CHAPTER - I

INTRODUCTION

1.1 Background of the Study

After re-advent of multiparty democracy in 1990 HMG Nepal had adopted the economic liberalization and open market policy. The policy encouraged private entrepreneur to invest in banking and financial sector. Joint venture banks appeared with foreign investment and investment in Nepali entrepreneurs. They came with new technology and modern banking facilities. Till 1990, there were only three joint venture banks with foreign collaboration. Nepalese stock market was very small in term of size and transaction.

After the restoration of democratic system in 1990, the political and governance environment became more conducive for the investment in overall sector of the national economy. The fast and increasing investment in banking and financial sector has been worth mentioning in this regard. These banking and financial institution needed huge capital investment. One of the sources of fulfilling capital needs of those institutions was to attract the external fund from the public issuance of shares.

Though, the history of public issue of ordinary shares dates back to 1937 with the public issue of share of Biratnagar Jute Mill and Nepal Bank Ltd. But the remarkable development of the capital market started only after the establishment of Securities Exchange Center in 1976.

It was the only capital-market- institution in Nepalese stock market, which undertook the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. With the proliferation of banking, financial institutions and other companies like hotel, manufacturing and service sectors, the existing securities center was not in a position to manage stock transaction after 1990.

In view of that situation, Securities Exchange Center was converted in to full-fledged stock exchange center and under its auspices; the broker system of secondary market was established. Nepal Stock Exchange is a non-profit organization and operates under Securities Exchange Act, 1983. With gradual growth of public limited companies in Nepal, the number of listed company is also increasing with Nepal Stock Exchange for having the trading of stocks for the interested investors. Though the number of listed companies have been remarkably increased and number of years have already been elapsed since the establishment of Nepal stock exchange, however, it is said that Nepal Stock Exchange is operating in its nascent stage attributed by low stock turnover, low participating companies, low level of transactions, low level of market capitalization and the volatile price situation. While viewing closely to the NEPSE level of the country it can be observed that the price of the shares within short span of time varies significantly.

1.2 Liberalization

This is the age of economic liberalization. Economic liberalization has a far-reaching effect on the world economy. The waves of economic liberalization began to urge in the 1980s, when the world economy literally went through an upheaval. The Berlin Wall of Germany crashed in the 1980s and the erstwhile Soviet Union underwent Balkanization. The then Soviet President Mikhail Gorbachov played a catalytic role in economic liberalization. It was his glasnost and perestroika policies that helped transform the world economy to a tremendous degree. The roots of economic liberalization are not, however, new. The seeds of economic liberalization had been sown way back in the eighteenth century Great Britain. At the time, private enterprises used to be put down by the state apparatus. Adam Smith, who is regarded as the Father of Economics, grew averse to this practice, which inspired him to write Wealth of Nations, a book on economics in 1776. He was against the government's dirigisme policy, i.e. the policy of keeping enterprises under state control. He was in favour of promoting private enterprises as a tool of economic development. Despite Adam Smith's initiative, promoting private enterprises, state control of enterprises persisted in the world till the 1980s, when it was realized that it would be better for the state to hand over the enterprises to the private sector and devote its time and energy to assume the role of supervisor for such enterprises. Since then, Nepal like the rest of the world, has adopted liberalization policy. As such, the private sector in the country has a bigger finger in the national economy pie. Economic liberalization aims at sustainable growth of the economy. It encompasses all sectors of the economy such as agriculture, industry, transport, construction and service. Stability and sustainability are the two hallmarks of economic liberalization. When the economy is in stable and sustainable condition, private resources flow into productive sectors, yielding a high rate of return. When inflation is stable and manageable, resources are efficiently used. Such L situation boosts the morale of investors, as it would put off ifs and buts associated with investments, In the present context, the economy of the country is not stable due especially to the on-going conflict. The existing enterprises are collapsing and investors are hesitating to make investments. Closures and lay-offs of business enterprises are frequent. This is a misfortune for the country, whose economic development is still fledgling and which has a long way to go to improve its development infrastructures. The mechanism of economic liberalization is manifold. It conceives of retrenching government expenditure, privatizing public enterprises and cutting down on or phasing out all kinds of subsidies. It puts a certain ceiling on government borrowing from the banking sector. Deregulation of the economy is what economic liberalization is all about. It deregulates both domestic and foreign private sectors and accentuates withdrawal of price controls from public and private sectors. In fact, economic liberalization concerned with how best the economy of a country can be managed. It deals with various economic problems such as poverty, unemployment, income and wealth distribution, standard of living and even gender bias. In developing countries like ours, economic activities need to be accelerated for overall economic development. Economic liberalization is not supportive of control of such activities by the state even if necessary. Rather, it strengthens the private sector to initiate such activities on its own price; market and competition are the major components of economic liberalization. The products and services of a country should have comparative and competitive edge to successfully penetrate the world market. To be on the cutting edge in the present-day world marked by cutthroat competition, such products and services should meet world quality requirements. For this, sound infrastructures like transport, communication, sophisticated technology and skilled manpower should be in place, something which developing countries like ours are lacking. Similarly, stabilization and structural adjustment are other important components of economic liberalization. Stabilization deals with devaluation control of government expenditure and domestic credit expansion, whereas structural adjustment deals with price stability, open market economy, bureaucratic reforms and changes in government plans and programmers. Public enterprises follow the objective self-reliance, high employment and overall development of backward areas. So they are prone to high costs. That is why: most of them are always in the red. (It can, however, be asserted that mismanagement and corruption are highly responsible for the sorry state of affairs the public enterprises in our country are in). On the other hand, private enterprises chase maximum profit through sound management.

Economic liberalization is the lifeblood of the economy of any country. Virtually all the countries in the world have adopted economic liberalization in one form or the other. If successfully, implemented, economic liberalization could transform the economy of the country. It should, therefore, be used as a tool for economic development for maximum benefit. It would, however, be saddening to note that the current state of affairs obtaining in the country is not satisfactory. Unless peace limps back to normal, we will not be able to reap maximum benefit from economic liberalization. Therefore, peace is a pro-requisite for economic liberalization to run its own course without any hitch.

In economic policy, liberalism expressed itself as a reaction against Environment intervention in economic affairs. Liberals favored free competition at home and free trade among nations. They regarded the organization of economic activity through free private enterprise operating in a competitive market as a direct expression of essential economic freedoms and as important also in facilitating the preservation of political liberty. They regarded free trade among nations as a means of eliminating conflicts that might otherwise produce war. Just as within a country, individuals following their own interests under the pressures of competition indirectly promote the interests of the whole; so, between countries individuals following their own interests under conditions of free trade, indirectly promote the interests of the world as a whole. By providing free access to goods, services, and resources on the same terms to all, free trade would knit the world into a single economic community.

According to World Bank "Liberalization means freeing prices, trade and entry to markets from state controls while stabilizing the economy". "Liberalization in the first step that makes all the other benefits of market reform possible decentralizing production decisions to enterprises and households and providing agents with the incentives and information to trade free and to respond to the forces of demand and supply"-WDR:1996:235

Commensurate with the changes in the global economy, Nepal too had adopted economic liberalization programme since the mid- eighties and its tempo accelerated further after the reinstitution of multi party democracy in the early nineties. With the mid term poll debacle in 1995, the liberalization policy was put to illiberal tests by the successive incoming and outgoing governments - a total of six governments within a span of five years.(Paykurel:1995:185)

Globalization is for real. It cannot be wished away. Hence the major lesson lot-Nepal, or for that matter other South Asian countries that are fairly closed, is that countries should prepare for globalization and manage capital flows effectively. This requires actions at the individual country and sub-regional level because financial contagion tends to be very virulent. Countries need to strengthen banks and recapitalize them so that they can intermediate effectively between entities. Countries also need to develop well-functioning capital markets to reduce the risks of potential instability in an integrated world. Most importantly, capital account liberalization should be sequenced properly. It is not advisable for countries to open up their capital account too hastily and in full force. Prudence in capital account, however, does not mean being complacent and freezing the reform process because the benefits of globalization are large. It means adopting a pace of liberalization consistent with the state of development of the financial sector and the soundness of macroeconomic management.

1.3 Historical Development of Liberalization of Nepalese Economy

As a precondition to economic liberalization, the industrial Enterprise Act was enacted in 1982 and Foreign Investment and Technology Transfer Act came into effect since 1983. Since 1985 Nepal has been following liberal economic policy. In its first stage of implementation, banking and financial sector was liberalized. A policy to invite foreigners to invest jointly with the domestic investors in the banking and financial sector was introduced.

Finance Companies Act 1986 was also enacted with a view to provide non-banking services to the people in order to promote their economic benefit in general through institutionalized investment. Accordingly, many banks and finance companies were incorporated in the private sector and listed in the securities exchange center. Nepal Rastra Bank liberalized the regulation of interest rate and endeavored to reform arid strengthen the financial sector by implementing various prudential financial norms like income recognition, loan classification, maintenance of adequate loan loss provisions, reserves and capital adequacy ratio and liquidity position of the banks and finance companies.

The multiparty election took place in April 1991 and the elected government while taking the steering of the economy realized the need to reform the financial sector and develop capital market along with the economic liberalization in the country for private sector growth. Towards this move, more joint venture companies were opened in the country and the Citizen Investment Trust was established as a pioneering market maker institution in the capital market.

After the restoration of multiparty democracy in 1990 Nepal has adopted many new policies such as Industrial Policy-1992, foreign investment and one Window Policy-1992, Trade Policy-1992, Labor Policy-1992, Industrial Enterprise Act-1992 and many others. When we look at the implementation and major development in Nepalese business sector, development in monetary, banking, insurance and finance sector can be taken as the major area. Next revolutionary sectors are airways, telecommunication, and service and education sectors.

Nepal has adopted liberalization from the end of sixth five-year plan. Nepal has adopted privatization and implemented privatization campaign after the restoration of democracy. It has significantly emphasized in public sector reform and encouragement to the private sectors in national development. Liberalization scheme specially focused on privatization, deregulation, delicensing, and abolition of subsidy. It also welcomed globalization process of Nepalese economy.

Nepalese capital market has significantly developed after 1990. However, there were few ups and during these days. There are around 120 listed companies up to Security Board, Stock Exchange Limited, Citizen Investment Fund, NIDC Capital Market, Listed Companies and Stock Brokers are the major players of today Nepalese capital market.(Dixit:1993:39)

1.4 Historical Development of Capital Market of Nepal

The history of capital market in Nepal is not very long. The origin of the stock market in Nepal goes back to 1937 when shares by Biratnagar Jute Mills Ltd. and. Nepal Bank Ltd. were first issued. Further this, ah important event in the development of the capital market in Nepal was the enactment of the company Act in 1964 with the objective of generating investors' interest in corporate securities by introducing the feature of liability, the first issuance of government bond in 1964 and the establishment of Security Exchange in 1993 and opened the trading floor on 13th January 1994. After the opening of open trading floor on 13"' January 1994, the securities business being started through member, market intermediaries such as broker, market makers etc. .(K.C:1999:30)

The capital market in Nepal has been passing through a transitory phase over the past few decades. Only after the inception of democracy in the country, a network of financial institutions was created through legislative measures to induce the growth of capital market

Those institutions comprises are of Nepal Rastra Bank (NRB), Nepal Industrial Development Corporation (NIDC), Agricultural Development Bank (ADB), Rastriya Banijya Bank (RBB), Provident Fund Corporation (PFC). Nepal Bank Limited (NBL|, and lately established were Securities Exchange Center (SEC) and Credit Guarantee Corporation (CGC) to form the nexus of Nepalese capital market.(K.C.:1993:31)

The need of capital market development in Nepal has been an accepted reality in the past. Where: democracy was restored in 1990 ten new constitution was farmed which has inspiring in the directive principles and provisions conductive of the private sector. The interim Government in the short period had initiated banking reformation and established a Citizen investment Trust as a pioneering capital market institution. The Establishment of NIDC capital markets Ltd. Was also another milestone in this regard

When Nepal entered into new economic system of privatization, liberalization and open market competition by the interim and elected Governments, which directly influenced the present operating system of capital market in the country. Till the date all the functions of modern financial systems moved undertaken by SEC under its conservative, rigid and inflexible policy of broke-ring, underwriting, share issues management, market making for government bonds and other financial services, which was much inconsistent and inappropriate with the new economic doctrine. Thus it was felt to change the whole operations of SEC to make it consistent and congenial with changing paradigm of economic system. As a result, HMG has brought changes in the existing structure of SEC by separating it into two distinct entities viz; Securities Board Nepal (SEBON) and

Nepal Stock Exchange Limited (NEPSE) at the policy level in 1993. which should have been done earlier to reform the capital markets in the nation. .(K.C.1999:32)

NEPSE is a nonprofit organization, is operated under securities exchange act, 1983. The basic objectives of NEPSE is to impart free marketability and liquidity to the Government bonds and corporate securities by facilitating transactions in its trading floor through financial intermediaries such as broker, market maker etc. NEPSE appointed eight issue managers and twenty seven brokers to avail the initial offering of the shares to the public and to smoothly conduct the daily transaction of buying and selling of securities under its restructure program in 1993. NEPSE opened its trading floor on January 13, 1994 for its/newly appointed brokers and market makers. NEPSE established in 1993 with objectives of initiating floor trading for importing fair exchanges, maintaining market liquidity of listed equities and facilitating the market makers. It is a non-profit making organization and has 9 board members representing Ministry of Finance (1), Security Board (2), Nepal Rastra Bank (2), Nepal Industrial Corporation (1), Licensed Members (2) and General Manager (1) of Nepal Security Exchange.(Bhattari:2004:109)

Equities of listed companies are traded in the security exchange. An investor can buy or sell equities listed through a broker in the floor. Broker places buy or sell order through open outcry method of market operation. Computer trading system is yet to be established. Exchange of equities above 5 percent of the total outstanding of any listed company is not allowed in the floor. Larger orders are executed outside the floor and informed to the stock exchange officials after execution.(Bhattari:2004:111)

Under a programme initiated to reform the capital market in the early 1990s, the Government converted the Securities Exchange Center into the Nepal Stock Exchange (NEPSE) on June 13, 1993. As a result of this change, brokers were permitted to trade in shares. This process was supported by a USAID Economic Liberalization Project.

The number of companies listed in the exchange, as mid-July, 2004 was 114 compared to 62 in 1994. Similarly paid up capital increased to Rs 13404.90 million, M-cap to Rs.41424.77 million and annual trading turnover of Rs.2144.27 million. Commercial banks, especially joint venture banks, insurance and finance companies compose major share in total M-cap. Other market indicators like share price annual trading turnover and number of transactions of commercial banks and famine companies swelled up relatively higher than those of hotels, trading, and manufacturing and processing companies in the, stock exchange during the last 10 years. Total equity turnover, a measure of market liquidity of equities was also very low except that of commercial banks and finance companies. It reveals the fact that the growth of financial sector in Nepal has been faster than in real sector after mid 1990s, in the course of financial sector development, the contribution of banks and finance companies to total M-cap should decrease, if the market becomes matured. The process of decreasing market concentration has not yet started.(Thesis:Dhungana:2005)

Privatization and equity market development are believed to have positive correlation. Despite the primitive stage of capital market development HMG started offering state-owned public enterprises to private hands since the beginning of 1990s with multiple objectives of reducing government budget deficit, enhancing productivity and increasing people participation in corporate governance. Such programs do not seem successful in the absence of a broad and deep capital market in the kingdom.

The overall performance of the Nepalese economy is not reflected in the NEPSE index. It is dragged by the share price movement of some joint venture commercial banks and finance companies, which have higher market concentration but meager contribution to the GDP. Market concentration is the contribution of top ten listed companies to total market capitalization. It is more than 80 percent in Nepal. Top ten companies based on total annual turnover and number of shares traded in the past couple of years is also from the financial sector.

Moreover, agricultural sector in Nepal contributes substantially to national employment and output; companies established in this sector have no place in the capital market and determining price index movement of the securities. Larger proportion of the securities investment (70 percent) owned by the promoters of the listed companies' evidences that the distribution of equity wealth in Nepal is skewed toward higher income group and benefit from equity investment accrues accordingly. Capital gain- the difference between buying and selling price ($P_1 - P_0$) and dividend are the two components of return on equity investment as given

below,

$ER = \{(P_1 - Po) + D_1\}/P_0$

Where, Pi, Po and D| are the buying price, selling price and dividend of a share respectively during one holding period. Legal ban on selling promoters'* share for a relatively longer period of time impedes free functioning of the market by restricting the supply of share. This short supply of shares is reflected in the higher equity price of profitable companies, particularly joint venture banks in Nepal. As consequences, capital gain from equity price hike accrues to speculators and increased wealth from capitalized reserve and dividend to promoters.*Thesis*(Roniyar:2005)

The establishment of the specialized firm as NEPSE proved to be a strong step towards the liberalization of the economy and a milestone in the path of economic development in the nation.

1.5 Statement of Problem

Liberalization in Nepal:- Sequences and Processes, some Nepali intellectuals have sought to answer the question, what has happened to Nepal's liberalization policy? In fact, an appropriate question would have been, what will happen to Nepal's liberalization policy in future?

Valid lessons can be drawn both from success and failure stories; looking backward is not a bad idea. However, evaluating the impacts of a policy decision is a very difficult proposition for a number of reasons. First, a policy may not be a conscious decision; it had to be taken commensurate with the changing time and sequence. One may not find an alternative policy to compare. It is often difficult to judge a course of action by saying that, had we taken this way instead of that way, we would have been better off by this much. Second, hosts of exogenous variables may influence the policy outcomes. Third, there are complex interaction effects, making it difficult to isolate the consequences of each policy decision. Liberalization as a policy has speed, process, sequence and consequence. It is very difficult to capture all these at one time.

Actually, the problems of the Nepalese Stock Market have not been diagnosed and identified. So the policy makers are unable to make the appropriate policy for the development of the stock market, most of the government efforts for the development of the stock market since mid seventies (establishment of the Securities Exchange Center in 1976) have poorly contributed to the stock market development. Only in the early nineties, the government policies to reform the capital market under the extended structural adjustment program (ESAP) have left some positive impact for the development of the stock market. However, this also has not become sustainable because of the lack of proper implementation of the policy.

1.6 Significant of study

Liberalization process in Nepal caught its speed after the formation of the elected government in 1991. Until now 13 more years have been spent and the time has come to evaluate the impact of liberalization in Nepalese economy. So that v/e can proceed further towards economic betterment Capital market plays a significant role to steer up the economy. They should change their behavioral approach in accordance with liberalization policy of the government. A close observation should be made in this aspect.

So, this study is to significant to the investors, government, finance students and capital market players, and those who have interest in this field.

