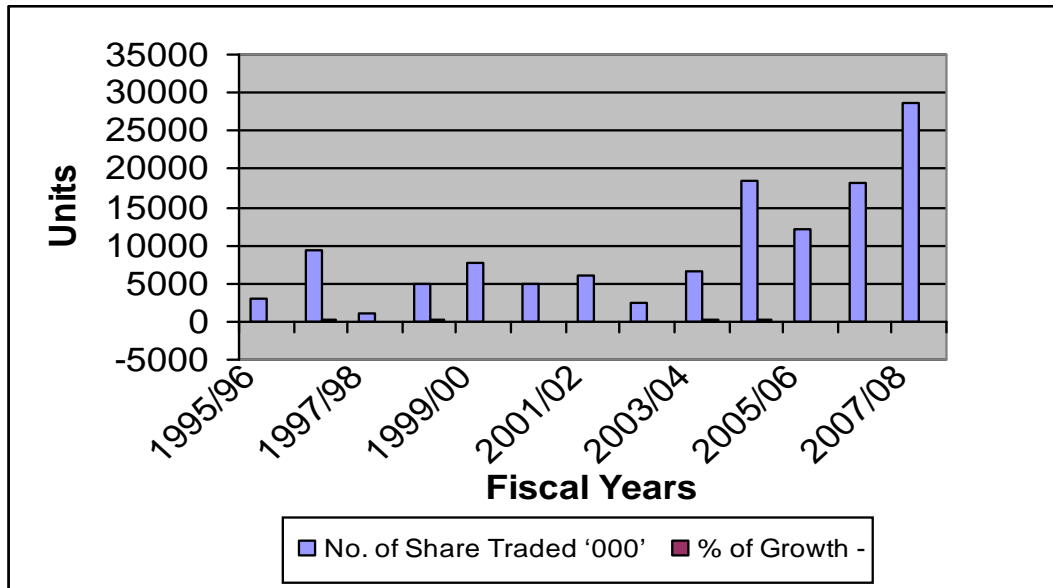
The number of listed companies was 79 in the base year 1994/95, 114 in 2003/04 and 142 in 2007/08. The growth rate of listed companies is positive in all these years except in the year 2001/02 with the negative growth rate of -16.52. In that year NEPSE deleted some companies from its list because of non-disclosure of necessary information correctly and timely. The growth rate was highest in 1995/96 with 12.66 percent and lowest in 2001/02 with -16.52 percent.

Figure 9
Number of Traded Company & its % growth Rate



The number of traded companies was 53 in the base year 1994/95 and, 116 and 136 in the year 2006/07 and 2007/08 respectively. Only 69 companies were traded in the trading floor and it rose up to 81 in the year 2001/02 and 2002/03. The number decreased to 67 in the year 2000/01 with the negative growth rate of -2.90 percent. However, the no. of trading companies is increasing after the year 2000/01. Then continue to increase under the Study Period...

Figure 10
No. of Share traded & it's % of Growth



The number of shares traded in different years; we conclude that it is very much fluctuating. The impact on growth rate is also affected. The number of shares traded in the year 1994/95 was only 3901000 whereas it was 2954000 in the year 1995/96 with the negative growth rate of 24.28 percent. Again, in the year 1997/98 it was declined and came to 1195000 with the negative growth rate of 87.35 percent. This negative trend of growth rate was continued in the year 2000/01, 2002/03 and 2005/06 with -34.99, -59.57 and -33.70 percent respectively. But in the year 2003/04 the growth rate was significantly increased and became 166.39 percent with the shares traded 6468000 as compared to the preceding year of 2428000 then also decrease in the fiscal year 2005/06 by -33.70 percent but it's recover in fiscal year 2006/07 and also increased in the fiscal year 2007/08 by 57.59 percent as compared to the last year.

4.2.6 Number of Transaction and Listed Securities in NEPSE

Table 11

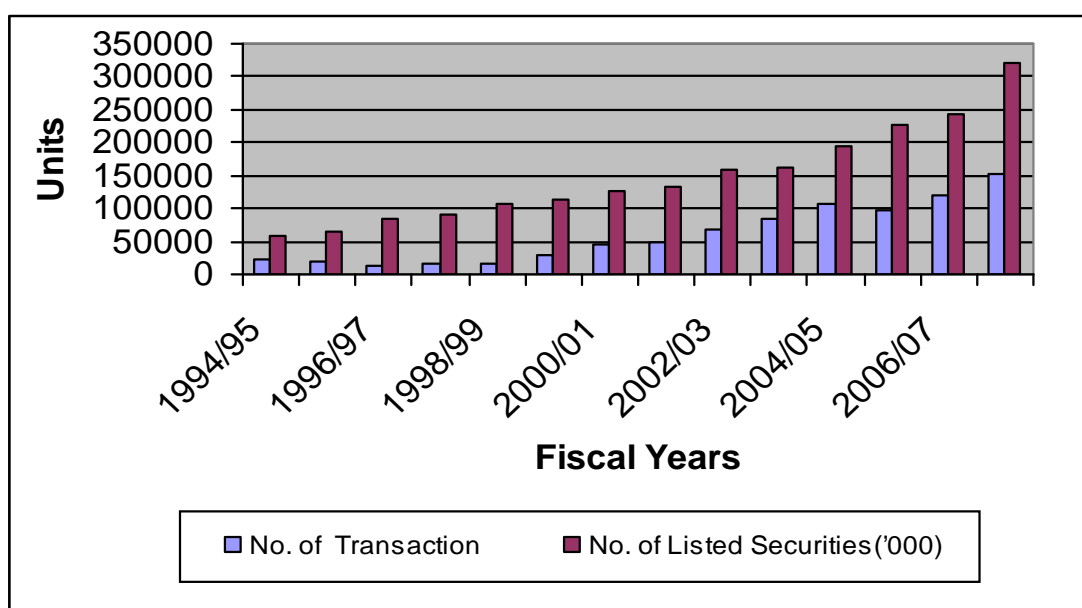
Number of Transaction and Listed Securities in NEPSE

Fiscal Year	No. of Transactions	% of Growth	No. of Listed Securities ('000)	% of Growth
1994/95	21472	-	58247	-
1995/96	17943	-16.44	65880	13.10
1996/97	12428	-30.74	85193	29.32
1997/98	15483	24.58	90107	5.77
1998/99	15814	2.14	105632	17.23
1999/00	29136	84.24	114057	7.98
2000/01	46095	58.21	124971	9.57
2001/02	48028	4.19	134150	7.34
2002/03	69163	44	159958	19.24
2003/04	85533	23.67	161141	0.74
2004/05	106246	24.21	194673	87.91
2005/06	97374	-8.35	226540	16.36
2006/07	120510	23.75	243504	6.96
2007/08	150800	25.13	321131	31.87

Source: Annual Report, SEBO 2007/08/ NEPSE, Summary Sheet of Transaction 2007/08

Figure 11

Number of Transactions and Listed Securities in NEPSE



Number of transactions is very much varied comparing with different years. In the year, 1994/95 the number of transaction was 21472. There was a negative growth rate in transaction in the year 1995/96 by 16.44 percent with transaction of 17943 and it was continued by -30.74 percent in the year 1996/97. The significant growth rate can be traced in the year 1999/00 by 84.24 percent as compared to the growth rate of 2.14 of 1998/99. The negative growth rate in number of transactions in 2005/06 was by -8.35 percent as compared to the growth rate of 24.21 percent of 2004/05. The growth rate in 2007/08 was by 25.13 percent with 150800 numbers of transactions.

The present system is that the securities issued to the public should be listed in stock exchange within 45 days after the allotment date. The growth rates of number of listed securities are all positive with lowest in the year 1997/98 and highest in the year 2004/05 and the numbers are 90107000 and 321131000 respectively.

4.2.7 Market Day Per Year and Daily Turnover

Table 12
Market Day Per Year and Percentage Growth Rate

Fiscal Year	Market Day Per Year	% of Growth
1994/95	242	-
1995/96	240	-0.83
1996/97	239	-0.42
1997/98	237	-0.84
1998/99	231	-2.53
1999/00	240	3.9
2000/01	231	-3.75
2001/02	246	6.50
2002/03	238	-3.25
2003/04	243	2.10
2004/05	236	2.88
2005/06	228	3.38
2006/07	232	1.75
2007/08	235	1.29

Source: Annual Report, SEBO

Figure 12
Market Day per Year and Percentage Growth Rate

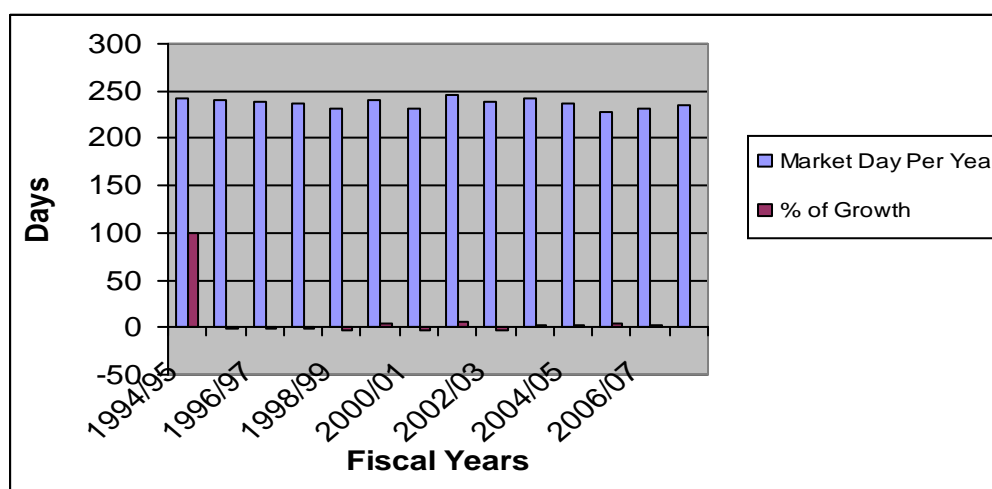


Table No. 12 and Figure No 12 represents that the highest turnover day was 246 days in 2001/02 and the lowest turnover year was 228 in fiscal year 2005/06