1.7 Objectives of the study

This study aims to hit the problems currently faced by capital market and critically analyze the impact of liberalization on capital market. To point out them:

1. To access the development of capital market of Nepal after the liberalization.

2. To access the impact of capital market in economic development of Nepal.

3. To analyze the impact of liberalization on capital market growth.

4. To provide necessary suggestions and recommendations.

1.8 Limitation of the study

As this is the study for the partial fulfillment for the degree of Masters of Business Studies some of the limitations faced at the time of preparing this study are listed below;

- Due to the usual problem associated with limited availability of the recent data, limitation of time factor and the difficulties surrounding the clear determination of direction, despite the attempt to be methodologically rigorous the results must be treated with a fair degree of caution.
- The implications arising this analysis directs for further research into the liberalization is effect on capital market development.
- The study provides a general overview on the overall situation of capital market of Nepal. Instead, the study progresses ahead with an objective of finding out the relation between liberalization program and capital market growth in Nepal.
- Due to the various factor, I analyze only 10 fiscal periods.
- The limitation of the data used for the study also needs to be considered. The relevance of the primary data completely depends of the attitude of respondents. The relevance of secondary data relies on the authenticity of publications.

1.9 Chapter Plan

- The first section provides an overall description of the study to be carried out. It presents the general background of the study and the problems associated. It discusses about the focus, importance and objectives of the study along with some limitations involved.
- The second section deals with framework of study and reviews of major empirical work in the areas of stock market and stock price behaviour. This study is based on the framework provided by the chapter.
- The third section discusses the methods adopted to explore -the present position of Nepal's capital market and the impact of liberalization on its development and data used for the analysis purpose.
- The fourth section discusses the results of the analysis. It examines the impact of liberalization on capital market development. It also presents the major findings of the study.
- The fifth section provides a summary and draws some broad conclusions. It also attempts to provide some suggestions and recommendations based on UK analysis of the study.

CHAPTER II

REVIEW OF LITERATURE

2.1 Concept of Liberalization and Capital Market

This is the age of advent 21st century. In this age economic liberalization has far reaching effect on the world economy. The whim of economic liberalization started to act in the 1980s. When, the world economy literally went in imbalance. The history of economic liberalization is fond of so back. It was started from England at the 18th century. At that time private enterprises used to be put down by the state control. Adam Smith who is regarded as the father of economies grew averse to that practice, which inspired him to write "wealth of Nation a book of economies" in 1776, he was against the government's policy of keeping enterprise under state control. He was at that time in favor of promoting private enterprise as a tool of economic development. But till to 1780s the theme of Adam was not realized. After, 1780s realizing the importance of private sector for stable economic condition the policy of handover public enterprise to private sectors. The countries which are development now have adopted the economic liberalization policy. Countries like Nepal are applying the police for sustainable growth of the economic. It promotes all sectors of the economy such as agriculture, industry, transport, construction and financial sectors and service. Stability and sustainability are the two main theme of economic liberalization. When the economies is in stable and sustainable condition private resources flow into production sectors yielding a high rate of return in the present context, the economy of country is not stable due to the ongoing conflict. The exciting enterprises are collapsing and investors are hesitating to make investment. This situation would be misfortune for the country, whose economic development is still fledgling and which has long way to go to improve its infrastructure development. The mechanism of economic liberalization is roadmap stable economy of a country. It contracts the government's expenditure, privatizing public enterprise and cutting down or phasing out all kind of subsidies. It puts a certain calling on government borrowing from the banking sectors. It deregulates all the forging private sectors and domestic takes out the hands form price control of market so, now we can say the economic liberalization concern with how best economy of country can be managed.

Economic liberalization is the life blood of the economy mostly of all country of the world has adopted economic liberalization in one from anther. It should therefore be used as tool for economic development for maximum benefits of all sectors. It can control the inflation being good competition among the private sectors.

In this advent age of modernization, the capital market has played very vital role regardless of the size of the economy of any particular nation. The primary work of capital market is to allocate the economy's capital stock among various firms and industries involving in trading investment and production. Securities prices play important role by providing signal in allocating the scare resources and investors can choose among the securities which represent ownership of firms activates under the assumption that securities present at any from. In fully reflects all available information of a particular firm. Now we can say that the capital market is a place where share of instead companies are traded or transformed form one hand to another at a fixed market price through the organized broker system.

Capital market is the composition of the various suppliers and users of long term finance. In the different from money and market which are of short term finance the services of capital market is being as a link between supplies and users of finance so capital market is the system of collecting small unit of money from public saving and using there in productive investment.

Our country is a developing country. The development activities were not launched in the past while our country was in the hands of Ranas and others

Kingship. While democracy was introduced our country adopted the economic liberalization policy which resulted to privative the public enterprises. Some of the privatize enterprise are listed in capital market. Which is the very good points or good effect of liberalizations, here I have tried to present the impact of liberalization on capital market development.

2.2 Capital Market

Capital markets have been a global phenomenon in the present world regardless of the size of the economy of any particular nation. The primary role of capital market is to allocate the economy's capital stock among various firms and industries involving in trading, investment and production dimensions. And securities prices play a vital role by providing signals in allocating the scarce resources and investors can choose among the securities that represent ownership of firm's activities under the assumption that securities present at any firm "fully reflect all available information. Thus, the capital market is a place where shares of listed companies are .traded or transferred from one hand to another at a fail-market price through the organized brokerage system.

Capital market refers to the trading between lenders and borrowers of funds arranging of funds transfer process to seek each other's benefit. These lenders and borrowers coming together in capital market play effective financial intermediary role to activities both primary and secondary market through the use of various long term capital market instruments like common stock, bonds. Preferred stock convertibles issues and many more like that. The participants in the capital market are small business, large business and government. Funds flowing in to the capital market are available by lenders for terms longer than those flowing in the money market (Philips: 1979:795)

Capital market consists of the various suppliers and users of long-term finance. As it is differentiate from money and market, which embraces snort-term finance the capital market service is as a link between suppliers and users of finance. It is a mechanism for the mobilization of public savings and channeling them in productive investment. (Philips:1997:797)

In this way, an important component of the capital market is the securities market. It has a wide term embracing the buyers and sellers of securities and institutions that assist the sale and resale of corporate securities. The elements required to establish capital market and stock exchange require simultaneous work on several fronts including:

Elements of Capital Market and Stock Exchange

- Public awareness about the benefits and opportunities of a stock market and owning shares in companies, and how liberalization contributes to this.
- Development of capital markets infrastructure, such as fast trading systems: clearance and settlement; share registries; & capital markets agents, such as brokers/dealers
- Development of a basic regulatory structure to promote public confidence and protect investors, emphasizing self-regulation
- Privatization to promote the supply of and demand for, share,

The development of capital markets is a must and it should be,

a) Fair: Both small large investors have equal access to shares at comparable prices.

b) Efficient: Trading system established in such a way that paperwork is minimized.

c) Liquid. The convenience and ease in buying and selling securities in the market making financial assets less risky.

d) Transparent: The transactions in the capital market should not be misleading.

(Tuladhar:2004:155)

2.3 Development of Securities Market in Nepal

The history of securities market in Nepal in not very long, it began hen shares of Biratnagar Jute Mill Ltd. and Nepal Bank Ltd. issued to the general public in the year 1937. Further this, an important event in the development of the securities market in Nepal was the enactment of the company act in 1964 with in the objective of generating investor's interest in corporate securities by introducing the feature of limited liability, the first issuance of Government bond in 1964 and the establishment of Securities Marketing Center [SMC] in 1976. Later in the year 1984 [SMC] was renamed as Securities Exchange Center [SEC] which was entitle for managing and operating primary and secondary markets of long-term Government and Corporate Securities. But the first amendment in the Securities Exchange act, 1983 in 1993 opened the way for the restructuring of securities market in Nepal, which led to the establishment of Securities Board of Nepal [SEBO] in 1993 and in the same year [SEC] was convert into Nepal Stock Exchange Ltd. [NEPSE] and opened the trading floor on 13th January 1994 which helped, the securities business start through members, market intermediaries such as Broker, Market maker etc.

The second amendment in Securities Exchange Act, 1983 was made in 1997. This amendment made provision for registering securities business persons in [SEBO] which provided licenses to the securities business person. Also the amendment made mandatory provisions for the listed companies to submit annual and semi-annual reports to the Securities Board of Nepal [SEBO]. Currently, there are 24 stock brokers, 2 securities dealers, 9 issue manager's one stock exchange and 125 listed companies in the Nepalese securities market. at present, the status securities market has been performing smoothly than in the past. The improvement in the securities market has been attributed to various factors including good prospect of corporate earnings and household participation in the stock market. Investors not only relay o the statement of broker, but they also have a concern over the financial information of the concern company. Therefore the shares of companies with better prospect of dividend, capital increment have normally higher prices in the securities market. Also, raise in the stock price may be due to the gradual fall in the bank interest rates on its deposit causing excess liquidity in the market. Thus, the securities market in Nepal has witnessed its strength surprisingly and this has raised hopes for sustained growth of corporate undertakings now a days. (Tuladhar:2004: 55)

2.3.1 Primary Market

Before the establishment of the Securities Exchange Centre (SEC) there was no, single institutional arrangement to undertake new issue and manage the sales of the shares and debentures according to the guidelines for new issues and sales arrangement 2043 (1986). It used to charge commission for its service to the issuing company varying from a minimum of 1.35 percent to a maximum of 2.0 percent depending on the amount of new issue. A lower amount of transaction would attract a higher rate of commission and vice versa. Therefore, the issuing company had to pay a commission of 2.0 percent for the management of new issue and sales services to SEC for an amount up to Rs. 2.5 million. The rate of commission for a new issue of Rs. 10 million and above as 1.35 percent. At present, the rate of commission ranges from 1.5 percent to 2.5 percent depending upon the value of securities sold. The issue managers who arrange the sale of securities charge commission to the issuing company at the rate of 2.5 percent of the value of the sold securities up to Rs. 205 million. If the value of the issue is more than Rs. 10 million, the rate of commission is 1.5 percent.

Primary market denotes the market mechanism for the original sale of securities by an issuer to the public. Also it is the market in which securities are sold at the tie of their initial issuance corporation and governmental bodies issues new securities in the primary market by the method of public floatation and private placement. The term primary market can also be defined as the market in which corporation's raises the new capital by selling newly created stocks and receives the proceeds from these transactions. Thus securities absorbs new fund or capital from the initial issues is known as primary market.(Nepal Stock ExchangeTrading Report:2006)

2.3.2 Secondary Market:

Secondary market is the market in which securities are traded that has been issued at some previous point of time. In other word we can say that the market where outstanding securities are traded is known as secondary or more popularly, the stock market. So, secondary market in a simple sense is the market in which existing, outstanding, securities are traded between the investors. It is the market that creates the price and allow for liquidity. If there have no place to sell their assets without liquidity many people would not invest at all. The corporations whose securities are being traded are not involved in receiving market transaction and thus, do not receive any funds from such a sale. The function of secondary market is to provide liquidity for the secondary purchased in the primary market.

In the fiscal year 2004/05, a total of Rs. 1476.82 million as mobilized by12 public companies from the securities market. This amount is higher by 43.7 percent compared to that of the last fiscal year. In the last fiscal year, total listed companies in Nepal Stock Exchange Ltd. wee 114, which have increased to 125 till the end of this fiscal year. Total market capitalization of the listed companies at the end of this fiscal year. In this fiscal year, the contribution of market capitalization to the GDO has been estimated to be 12.17 percent. The price index of the listed securities (NEPSE Index) has closed at 286.67 points in the fiscal year. It is 64.63 points higher than that of the last fiscal year. Securities market indicators in the fiscal year 2004/05.(.(Nepal Stock Exchange Trading Report:2006)

2.3.3 An Introduction on SEBO/N:

Securities Board, Nepal was established in the year 1993 A.D. on May 26th, under the provision of securities exchange act 1983A.D. [first amendment]. Since the date of establishment, it has been concentrating to improve the legal ad statutory framework, for the healthy development of capital market. In the year 1997 on January 30th the first act was amended for the second time. This amendment paved the way for the establishment of SEBO/N as an apex regulatory body as it livened the horizon by bringing market intermediaries directly under its jurisdiction and also made it mandatory for the corporation to report annual or semi-annually to SEBO/N. Although the second amendment in the act established to make direct relationship of SEBO/N with market intermediaries and the listed companies, supremacy in its jurisdiction is yet to be established and clearly recognized.

Also in order to improve such situation, SEBON/N focusing on the major areas where improvements are necessary has launched a four-year strategies plan [1998-2002 AD] with major thrust in four major policy development areas. SEBO/N has also drafted a new Securities and Exchange Act, which has sought to improve inconsistencies observed in the present act and establish SEBO/N as an apex regulatory of the securities market.

Thus, SEBO has a dual role of regulating and developing the securities market in the country. Nepal accession to the World Trade Organization has added greater challenges in the securities markets, as it should be opened to foreign investors and foreign securities businesspersons. Fulfilling more roles and responsibilities with limited resources can seriously compromise the potential of a thriving capital market and also due to low level of income from the securities market, SEBO has no alternative then to depend on government funding to carry out its regulating and market development roles. However in the long term SEBO cannot realy on government grant and would have to look for other alternatives to provide SEBO with greater operational and financial autonomy.

The functions of SEBON are as follows:

- Register securities and approve prospectus of public companies.
- Provide license to operate stock exchanges.
- Provide license to operate securities businesses.
- Give permission to operate collective investment schemes and investment funds.

- Draft regulations, issue directives and guidelines, and approve by laws of stock exchanges.
- Take enforcement measures to ensure market integrity.
- Review reporting of issuer and listed companies, and securities businesspersons.
- Conduct research, study and awareness programmers regarding securities market.
- Coordinate and cooperate with other domestic as well as international regulators.
- Frame policies and programmers relating to securities markets and advise HMG/N in this aspect. .(SEBON's Report:2006/7)

As per the Securities Ordinance, 2005, the governing Board of SEBON is composed of seven members including a full time Chairman appointed by the HMG/N for the tenure of four years. Other members of the Board are joint secretary from Ministry of Finance, joint secretary from Ministry of Law, Justice and Parliamentary Affairs, representative from Nepal Rastra Bank, representative from Institute of Chartered Accountants of Nepal, representative from Federation of Nepalese Chambers of Commerce and Industries, and one member appointed by the HMG/N on the recommendation of SEBON from amongst the market experts.(SEBON's Report:2006/7)

As per the Section 3 of Securities Exchange Act, 2040, the governing Board of SEBON was composed of one full time Chairman appointed by HMG/N, representatives one each from Ministry of Finance, Ministry of Law, Justice and Parliamentary Affairs, Ministry of Industries, Commerce and Suppliers, Nepal Rastra Bank, Federation of Nepalese Chambers of Commerce and Industries and Association of Chartered Accountants of Nepal.

2.3.4 NEPSE:

NEPSE is nonprofit organization, which has been operated under securities exchange act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the Government bonds and corporate securities by facilitating transaction in its trading floor through financial intermediaries such as broker, market maker etc. Eleven issue managers and twenty-seven brokers were appointed to avail the daily transactions of buying and selling of securities under its restructure program in the year 1993. Also in the year 1994 on January 13^{th} NEPSE opened for its newly appointed brokers and market makers. NEPSE has adopted an "Open-Out-Cry" system. It means truncations of securities are conducted on the open auction principle on the trading floor. The buying broker with the highest did will post the price and his code number on the buying column, while the selling broker with the lowest offer will post the price and code the number on the selling column on the quotation board. The market makers quote their bid and offer price on their own board before the floor starts. Once the bid and offer price match, contracts between the buying and selling broker or between broker and market maker are conducted on the floor.

NEPSE has adopted a T=5 to T=3 systems which mean that settlement of transactions should be done within 5 working days following the transactions day. Settlement will be carried out on the basis of paper verses payment.

2.3.5 Prices of the Securities

Securities market is the most important part of any financial market were prices of the Securities determine the performance of the company and information dissemination process. Entrepreneurs who have ideas but lacks funds to establish, manage and operate the business can collect the required funds by mobilizing the scattered pubic savings by issuing tradable.

2.4 Legal Reforms in the field of Liberalization

With compatible to the liberalization policy of the government the following legal reforms has been initiated. The most significant foreign investment laws are the Foreign investment and One Window Policy of 1992, the Foreign investment and Technology Transfer Acts of 1992 and 1996; the Finance Act 2002 and the recent Financial Ordinance of 2004 (Annual budget act); the immigration Rules of 1994; the customs Act of 1997; the Industrial Enterprises Act of 1997: the Electricity Act of 1992; and the Patent Design and Trademark Act of 1965. In *a* positive development, Nepal passed all types of electronic and electrical audio video materials, provides for financial penalties as well as imprisonment, and videos for confiscation of sold and published unauthorized materials. The fender would also have to pay compensation claimed by the copyright holder. However, the revised Copyright Act is not yet to the level required for trade-dated into actual property rights necessary under the World Trade organization. Revisions are likely, as Nepal acceded to the WTO in April 2004.(Bhattari:2004:187)

The Foreign, investment and One Window Policy of 1992 restates the desired benefits Iron- foreign investment; lists acceptable forms of investment; allows for foreign sharps up to 100 percent in business areas not on a "negative list" establishes currency repatriation guidelines; and outlines visa arrangements. Arbitration guidelines and a special "one window committee" for foreign investor. The Foreign Investment and Technology Transfer Act, as revised in 1996, eliminates the minimum investment requirement: clarifies rules relating to business and resident visas; exempts interest on foreign loans from tax; and gives contract terms precedence over-Nepali law of investments valued at more than Nepali rupees 500 million approximately (USD 7.0 million). The 2004 Finance Ordinance outlines customs, duties, expo.: service charges, sales, airfreight and income taxes, and other excise taxes that affect foreign investment. The Immigration Rules of 1994 describe visa regulations. The Customs Act and the Industrial Enterprises Act, as revised in 1997, establish invoice-based customs valuations and eliminate many investment incentive installing in their place a lower, uniform rate. The Electricity Act defines special terms and conditions for investments in hydropower development. The 2002 Copyright Act and the 1965 Patent, Design and Trademark Act define the terms and conditions of intellectual property rights protection.(Bhattari:2004:205)

Institutional Arrangements: The Department of Industry is designated as the "one window servicing agency" with the Industrial Promotion Board as a focal point for foreign investment under the Foreign Investment and Technology Transfer Act. The Department of Industry facilitates corporate registration, land transfer. Utility connections, administrative services agreements, and coordination among various agencies. The Investment Promotion Board (IPB), chaired by the Minister of Industry, Commerce and Supplies, is the primary government agency responsible for foreign investment. The IPB is intended to coordinate policy level institutions, to establish guidelines for economic policies, to approve or disapprove foreign investment proposals, and to determine applicable investment incentives. .(Bhattari:2004:206)

2.5 Economic Liberalization: Theoretical Overview

Economic Development holds, probably, the most important role in a country's overall development. No state can achieve economic development without appropriate economic policy. Various policies have been put into practice as a certain economic model in the age-long economic history. Capitalism and socialism are the two key economic theories. Both of them are prevailing in many countries throughout a long period. The two economic models are the centers of political polarization, too. USA and the USSR played the captainship of the "ism" economic battle. Today, too, USA & EU stand for capitalism and China, Cuba, North Korea etc. stand for socialistic model.(Beesleyand Littlechild:1994:323)

When USA and USSR were plunged into cold war, most of the developing countries preferred to remain apart from them and formed a Non-Alignment Movement. The NAM countries adopted a different economic policy viz. mixed economy. It is nothing new than a blend between capitalism and socialism.

Though, mixed economy is a favourable blend, it could not boost up the developing economies even rather than the single pick-up of the two leading economic theories. The drawbacks of the singular model were in their own places. Every nation and her economists stormed their brains to overcome the policy-gap and today, most of them are unified towards liberal economy. (Beesley and Littlechild:1994:323)

Liberal economy in its own sense is free from forced controls by government rather it is run by the market forces. Production, distribution, consumption, pricing etc. are directed by market principles like demand and supply. There is no need of license in doing business, establishing industry, in export and import foreign investment etc. So that, the concept at large, becomes globalization. Global competition makes compulsion to follow up the policy because no country can remain aloof, where the most countries have liberalized their economy. Nepal, too, faced the same problem and stepped into economic liberalization.

"Liberalization is a concept with many meanings. In its most far - reaching interpretation it stands for minimal government, the virtual withdrawal of state from economic activity. But, the concept has often been given more limited meanings. Sometimes it has been used to imply the abandonment of direct discretionary control for automatic regulation through the price system." (*Guha: 1990:13)*

"The consensus, if any is that liberalization/in order to have a change of success, must not be piecemeal. The primacy for liberalization rests on a change in the organization of domestic industry, which would introduce competitive pressures towards higher performance rather than on the more standard competitive advantage arguments. Such structural changes in industry are bound to be resisted, yet in their absence can only remain an empty act" *(Guha: 1990:13*

2.3.1 Brief History in the World Economy

"There is nothing new under the sun. The liberalization debate which was kept Indian economists & politicians so happily occupied for the last few years is only The latest new enactment of a drama at least as well as the subject of economics itself" (*Guha: 1990:*204). When government was even not found and if it was, the government was not able to think of economic development. But the real sense of today's economic liberalization originated in l970s in the essence of liberalization.

As the 1970s came to end, the international economy was subjected to serve pressures associated with a new round of sharp increase in world energy prices. Many countries were still experiencing difficulties resulting from an incomplete adjustment to and recovery from, the troubles of the early and mid 1970s as a consequence, the world economic situation was characterized by a number of disturbing features. In the many countries, inflation continued at historically high rates and showed no signs of slacking. Rates of economic growth were declining. Particularly in the industrial countries, a trend that threatened to jeopardize the necessary expansion in world trade and to steer the world economy toward another recession. At the same time, the current account surpluses and deficits in the balance of payments of major groups of countries increased and underwent sudden shifts. These developments placed great strains on world payments and gave rise to widespread concern about how the unprecedented deficits, especially those of the oil importing developing countries could be financed. These economic developments led the fund to modify its conditionality practices further. One of the initiatives taken involves a renewed emphasis on policies to increase productivity and to improve resource allocation. Another involves the strengthening of collaboration with the World Bank, a requirement made increasingly important by an environment that calls for structural adjustments in many member economies. Guitian: 1995: 175)

"Mexico's announcement that she could no longer voluntarily service her debt obligations was one of the important reasons that LDCs were forced to revamp economic policies m early 1980s Chile and Turkey to have initiated economic reform programs prior to the debt crisis. In the name of economic reform programs, many countries are found to have attempted to reorient their economic policies under the World Bank and IMF's SAP. Some other countries like Brazil are found to have undergone five such policy reforms in as many years without significant alteration in the country's fundamental economic problems. Argentina for example, announced eleventh such crash economic package in 1989."(*Paykurel:1995:140*

Economic liberalization in South Asia, too, was introduced when balance of linens obligations and debt servicing commitments reached a critical default level. It was initially started by Sri Lanka, Pakistan and Bangladesh in 1975-77 and was followed by Nepal during 1980s and India during early 1990s.

2.3.2 Evolution in Nepalese Perspective

Nepal's policy shift for market oriented economy can be linked with the economic mismanagement during early 1980s which led to various distortions such as huge fiscal deficit, deteriorating BOPs and price situation and appreciation of the real effective exchange rate of Nepalese rupee. The adoption of the IMF-World Bank sponsored SAP in later 1980s, ESA and macro economic liberalization programs in recent years as the corrective measures are the direct and indirect consequences of such distortions.

- inability of weak domestic industries to complete with established industries,
- suspicion of market mechanism and call for government intervention, and
- undermine the value of traditional activities(*Paykurel:1995:98)*

Though, some kind of economic liberalization was previously introduced, this study has assumed that Nepalese economy was not liberalized before 1991. After the accession of Nepali Congress to power, the processes of policy reform for greater reliance on private sector activities are pursued.

2.6 Areas of Economic Reforms in Nepal

The agreement with the IMF for the Enhanced Structural Adjustment Facility (ESAF) sets the frameworks under which reforms in economic policy were initiated in early 1990s. This simply means that the reform program was initiated abruptly without consultation with the various stakeholders including political forces represented in the parliament. Hence, rather than being a political process Nepal's, reform process were implemented by bureaucrats under the donors policy prescriptions. At the same time reform focused on few areas assuming that the outcome would spillover throughout the economy.

Accordingly, various components of the economic policy reforms were carried in Nepal during the last one and half decade. In the beginning, the emphasis of economic reform was on the fiscal side. Fiscal reforms were carried on the revenue, expenditure and borrowing side. Taxes were rationalized both on levels and slabs, tax rates were drastically slashed and tax brackets were also reduced. So, In the view indirect taxes, occupying important place in total revenue, reforms were focused on indirect taxation. Reforms have also been executed in foreign exchange *front.* There are no foreign exchange controls on current account. As a result Nepal *obtained the status of IMF* Article VIII in 1994, although exchange N of Nepalese rupee vis a vis Indian currency is fixed exchange rate of Nepalese currency with convertible currencies has left to market forces. .(Acharya:2002:105

Suitable changes are also initiated in Industrial Policy and Foreign Investment and Foreign Technology Transfer Policy with a view to making these policies | compatible with the liberal commercial policies, industrial licensing policy has |been removed. Foreign investment both direct and portfolio are welcome. With a view to attracting foreign investment, Nepal has removed any restrictions on repatriation of foreign capital invested in the country and earnings from such investment. Single window facility has been provided to both domestic and I foreign investors. .(Acharya:2002:106)

Along with the external sector reform, Nepal has also initiated financial sector .reforms. Removal of entry barrier, enactment of Finance Companies Act 1985 and its amendment in 1992, abolition of pre-emption of bank resources in the form of liquidity requirement, establishment of prudential norm, enactment of NRB Act 2002 granting autonomy to the central bank and introduction of Loan Recovery Act 2002 are the key reforms measures introduced in the financial sector. .(Acharya:2002:110)

2.6.1 Fiscal Policy Reforms

One of the major parts of Nepalese economic policy reform is- in - its fiscal policy. It was, because, pervading fiscal policy was worsening the economic condition. It was, in such a row of worsening the national economy ~ more public outlays than revenues, budget deficit borrowing from domestic banks, rising domestic-price-deteriorating, BOPs position and less private investments. Pointing out this kind of phenomenon, PM Dixit says: "Such was in fact the situation in Nepal in the late eighties, where budget deficit as proportion of GDP was close to 10% annual inflation averaged more than 20% and private investment as share of GDP was not much higher than die ratio of public investment to GDP. To overcome possible consequences of such practices, Nepal started fiscal policy reform on the support of ESAM, IMF. These reforms were domestic resource mobilization, containing regular expenditures and matching development budget with resource availability and implementing capacities.(Bhattari:2002:155)

2.6.2 Tax Policy Reforms

Various reforms have been initiated to improve the quality of service in tax administration, make the administration taxpayer friendly and increase the revenue yields required for meeting expenses of various development activities. Sweeping changes have occurred in the tax policy in recent years, as it changed from the regime of high tax incentives for directing private sector environment in predefined priority areas to the regimes of equal treatment to all sectors. In early stage of liberalization and private sector development tax incentives were taken as the instruments for attracting private investments whereas in recent years maintaining neutrality and rationalizing tax rates have been the main agenda of tax reforms in the country. Despite significant reforms there still persists the problem of inefficiency, narrow base and procedural rigidity and non-clarify in tax system, which requires further reform in policy legislation und procedure. In addition, creation of tax payer friendly environment as well as competent and professional tax administration capable of functioning efficiently in the changed context of global economic integration has become the need of time.

- In order to improve revenue collection a major tax reform program was introduced. Its main elements included;
- The introduction of Value Added Tax (VAT) and extending its coverage to include many small and medium enterprises
- Improving the import valuation system for customs and requiring payments to be made through banks
- Revising the Income Tax Act in order to consolidate tax laws and simplify payments procedure
- Strengthening the tax administration by amalgamation the Departments of taxation and VAT into one. And
- Strengthening anti corruption measures (Bhattari:2004:257)

These measures however had little impact in the revenue performance of government in these days. The performance of the VAT regime at the beginning although was not satisfactory however very recently the government has reorganized the tax administration creating a new Inland and Revenue Department as well as enacting a new Income Tax legislation. These steps arc expected to bring positive impact in creating investment and taxpayer's friendly environment.

2.6.3 Public Enterprises Reform

In 1991 29 of the 59 PEs were loss-making and total loss was Rs 1.7 billion or nearly 7.0% of the budget outlay for that year. In order to overcome this situation, government introduced the privatization policy. PEs are delegated authority to adjust prices charged for their services/products based on commercial consideration.

The concept of privatization in Nepal did emerge in parallel with the establishment of democratic government in Nepal in 1990, in the light that public corporations in numbers of services sectors being ridden with severe economic problems despite being very much economically feasible and having ample market opportunity. Lack of proper management, overstaffing, administrative interference, low rate of return, lack of accountability, decreasing quality of product, lack of motivation etc. have made these institutions a white elephant for the Government. Thus, the HMGN has since then privatized many of such public corporations, and are planning to do so for some more.(Dawadi:1994:105)

With the adoption of open market policy liberal economic policy, and to attract multinational companies to invest in Nepal, the HMGN has been taking many suitable and promotional steps in this regard. The HMGN is privatizing services sector as well. The first in this sector has been Micro and Small Hydropower Systems. Energy Projects with a total of 96 MW are under private development. The Ninth Five Year Plan of the HMGN has planned four more projects of total 121 MW for private sector development. Similarly, solid waste management telecommunication is other service sectors that are being privatized.(Dawdi:1994:106)

In Nepal most public enterprises (PEs), were established beginning from the Second to Seven Five year Plan periods as a vehicle of development. These units were created as instruments for production and for achieving socio-economic policies of the Government. This initiative of the Government was essential and justified at a time when private sector investment was not forthcoming in the provision of basic social and economic services. The number of such enterprises in the industry, business, services, social and public utility sector exceeded 60. Many of them were established with the assistance of donor countries. From these public sector organizations it was expected that they would create an industrial base in the country, enhance domestic production, substitute imports generate employment opportunities and Contribute to the national treasury. But most PEs characterized by operating deficits, overstaffing, heavy dependence credit, and inefficient management and low capacity utilization, sub-optimal use of resources, etc incurred losses. The performances of public enterprises particularly those involved in industry and trade sector turned out to be very poor.(Rastrasewak:1995:112)

On the basis of analysis and evaluation of the roles and performance of these enterprises, the elected government which assumed power after the restoration of democracy in 1990, concluded that the economic conditions and financial efficiency of the government corporations were unsatisfactory. Lack of basic elements contributing to the development of professional culture in their inherent structure and operating procedures was singled out as the main cause for their poor performance. Public enterprises confronted with various problems and hindrances such as lack of managerial autonomy, inefficient use of means and resources, shortsightedness and weakness on the part of political leadership production of low quality goods and services, uncontrolled administrative expenses, lack of competitive ability, lack of motivation in incumbent human resources, adoption of traditional technology and minimum use of professionalism. All these factors brought about a progressive decline in their output and made the vast amount of government investment unproductive. Thus, these public corporations have not only failed to achieve their objectives but also become a heavy burden on the national economy.

"Their performance has been deteriorating steadily since the 1980s, while no attempts have been made to eliminate shortfalls in spending for operation and maintenance as such by public corporations a review of their operation suggests not only that their operation and maintenance function is seriously deficient but furthermore many of. these corporations are becoming a serious drain on fiscal resources."(World Bank Report)

Nepal implemented Structural Adjustment Program (SAP) as early as in 1985 which included tariff rationalization, reduction of fiscal deficits and privatization of PEs. But the efforts at privatization were not materialized until the political changed in the country in 1990.

Privatization of public enterprises initiated under the framework of overall economic reform program in early nineties is another commitment of the government for private sector development. Under the program so far Government has privatized 25 companies (including one leased brick and tile making unit which was taken back by the HNG but again leased out recently) of various sizes and areas by experimenting with the sales of assets and business, sales of shares, leasing out, management contract, and liquidation as the methods of privatization.(Dawadi:1994:95)

Table 1.1

Privatization of Government - Owned Enterprises

Name of the company	Year Privatization	Method of Privatization	Sales proceeds (Rs '000')	Sale of Shares %
Bhrikuti Paper Mills	Oct 1992	Assets and business sale	229,800	-
Harisidhi Brick and tile Factory	Oct 1992	Assets and business sale	226,900	-
Banshari Leather and I Shoe Factory	Mar. 1992	Assets and business sale	22,400	-
Nepal Film Development Corporation	Nov. 1993	Share sale	64,662	51
Balaju Textile Industry Ltd.	Dec. 1993	Share sale	17,716	70
Raw Hide Collection and Development Corporation Ltd.	Dec 1993	Share sale	3,990	
Nepal Bitumen and Barrel Udhyog Ltd	Jan 1994	Share sale	11,640	65
Nepal Lube Oil Ltd.	Jan 1994	Share sale	30,242	40
Nepal Jute Trade and Development Company	1993	Liquidation	Liquidation	-
Tobacco Development Company	1994	Liquidation	Liquidation	-
Nepal Foundry Industry	Mar 1996	Share sale	14,473	51
Raghupati Jute mills	Aug 1996	Share sale	82,204	65
Biratnagar Jute Mills	Dec 1996	Management contract	Business Contract	
Nepal Bank Ltd.	Mar 1997	Share sale	125,140	
Agricultural Tools Factory	May 1997	Share sale	95,100	New Liquidated
Bhaktapur Bricks factory	Aug 1997	Lease	20,300 (10 years lease)	
Nepal Tea Development Corporation	June 2000	Share sales and Lease	267,105	65
Agricultural Project Services Center (APRPSC)	2001	Liquidation	-	-
Cottage Handicrafts Sales Emporium	2002	Liquidation	-	-
Nepal Cola Ltd.	2002	Liquidation	-	-
Hatauda Textiles Ltd	2002	Liquidation	-	-
Nepal Transport Corporation	2002	Liquidation	-	-
Butwal Power Company	Jan 3003	Share Sales	874,200	75
Birgung Sugar Mills	2003	Liquidation	-	-
Nepal Telecommunication	2004			
Birgung Sugar mills	2006			

Source: Economic Survey 2006/2007

The privatization process went smoothly and could get active participation of private sector at the initial phase: however, the slow down in the economy experienced in latter part of the last decade has plagued its momentum. Replacing public monopolies with competition particularly in utilities sector under appropriate regulatory arrangements would further improve the environment for promoting the private sector.

2.6.4 Financial Sector Reform

Non-economic factors have exerted negative influence on the economy of Nepal in recent years. The negative balance of payment and huge deficit in current account manifest the unpleasant positioning of the economy in recent times. Several factors are known to have contributed to the slowdown in the economy. Factors like security related problems emanating from Maoist struggle, political instability and weakness in corporate governance-poor institutional opacity, poor transparency and accountability, inadequate legal frameworks and weak human resources that limited the country's growth potential.(Bhattari:2004:195)

It is being increasingly felt that a sound and efficient system of government administration has lot to do with the effective operation of the economy. The importance of these issues in Nepal is highlighted by the World Bank's argument that central constraint on Nepal's development over the last few decades has not been paucity of funds but lack of good governance and well functioning institutions.(Bhattari:2004:196)

The financial sector is by no means an exception to this. NRB feels that strong corporate governance is necessary for the development of a vibrant and resilient financial market and is an effective tool to protect the interest of investors and depositors. Moreover, the ASEAN crisis of 1997 and failures of companies like ENRON and Worldcom have attracted serious attention to the issue of corporate governance. Highly unsatisfactory performance of the two banks (RBB and NBL) and reports of rampant irregularities of a number of financial institutions have prompted NRB to initiate appropriate actions encouraging transparency and accountability.(Bhattari:2004:201)

The establishment of Nepal Bank Limited in 1937 marked the beginning of banking sector development in Nepal. Nepal Rastra Bank came into existence as the central bank of the country in 1953, which was followed by creation of NIDC in 1959, Employee Provident Fund (EPF) in 1962, Rastriya Banijya Bank (RBB) in 1966 and Agricultural Development Bank (ADB) in 1968.

The liberalization of financial sector started in 1984. The liberal policy adopted then and pursued move vigorously thereafter has helped the sector to grow rapidly and also had built foundation for the creation of a competitive environment in the financial market. Currently, there are 22 commercial banks, 18 development banks, 5 regional rural development banks, 54 finance companies, 36 micro credit institutions, 34 cooperative societies doing limited banking activities, 116 postal banks, 12 insurance companies, 1 EPF, 1 CIT, 1 Deposit Insurance and Credit Guarantee Corporation, 1 Security Board and 1 Nepal Stock Exchange (NEPSE)(Bhattari:2004:188).