4.2.8 Market Turnover in Volume and Value

Table 13
Annual Market Turnover in Volume and Value

Fiscal Year	Annual Turnover in Volume (00000)	Annual Turnover in Value (Rs. in million)
1994/95	39.00	1054.30
1995/96	29.47	215.60
1996/97	91.43	416.20
1997/98	11.95	202.60
1998/99	47.88	1500.00
1999/2000	76.74	1157.00
2000/01	49.87	2344.20
2001/02	57.91	1540.60
2002/03	24.28	575.99
2003/04	64.68	2144.27
2004/05	184.33	4507.68
2005/06	122.21	3451.43
2006/07	181.47	8630.10
2007/08	285.99	22820.80

Source: Annual Report, SEBO 2007/08

Figure 13
Annual Market Turnover in Volume and Value

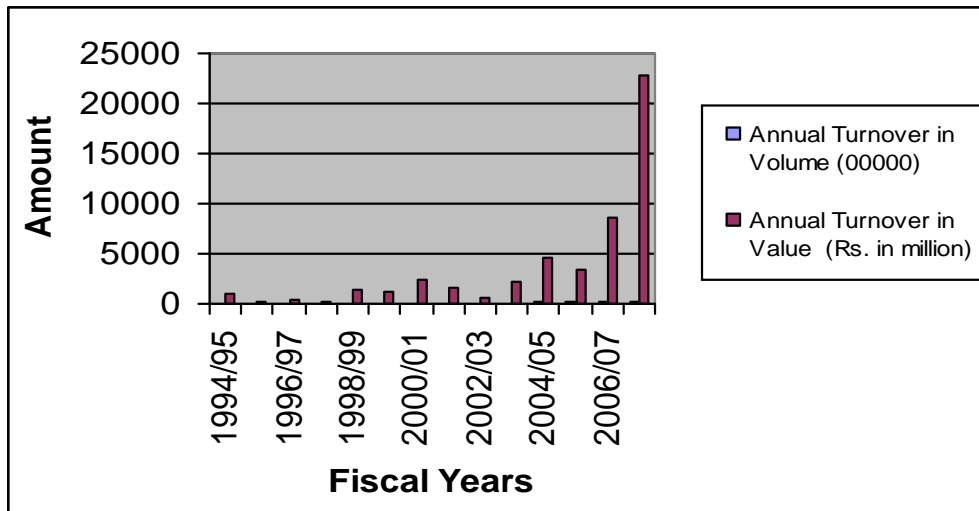


Table 13 and Figure 13 shows that the highest Annual Market Turnover value is Rs 22820.80 million in the fiscal year 2007/08 and lowest was Rs 202.60 million in fiscal year 1997/98. In the year 2007/08 Annual market turnover value is increased by 164.44 percent with respect to the year 2006/07. The volume of Market Turnover was highest in the year 2007/08 and lowest in the year 1997/98.

4.2.9 NEPSE Index

Market indexes are used to determine the relationship between historical price movements and economic variables and to determine the systematic risk for individual securities and portfolios. The index is taken as a measuring tool whether the performance of stock market is good or not. This clearly focuses on the price of stocks that is increasing or decreasing in the market. Because the prices of stocks go up and down in a particular period compared to the previous period as disclosed by index. The highest index suggests the increase in market price of the stocks and implies the better performance of companies and vice-versa. Thus the NEPSE index shows the behaviour of stock prices in the capital market.

The computation formula for price index is as follows:

$$\text{Each day's index} = \frac{\text{Each day's total market value}}{\text{Base day's total market value}} \times 100$$

$$P_{01} = \frac{\sum P_1 \times Q_1}{\sum P_0 \times Q_0} \times 100$$

Where,

P_0 = Base Market Price

P_{01} = NEPSE Price Index

P_1 = Today's Stock Price

Q_1 = Listed Shares (i.e. no. of Shares outstanding)

Q_0 = Base Listed Shares.

Table 14
NEPSE Index

Year	NEPSE Index	% Change in Index
1994/95	195.48	-
1995/96	185.61	-5.05
1996/97	176.31	-5.01
1997/98	163.35	-7.35
1998/99	216.92	32.79
1999/00	360.70	66.28
2000/01	348.43	-3.40
2001/02	227.54	-34.70
2002/03	204.86	-9.97
2003/04	222.04	8.39
2004/05	286.67	29.10
2005/06	386.83	34.93
2006/07	683.95	76.80
2007/08	963.36	40.85

Source: Trading Report NEPSE, 2007/08

Figure 14
NEPSE Index (Fiscal year 1994/05 to 2007/08)