The liberalization and opening up of financial sector started in mid 1980s in response to the wind of globalization and financial liberalization that blew across the planet. It was initiated under the Structure Adjustment Facility (SAP) program of the World Bank and IMF. It may be noted that prior to liberalization, NRB dictated deposits and lending rates, margin rates and statutory liquidity ratio. However, post liberalization period has witnessed a progressive shift towards indirect methods of control and deregulation. Some of the measures include allowing joint venture banks to operate in Nepal, greater resources to open market operation to contain monetary aggregates, deregulating interest rates, conducting CBPASS, abolishing SLR, opening secondary market for auctioning at market determined rates of T-bills and development bonds and introducing a full convertibility of NRS in the current account. NRB has taken a decision to do away with priority sector lending by commercial banks within next five years and is determined to concentrate only on the core functions.(Bhattari:2004:189)

Due to poor accounting and auditing standards, some institutions were able to paint a far belier picture than what the financial healthy actually was. In view of this, NRB issued new accounting policy directives in conformity with international accounting standard and Generally Accepted Accounting Principles (GAAP): Various disclosure requirements along with other regulatory and supervisory frameworks have contributed to make the share values of commercial banks stocks more realistic. The dominant role of the government as an owner or operator of NRB, RBB, NBL ADB, and NIDC is often blamed for the deterioration of financial sector, which also limited the supervisory and regulatory authority of NRB.(Bhattari:2004:189)

The present NRB act has given it full autonomy and independence in discharge of its responsibilities as a supervisor of the financial industry and independent formulator of monetary policy. NBL and RBB management has been handed over to outside parties and NRB reengineering team is in place. Debt recovery act has been approved and an umbrella act covering all deposits taking institutions has been approved. NRB wants to make sure that no financial institutions should be opened with government or NRB's stake in their equity. NRB has started reorienting its role from one of active participant in the conduct of business of financial institutions to that of a regulator.(Bhattari:2004::190)

Financial sector reforms have also been carried out to support trade and industrial reforms. Administrative interest rates were deregulated and joint- venture banks and finance companies were allowed to open-up. Nepal also introduced current account convertibility. The overvalued Nepalese currency was also corrected to improve export competitiveness of the trade and industrial sector.(Bhattari:2004:191)

During the 1990s, the growth rate of narrow money supply was about 15.4 percent. In some years, flow of large amount of domestic credit to the government from the banking sector became a reason for high monetary expansion; while in other years/increase in net foreign assets resulted in the higher rate of money supply. However, whatever was the reason for monetary expansion, it was under control, and that helped in maintaining internal and external stability.(Bhattari:2004:192)

However, the financial sector in Nepal is in a critical stage when viewed not only from the perspective of macroeconomic stability, but also from poverty and unemployment. The main problem of the banking system is inefficiency, which has resulted in high spread rates and increasing non-performing assets. Financial problems, which can also bring currency crisis, could result in devaluation, higher inflation, and significant loss in output. As a result, unemployment and poverty may increase. The cost of restructuring of the financial crisis could be high. Competitive and efficient financial intermediation system reduces cost of capital, leads to efficient utilization of resources, and supports sustainable growth and reduces poverty.(Bhattari:2004:193)

2.6.5 Industrial Policy Reform

Nepal's stand during the accession to the World Trade Organization (WTO) also was made clear that major objective of national economic policy was to promote and encourage a transparent and fair business environment for both domestic and foreign investment, and to increase the role of private sectors in Nepal's development process. For this purpose, a liberal industrial policy was adopted in 1992 consisting of the Industrial Enterprises Act 1992, the Foreign Investment and Technology Act 1992, and the One Window Policy of 1992. Sections 2, 3 and annex of the Foreign Investment and Technology Transfer Act 1992 are relevant for all foreign investment cover the major criteria for the permission of foreign investment. Under this policy, a high level committee had been formed with the Director General of the Department of Industries as its coordinator in order to coordinate the activities of various agencies related to industrial enterprises. The major thrust of these Acts and policies lies in their openness with emphasis on market-driven strategies and the dominant role of private initiative and enterprise. The Government acts as a facilitator to the private sector concentrates its efforts on the development of the infrastructure required, as well as in guaranteeing stable macroeconomic activities within the country. The

Industrial Policy of 1992 identified foreign investment promotion as an important strategy in achieving the objectives of increasing industrial production. The basic needs of the people are creating maximum employment opportunities, and paving the way for improvement in the balance of payments situation. Foreign investment was expected to supplement domestic private investment through foreign capital flows, technology transfer, and providing access to international markets.(Acharya:2002:15)

Various institutional arrangements have been framed to facilitate and support the private initiatives in the economy. The set up of One Window Committee, as provisioned by the industrial policy 1992 to facilitate various services like electricity, water, telecommunications and tax incentives under a single roof, has been one of the several arrangements made to this end.

In addition, several government, semi-government organizations like Cottage and Small Industry Development Board National Productivity and Economic Development Centre, Trade Promotion Centre, Council for Technical and Vocational Education, Industrial Enterprise Development Institute and Private Institutions are involved on developing entrepreneurial skill and providing support to private sector through the production of skilled and semiskilled manpower as per the market requirements, and providing other industry and trade related services to the entrepreneurs.Thesis(Adhakari:2006)

In addition to these liberalization steps in economic policy, the government has accordingly reformed in agriculture sector, public administration, public investment, legal provision etc.

2.7 Conceptual Framework of Capital Market

Share:

A capital market refers to the links between lenders and borrowers of funds arranging a funds transfer process to seek each others benefits. The lenders and borrowers coming together in capital market play effective financial intermediary role to activate both primary-and-secondary through the use of various long-term capital market instruments like common stock, bonds, preferred stock, convertible issues and many more like that (Shrestha, 1992:14). People invest his money in the form of primary market and secondary market. In general context, there are mainly three types of shares traded in stock -exchanges.(shrestha:1992:15)

Preference shares:

Preferred stock unlike bonds has an investment value, as it resembles both bonds as well as common stock. It is a hybrid between the bond and common stock. It resembles a bond, as it has a prior claim on the assets of the firm at tlie time of liquidation. Like the common stock the preference shareholders receive dividend and have similar features as common stock and liabilities at the time of liquidation of firm. (Shrestha:1992:15)

Ordinary Share:

Common shares are more risky than both bonds and preference shares. They afford greater advantage that both the other securities and in the capital market enjoy better positions as far as the investor's attraction is concerned. Equity stock gives several rights to the shareholders. The shareholders have right to vote, the right of dividends, and the right of being offered right shares, I he right to bonus issues as d dividend and certain tax benefits.(Shrestha:1992:15)

Bonds

Bonds art senior securities in a firm they represent a promise by a company to the holders to pay a specified rate of interest during a stated time period and the return of principal sum at the date of maturity. The difference in bonds due to the terms and conditions and features each bond bears, bonds may be distinguished according to their repayment provisions/type of security pledged, time of maturity and technical factors. (Shrestha:1992:17).

The bond/debenture is a legal instrument incorporating an agreement between the corporation which issues bonds, the bond holder who lends money and the trustee, which is either the commercial bank of trust company and represents as a bondholder. Thus three parties are involved; the company, bondholder and trustee (Market makers).

Primary Market (New Issue Market)

The New Issue Market deals with those securities^ which have been made available to the public for the first time.

The growth of primary market is encouraging since many public limited companies including, joint venture banks have been successful to tap capital through the floatation of securities to the general investing public.

Role of Primary Market:

The New Issue Market has three important functions: they are origination, underwriting and distribution. The New Issue Market facilitate the capital market to raise long-term funds industry new issues are further classified as "initial "issues and" further" issues, initial issues are capital issues offered for the first time by a new company. Initial capital can be raised only through equity or preference share. When existing companies raise issues, it is called "further" capital. Such organization can raise debentures. The interplay of these functions helps to transfer resources from the sources of surplus funds to those who require these funds, in ultimate users of these funds. (Henderson: 1995:205)

2.7.1 The Relationship of the New Issue Market and Stock Exchange

The new issue market and stock exchange are inter-linked and work in conjunction with each other. They can not be described as two separate markets because of the kind of functions they perform. Although they differ from each other in the sense that the new issue market with new securities issued for the first time to the public and the stock exchange deals with those securities which have already been issued once to the public, they are complementary in nature because of this particular function. The "New issues" first placed with the new issue market have a regular and continuous purchases and sale in the stock exchange when secondary purchases have to be made by the investors. (SEBON's Bulletin)

The role of the New Issue Market and the stock exchange complementary to each other is the infrastructure facilities provided for sale and purchase of securities. The NIM does not have a physical existence but the service as is provided in Nepal is taken up entirely by the financial intermediaries.

The NIM and stock exchange is the relative strength and public confidence in joint participation in the sale, purchase and transfer of securities. In Nepal, the NIM and Stock Exchange are connected to each other even at the time of new issue. The usual practice by the firms issuing securities is to register themselves on a Stock Exchange by applying for listing of securities.

Secondary Market:

The secondary market is not keeping pace with the growth of primary market. This is mainly due to lack of the needed efforts on the concerned authority to devise suitable package of measures to encourage the growth of broker's networks in the country's stock exchange.

Stocks are traded in two different kinds of markets-exchanges and OTC markets. These markets differ in important respects. In exchange markets, members firms act for themselves and as agents for customers^ bringing their orders to control facility - a "floor" - to be executed. Orders can be executed in two ways: against other orders i.e. a bid to buy matching an offer to sell^ or if there is no such order at an acceptable price/by sale to or purchase from the "specialist" - a member designated by the exchange to the sole market-maker for that stock. (NEPSE Rule)

2.8 Review of Past Research Work

The study of liberalization and its impact on economy of Nepal has been found in several numbers. But any study such as impact of liberalization on capital market of Nepal is not done. Analysis of liberalization policy should have done by the capital market in full phase but only some hints of the impacts are found in their annual reports. But, there is not a single study merely on this front. Some researchers on liberalization and its impact on economy of Nepal have included few hints about capital market. They will be reviewed here.

2.8.1 Book Review

a) Paykuryal Dr. Bihmmibher: 1995:

In his study on impact of economic liberalization he has found following impact on various sectors.

- The new industrial policy has grown the production index of major manufacturing industries.
- The degree of deregulation was however, less effective in regard to foreign investment and promotional policies and therefore, there was comparatively a little impact on the flow of foreign investment. This demands immediate steps to be taken on promotional activities to attract foreign investment because the confidence of international business community is important for speeding up direct foreign investment.
- External debt burden has been growing mainly by devaluation of Nepalese currency and fiscal deficit.
- Third country trade has been increasing but the trade with India has been decreasing
- More liberalization is needed in trade sector.
- The production and sale of the then privatized enterprises has increased, government income is increased but the process of privatization lias a little ground to criticize.

These are the points with a macro view of liberalization in Nepalese economy. His study has not specifically touched with capital market. My attempt, therefore, is different from him.

b. Economic Liberalization in Nepal: Keshav P. Acharya, Nara Bahadur Thapa and Shiva Sharma 2004

In their study they have emphasized on the sequence and process of economic liberalization in Nepal. In their study they concluded that liberalization has become a global phenomenon with more countries adopting this policy Yet, it faces rising number of questions not only from the poor, environmentalists and human rights activists but also from economist of repute stature. Nepal entered the era of liberalization in 1985 when the country First entered into stand-by agreement with the speed firmed up with the SAF agreement with the IMF, supplemented by the Sal programme with the World Bank in 1987. Restoration of democracy in 1990 and the ESAF agreement with the Fund in 1992 further accelerated the pace of economic reforms.

So far major components of reform have been the deregulation of financial sector. This included deregulation of interest rate (1984-89), OMO on government securities (1988), introduction and strengthening of prudential norms of banks (1988-95) and replacement of direct measures of monetary control by indirect policy instruments.

The external sector occupies the pride of place in Nepal's economy. Merchandise trade flows account for nearly two-fifths of the GDP. If one also includes non-trade flows in the rest if the current account, the country's aggregate external (lows approximate nearly half of the GDP. External sector reforms basically involve management of exchange rate and foreign exchange reserves, liberalization of current account transactions such as exports, imports, services and transfers, and general lowering as well as rationalization of tax/tariff rates and revenue structure. Towards this end, import, licensing has been replaced by auctioning in 1986 and by OGL in 1992 and 1993. The Nepali rupee was made fully convertible in all current accounts by early 1993. Holding and operating of foreign currency deposit and borrowing has been liberalized.

In the global economy spectrum, Nepal is gradually falling towards the bottom rank. Incidence of poverty is still at much higher level, probably highest in the South Asia region. It is in regard to poverty where sincere concerns are expressed particularly with regard to the financial sector reform. Commercial bank branch expansion in the rural areas is no more a policy concern. Loss making branches do not get subsidized any more. Targeted credit programmes of any meaningful coverage such us IBP and SFDP attracts the least attention of bank management. Interested subsidy provided on borrowing of up to Rs. 15,000 has been withdrawn. To offset such contraction there stand newer programmes such as PCRW, rural self-help fund, credit to deprived sector, micro credit for women, RRDBs, banking with the poor and liberalization of specified banking transactions by the co-operatives, NGO and the development banks. The magnitude of alter transactions, however, are dwarf as compared to those of banks and AD1 /N

c) Shree Prasad Poudel:2004

In his study on Equity Market Development in Nepal, he has found out that low ratios of paid up value-GDP, market capitalization-GDP and annual trading turnover-GDP, and relatively higher annual trading turnover-market capitalization (M-cap) ratios reveal primitive stage of equity market development in Nepal. Joint-stocks companies were few and not listed in stock exchange. Initial public offering of equities was merger and exchange of equities in secondary market was nominal till floor trading in Nepal Stock Exchange (NEPSE) started in 1994. Various market imperfections like limited number of buyers and sellers, stringent government policies and asymmetry of information hinder market forces to determine a fair equity price in NEPSE. Thus, equity market in Nepal is not yet efficient to allocate resources. Stock market in emerging markets is relatively high and attractive for domestic and foreign investment. However, equity return volatility, an indicator of risk is also high and has discouraged foreign potential investors for equity investment. Domestic markets are to be integrated to reduce the cost and increase inflow of capital. Increased foreign equity investment in LDCs increases income, and saving which in turns increases equity investment.

Commercial banks and finance companies in terms of equity price, M-cap and total turnover dominate Nepalese stock market. NEPSE index is mainly dragged by stock prices of foreign joint venture banks and finance companies. Real sector companies have minimum role in the exchange market. It is a structural problem in the course of industrial and financial development. In the long run, higher concentration ratio of financial sector goes down when real sector investment goes up. Due to the dichotomized nature of the economy, investors of rural sector are deprived of reaping the fruits of equity market development. It is expected that development of information technology can mitigate the gap of wealth distribution between investors in rural and urban sector. Open out cry system of market operation should be replaced by computer system of order placing and execution of trading which helps market integration at both national equity investors awareness programs like banking development programs need 10 be run from Radio and Television.

2.8.2 Journal Review

a) Dr. Bijay K.C. :2004

In his study "Development of stock market and Economic Growth in Nepal" He has made the relationship between financial development and economic growth, with focus on development 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 the 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 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 prior rigging. Low turnover ratio and value-traded-ratio to volatility, and low 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 option to invest in securities according to their risk-return preference. Similarly firms avoid 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.

b) Mr. Navaraj Adhikari : 2006

In his article tiled "Securities Market in Nepal" he highlighted that capitals plays a vital role in the economic development of a country. Being a capital deficient country, Nepal has to make every endeavor to mobilize available capital efficiently. Securities markets provide mobility of the scattered savings. Retail investors with limited capital fund could also participate in the industrial process of the country through their investment in the securities. However, both individuals and institutions are putting most of their savings into bank deposits and bullion market because of the present state of the securities markets. Thus, long-term savings that should be invested in the securities markets going into short-term investments. Presently, stock exchange facility is available only in Kathmandu valley. Hence, there is a scope of expanding the facility in other regions of the country. Privatization of public enterprises such as Nepal Telecommunication Corporation, Royal Nepal Airlines and other public enterprises using share sale mode of privatization as announced by HMG/N in the budget speech of FY 2003/04 could provide a huge investment opportunity in the securities markets.

Tourism and hydropower sector can be the backbone for Nepal's economic development. Hydropower projects, in particular, are long term investment projects and Nepalese banks, which normally lend for short-term purpose, can not be a suitable source of financing. Hence, the issue of debt securities for this purpose could provide a strong dynamic for the development of the securities markets in Nepal.

Development of the securities markets depends crucially on the quality of financial information. HMG/N has established Accounting Standards Board and

Auditing Standard Board for improving accounting and auditing standards. These boards have developed some accounting and auditing standards to be implemented in the country. It is expected that the implementation of these standards would improve quality of financial information. Improved financial information would help to make informed investment decisions in the securities markets leading to efficient securities markets in the country.

2.8.3 Thesis Review

a) Deepak Dhungana-2007

In his unpublished Master's Degree thesis of "Impact of Liberalization on capital Market"; he has found that liberalization is the base for the growth of capital market. While there was not the economic liberalization policy, the capital market has not any existence. While our country adopted the economic liberalization policy, there was found drastic change in the development this sector. In his view, the growth of capital market is the product of liberalization. There were only one or two sectors of capital market before liberalization but now we have eight sectors having more than 125 listed companies. He has also tried to present, there is positive relationship between liberalization and capital market. He has also added that privatization play the role of bridge to join liberalization and capital market.

b) Bhusal Murari, 2004

In his study, he has focused on privatization and its performance in the capital market of our country. He has put to analyze the privatization activities and its result as his main objective. He was able to find out his objective through his this thesis. He has given the history of all privatized enterprises in details with relevant data. He has also indicated their situation before and after privatization. The profit of the privatized enterprises where not good, than the before privatization. But he has not given any reasons for this.

In his study, we can get the capital after privatization is increasing, among them

HBTF's capital has been increasing by 3400%. He has found that the big capital being companies wear in heavy loss after privatization only RJM could earned profit. From his study we can predict that the impact of privatization was seen on growth in capacity, technology, advancement, market expansion and product diversification.

2.9 Research Gap

The thesis writing on the pattern prescribed by T.U. would be very easy for me if I have chosen the other topic rather than this "Impact of Liberalization on Capital Market Development". There is not found any research work to mach my thesis report. It was too difficult for me to collect the information, view and data related to this thesis. Now this thesis work would be the easy solution to all the researchers who want to know about the impact of liberalization on capital market development. This thesis is fruitful to academicians, public enterprises, privatized enterprises, investors, government and public too.

The research has found the development of capital market can be successes if the government applies the liberalized economic policy. The policy makes free to public enterprises to be privatized, which leads in the increase of capital market. Here, with the help of available date and information this research try to examine the performance of privatized enterprise in capital market development. This research also put some recommendation to the all stakeholders too. This research of course is fruitfully to the concerned parties to take into consideration.

CHAPTER III

RESEARCH METHODOLOGY

Under research methodology, a well thought out activities of analyzing and interpreting the collected data with a purpose of obtaining answers regarding the lack of enterprises in the capital market after and before liberalization has been carried out. It involves detailed investigation in search of facts regarding the liberalization in the capital market growth of Nepal. Various qualitative and quantitative techniques are used in order to achieve the objectives. Efforts are made to provide realistic pictures of the capital market situation of the enterprises through collection, analysis, presentation and interpretation of the relevant details.

3.1 Research Design

The research design of the study is classified into three categories namely sample design, observation design and statistical design. Under sample design, the listed enterprises of Nepal through the issue of shares are selected under study. The observation design is concerned with capital market condition of the privatized public enterprises of Nepal. The statistical design is concentrated on the volume of share transaction, amount traded, and number of share transactions and the market capitalization of listed enterprises in capital market of Nepal. Both empirical and analytical tools are used in order to analyze liberalization and its contribution to capital market.

3.2 Population and Sample

The total of 152 listed enterprises is considered as the population for the study. As the study 'tempts to understand the capital market situation of the company, it has selected only 9 enterprises, as sample, which have large traded amount

3.3 Criteria for Measurement

The study tries to find the performance of enterprises and contribution of those enterprises on the capital market growth of Nepal. The study has tried to analyze the subject in a phase wise manner. It tries to analyze the profitability performance of listed companies and the performance in the capital market growth after liberalization.

The trading volume, share price, number of share transactions and market capitalization has been considered as the criteria for measuring the development of capital markets of Nepal. Like wise stock market size, liquidity, concentration and volatility are also used as criteria of measurement.