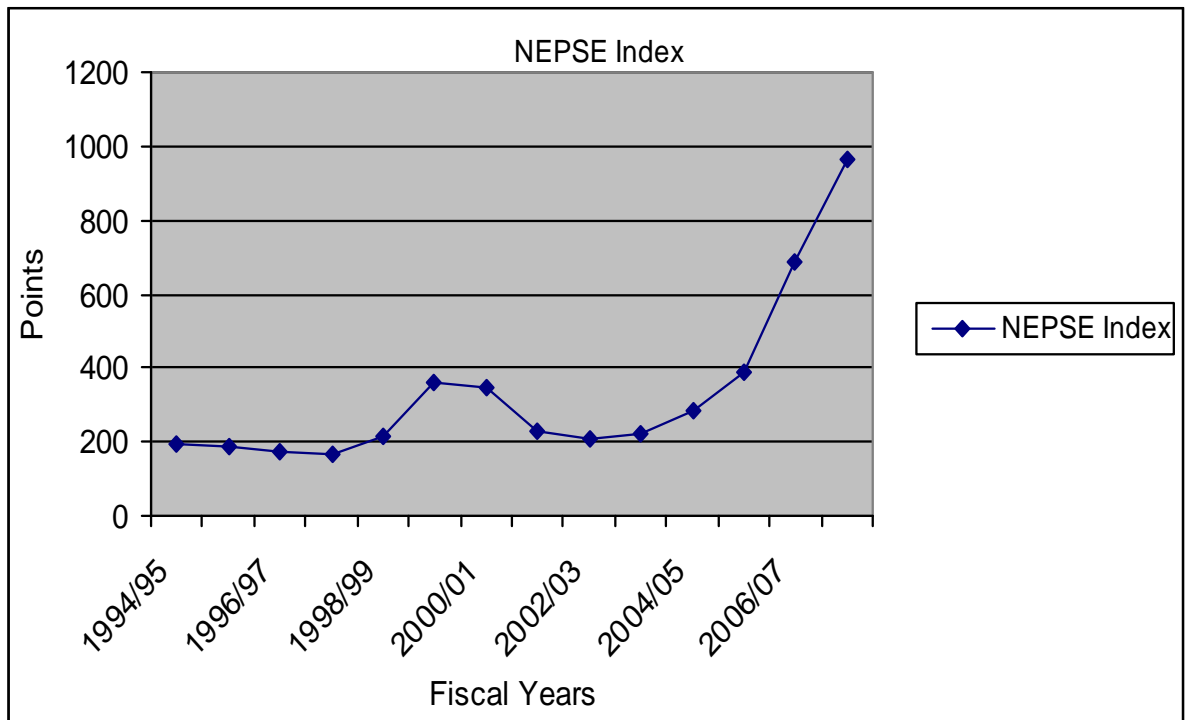


Table 14 and Figure 14 represents that the NEPSE Index is fluctuating trend before fiscal year 2003/04, but after that fiscal year NEPSE Index is increasing trend over the study period. The NEPSE index is highest in the fiscal year 2007/08 with 963.36 and it was lowest in the year 1997/98 by 163.35 points. The NEPSE index for this fiscal year 2007/08 is 963.36 which is somewhat higher than 683.95 of the previous year 2006/07.

4.2.10 Market Capitalization Vs Nominal GDP

Table 15
Market Capitalization Vs Nominal GDP

Fiscal Year	Market Capitalization (Rs. in Million)	GDP (Rs. in Million)	% Increased in Capitalization on Nominal GDP
1994/95	12963	209974	6.17
1995/96	12295	239388	5.14
1996/97	12698	269570	4.71
1997/98	14289	289798	4.93
1998/99	23508	329960	7.12
1999/00	43123	365465	11.77
2000/01	46349	392532	11.78
2001/02	34703	405632	8.56
2002/03	35240	435531	8.09
2003/04	41424	472424	8.77
2004/05	61365	548484	11.18
2005/06	96813	603672	16.03
2006/07	186301	670588	27.78
2007/08	366247.50	678832	44.62

Source: Annual Report Ministry of Finance, SEBO 2007/08 Trading Report, NEPSE 2007/08.

The highest percentage of market capitalization on nominal GDP was 44.62 percent in the year 2007/08. Likewise the lowest was 4.71 in 1996/97. The contributions of market capitalization on GDP for the year 2003/04, 2004/05, 2005/06 and 2006/07 are 8.77, 11.18, 16.03, and 27.78 respectively.

4.3 Presentation and Analysis of Primary Data

The questionnaire survey method is used to analyse the “problems and prospects of stock market growth in Nepal.” Samples are taken from different sectors such

as investors, offices of SEBO & NEPSE, Share brokers, students. The results are analysed carefully so that it could lead to real problems and prospects of stock market in Nepal.

4.3.1 Questionnaire Survey

Table 16
Analysis of the Problem Faced by Stock Market

S. N.	Problems	No of respondent	% of respondent
A	Shortcomings of rules and regulations	6	12
B	Lack of sufficient knowledge among investors	30	60
C	Lack of proper coordination between authoritative body	4	8
D	Restriction to foreign investors	8	16
E	All of the above	2	4
	Total	50	100

Source: Field Survey

Regarding this question, almost the same percentage of respondents agrees about the lack of sufficient knowledge among investors and stock market intermediaries. Actually Nepalese investors as well as stock market intermediaries do not have sufficient knowledge about the stock market.

Analysis of Information Provided by NEPSE and SEBO Correctly and Timely

Table 17
Analysis of Information Provided by NEPSE and SEBO Correctly and Timely

S. N.	Variables	No. of respondent	% of respondent
A	Yes	6	12
B	No	40	80
C	Do not know	4	8
	Total	50	100

Source: Field Survey

Regarding this question, 80 percent of the respondents are of the view that the information provided by NEPSE and SEBO are not correct and timely.

Analysis of the Performance of Nepal Stock Exchange

Table 18

Analysis of the Performance of Nepal Stock Exchange

S. N.	Variables	No. of respondent	% of respondent
A	Yes	22	44
B	No	18	36
C	Do not know	10	20
	Total	50	100

Source: Field Survey

Regarding this question, more than 40 percent (44) are satisfied about the performance of Nepal Stock Exchange. 36 percent are not satisfied and 20 percent do not know about the performance. In fact, despite of many rise and fall the work of NEPSE is satisfactory.

Analysis of the Growth Trend of Nepalese Stock Market

Table 19

Analysis of the Growth Trend of Nepalese Stock Market

S. N.	Variables	No. of respondent	% of respondent
A	Good	18	36
B	Bad	28	56
C	Do not know	4	8
	Total	50	100

Source: Field Survey

Regarding this question, 36 percent agree the growth trend of Nepalese Stock Market is good, 56 percent feels it bad and other 8 percent are unknown about it. If

I were put forward my opinion about growth trend of stock market, I am to some extent satisfied with the growth trend of Nepalese Stock Market.

Analysis of Motivating Factors for Investment

Responses about factors, which motivate investment

Table 20
Analysis of Motivating Factors for Investment

S. N.	Variables	No. of respondent	% of respondent
1	Marketability & Profitability	22	44
2	Limited opportunity to invest in other sector	8	16
3	Friends and Family	14	28
4	Share brokers consultation	4	8
5	If other, please specify	2	4
	Total	50	100

Source: Field Survey

Regarding this question, 44 percent of the respondents invest in stock because of marketability and profitability, 28 percent invest with consultations from family and friends, 16 percent are of the view that they see limited opportunities of investment, 8 percent consult brokers and 4 percent say that they act on a whim of the market, political legal environment. We can clearly observe that Nepalese investors are more profit concerned, and a large number also invest taking suggestions with friends and family. We may conclude that a scenario for tendency of observation and analysis has been developed quite among Nepalese investors.

Analysis of Share Purchase

Response to share purchase decision

Table 21
Analysis of Share Purchase

S. N.	Variables	No. of respondent	% of respondent
1	Increasing Market price of the share	20	40
2	Profit/Loss trend of the Company	18	36
3	Act of whim	8	16
4	Broker's consultation	3	6
5	If others, please specify	1	2
	Total	50	100

Source: Field Survey

Answer to this question, about 40 percent purchase the share observing the trend of market price, other 36 percent observe Profit/Loss situation of the company, 16 percent act on the whim of market, 6 percent consults brokers and rest 2 percent analyze management team.

Analysis of Disclosure Requirements

Response to weakness of Players

Table 22
Analysis of Disclosure Requirements

S. N.	Variables	No. of respondent	% of respondent
1	The office of the company registrar	25	50
2	Security Board Nepal (SEBO/N)	15	30
3	Nepal Stock Exchange (NEPSE)	5	10
4	Investors/ Brokers	2	4
5	Particular company	3	6
	Total	50	100

Source: Field Survey

In response to this question, 50 percent of the respondents are of the opinion that company registrar office is responsible for not presenting the financial statement of particular company to SEBO and NEPSE 30 percent blame it to SEBO, 10

percent to NEPSE and other 4 and 6 percent to Investors/Brokers and to the particular company respectively.

Analysis of Interrelationship between Stock Market and Economy

Response to relationship between stock market

Table 23

Analysis of Interrelationship between Stock Market and Economy

S. N.	Variables	No. of respondent	% of respondent
1	High	30	60
2	Moderate	15	30
3	Low	5	10
	Total	50	100

Source: Field Survey

Regarding this question, 60 percent agree towards high relationship between stock market and economy, 15 percent say it moderate and other 10 percent rank it low correlated. Undoubtedly, we can say that stock market and economy is positively correlated i.e. highly related to each other.

Analysis of Performance of Stock Market for the Development of the Economy

Response to performance of stock market for development of economy

Table 24

Analysis of Performance of Stock Market for the Development of the Economy

S. N.	Variables	No. of respondent	% of respondent
1	Yes	25	50
2	No	20	40
3	Do not know	5	10
	Total	50	100

Source: Field Survey

In response to this question, 50 percent are satisfied with the performance of stock market, 40 are not and other 10 percent do not know about it.