3.4 Source of Data

Both primary and secondary data are used for the analysis and evaluation purpose of the study. Primary data are generally used in those cases where the secondary data do not provide an adequate basis for analysis.

Fore the purpose of primary data collection, questionnaires are distributed to responsible bodies of government organization. Both formal interview and informal conversation method are also utilized for the purpose of soliciting information The publication of Ministry of Finance, Articles and Journals, Annual trading reports of NEPSE and SEBO, Research reports, previous studies and unpublished reports. Economic Survey Reports, Government Reports, Publications of Determent of Statistics and related Websites are referred for the purpose of secondary data collection.

3.5 Data Collection Technique

Since both the primary and secondary sources of data are utilized, various techniques of data collection are undertaken. For the purpose of primary data collection, personal interviews and informal conversation method are used in order to discover new facts and details. Secondary data are collected through referring to the various published statistics, unpublished reports, journals, articles, previous research works, various dissertations etc. But the Research is basically descriptive in nature rather than analytical.

3.6 Data Analysis Tools

Under data analysis, the collected raw data on liberalization and capital market ' growth is analyzed to draw on practical results. The collected facts and figures regarding the variables under study are processed with a view to reducing them to the manageable meaningful interpretation of the data.

3.6.1 Descriptive Statistical Analysis

Under descriptive statistical analysis, the explanation of the collected date is presented by the using the statistical tools and techniques. The data can be analyzed through the average behavior. Degrees of variation, degree of association are analyzed through the help of descriptive statistical analysis. The analysis provides the desired result in the case when there exists a relationship between variables.

3.6.2 Tabular Presentation

Tabular presentation is used to summarize the raw data in a compact form so as to facilitate comparisons and show the involved relations between liberalization and capital market situation. The tabular presentation has provided a basis for further analysis and interpretation of the collected data from primary and secondary sources.

3.6.3 Diagrammatic Presentation

The diagrammatic presentation is used in certain portion of the study where the other forms of statistical analysis are unable to present better interpretation. The simple bar diagrams are used for the purpose of diagrammatic representation in the study in order to project the relationship between the variables under study.

3.6.4 Graphical Presentation

Graphical presentation tool is also used for representing statistical facts and information. It is also utilized where the nature of data is such that it represents the trend of occurrence over the period of time. It is also applied to the situation where large mass of data is to be dealt with proper degree of accuracy.

3.6.5 Measures of Central Tendency and Dispersion

Mean is used to examine and understand the average behaviour of the variables under study. It is also calculated for the purpose of further analysis of the data on capital market growth. Mean is computed using following formula:

$$\frac{1}{N}\sum_{i=1}^{n} X_t$$

Standard deviation is also used for the analysis purpose of the study. It is used to find out the deviations of the observations from the arithmetic mean of the distribution. The standard deviation for the study is computed by using the following formula,

$$\sigma = \frac{\sqrt{\sum_{i=1}^{n} \left(X_t - \bar{X}\right)^2}}{N}$$

In order to compare the homogeneity, uniformity and variability of the results shown by the data under analysis coefficient of variation is computed. It is used in order to determine the level of risk of the sample studies. This tool of statistical analysis is used to find degree of variation of the collected data from its average value. It is computed by using the following formula:

$$CV = \frac{\sigma_x}{\bar{X}}$$

3.6.6 Correlation and Regression Analysis

As correlation is the measure of relationship between two or more characteristics of the sample, the correlation analysis is carried out between the capital market variables and the other variables of liberalization under study. The objective behind correlation analysis is to determine the degree of relationship between the capital market and other variables of liberalization.

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - \left(\sum x\right)^2}\sqrt{n\sum y^2 - \left(\sum y\right)^2}}$$

Similarly, regression analysis is carried out in order to estimate the effect of the independent variables on the dependent variables undertaken in the study. The objective is to measure the form and association of the relationship between the variables under study. As it explains the independent variable explained or predicted by the dependent variable, it can be expressed as;

$$Y = a + bX$$

3.6.7 Multiple Regression Analysis

Under multiple regression analysis, two independent variables of capital market are used to estimate the values of a dependent variable. The multiple regression analysis used to make estimates of the dependent variable from values of the two or more independent variables through *least square method*, to measure the *standard error* involved in using the equation and to obtain the measure the proportion of variance in the dependent variable explained by the independent variable through coefficient of multiple determination.

If there variables are X_1, X_2 and X_3, the multiple regression equation can be expressed as;

$$X_1 = a_{1.23} + b_{12.3} X_2 + b_{13.2} X_3$$

Where,

$a_{1.23}$ = intercept made of regression plane i.e.; value when $X_2 = 0$ and $X_3 = 0$

$b_{12.3}$ = partial regression coefficient i.e., amount change in X_1 per unit change in X_2 when X_3 is constant.

$b_{13.2}$ = partial regression coefficient i.e., amount change in X_1 per unit change in X_3 when X_2 constant.

Hest Analysis:

Hest has been done by setting hypothesis wherever possible.

3.7 Financial Tools:

3.7.1 Market Capitalization Ratio:

Market capitalization ratio is used in order to see the relation between the capital mobilization and changes is the market capitalization of industry. To compute it following mentioned formula is used.

$$\text{Market Capitalization Ratio} = \frac{Market\ \mathrm{Pr}ice\ x\ Number\ of\ Shares}{Total\ Capitalization}$$

3.7.2 Annual Turnover Ratio:

As turnover ratio determines the liquidity of the stock market and is indicative of trading relative to the size of the stock market, the ratio is used to find out the marketability and liquidity of the stocks of enterprises traded in the capital market. Liquidity of the stock market is the ratio of the value of shares traded to market capitalization.

$$\text{Turnover Ratio} = \frac{Value\ of\ shares\ Traded}{Market\ Capitalization}$$

The turnover ratio, as a measure of stock market liquidity, reflects increase in both the value of shares traded and the stock market capitalization measures rather than just measuring absolute growth in trading volume. It is conservative measure of the growth in liquidity.

3.7.3 Market Concentration Ratio:

Market concentration ratio is used to measure, in a stock market which has high concentration shares of few companies account for major percentage of total market value and are traded most frequently relative to stocks of other companies.

$$\text{Market Concentration Ration} = \frac{Share\ of\ Outstanding\ Stocks}{Total\ Market\ Value\ of\ Shares}$$

3.7.4 Percentage Analysis:

Percentage analysis is also used in order to examine the variations and associations in the responses given by the groups of respondents. The proportion of the particular observation on the total observation is studied in order to determine the significance of the matter. The percentage analysis is used as and when necessary.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Analysis of capital market situation through study of relationship within NEPSE index, market capitalization and annual turnover.

Market index is the important indicator of the capital market situation of any economy. It serves as a benchmark against which the organizations and enterprises evaluated their performance. It shows how much capital has been mobilized in the capital market and what the trend of capital mobilization is. Market index is used in order to study and analyze how much capital is needed by the market in order to be efficient. The efficiency of the capital market is imperative for the efficiency of the individual stock in the capital market. The analysis focuses on the trend of capital flow that is increasing or decreasing in the market, due to market variables like market capitalization and annual turnover.

The stock market of Nepal (NEPSE) follows the standard and Poor's Index of U.S.A. for the calculation of the market index.

$$P_{01} = \frac{P_1 x Q_1}{P_0 x Q_0}$$

Where

P_{01} = NEPSE Price Index

Table: 4.1

Relationship between NEPSE, Market Capitalization & Annual Turnover

Year	NEPSE Index (Y)	Market Capitalization (X_1)	Annual Turnover (X)
1994/95	226.03	13872	442
1995/96	195.48	12963	1054
1996/97	185.61	12295	216
1997/98	176.31	12698	416
1998/99	163.35	14289	203
1999/00	216.92	23508	1500
2000/01	360.70	43123	1157
2001/02	348.43	46349	2344
2002/03	227.54	34704	1541
2003/04	204.86	35240	576
2004/05	222.04	41425	2144
2005/06	277.88	61366	4507.68

(Source: SEBO Journal 2007)

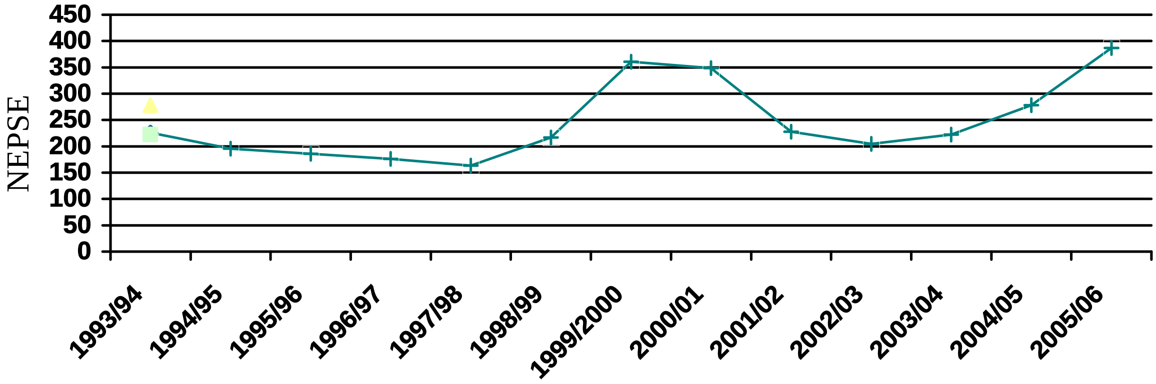
The multiple regression analysis is used in order to analyze the effect of annual turnover and market capitalization of NEPSE Index. The analysis produces the following result.

$$Y=167.27 + 0.00352X_1 + 0.0088\ X_2$$

The standard error estimate produced by the above equation is 67.45 which I very high, we can conclude that this analysis might not provide us with an accurate estimate of the effect_but_there is a positive relationship among the annual turnover, market capitalization and NEPSE Index. It presents that the flow of capital in the market is increasing but at a very minimum rate.

Figure 4.1

Trend of NEPSE Index



Fiscal Year

The NEPSE Index shows a declining trend as shown in Fig: 4.1 The index picked its height in the year 1999/2000 and started to decline over the recent years. It is analyzed that market capitalization and annual turnover bears a positive relationship with NEPSE Index. From the declining trend of NEPSE Index. We can draw broad conclusions that the annual turnover and market capitalization of the capital market is also in the declining trend but in the year 2004/05 to 2006/07 it started slight increment.

4.1.1 Privatized Enterprises & Their Share in Capital Market

Public participation in privatized units through share ownership has contributed to the development of the capital market in the country. The total number of shareholders in the privatized units is around 32,000. This is a significant figure in comparison to the total shareholders in the country. A large number of shareholders are in Nepal Bank, Harisiddhi Bricks, and Nepal Film. Although the absolute number of shareholders in privatized units has increase, public response to share holdings is not that encouraging. The shares offered by Harisiddhi Bricks are being converted into debentures. The poor public response is reflected by the downward trend in share prices of privatized units.

Till today, nine out of the total privatized enterprises have already received approval from security market tin order to mobilize the capital worth 55 Crore 26 Lacs and 30 Thousand i.e. 9.7% of the total issued value. However, only 8 privatized enterprises have listed themselves in the Security Exchange Market for the public offering of the securities and its dealings. Even out of the eight listed enterprises, Nepal Bank has already de-listed its transactions from the capital market. And Butwal Power Company has entered in the capital market of Nepal through share issued privatization.

Table: 4.2

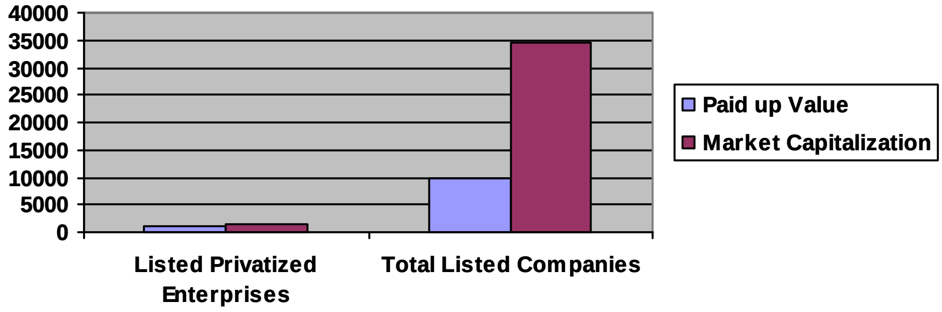
Capital Market Situation of Privatized Enterprises

Particulars	Listed Privatized Enterprises	Total Listed Companies	Share of Privatized Enterprises
Paid Up Value	1246.40	9685.04	12.87
Market Capitalization	1441.34	34703.87	4.15

(Source: SEBO Journal 2007)

Figure 4.2

Listed Privatized Enterprises and Total Listed Companies and their Market Capitalization and Annual Turnover



From above diagram we can see that the market capitalization of the total listed companies is significantly higher than the paid up value. But, however, incase of the listed privatized enterprises there is not much difference in the paid up value and the market capitalization. The privatized firms need to increase their operational efficiency and profit performance significantly in order to increase their market capitalization against the paid up capital.

The total paid up capital of the 8 privatized enterprises is around 1 Arab 24 Crores 64 Lacs and 21 Thousand rupees. And the total capitalization is around 1 Arab 44 Crores 13 Lacs and 68 Thousand rupees. The yearly turnover of these enterprises from Fiscal year 2052/53 to Fiscal year 2062/63 averages around 6.79%, i.e., total value 54 Crore 3 Lacs and 70 Thousand.

Table: 4.3

General Information on Capital Market Situation of Privatized Enterprises

… Enterprises	Issued Capital	Listed Date	No. of Listed Securities	Paid up Value	Market Capitalization
Nepal Bank Limited	241.95	042/06/07	3802846	380.28	855.64
Bhrikuti Palp &	105.00	054/05/18	3500000	350	210

Paper					
Harisidhi Brick & Tile Factory Ltd.	53.20	051/01/22	18650000	186.50	27.97
Leatherage Bansbari Tannery & Shoe Factory	15	054/12/19	500000	50	31.50
Nepal Film Dev. Corporation	21.90	053/03/31	446623	44.66	20.09
Balaju Textile Udhyog	7.50	Not done	-	-	-
Nepal Bitumen & Barrel Udhyog Ltd.	7.4	056/01/27	210680	21.06	21.06
Nepal Lube Oil Limited	-	-	603936	20.39	81.57
Shri Raghupati Jute Mills	-	045/03/03	11407040	182.51	182.51

(Source: SEBO Journal, Vol. I, June 2007)

The RHCDC stands as a unique case where the modality of privatization was some sort of producers' consortium. Each of the bidding tanneries was given a share not exceeding 17 percent of the total. Excepting NLO, where the management was given only 40 percent share, in all other cases the government had sold off majority shares to a small number of promoters. In case of HBTF the share was sold to the extent of 72 percent. The share of public offering has ranged from 25 to 37 percent. Employees were allocated 5 percent of share capital. Transfer of majority holdings to a limited number of promoters reflects government's determination to dispose off the enterprises as quickly as possible. The then government had to face criticism over its privatization programme even within its party ranjs primarily because of this ownership transfer to a small group of people. It was reasoned that such a transfer was desirable where the privatized enterprises needed management control for bringing about required changes in terms of achieving commercial objectives like rapid expansion growth in productivity, and the injection of new technology through massive inflow of capital.

BSFL is the only unit sold to a foreign national. The other enterprise with foreign investment is BPM with 20% share of Inter Match Limited, UK. Only the machineries were sold off, the land and building are still owned by the government. There had been some delay in the actual handover is the enterprises due to the new management. Overall, the decision to privatize had been taken very fast.

4.1.2 Analysis of Performance of Public Enterprises in Terms of Profitability

The establishment and growth of public enterprises speeded up in Nepal during the period of 60s ad 70s. Likely, privatization program of public enterprises started up since late 80s in Nepal. Inability of public enterprises to generate enough revenue to run its operation has been the stimulating factor behind the privatization step adopted.

The present and past performance of the public enterprises has been analyzed in terms of their profitability. The gross profit trend of public enterprises is used to analyze the performance, by using fifteen years data. The regression equation is used in order to find the trend of the profitability of the public enterprises from the past present situation.

Regression equation

$Y = a + bt$

Where, t = year - mean years

$a = \sum \frac{y}{n}$ $\qquad\qquad$ $b = \sum \frac{yt}{t^2}$

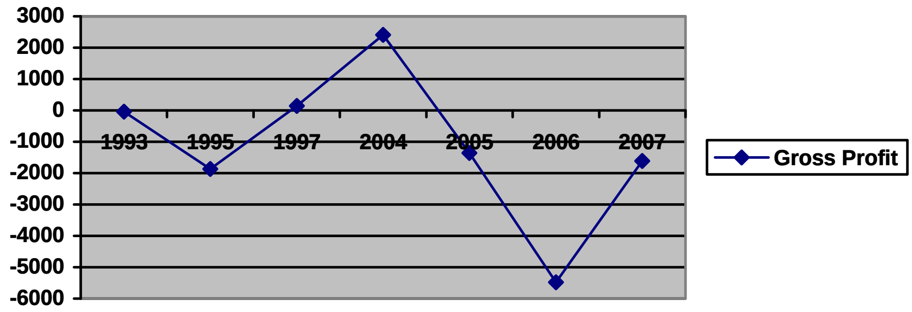
The calculated equation of the trend line is

$$Y = -4.94 - 61.94t \text{ (Annex 2)}$$

The trend analysis shows the negative relationship of the gross profit of public enterprises in relation to the tie factor. This means that the gross profit of the public enterprises is in the disappointing trend. The profitability of the public enterprises is decreasing in relation to the passage of time.

Figure 4.3

Gross Profit of Public Enterprises



(Source: Annex 2)

The Fig 4.3 shows us that public enterprises have been incurring loss right from the early times. During 1993, the loss amount as around Rs 38 million. By 1995 the loss amount reached around Rs. 1872 million. The profitability of the public enterprises started from the year 1997 and the enterprises enjoyed the profitability situation till the year 2004. However, in the year 2005, the public enterprises again had to bear loss with the loss amount reaching upto Rs. 5475 million by the year 2006. The loss amount reduced to Rs. 1614 million in the year 2007.

The graph shows the trend of gross profit of the public enterprises over the fifteen years period of time. The analysis is confined to the study of gross profit due to inaccessibility of the net profit data. From the above analysis it is quite clear that the public enterprises are suffering in heavy loss. However the situation is worse if net profit data could be analyzed. As net profit is computed after deducting the tax on earnings and carried over losses of the previous period, it conveys the true picture of the profitability.

4.1.3 Analysis of Public Enterprises through the relationship between Gross Profit and Capital Employed

The analysis of public enterprises in terms of Gross Profit and Capital Employed intend to study the relationship between the volume of capital employed and its effect on the gross profit situation. The general assumption guiding the analysis is that there is direct relationship between the Gross profit and Capital Employed. The Level of Gross profit depends on the level of Capital Employed i.e., the gross profit increases with the increase in the level of capital employed and vice versa. Using fifteen years data to analyze the relationship the regression analysis as a tool is utilized.