Analysis of Risky Investment

Response of risk for investment

Table 25

Analysis of Risky Investment

S. N.	Variables	No. of respondent	% of respondent
A	Buying the share when first issued	12	24
B	Buying the share in secondary market	8	16
C	Both of them	30	60
D	None of them	-	-
	Total	50	100

Source: Field Survey

Regarding this question, 60 percent feel both investments mentioned above in 1. and 2. are risky, 16 percent feel investment through buying from secondary market is risky, while the other 24 percent feel investment in primary issue is more risky. As an analyst, I feel both of them are risky as it is said profit is the consideration for risk.

Analysis of Time to Sell the Share

Response of time to sell the share

Table 26

Analysis of Time to Sell the Share

S. N.	Variables	No. of respondent	% of respondent
A	When company's profit declines	15	30
B	When company fails to pay dividend	13	26
C	When market price of the share starts declines	12	24
D	When cash is needed	8	16
E	If other, please specify	2	4
	Total	50	100

Source: Field Survey

Regarding to this questions, 30 percent sell their share when company's profit declines, 26 percent sell their share when it fails to pay dividend, 24 percent sell it when market price of the share starts declining, 16 percent sell it when cash is needed and other 4 percent sell it to maintain portfolio investment.

Analysis of the Points that Provide Prospects to Nepalese Stock Market Growth

Responses in prospect of stock market growth

Table 27
Analysis of the Points that Provide Prospects to Nepalese Stock Market Growth

S. N.	Variables	No. of respondent	% of respondent
A	Stock market provides max returns	10	20
B	Limited opportunities for investment	8	16
C	Liquidity & Marketability of securities	12	24
D	Increasing concerns of generals and academicians in stock market	8	16
E	All of the above	12	24
	Total	50	100

Source: Field Survey

Regarding to the question, the highest 24 percent agree on liquidity & marketability in the prospect of stock market development, while the other 24 percent agree that all the points are equally important. Other 20 percent, 16 percents are divided into maximum returns, limited opportunities and growing concerns in this sector.

Experience about the Problems in NEPSE

One question was asked to respondents to share the view regarding the problems of stock market in Nepal. 4 respondents have given many suggestions answering their views out of the 50 respondents. They are presented below:

- The operation of NEPSE is not transparent.
- There is not efficient information system and much delay in providing company's financial status.
- Brokers do not provide proper advice and suggestions to the clients.
- Brokers are commission oriented and have very little knowledge about stock market mechanism.
- The process of transferring of ownership of shares is lousy and time consuming.

They provide many suggestions to solve these problems

- The securities board should monitor and regulate stock market by following strict controlling mechanism and appropriate penalty system. It should withdraw traditional operation by introducing modern International standards of trading.
- The stock exchange should carry out periodic research and analysis and findings should be made public.
- The open-out-cry system of trading should be replaced by e-trading mechanism. The Automated Trading System (ATS), an internationally compatible trading system is inaugurated by the Former Finance Minister Dr. Ram Sharan Mahat on 24 August 2007. So nowadays shares are transacted by Computer Assisted Trading System.
- Laws governing the stock market should be more liberal but strict to maintain stock market discipline.
- Investors should be provided with investment guidelines.
- The role of market player in the stock market should be made more effective.

4.4 Major Findings of the Study

The major findings of the study from the analysis of primary and secondary data are as follows:

- It was found that the stock market in Nepal is in developing stage, however, majorities of the respondents are not fully satisfied with the growth trend of the market.
- The major portions of Nepalese investors do not have sufficient knowledge about investment.
- Majority of respondents are not satisfied with the performance of stock market for the development of the economy.
- NEPSE and SEBO do not provide information accurate and timely. They further added that information provided is not sufficient.
- Marketability and profitability are the major motivating factors of investment for investors. Majority of them make share purchasing decision without analysing the financial performance of the company and without consulting the experts.
- Most of the respondents feel the company registrar's office should play vital role in providing the financial statement of particular company to SEBO and NEPSE. They further added that the government should play the important role to increase investment in stock.
- Among the listed companies during the year 2007/08, majority are from the finance companies which is 38.75 % of the whole.
- The numbers of listed securities are increasing gradually whereas 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.
- Paid-up value is increased by 1251.71 percent in fiscal year 2007/08 and paid up capital is 72.45 percent increase in this fiscal year.
- The highest increase in market capitalization rate is 93.58 percent in fiscal year 2007/08. Banking sector covered most of the market capitalization in NEPSE.

- NEPSE index continuously declined from the year 1994/95 to 1998/99. It was highest in the year 1999/00 by 360.70 points. Because of weak law and order situation, industrial service and trading sector cannot perform well. But after fiscal year 2003/04 NEPSE index increasing trend to reach 963.36 points in fiscal year 2007/08.
- Percent of market capitalization on nominal GDP is positive in all the years and is maximum in year 2007/08 with nearly 45 percent.
- There are many problems by which stock market is suffering but the prospect of it is also equally strong.

CHAPTER –V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

As stated earlier, the process of stock market development in the country actually started in 1976 when the government established Securities Exchange Centre to provide and develop market for securities, both the government bond and corporate securities. In 1993, Securities Board Nepal was established with the objectives to regulate, supervise and monitor the securities market. Similarly, the Securities Exchange Centre was converted into Nepal Stock Exchange Limited (NEPSE) with the objectives to provide secondary market for securities transaction. NEPSE, now, is adopting Computer Assisted Trading System, where the investors are allowed to deal in securities out through licensed brokers.