The regression Equation $Y = a + bx$

The gross profit is considered to be Y and Capital Employed is considered as X. the assumption that Gross profit is dependent on capital Employed is expressed a $= a + bX$. Where,

X = Independent Variable

Y = Dependent Variable, [Gross profit (Y) depends on Capital Employed (X)]

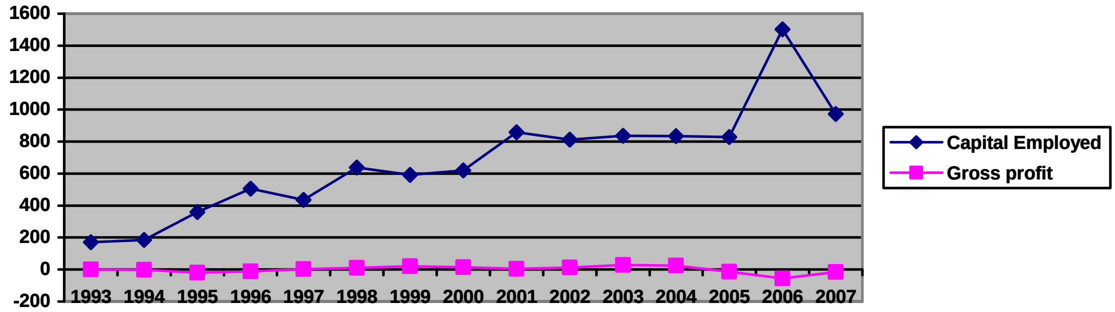
The calculated regression equation,

$Y = 4.346 - 0.00565X$ (Annex 3)

This shows the negative relationship between the level of capital employed and its effect on gross profit. The level of profitability increases with the increase in the level of capital employed. But it is not happening in case of the public enterprises in Nepal. The level of gross profit has been declining with no regard to the level of capital employed. As the correlation between the level of gross profit and capital employed. There is no positive impact on the level of gross profit with increase in capital employed.

Figure 4.4

Relationship between Gross Profit and Capital Employed



(Source: Annex 3)

The Fig 4.4 depicts the diagrammatic representation of the relationship between the gross profit and capital employed of the public enterprises. There is no effect on the profitability despite of pumping huge amount of capital.

The level of capital employed increased from 184.762 million to 358.432 million in 1994/95, whereas the loss amount increased from 2.45 million to 18.72 million. Similarly, the public enterprises recorded a period of increase in profitability from 1997/98 to 2004/05 without any significant changes in the volume of capital employed. The year 2005/06 recorded a loss of 13.53 million with no significant changes in capital investment. The loss amount inclined to 54.75 million in 2006/07 even with the huge amount of capital investment of 1500.882 million. And in year 2007/08 the loss amount reduced to 16.14 million with the similar reduction in capital employed of 972.32 million.

Profitability is the ultimate indicator of better performance. It could be seen that the efficiency of the public enterprises is deteriorating in terms of profitability. There is an increasing trend of the capital employed in the public enterprise but the level of gross profit is unaffected with it.

4.1.4 Analysis of performance of privatized Enterprises before and after privatization.

Analysis of Profitability:

The performance of the privatized enterprises has been analyzed by using the profitability data of nine privatized enterprises, before and after privatization. The sample of privatized enterprises selected for analysis is the ones that are privatized through the issue of shares as shown in Table 4.4.

Table: 4.4

Profitability of Privatized Enterprises Before and After Privatization

	Before Privatization	After Privatization
Raju Textile Industry	-5.56	-0.2
Nepal Lube Oil Limited	0.6	17.14
Pashupati Jute Mills	11.3	-3.18
Harisiddhi Brick & Tile Factory	1.65	-20.28
Bhrikuti Pulp & Paper Industry	4.3	5.88
Bansbari Leatherage & Tannery	0.48	0.13
Bal Bitumen & Barrel Udhyog	-4.63	5.38
Nepal Foundry Industry	-3.88	0.83
Nepal Film Development Corporation	-8.67	0.25

(Source: Monitoring Privatized Enterprises, MOF, Details in Annex 5)

The tool used for the analysis is t-test

In order to determine the profitability level of the privatized enterprises, before and after privatization, the following hypotheses are set.

HO: There is no significant difference in the profitability, before and after privatization. The profit performance of the public enterprises has nit improved after privatization.

III: There is a significant difference in the profitability, before and after privatization. The profit performance of the public enterprises has improved after privatization.

The calculated value of t[0.2837] is less than the tabulated value of t[1.397] for eight degree of freedom and at ten percent level of significance (Refer annex 5). Hence, we reject the alternate hypothesis. There is no improvement in the profit performance of the public enterprises even after privatization.

4.1.5 Analysis of Employment Level:

Similarly, a study of the employment situating of the privatized enterprises before and after privatization has also been carried out to find the employment position. It is highly acclaimed that the privatized enterprises have significantly reduced the employment level. The relevance of the matter is analyzed with the help of employment situation of the nine privatized enterprises, privatized through issued of shares.

Table: 4.5

Employment Level of Privatized Enterprises, Before and After Privatization

	Before Privatization	After Privatization
Textile Industry	108	75
Lube Oil Limited	106	94
Pashupati Jute Mills	113	1654
Harisiddhi Brick & Tile Factory	595	593
Bhrikuti Pulp & Paper Industry	283	1078
Leatherage & Tannery	484	97
Bitumen & Barrel Udhyog	55	56
Foundry Industry	45	52
Film Development Corporation	100	55

(Source: Monitoring Privatized Enterprises, MOF, Details in Annex 6)

The tool used for the analysis is t-test.

The hypothesis is set and t-test analysis is done in order to find out the employment level of privatized enterprises, before and after privatization.

HO: There is no increase in the employment level of the privatized enterprises after privatization. The employment level has not increased after privatization.

III. There is increase in the level of employment of privatized enterprises, before and after privatization.

The calculated value of t[0.0987] is less than the tabulated value of t[1,397] for eight degree of freedom and at ten percent level of significance [Refer Annex 6]. Hence, we reject the alternate hypothesis. There is no increase in the level of employment in the privatized enterprises after privatization.

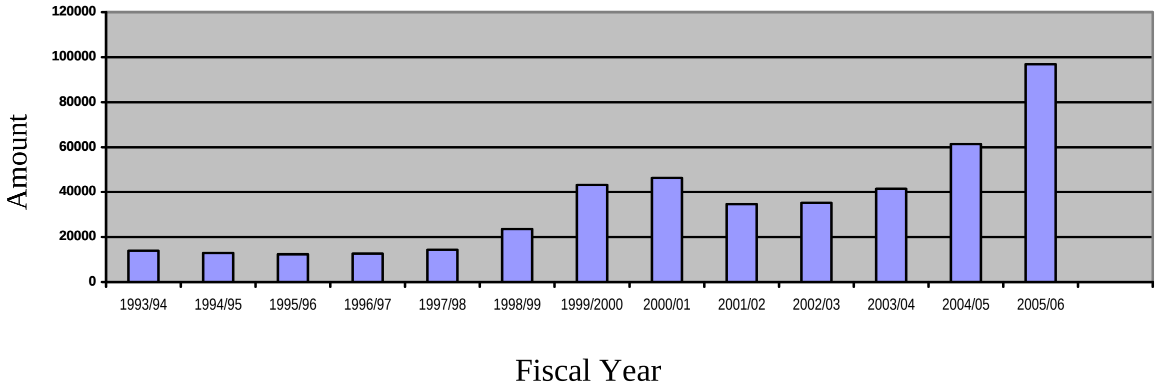
4.2 Analysis of Stock Market Size

Generally large stock market size indicates developed stock market. One of the measures of stock market size is the number of companies and scrip listed with the stock exchange. Size of stock market increases with the increase in the number of listed companies. In Nepal the number of companies listed with the NEPSE was 107 in 1998/99, which increased to 137 in FY 2007/08. It is, however, interesting to note that despite the increase in the number of companies and paid up value of the securities listed with the exchange, only about 12 percent of the companies registered with the Office of the company Registrar as public limited period are listed with the NEPSE during the 12 year period. 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, a single company from hydroelectricity and not a single company from information technology and construction sectors have 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 in comparison to those registered as public limited during last one and half decade also supports this view. This has adversely affected the liquidity and supply of securities in the stock market.

Another important measure of the stock market size is the *market capitalization ratio*, which is aggregate market value of the listed shares divided by gross Domestic Product. This ratio indicates the relative importance of stock market to the national economy and assumes that stock market size is positively correlated with ability to mobilize capital and diversify risk. As can be seen from Table 4.6, the market capitalization ratio has, on average, been only around .012 for the period between 1998/99 and 2007/08. It is important to remember that in countries with developed stock market this ratio is greater than 1 and in many developing countries it is between 0.2 and 0.4. Low market capitalization ratio in Nepal indicates that stock market is yet to show its impact on the economic activities of the country.

Figure 4.5

Market Capitalization



(Source: Annex 7)

Table: 4.6

Stock Market Size

Years	M-Cap (Rs.)	GDP	M-Cap Ratio	No. of Co. Listed	Paid Up values of Listed Securities (Rs.)
1993/94	13872.00	191596.0	0.07	66	2182.2
1994/95	12963.00	209974.0	0.06	79	2961.8
1995/96	12295.00	239388.0	0.05	89	3358.5

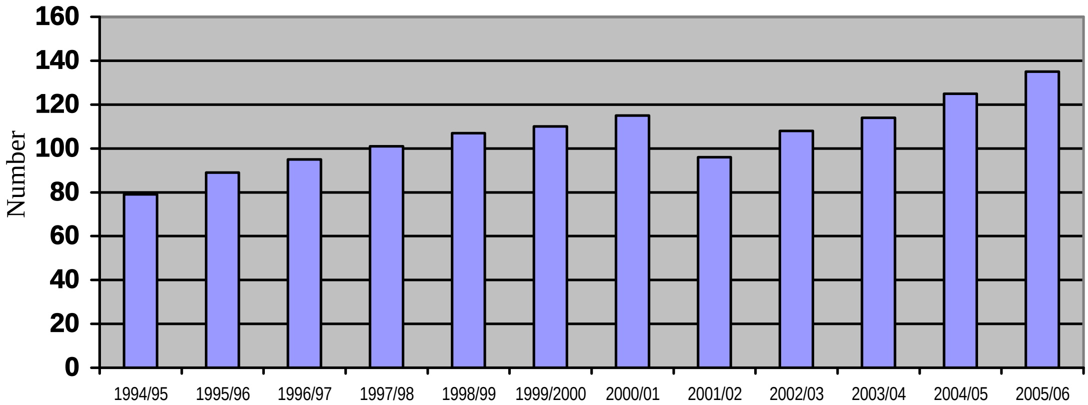
1996/97	12698.00	269570.0	0.05	95	4476.5
1997/98	14289.00	289798.0	0.05	101	4959.8
1998/99	23508.00	330018.0	0.07	107	6487.4
1999/2000	43123.33	366251.0	0.12	110	7347.4
2000/01	40063.33	393563.0	0.10	115	8165.2
2001/02	34704.00	405632.0	0.09	96	9685.0
2002/03	35240.39	435531.0	0.08	108	12560.1
2003/04	41425.00	472424.0	0.09	114	13404.90
2004/05	61356.89	504101.0	0.12	125	16771.84
2005/06	96813.7				20008.6
2006/07	18630.1				2179.9

(Source: Economic Survey & SEBON Annual Report 2007/08)

Sometimes it is argued that stock market size as measured by the number of listed companies is good predictor of economic growth. Nepalese stock market has 137 listed companies up to 2007/08 which can be clear from the Fig. 4.5

Figure 4.6

No. of Listed Companies



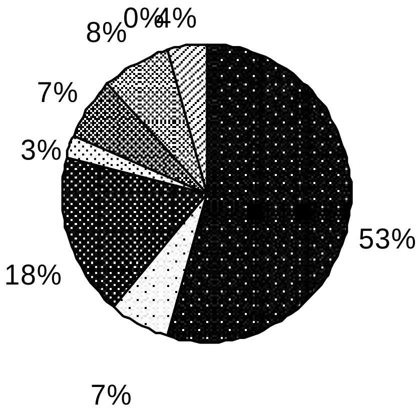
F

iscal year

Figure 4.7

Total Securities Issue

(Fiscsl Year 1993/94-2006/07)



(Source : Annex 8)

Form Table: 4.7 and Fig 4.8 it can be clear that, there is greater dominance of commercial banks in the capital market as its % on market capitalization is almost all about 65.38% and service industry has low share. Likewise in FY 2006/07 market capitalization in capital market is 61 Arab 36 Crore 58 Lacs 90 thousand which is 4142.50 Lacs in the last fiscal year Fig: 4.3 also depicts that commercial banks have 65.38% share in the capital market capitalization and other industry has almost low share like hotel, trading business because most of the hotel and trading business were not listed in the stock exchange.

4.3 Analysis of Growth of Stock Market after and before Liberalization

The history of stock market began with the floatation of share by Biratnagar Jute Mill Ltd. and Nepal Bank Ltd. in 1973. Other development relating capital markets were the introduction of the Company act in 1964 and the establishment of securities Exchange center Ltd. in 1976 were other significant development resulting to capital markets. it assisted pubic limited companies to raise capital through eh issue of share and debentures and also provide a market place for trading the securities. Although the purpose of the establishment was to assist the public Ltd. companies, but its was only concern with dealing the government bonds and treasury bills in the beginning phase of establishment. After the securities exchange act in 1983, the security market center was changed to securities exchange center and it opened the floor of secondary trading of share to provide liquidity and marketability of new issued securities. Nepal Government under a program initiated to reform capital market, converted securities exchange center in to Nepal Stock Exchange (NEPSE) in 1993.

After opening the floor of secondary trading of share in 1984, 16 companies listed with paid up capital and market capital of Rs. 307.32 and 318.67 million respectively. at that time security exchange center as new concept to work the new environment the existing laws and regulations from government side and also the awareness of people of security exchange activities were essential. However, Nepalese economy is week then developed country. Gross Domestic Product (GDP) is very low and people have tendency to invest in unproductive sector, rather than productive activities, stock market activities was very slow.

The tables below shows the development of stock market before and after liberalization policy followed.

4.4 Capitalization by Industry

Table: 4.7

Capitalization by Industry

Industry	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Banks	13632.42	28355.04	31235.21	22298.51	22453.49	27944.27
Finance Companies & Insurance	2557.18	4217.66	5255.64	4328.55	4949.7	5461.05
Service	3392.23	4673.62	3886.59	3442.04	3105.95	3374.85
Mfg. & Processing Co.	3925.81	5823.00	5971.97	4634.47	4731.3	4644.59
Total	23507.64	14217.84	46349.41	34704.00	35240.39	41425.00

(Source: SEBON 2006/07)

Table: 4.8

Capitalization by Industry for FY: 2006/07

S. No.	Industry	M-Cap	%
1.	Commercial Bank	40119.88	65.38
2.	Development Bank	1050.07	1.71
3.	Finance Co.	3666.13	5.97
4.	Insurance co.	3966.10	6.46
5.	Hotel	2308.38	3.76
6.	Manufacturing and processing co.	5024.83	8.19
7.	Trading business	635.88	1.04
8.	Others	4594.62	7.49
	Total	61365.89	100

(Source: SEBON 2006/07)

4.5 Annual Trading of Securities Industry wise:

In the FY 2006/07 the total amount of securities traded in the capital market is 4507.68 Lacs that is only 21445 Lacs in FY 2004/05 where there is 110% increment. The Table: 4.7 and Fig: 4.8 clearly depict the industry wise trading of securities in the capital market.

Table: 4.9

Annual Trading of Securities For FY 2006/07

S. No.	Industry	Turnover (In Rs.)	%
1.	Commercial Bank	4021.83	89.23
2.	Development Bank	22.01	0.48
3.	Finance Co.	216.37	4.80

4.	Insurance Co.	67.62	1.50
5.	Hotel	4.48	0.10
6.	Manufacturing and processing	114.90	2.55
7.	Trading business	7.99	0.18
8.	Others	52.48	1.16
	Total	4507.68	100

(Source: SEBON 2006/07)

Figure 4.8

Annual Turnover For FY 2006/07

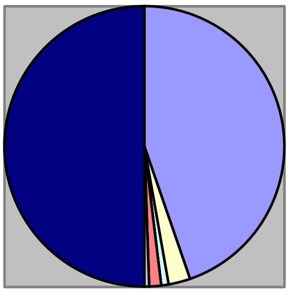


Fig. 4.8 and Table: 4.9, it can be concluded that commercial banking sector has …… that commercial banking sector has almost dominance on the annual turnover al market. As almost all the commercial banks were already listed in the capital and they were earning good operating profit by which investors were interested …… of such companies. But in the case of hotel and other service sector some hotel were already closed due to political and their own reason. So, they have manage in the capital market.

4.6 Analysis of Market Liquidity

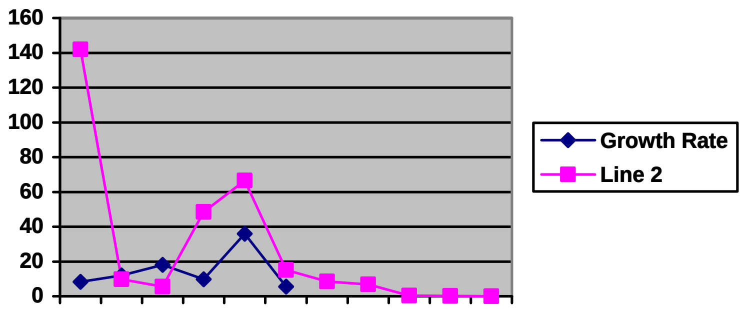
Liquidity in the stock market parlance refers to the convenience and case in buying and selling securities in the market. By allowing investors to alter their investment portfolios conveniently at any time and low cost, liquidity makes the financial assets less risky. This improves efficient allocation of resources and promotes; long term economic growth. There are two main indicators of market liquidity. One of these is the total value of shares traded in the stock market as a percentage of Gross Domestic Products. Although this indicator doesn't measure directly the cost of trading of shares, it does indicate the extent of case in trading in stock market in a country. It is expected that the volume of organized trading of equities as a share of national output increase when such trading is less costly and easy. Evidence shows that countries with relatively liquid stock market tend grow much faster than countries with liquid markets.

4.7 Analysis of Market Turnover

Compared to previous year's transaction of the shares on the basis of amount it increased by 142 percent to Rs. 8.36 billion in FY 2006/07 while the number of transactions increased by 23.76 percent to 12.05 million. It was 9.73 million in preceding year. The number of companies share traded during the year increased by 5.45 percent to 116 which was 110 a year before. Similarly, the numbher of ordinary shares traded during the review period was 181.47 m. which is 48.58 percent increment over previous year. The daily average trade size recorded in the year was Rs. 36.03 million as the market floor opened 232 days for trading.

Figure 4.9

Sector wise Turnover and Growth Rate



In the total turnover, the banking sector dominates other. In the review period total turnover of the banking sector was Rs. 5.56 billions which is 66.54 percent of total turnover. Other sector (mainly hydropower companies) came in second place on the basis of annual turnover. This sector's turnover was Rs. 1.25 billion which is accounted to 15.05 percent of the total transaction. In the same way, financial sector occupied 8.53 percent, development bank sector 6.90 percent, manufacturing and processing sector 0.29 percent, trading sector 0.12 and hotel sector 0.08 percent.

The turnover of the development banking sector and the other sector increased by approximately six fold compared to previous year. Similarly commercial bank, finance companies posted good rate of growth on the basis of turnover while insurance companies, manufacturing and processing companies posted relatively moderate rate of growth but hotel and trading companies' decline.

However, the composition of traded securities doesn't show the balanced figure. Buying and selling of securities other than ordinary shares rarely occurred in the secondary market during the review period. A total of 31,800 (1.72 percent of securities traded) government bond amounting Rs. 366.77 millions have been traded in 7 transactions during the year. Similarly, corporate bond occupies 0.02 percent in the composition of securities traded. In the review period 3570 corporate bond amounting Rs. 3.57 millions have been traded in 11 transactions.

Table: 4.10

Measures of Market Liquidity of NEPSE

(Rs. in million)

Year	Values of Shares Traded (Rs.)	Value of Shares traded to GDP	Value of shares traded to Market Capitalization
1995/96	431.34	0.002	0.031
1996/97	1054.26	0.005	0.081

1997/98	209.01	0.001	0.017
1998/99	416.19	0.002	0.033
1999/2000	202.61	0.001	0.014
2000/01	1485.55	0.005	0.063
2001/02	1157.00	0.003	0.027
2002/03	2335.91	0.006	0.058
2003/04	1540.63	0.004	0.044
2004/05	575.80	0.001	0.016
2005/06	2144.27	0.005	0.052
2006/07	4507.68	0.008	0.073

(Source: SEBO, 2006/07)

As we can see from table 4.10, ratio of the value of shares traded to Gross Domestic Product was always below 0.005, except in the fiscal year 2000/01 during the eleven-year period between 1995/96 and 2006/07. During this period the value of shares traded accounted, on an average, only for about 0.003 of Gross Domestic in countries with developed stock market this figure is as high as 0.4 and in many developing countries the values of shares traded vary in a range of 0.001 to 0.01 of Gross Domestic Product. Low ratio of value of shares traded to Gross Domestic product indicates that trading in equity relatively to the size of economy is very low in Nepal.

Another measure of liquidity of stock is the ratio of value of shares traded to market capitalization. This measure, also known as turnover ratio equals the value of shares traded divided by market capitalization and indicative of the trading relative of the size of stock market. A high turnover ratio may indicate low transaction cost and relative ease in buying and selling of shares. Experience shows that countries with high turnover ratio develop fast than countries with low turnover ratio. Countries with small stock market are measured by market capitalization ratio, may have a high turnover ratio and grow fast. In developed countries this ratio is greater than or very closes to 0.9. Whereas in many countries this ratio stands in the range of 0.15 to 0.3. In Nepal the turnover ratio has remained very low during the twelve-year period between 1995/96 and 2006/07. This ratio was the highest in 1996/97, indicating sizable turnover of shares. As the table shows, the value of shares traded relative to both Gross Domestic Product and market capitalization is on decline since 2003/04, indicating growing illiquidity in the country’s stock market. …. together these ratios i.e. market capitalization, value of shares traded to Domestic Product, and turnover, indicate that the stock market in Nepal is small relative to its economy, and highly illiquid and stock market in Nepal to make its presence felt in the national economy.

4.8 Market Concentrations

Country's stock market is considered highly concentrated if few large company dominate it. In other words, in a stock market which has concentration of few companies account for major percentage of total market value and it most frequently relative to stocks of other companies. High price is not desirable as it adversely affects liquidity in the stock market. Market is measured by computing the share of ten stocks to total market value of shares. Countries with family owned enterprises and limited number of listed companies have high ratio. Table 4.6 gives the market concentration ratio calculated on basis of market capitalization in the stock market in Nepal.

Table: 4.11

Market Concentration Ratio in NEPSE

Years	Market Concentration Ratio
1996/97	0.71
1997/98	0.73
1998/99	0.68
1999/2000	0.66
2000/01	0.65
2001/02	0.68
2002/03	0.71
2003/04	0.58
2004/05	0.60
2005/06	0.70
2006/07	0.74

(Source: SEBON 2007)

Countries with developed stock market have concentration ratios of about 0.2 of the market whereas in countries with undeveloped stock market this ratio is as high as 0.9. In Nepal the ratio was on average around 0.67. Over the past 12 years, which indicates that, the market value of shares of ten largest companies account for 67 percent of the total market value? The concentration ratio is as high as 0.8 when it is computed on the basis of turnover. This indicates that the stock market in Nepal is highly dominated by largest ten companies in terms of either market capitalization or turnover. It is interesting to note that of the ten largest companies dominating the market in 2007 nine are commercial banks. High concentration has adversely affected liquidity and significance of the stock market in the national economy.

4.9 Market Volatility

Volatility is one of the important indicators of development of a country's stock market. Although high volatility in the stock market denotes risk in equity investment, it does not necessarily imply undeveloped stock market. It is generally expected that developed stock markets absorb risks in financial assets and offer higher return with less volatility. Put, simply it means that as a indicator of a country's stock market development less volatility is preferred to high. Volatility may be measured as a twelve month, rolling of market returns. Higher standard deviations mean higher volatility, as more risk.

Table: 4.12

Calculation of Market Volatility

Years	Twelve-month rolling standard deviation	Value-traded-ratio to volatility
1997/98	26.47	0.0012
1998/99	7.36	0.0111
1999/2000	4.11	0.0041
2000/01	2.71	0.0121
2001/02	4.57	0.0031
2002/03	3.79	0.0167
2003/04	5.53	0.0049
2004/05	9.24	0.0063
2005/06	12.79	0.0035
2006/07	3.08	0.0053

(Source: SEBON 2006/07)

Although volatility in the stock market in Nepal was high during the initial years, it was on decline till 2000/01 indicating that equity prices in the stock market tended to stabilize during this period. From 2002/03 onwards volatility in the stock market had wider fluctuation but it showed a tendency to rise consistently.

Countries wit high inflation rates seem to have higher volatility in the stock market in Nepal is less than the average volatility of other developing countries. The reason for this is mainly low volume of trading of equities due to low demand. Volatility in these three years was high due to increase in the volume of trading triggered by speculative motive of investors.

Analysts argue that developed stock market should not only provide high liquidity but also handle large volume of trading with less price swings. In other words a liquid market should allow large volume of trading with less volatility. On of the indicators to measure this ratio is a ratio of value-traded-ratio to volatility. A high ratio indicates the ability of the stock market to provide liquidity and handle risk. Empirical evidence shows that this ratio is a good predictor of economic growth and countries with high ratios have grown much faster than countries with low ratios. These ratios for the stock market in Nepal are shown on column 3 of table 4.6. These ratios indicate inability of stock market in Nepal to handle risk relatively to volume of trading of shares. A positive but very weal relationship is observed between volatility and volume of trading of shares in the stock market.

4.10 Recent Improvement in Govt. Policy

The securities policy and other Acts related to capital market were vague and complicated which were unable to capture all the companies and institution under an umbrella of capital market. But the securities ordinance issued late September replacing the securities exchange Act 1984 has September replacing the securities exchange Act 1984 has introduced a number of new provisions with objective of boosting the capital market. SEBO Nepal, the supreme regulator of Nepali capital market was an ineffective body in the absence of sufficient laws but the new law has vested additional power on the board. New ordinance has given the authority to the board that it can cancel the license of the stock exchange members as well as that of stock exchange itself. After the enactment of the ordinance, the board is expected to be financially sound. The board can now arrange ore financial resources to be self-sufficient. Before it has to depend on the government subsidy and other sources like from listing of securities, registration fee from the stock exchange, securities registration fee from companies, donation etc. It can get a share in the commission that the stock exchange earns from its members. Similarly, there is a provision to set up a revolving fund out of which the board can earn additionally.

This new ordinance has opened the way to start over the counter (OTC) market. Though it is not year clear, as to who can operate the market and what conditions should be fulfilled, if OTC market is opened, it will help investors. The securities not listed in stock exchange can be traded on OTC market and no formal requirements are set for the eligibility of trading on OTC market. Before this, there was no provision for trading on such securities and investors had to suffer losses when a company was de-listed from the stock exchange. Another positive provision made in the ordinance is the establishment of central Depository System (CDS) which will bring greater efficiency in the clearing and settlement of this system ownership transfer of securities will be possible by dematerializing securities and making electronic book entries. But who will run the organizations still not clear.

This ordinance has made the directors more responsible towards the stock exchange and through this ordinance the companies can sell securities through private placement which will avoid the more expensive route of public offering when they have to raise the small amount.

Another company ordinance has too made the capital market broader than the present level. It has allowed the company to determine the par value of the shares. This provision has made it earlier for the company to collect share capital from a wider population. This ordinance has allowed companies to issue shares premium as well as in discount under specified conditions. This ordinance has stopped the practice of giving any gift in cash or kind other than dividend because before the practices are to give bride to those shareholders who have majority of shares and have influence in the broad meeting

Government has already announced that beginning the new fiscal year 2005-06, companies listed in Nepal Stock Exchange (NEPSSE) will have to pay a 2 percent low tax than applicable to similar other unlisted companies,. This is being done with the intention of motivating companies to go to public and list their securities in the stock exchange. This reduction ill increase the net profit after tax of the companies if they list their securities. However, this reduction in the tax cannot be expected to affect the listing of the banks, finance companies and insurance companies because there are no new such companies which are unlisted., those few that are unlisted are already prepared to go to the public and get listed.

The government should have brought a more concrete policy to force or motivate large manufacturing companies like Dabur Nepal, Asian Paints, Pepsi Cola and Surya Nepal etc. to go to the public and list their shares. There is doubt whether these companies will find the 2 percent tax concession as enough motivation. However, it is learnt that the security Board (SEBON) is trying to continue these companies to go to public and are being promised permission to issue their shares in premium though the existing company law does not allow the issue of shares in premium.

To increase the number of companies listed in NEPSE, the government should take the lead by first privatizing large corporations like Nepal Telecom, RNAC. Nepal Electricity Authority and Nepal Oil Corporation. Though the government has been repeating the plan to privatize these entities, the progress so far has been very slow. The government also stated to sell the shares of NTC to the public. But there is doubt on the government's intention as these companies capital market has been recently stripped by a hearty dividend taken by the govern.

Table: 4.13

Development of Stock Market Before Liberalization Policy (RS. In millions)

Fiscal year / Details	1985/86	1986/87	1987/88	1988/89	1989/99	1990/91	1991/92	1992/93
Paid up Value (listed share)	307.32	429.9	528.82	740.49	843.96	107.81	1272.73	1682.84
Market capitalization	318.67	673.59	923.38	1481.99	1752.49	2015.93	3350.67	385.67
No. of Listed Companies	16	23	31	36	41	46	62	62
No. of Primary Issue	2	3	3	3	2	1	1	10
Market Capitalization to GDP (%)	0.0057	0.0105	0.012	0.00166	0.0169	0.0167	0.0224	0.0223
Market Capitalization to Paid up value	1.037	1.567	1.746	2.001	2.076	2.000	2.633	2.261

Source: SEBON/Annual Report

This table shows that year wise stock market development paid up value, market capitalization number of listed companies, number of listed companies, number of primary issue, market capitalization to GDP% and market capitalization to paid up value. These are the most important items for the equity market growth and development. Number of listed companies were substantially increase annually, market capitalization to paid up ratio were increasing slowly.

Similarly market capitalization to GDP was very low and number of primary issue was an average. It implies that size of stock market was very small. The total value of equity capital was less than one % of GDP. Conceptually, the market capitalization, average company size and market size wore very low. The public response to primary issue and institutional development of stock market were very poor. We can say that development of tock market could not contribute the national economy before liberalization policy.

Table 4.14

Development of Stock Market after Liberalization Policy (RS. In millions)

Details \ Fiscal year	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Paid up Value listed salary	4476.5	4959.8	6487.4	7347.4	8165.2	9685.04	1256.07	13404.9	16771.9	20008.6
Market capitalization (Rs.)	12698	14289	23508	43123.3	463494	34703.9	352404	41424.3	61365.9	96813.7
No. of Listed Companies	95	101	107	110	115	96	108	114	125	135
Number of Traded companies	67	68	69	69	67	69	81	92	102	110
No. of share Traded (000)	9443	1195	4857	7674	4989	6005	2428	6468	18434	12221.93
% of market Capitalization on nominal GDP at market price	4.71	4.93	7.12	11.77	11.78	5.58*	8.22#	8.77	12.17#	17.35#
Annual turnover (Rs.)	416.23	202.61	1499.98	1157.03	2344.16	1540.63	575.80	2144.3	4507.7	3451.4
NEPSE index (16th July) Base year 1993/94	176.31	163.35	216.92	360.70	348.43	227.54	204.86	222.04	286.67	386.83

- Revised Estimate of GDP
- # Preliminary Estimate of GDP

Source: Economic survey of HMG/Nepal. 2006/07 and NEPSE Trading report, SEBON Annual Report.

After restoration of democracy government followed liberalization policy and also opened the domestic market for foreign investors. This policy of government as the positive sign for the development of stock market. Security Exchange Center was also converted into Nepal Stock Exchange Ltd. (NEPSE). It opened trading floor for its newly appointed broker and market markers from 13th January 1994.

The table above shows the year wise transaction summary in stock market after the establishment of NEPSE. These are the most important indicator for the measurement of stock market growth. Although the number of listed companies subsequently increased up to 2000/01 the number of listed companies increased up to 115 but the number of share traded decreased to 4989 million. Market capitalization remained more or less stagnant up to1997/98 with the capitalization of Rs. 14289 million. This amount grew rapidly. In 1990/2000 and 2000/01 reaching a height of Rs. 46349.3 million with the entry of new banks and finance companies, NEPSE index after liberalization policy doesn't seems satisfactory because it is not growing and fluctuate unexpectedly.

4.11 Listing and De-listing

The total number of listed companies in FY 2006/07 was 147 with listing of 12 new companies. However the number of listed companies at the end of fiscal ear remain the same (135) as of previous years' with the delisting of 12 companies on 5 March 2007. This is second tie in NEPSE history while on 17 July 2002 it had de-listed 25 companies. de-listed companies have been either already closed, or have not held Annual General Meetings or have no audited results for more than two years. Altogether 3.64 million shares amounting Rs. 384.24 million have been de-listed.

At the end of FY 2006/07 there were 15 companies listed under commercial bank group. Similarly, there were 16 companies in development bank group, 16 companies in insurance group, 53 companies in finance group, 21 companies in manufacturing and processing group, 4 companies in hotel group, 5 each in trading and other group. Prices of listed share reached Rs. 21.74 billion during FY 2006/07, which rose 8.96 percent over the previous year.

The number of listed securities other than corporate and government bond up to FY 2006/07 reached to 243.50 million which as 226.54 million in previous year and the increment is 7.48 percent. During the year 19.71 million ordinary share amounting Rs. 1071.40 million, 9.14 million rights share amounting Rs. 914.39

million, 10.25 million bonus shares amounting Rs. 1025.73 million, 1.81 million corporate debenture amounting Rs. 1810.00 million and 30.00 million government bond amounting 3300.00 million listed for trading. As mentioned above, during the same period 3.64 million shares amounting Rs. 384.24 million have been de-listed.

4.12 Primary Data Analysis

The analysis of Impact of "Liberalization on Capital Market Development" is not complete without analyzing its primary data, here; I have taken interviews with a financial experts to be more cleared about it.

Economic liberalization is a factor of democratic government where private sector are deregulated to do its legal activities, which is able to develop the capital market as economic liberalization is the good environment for the development of capital market.

In his view, privatization is the production of economic liberalization and capital market is the 2nd stage of privatization. So economic liberalization creates privatization and privatization makes development of capital market. Privatizing system in our country is not goal oriented. It has not accepted the norms of privatization. By which privatized enterprises are in loss now. In his version, Being in loss of privatized enterprises is weak polices of government in this sector.

He has stressed that after the economic liberalization policy applying of government, the capital market is developed very rapidly. There were only less than 10 companies listed in share market but now we have 152 companies are listing in it. Among them, only of the privatizing enterprises Nepal Telicom occupies about 25% of share capital which, we can say the product of economic liberalization.

In our country, we are not able to make capital market fame among all the people. It is centralized in Kathmandu Valley only. There are several causes behind it. To develop this sector the involvement of the people should be increased with good capital investment. For this, capital market should takes the policy of decentralizing it, to other main places also. Now, the women participation is seen in this sector as these were no one in the past.

Government can regulate the capital market sector also. As the present governments changing voices about the capital market. The NEPSE was deceased and found stable in these days.

Because of loss on privatized enterprises, investors are not interested to invest in privatized enterprises. But all investor are interested to invest in Telicome as its profit is good at present days.

At last his suggestions would be very fruitful to all. As he suggested that to invest into those companies which are in profit and distribute the bonus share too.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary & Conclusion

The fundamental economic problem is to decide what to produce and for whom in a situation of limited resources. In 20th century, two competing economic systems were used to solve these problems. They were - command economies directed by a centralized government, and market economies based on private enterprises. In the last decade of the 20th century it was found that the command economy has failed to sustain economic security for its citizens. So many countries of the world have turned to market economy or liberalization.

Economic liberalization aims at sustainable growth of the economy. It encompasses all sectors of the economy such as agriculture, industry, transport, construction and service. Stability and sustainability are the two hallmarks of economic liberalization. When the economy is in stable and sustainable [a] condition, private resources flow into productive sectors, yielding a high rate of return. When inflation is stable and manageable, resources are efficiently used, Such a situation boosts the morale of investors, as it would put off ifs and buts associated with investments. In the present context, the economy of the country is not stable due especially to the ongoing conflict. The existing enterprises are collapsing and investors are hesitating to make investments. Closures and lay-offs of business enterprises are frequent. This is a misfortune for the country, whose economic development is still fledgling and which has a long way to go to improve its development infrastructures.