The equity market activities grow with the development and reform in the financial sector. Over the past 15 years the stock market of Nepal has made some progress. For example, between the fiscal year 1994/95 and 2007/08, the number of listed companies in NEPSE increased almost two-fold from 62 to 142 and the market capitalization value rose almost twenty-eight times from Rs. 12963 million to Rs. 366247.50 million. Likewise, during the same period the number of annual transactions increased more than ten times from around 21 thousands to 150 thousands. During this period NEPSE index jumped from its base value of 100 to 963.36

The paid-up value at the beginning of the fiscal year 1994/95 was Rs. 2961.8 million as compared to the paid-up value of Rs. 294657.96 million of the fiscal year 2007/08. But annual turnover has lot of fluctuations during this period. Average daily turnover and market day per year in 2007/08 are also in satisfactory level.

Despite the large volumes traded on stock exchanges many listed stocks trade infrequently; or their balance of trading is not sound. For example, in NEPSE mostly the commercial banks shares are transacted. The reason behind this might be traditionally guided investors return principle where most earnings of investors have been in the form of divided rather than capital gains. Though regular and high dividends are provided only by commercial banks in past day, it becomes the only potential investment destination comparing to the other stock market participants. Therefore, the serious problem facing by Nepali Stock market is among various sectors only the banking sector is doing well in terms of liquidity, but other sectors rarely do so.

Unfortunately, in Nepal, despite a history of about half a decade of planned economic activities to develop real sector of the country, little attention was paid to the development of financial sector. Over the past one and half decade, financial sector, despite many problems has developed significantly in Nepal. However, most of the developments were confined to the banking sector stock market has virtually remained stalled because of the low priority in the government's financial reform policies.

Various measures of stock market development 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 rates and value-traded-rate 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 invest in securities according to the risk-return preference. Similarly firms shun it because stock market is less reliable source of raising funds for them. Due to this financial system in Nepal has remained basically bank-dominated.

5.2 Conclusions

The development of stock market in Nepal so far cannot be considered satisfactory. This is evident from the facts and figure available in the stock market

performance during the last 15 years. The diverse sector is coming up that need capital. The only requirement to fulfil the objectives of both parties is to create a conducive atmosphere where investors can avail the required capital from the market at low cost.

The dynamism of the stock market has been greatly reduced by the domination of the long-term shareholders, who prefer holding the shares with the hope of increasing their wealth. This can be justified by small number of shares that are traded on the stock market. Even though this reduces the dynamism of the stock market the investors have very few rather no alternative to holding shares.

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 a good prospect for the resource mobilization to finance the productive enterprises in the Nepalese economy.

Despite the increase in the number of companies and paid-up value of the securities listed with the exchange, Most of the companies that are listed with the exchange belong to banking, finance, and insurance sectors. While only few companies from the trading, hotel, manufacturing, and aviation sectors are listed with the exchange, not a single company from powers information technology and construction sectors has entered the organized stock exchange of the country. This indicates that firms tend to avoid stock market as an alternative source of long-term capital in Nepal. Significant increase in the number of companies registered as private limited during the last one and half decade also supports this view. This has adversely affected the liquidity and supply of securities in the stock market.

All Brokers agreed that there should be right code of conduct and monitoring for brokers operations. It was observed that the prescribed code of conduct is hardly enforced.

In the context of primary share issue, there should be strict time frame for allotment of share, refund of money, distribution of share certificate and listing of shares. There should be strict punishment if the prospectus is misleading and investors are affected by misleading prospectus.

The brokers do not have problem with each other in share transaction and settlement. But they have experienced conflicts in buying and selling of shares, mostly in signature verifications, and cash payment. Investors do not pay when prices fall and do not accept share price when prices rise. Shouting system was not effective because sometimes the board marker (person who writes in the board placed on the wall) may not listen to the first broker's quote and writes another broker's number in the board. It created conflicts in the floor. Now this problem is solved by introducing Computer Assisted Trading System.

Majority of brokers agree that certain requirement like minimum qualifications and experiences should be met. Some added the brokers should be allowed to operate according to volume of transaction.

Investor's confidence in Nepalese stock market is relatively low because of stock market volatility, low return in investment, inadequate information, lack of financial market instruments and investors not knowing about the risk of the stock market investment. The size of the market in terms of market capitalization and number of issue is relatively small. Market for corporate debt instrument is undeveloped. The retailers also dominate present stock market in the absence of foreign investors and local institutional investors. Only a small portion of shares is actively traded while others are traded either in small number or infrequently which leads to poor liquidity and small turnover in the market.

Transparency and openness of transaction, quality professional services, adequate corporate financial disclosures and improved legal and supervisory framework are the urgent needs of Nepalese stock market.