The mechanisms of economic liberalization are manifold. It conceives *of* retrenching government expenditure, privatizing public enterprises and cutting down on or phasing out all kinds of subsidies. It puts a certain ceiling on government borrowing from the banking sector. Deregulation of the economy is what economic liberalization is all about. It deregulates both domestic and foreign private sectors and accentuates withdrawal of price controls from public and private sectors. In fact, economic liberalization is concerned with how best the economy of a country can be managed. It deals with various economic problems such as poverty, unemployment, income and wealth distribution, and standard of living and even genders bias. In developing countries like ours, economic activities need to be accelerated for overall economic development. Economic liberalization is not supportive of control of such activities by the state even if necessary. Rather, it strengthens the private sector to initiate such activities on its own. Price, market and competition are the major components of economic liberalization. The products and services of a country should have comparative and competitive edge to successfully penetrate the world market. To be on the cutting edge in the present-day world marked by cutthroat competition, such products and services should meet world quality requirements. For this, sound infrastructures like transport, communication, sophisticated technology and skilled manpower should be in place, something which developing countries like ours are lacking. Similarly, stabilization and structural adjustment are other important components of economic liberalization. Stabilization deals with devaluation control of government expenditure and domestic credit expansion, whereas structural adjustment deals with price stability 3 open-market economy, bureaucratic; reforms and changes in government plans and programmes. Public enterprises follow the objective self-reliance, high employment and overall development of backward areas. So they are prone to high costs. That is why: most of them are always in the red. (It can, however, be asserted that mismanagement and corruption are highly responsible for the sorry state of *MMm* title public enterprises in our country are in.) On the other hand, private enterprises chase maximum profit through sound and efficient management. Investors invest in capital market with the hope of sharing profits earned by the firms, dividend and interest thereof. Since the motive of shareholder is to receive returns on their investment. Nothing please them more than knowing the firm earning more and more profits, more dividends coming in and stock price increasing. IJ profits are distributed, benefits are directs and are at present. If they are invested, the benefits are indirect and come in some future period in the form of expected stock price increase that results in capital gain when they sell shares.

Liberalization has been a topic of debate worldwide and for Nepal the reinstatemeiil of the multi-party democracy marked the beginning of economic openness as well. It rode on the euphoria of globalization and reforms, as did many other developing countries in the early nineties. Successive governments promised economic reforms and thereby economic growth. However, the opening of the economy has been dictated by closed thinking. It failed to look at the process of liberalization as something that requires political will. An unstable political leadership cannot provide the confidence required by business

Liberalization brought about competition to government owned enterprises - be it airlines, banking or insurance. The opening up of many sectors for foreign investment brought in large multinational and transnational corporations making their presence felt in Nepal. The government enterprises went bust and privatization remained a theoretical panacea. Political instability and infighting within political parties ensured that the voter is more important than the businesses that fund political parties. Performs took a back seat and liberalization remained a word for seminars and workshops. The confusion was further fuelled by the emergence of the Maoist movement in parts of Nepal. The movement believes in a strong socialistic economic model, therefore liberalization is clearly a policy they oppose.

Liberalization in Nepal was initially homegrown but later it started to be pursued more relentlessly by the donor communities that prescribed their own pills for development. Never did the political think tanks agree to liberalization as a political or economic ideology and Nepal did not produce anyone in the government or other sectors that championed the cause. The private sector itself was in no better state of understanding. The wiping out of local toothpaste brands by multinationals gave a quick preview of the days to come. Therefore, the local businesses resented and lobbied for protection and the political bosses obliged.

Therefore, neither foreign media houses nor travel agencies ever made to Nepal as they are still being opposed vehemently.

For Nepal, the economic *pundits* in Singha Durbar ought to think of a Liberalization Policy. If liberalization is not to be pursued then there is no point in relentlessly pursuing an agenda to please the donors. If it has to be pursued then the agenda for reform should be ready. The understanding of liberalization and its stages is important along with identification of areas for economy to remain protected. In an environment of free trade and fast pace of technological advancement, government has a different but larger role to play. The geopolitics of tine country also demands a different perspective to liberalization. It is a big issue and it has to be discussed, not evaded.

Investment is defined simply to be the sacrifice of current consumption for future consumption whose objective is to increase future wealth. The sacrifice of current consumption takes place at present with certainty and the investor expects desired level of wealth at the end of his investment horizon. The general principle is that the investment can be retired when cash is needed. The decision to investment how is a most crucial decision as the future level of wealth is not certain. Time and risk are the two conflicting attributes Involved in the investment decision. Broadly investment alternatives fall into two categories; real assets and functional assets. Real assets are tangible while Financial assets involve contracts written on pieces of papers such as common stocks, bonds and debentures. Financial assets are bought and sold in organized capital market.

Organized capital markets exist to facilitate the exchange of financial assets. Specialized markets also exist to deal in specific type of securities as bond markets, stock markets and government bond market. In Nepal, Nepal Stock Exchange Limited (NEPSE) is the only organized stock market facilitating the trading of corporate securities, mainly common stock.

5.2 Finding and Recommendation

5.2.1 Findings

The organized financial sector in the country is oriented towards commercial banking. Its almost all commercial banks occupy more than three fourths of the financial sector's resources. The capital market being comparatively new and small, the balanced development of financial sector has not occurred.

The present structure of the capital market is also mainly lending oriented. The security market is dominated by bonds and securities issued by Nepal Government, though the practice of floating shares by the organized sector is growing; the earth of feasible projects and the lack of incentives to enter the capital marker have prevented the security market from taking on a more active role. The only industrial bank has not been able to expand its operations due to limitations of resources, organizations, capable of mobilizing resources such as Employees' provident Fund and insurance companies limit their resources to government securities, *bonk* deposits and loan extension and hence have not been able to influence institutional securities. The organized sector has not been able to become market oriented and competitive because of the practice of meting the financial requirements of the government institutions from the budget.

The collection of capital by the issue of shares is not yet an established method of fund raising, nor has it been possible to bring out the differentiations in the nature r *of* shares, The practice of speculating with investors' risk-bearing capacity and the expected returns; and issuing government bonds and shares on the basis of speculations has not yet developed. Similarly, the practice of fulfilling the demand of capital by issuing accumulative, non accumulative or convertible preference shares, debentures, floating rate binds, etc has not been developed. Government and non-government units do not issued shares in marker. The tradition of companies accepting public deposits has not developed. In the same way, there is a lack of unit with requisite policy programme to fix and coordinate the returns rates of capital market.

Because the Security Exchange Centre is in itself the controller, the market builder and the coordinator of the secondary market; a controlled and coordinated development has not been developed, and this has adversely affected the growth of the capital market. Because the environment in the secondary market is not conducive to the active participation of brokers, the scope of such markets is severely limited. This situation *has* not inspired the growth of even the primary market. Thus, the capital market, specially the stock market has remained small.

Almost 70% of the share of capital market is captured by hank and financial institutions.

Pace of Privatization is very slow and the goal of privatization has not been achieved yet they all are still remain on the governments policy paper only.

5.2.2 Recommendations

In order to encourage the participation of Employees Provident Fund, insurance Companies, Banks and financial institutions in the capital market, the required amendments to their acts and regulations should be made and similarly, the dependence of private and public sector institutions, local units and development banks for medium and long term capital on Nepal government should be reduced by issuing different types of shares to collect capital.

The pace of privatization of public limited companies should be made faster in order to achieve the goals of making capital market strong and efficient which is necessary for Liberalized economy.

Production and service sectors should be encouraged in order to float their shares in the capital market as bank and financial institution have occupied the large chunk of the share of capital market. In this context if the production, manufacturing and service sectors of the country has not been developed then overall economy of the country cannot be developed in this liberalized world.

Provisions should be made to conduct regular training and seminars on various aspects of security market such as project, company, and share evaluations

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Annex 1

Multiple Regression Analysis of NEPSE Index with Market

NEPSE	Market	Annual	YXI	YX2	XIX2	X1	X2
226.03	13872	442	3135488	99905.26	6131424	192432384	195364
195.48	12963	1054	2534007	206035.9	13663002	168039369	1110916
185.61	12295	216	2282075	40091.76	2655720	151167025	46656
176.31	12698	416	2238784	73344.96	5282368	161239204	173056
163.35	14289	203	2334108	33160.05	2900667	204175521	41209
216.92	23508	1500	5099355	325380	35262000	552626064	2250000
360.7	43123	1157	15554466	417329.9	49893311	1859593129	1338649
348.43	46349	2344	16149382	816719.9	108642056	2148229801	5494336
227.54	34704	1541	7896548	350639.1	53478864	12043657616	2374681
204.86	35240	576	7219266	117999.4	20298240	124185760	331776
222.04	41425	2144	9198007	476053.8	88815200	1716030625	4596736
277.88	61366	4508	17052384	1252683	276637928	3765785956	20322064
ΣY=2805.15	ΣX1= 351832	ΣX^2 = 16101	ΣYX_1 = 90693872.05	ΣXY_2= 4209343	ΣX_1X_2 =	Wx_1^2 = 13365544294	ΣX_2^2= 38275443

(Source SEBO/N Journal 2007)

Annex 2

Computation of Trend Analysis of Profitability of Public Enterprises

Year	Time (+)	t^2	y	yt
1993	-8	64	-38.8	310.4
1994	-7	49	-244.6	1712.2
1995	-6	36	-1871.7	11230.2
1996	-5	25	-1145.5	5727.5
1997	-4	16	146.4	-585.6
1998	-3	9	1073.7	-3221.1
1999	-2	4	1965.6	-3931.2
2000	-1	1	1377.6	-1377.6
2001	0	0	475.9	0
2002	1	1	1377.6	-1377.6
2003	2	4	2903.3	5806.6
2004	3	9	2404.4	7213.2
2005	4	16	-1353.2	-5412.8
2006	5	25	-5475.3	-27376.5
2007	6	36	-1614.4	-9686.4
Total		$\Sigma t^2 = 295$	$\Sigma y = -79$	$\Sigma yr = =18273.5$

(Source SEBO/N Journal 2007)

Y = Gross Profitability of Public Enterprises

t = Time Factor

Annex 3

Computation of Regression Equation and Analysis of Gross Profit and Capital Employed

Year	Y	X	y(Y-Y)	x(X-X)	y^2	x^2	xy
1993	-0.39	171.182	-0.34	-505.5	0	255488	171
1994	-2.45	184.762	-2.4	-491.9	6	241944	1179
1995	-18.72	358.432	-18.67	-318.2	349	101256	5941
1996	-11.45	505.303	-11.4	-171.3	130	29356	1953
1997	1.46	434.829	1.51	-241.8	2	58473	-365
1998	10.74	638.85	10.79	-37.8	116	1428	-408
1999	19.66	592.448	19.71	-84.2	388	7088	-1659
2000	13.78	620.109	13.83	-56.5	191	3196	-782
2001	4.76	857.579	4.81	180.9	23	32739	870
2002	13.18	812.708	13.23	136.1	175	18515	1800
2003	29.03	836.856	29.08	160.2	846	25669	4660
2004	24.04	834.206	24.09	157.6	581	24827	3796
2005	-13.53	829.105	-13.48	152.5	182	23246	-2056
2006	-54.75	1500.882	-54.7	824.2	2992	679375	-45089
2007	-16.14	972.32	-16.09	295.7	259	87427	-4759
Total	$\Sigma Y = -0.78$	$\Sigma X=10149.57$	$\Sigma y=0$	$\Sigma x = 0$	$\Sigma y^2=6240$	$\Sigma x^2=1590027$	$\Sigma xy= -34748$

Y=Gross Profit of the public enterprises

X=Capital Employed in the public enterprises

Annex 4

Calculation of t-test of profitability of privatized Enterprises, before and After Privatization

Name	X_1	X_2	$d=X_2-X_1$	d^2
Balaju Textile Industry	-5.56	-0.2	5.36	28.7296
Nepal Lube Oil Limited	0.6	17.14	16.54	273.5716
Raghupati Jute Mills	11.3	-3.18	-14.48	209.6704
Harisiddhi Brick & Tile Factory	1.65	-20.28	-21.93	480.9249
Sri Bhrikuti Pulp & Paper Industry	4.3	5.88	1.58	2.4964
Bansbari Leatherage & Tannery	0.48	0.13	-0.35	0.1225
Nepal Bitumen & Barrel Udhyog	-4.63	5.38	10.01	100.2001
Nepal Foundry Industry	-3.88	0.83	4.71	22.1841
Nepal Film Development corp.	-8.67	0.25	8.92	79.5664
Total			$\Sigma d = 10.36$	$d^2 = 1197.466$

Annex 5

T-test of Employment Level of Privatized Enterprises, Before and After Privatization

Name	X1	X_2	$d = X_2 - X_1$	d_2
Balaju Textile Industry	108	75	-33	1089
Nepal Lube Oil Limited	106	94	-12	144
Raghupati Jute Mills	113	1654	1541	2374681
Harisiddhi Brick & Tile Factory	595	593	-2	4
Sri Bhrikuti Pulp & Paper Industry	283	1078	795	632025
Bansbari Leatherage & Tannery	484	97	-387	149769
Nepal Bitumen & Barrel Udhyog	55	56	1	1
Nepal Foundry Industry	45	52	7	49
Nepal Film Development Corp.	100	55	-45	2025
Total			$\Sigma d = 1865$	$\Sigma d^2 = 3159787$

Annex 6

Ratio of Market Indicators of Macroeconomic Variables

Fiscal year	No. of Co.	Pdval/GDP	M-cap/GDP	TT/GDP	TT/M-cap
1995/96	66	0.10	0.07	0.0022	0.029
1996/97	79	0.01	0.06	0.0048	0.081
1997/98	89	0.01	0.05	0.0008	0.017
1998/99	95	0.02	0.05	0.0015	0.033
1999/2000	101	0.02	0.05	0.007	0.014
2000/01	107	0.02	0.07	0.0044	0.064
2001/02	110	0.02	0.12	0.0031	0.027
2002/03	115	0.02	0.10	0.0059	0.058
2003/04	96	0.02	0.09	0.0038	0.044
2004/05	114	0.02	0.09	0.0045	0.052
2005/06	135	0.03	0.12	0.0089	0.073

Annex 7

Market Capitalization

(Fiscal Year 1993/94 to 2005/06)

(in million)

Year	Amount
1993/94	13872.0
1994/95	12963.0
1995/96	12295.0
1996/97	12698.0
1997/98	14289.0
1998/99	23508.0
1999/2000	43123.0
2000/01	46349.4
2001/02	34703.9
2002/03	35240.4
2003/04	41424.3
2004/05	61365.9
2005/06	96813.7

Annex 8

Securities Market Indicators

(Fiscal Year 1993/94-2004/05)

Securities Market Indicators	Fiscal Year										
	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Number of Issue Approved	12	12	5	12	5	9	9	16	17	16	12
Total Amount of Issue Approved (Rs.)	254.21	2936.74	332.20	462.36	258.00	630.31	493.40	1579.81	696.63	1090.37	1476.82
Total Amount of Public Issue (Rs.)	173.96	226.74	302.20	462.36	258.00	420.11	493.40	1579.81	696.63	1090.37	1476.82
Paid-up Value of Listed Securities (Rs.)	2961.8	3358.5	4476.5	4959.8	6487.4	7347.4	8165.2	9685.04	12560.07	13404.90	16771.9
Market Capitalization (Rs.)	12963.0	12295.0	12698.0	14289.0	23508.0	43123.3	43649.4	34703.9	35240.0	41424.77	61365.9
Annual Turnover (Rs.)	1054.27	215.61	416.23	202.61	1499.98	1157.03	2344.16	1540.63	575.80	2144.27	4507.7
% of Turnover on Paid up Value	5.60	6.42	9.30	4.09	23.12	15.75	28.71	15.91	4.58	16.00	23.00
% of Turnover on Market Capitalization	8.13	1.75	3.28	1.42	6.38	2.68	5.06	4.44	1.63	5.18	7.00
% of Market Capitalization on Nominal GDP at Market Price	6.17	5.14	4.71	4.93	7.12	11.77	11.78	8.56	8.09	8.77	12.17
Market Day	242	240	239	237	231	240	231	246	238	243	236
Average Daily Turnover (Rs.)	4.36	0.90	1.74	0.85	6.49	4.82	10.14	6.26	2.42	8.82	19.10
Total Number of	79	89	95	101	107	110	115	96	108	114	125

Listed Companies											
Number of Company Traded	53	59	67	68	69	69	67	69	81	92	102
Number of Shares Traded ('000)	3901	2954	9443	1195	4857	7674	4989	6005	2428	6468	18434
Number of Transaction	21472	17943	12428	15428	15483	29136	46095	42028	69163	85533	106246
Number of Listed Securities ('000)	58247	65880	85193	90107	105632	114057	124971	122685	159958	161141	194673
NEPSE Index (points)	195.48	185.61	176.31	163.35	216.92	360.70	348.43	227.54	204.86	222.04	286.67

Source SEBON *Revised Estimate of GDP #Preliminary Estimate of GDP

Interview taken with financial experts

1. How do you define economic liberalization?

It is the way or system of not regulating the activities of private sector in the legal activities on any sector.

2. Does economic liberalization able to develop the capital market?

Yes, of course economic liberalization is the policy of government. It creates the environment for the development of capital market.

3. Have you found any relationship between liberalization and privatization?

As the liberalization is given power to private sector for market equilibrium the public enterprises could not able to compete the market. So. In economic liberalization there is automatically privatization so we can say that liberalization is the producer of privatization.

4. After applying liberalization policy in our country what short of activities did you find in the sector of privatization?

After the re-advent of democracy in our country the whim of revolution was found much public enterprise became paralyzed.

5. What types of report do you have of those companies which are privatized?

In my report the privatized enterprises are not able to have profit till these years some of these already liquidated not able to competing in the market.

6. What is responsible for the adverse situation of privatized enterprises?

In my opinion the norms of privatization was not applied while these enterprises privatized. The direct or indirect regulating system of government also paralyzed these enterprises. The weak policy of government are also responsible for these

7. How does economic liberalization help for the development of over all capital market?

| After the economic liberalization the capital market is growth in rapidly, before liberalization there were only less than ten companies listed in capital market. The people were also unknown about the capital market but now there are 152 listed companies only in the share market. People are getting very good sector of investment for earning good income.

8. Do you think that all people of Nepal are known abut capital market?

| No, the capital market is limited only within Kathmandu valley.

9. Whet would be the causes behind not having more people in this sector?

| Through, it is said that capital market is develop, it is not so developed like as American share market and Indian hare market. Here are listed some causes.

a. Lack of capital market education
b. Lack of capital on invest
c. Lack of listed company in SARC.

10. How can capital market be a good area of investment to all the Nepali people?

| For the involvement of more people in the sector, the share market should be decentralized. The tradition of centralizing in Kathmandu should be end. Capital markets education must give to the people of every nook and corners.

11. How have you seen the involvement of women in this sector?

| Before liberalization the involvement of women was not found but now women participation is found in this capital market as well.

12. In there any regulating system government in capital market sector too?

Yes, in every sector the government can do some regulations, by the fear of it the NEPSE which was increasing from 2061 to till 2065 Bhadra, it was found in peak but it is in stable now. While government did not speak about its regulation the increasing grand may not be held.

13. How have you seen the present capital market of our country?

The NEPSE index is decreased now but we are not able to say that the investors are in loss. The investor has already received bonus share and other benefit too. While calculating these all there is not found loss in the present market, though NEPSE index is decreased.

14. Why investors are not interested to invest in privatized enterprises?

The privatized enterprises were not able to earn profit form in the capital market. They are found in loss in more time but Telicom now is able to bear 25%. of total share market. All investor are interested to invest in Telicom. So, if the enterprises are in good condition their price of share would be increased so, for making the interest of investor privatized enterprises company should be strong.

15. What would you like to say to investor?

First of all I would like to say to all investors happy new year, 2066. While investing you most not invest in all sectors. Which company entering profit and can distribute bonus share, you should choose for investment to these company.