5.3 Recommendations

- The Government, Securities Board Nepal (SEBO/N) should not make policies should regulate NEPSE and other financial institutions adequately, appropriately and effectively.
- The Securities Board in co-ordination with the Ministry of Finance and NEPSE should develop research, public awareness and investor education programmes, should encourage and stimulate capital formation. Manipulative practices like wash sales and churning should be strictly controlled. Investment in corporate sector should be encouraged. The listed firms whose shares are not traded should provide the financial status publicly in order to make the investors aware about their exact financial condition.
- The government should make appropriate policies and programs for the enhancement of the entrepreneurship development in the Nepalese economy. Large and ineffective government corporations should be privatized in order to develop the Nepalese stock market through the wide spread distribution of shares to public investors. The government should allow foreign investors to invest in Nepalese Capital Market., The procedure for offering public issue should be simplified and rationalized, information and financial statements of the companies should be disseminated properly and timely different market intermediaries should be educated, trained and professionalized.

Besides it the most needed changes which are fundamental for stock market development are listed below:

- The Automation in the clearance system. De-mat system of securities. Mutual saving schemes should be enhanced, Stock Exchange should be privatized.

Besides these other factors which have slowed the stock market growth should be adjusted and improved. They are:

- Unfavourable macroeconomic conditions.
- Political instability.
- Low investors confidence.
- Weak tax system.
- Slow privatization process.

The laws and policies regarding capital market are not very clear. This sometimes creates confusion among the investors. So government should make clear and specific plans and policies to expand the capital market and should implement these.

Besides there is only one stock market in Nepal so the government of Nepal and SEBON will quickly have to start process to open another stock market not in Kathmandu, in out of Kathmandu City. Then people out of Kathmandu valley also have access to buy and sell shares from secondary market. Privatization process needs to be carried out effectively in order to develop Nepalese stock market. Tax system should be reformed which should encourage and stimulate capital formation.

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APPENDIX

Dear Sir/Madam,

I am preparing my research work on the topic “Problems and Prospects of Stock Market Growth in Nepal” for the partial fulfillment of the requirement for the degree of Master in Business Study. The questionnaire given below will be very helpful to collect primary data in respect of my research work. Therefore, I would like to request for your grateful opinions and correct information’s regarding these questions.

I hope forward for your kind cooperation.

Respondent

Name: -----

Education: -----

Occupation and Position: -----

Date: -----

QUESTIONS:

1. Which of the following problem that the Nepalese stock market has been suffering from?

- (a) Shortcomings of rules and regulations. []
- (b) Lack of sufficient knowledge among investors. []
- (c) Lack of sufficient knowledge among stock market intermediaries. []
- (d) Lack of proper coordination between authoritative bodies. []
- (e) Restriction to foreign investors. []
- (f) All of the above. []

2. Do you think Nepal Stock Exchange and Security Board Nepal (NEPSE & SEBON) provides information correctly and timely?

- (a) Yes []
- (b) No []
- (c) Do not Know []

3. Are you satisfied with the performance of Nepal Stock Exchange?

- (a) Yes []
- (b) No []
- (c) Do not Know []

4. What do you think about the growth trend of Nepalese Stock Market?
- (a) Good []
 - (b) Bad []
 - (c) Do not Know []
5. What factor motivates you to make investment in stock?
- (a) Marketability and profitability. []
 - (b) Limited Opportunity to invest in other sector. []
 - (c) Friends and Family. []
 - (d) Share Brokers. []
 - (e) If other, please specify. []
6. Which of the following factor makes you decide to buy share of particular company?
- (a) Increasing Market Price of the share. []
 - (b) Profit/Loss trend of the company. []
 - (c) Act of whim. []
 - (d) Brokers, consultation. []
 - (e) If other, please specify. []
7. Listed companies do not present financial statement in time to NEPSE & SEBON who is responsible for this?
- (a) The office of the company registrar. []
 - (b) Security Board Nepal (SEBON) []
 - (c) Nepal Stock Exchange (NEPSE) []
 - (d) Investors/Brokers. []
 - (e) Particular Company. []
8. To what extent Nepalese Stock Market and Nepalese economy are interrelated?
- (a) High []
 - (b) Moderate []
 - (c) Low []

9. Are you satisfied with the performance of stock market for the development of the economy?

- (a) Yes []
- (b) No []
- (c) Do not Know []

10. Which is risky to invest?

- (a) Buying the share when first issued. []
- (b) Buying the share in secondary market. []
- (c) Both of them. []
- (d) None of them. []

11. When would you like to sell your share in secondary market?

- (a) When company's profit decline. []
- (b) When company fails to pay dividend. []
- (c) When Market Price of the share starts declining. []
- (d) When cash is needed. []
- (e) If other, Please Specify []

12. Which of the following is more relevant in the prospect of Nepalese Stock Market growth?

- (a) Stock market provides maximum return. []
- (b) Limited opportunities of investment other than in stock. []
- (c) Liquidity and Marketability of securities. []
- (d) Increasing concerns of academicians and general public in stock market. []
- (e) All of the above. []

13. Express your views for the development of Nepalese Stock Market?

Problems:

Solutions:

Thank you, for your co-operation.

Researcher
Achyut Sigdel
Shanker Dev Campus
MBS Student

THE END