

CHAPTER 1

INTRODUCTION

1.1 Background Information

The whole spectrum of the financial system in the economy constitutes financial institutions and the financial markets. The financial institutions are those corporate and government ventures that collect and process information more efficiently thereby lending and borrowing of funds in the market. This is because the financial institutions/intermediaries offer lenders or borrowers a large amount of facilities in the fund transformation process through better risk return combination. In the words of *Kolb & Rodriguez (1996)*,"A financial intermediary is a financial institution that acquires funds from one group of investors and make available to another economic unit. Thus, financial intermediaries play a very pertinent role in the economy by channeling funds from surplus saving units to deficit saving units." Financial intermediation is very important for the efficient functioning of whole financial system. This is because the financial intermediation forms the main basis of the financial market in setting the process of saving and investment in the financial system. Usually banks, financial institutions, and other non-depository institutions are involved in financial intermediary functions.

Another important part of the financial system is, 'financial market'. Literally the word 'market' refers to the aggregate of possible buyers and sellers to trade a commodity or service. Sometimes it typically means the exchanges, organizations that facilitate a trade in financial securities like a stock exchange or a commodity exchange. And the transaction may be done physically or electronically and can either be domestic or global market. Moreover, a financial market can be defined as a mechanism for bringing together buyers and sellers of financial securities in order to facilitate trading of such securities. In [economics](#), a **financial market** is a mechanism that allows people to easily buy and sell ([trade](#)) financial [securities](#) (such as stocks and bonds), [commodities](#) (such as precious metals or agricultural goods), and other [fungible](#) items of value at low [transaction costs](#) and at prices that reflect the [efficient-market hypothesis](#). Financial markets have evolved significantly over several hundred years and are undergoing constant innovation to improve [liquidity](#). (www.wikipedia.org)

Financial market facilitates:

-) The raising of capital (in the [capital markets](#))
-) The transfer of [risk](#) (in the derivatives markets)
-) [International trade](#) (in the currency markets)

As defined above, a financial market may be classified basing on the nature and type of securities being traded. There is no any hard and fast rule of classifying a security market in definite forms, hence, any attempt to classify financial market becomes arbitrary. In this respect, financial market may be divided into—Capital market (stock market and bond market), commodity market, derivatives market (future market and forward market), money market, insurance market, foreign exchange market etc (*www.wikipedia.org*). The capital market may be further divided into primary market and secondary market. The primary market is the one where a fresh issue of securities is dealt, where as the secondary market deals with second hand securities or existing securities.

Similarly, the Oxford Advanced Learner’s Dictionary, (2000) defines the term ‘stock market’ as “the business of buying and selling shares in companies and the place where this happens”. In today’s global financial system an efficient functioning of a financial system is immense for the transformation and the utilization of funds. The whole financial system helps in integrating the various sectors of the economy. As we see in our Nepalese context, these days the financial system is getting momentum with regard to macro-economic policy transformation. The importance of efficient functioning of a financial system is vital for the overall development of the economy. The global financial crisis which started to show its effects in the middle of 2007 and into 2008 has shown how the governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems if they do not function well. (*www.wikipedia.org*)

Over the last few years, despite the political instability and low economic growth rate the one and only stock market of Nepal is gaining more momentum with regard to trading of securities. Undoubtedly, there is a positive relationship between financial development and economic

growth and the measurement of performance and growth of stock market is crucial for the measurement of financial development as it is one of the parts of whole economic system. The stock market where the financial assets are being traded is a financial intermediary as it works as a gateway for the transformation of savings into investment. As the security market of Nepal is overwhelmingly dominated by banking and financial securities, this shows the non-proportional expansion of security market. Besides, Nepalese security market is not mechanized yet. These days too, the trading pattern follows the same open-out-cry model of trading. However, from the middle of 2007 the stock exchange tried to adopt automated system for the trading of securities with a great endeavor. (NEPSE website)

Over the period of last five years, the NEPSE index is moving an upward direction continuously, but in those days an unrealistic growth of stock market is seen. Here in this research work an attempt is endeavored to analyse the trend of NEPSE index and its relevancy with regard to the macroeconomic indicators. Similarly, the next aspect of the study is to examine the challenges and weaknesses of Nepalese security market.

1.2 Focus of the study

The capital market has experienced an impressive growth in the last few years. With the end of a decade long struggle the then government and the former rebel group had jointly signed in the Peace Accord in 2006. The progress of peace and security situation in the country has conducted a positive environment for the establishment of different companies. As a result of which we have felt the excessive growth of financial institutions in recent years. All these financial institutions need to go to public for the collection of required capital. And they are required to issue public shares for the collection of such capital. This has finally contributed to grow capital market. Moreover, the mandatory requirement of the NRB (Nepal Rastra Bank) to increase the capital of different financial institutions also contributed to the growth of the capital market in recent year. This shows a significant growth in primary and secondary market activities in recent years.

In the light of the above mentioned background, this study focuses on recent trends and challenges of Nepalese capital market. The capital market of Nepal has experienced an

impressive growth in recent years. Whether it is realistically accompanied by the real growth of GDP? Is the price movement in Nepalese stock market realistic in terms of investor's awareness and the overall economic growth of the nation? Does the broker influence the stock price? What could be the challenges of stock market? To find out the answer of all these questions this study is focused on the case study of Nepalese stock market. The study is primarily based on the recent growth trend of stock market and challenges it faces.

Finding out the solutions of aforementioned problems, the price of stock may be determined with the demand and supply mechanism thereby demanding more stocks when price falls and supplying more stocks when price rises. On the other hand, the stock price may be influenced by brokers too. While supplying other causes for price movement signaling effect, lack of investor's awareness, income level of investors, offering of right shares by the financial institutions also contributed for the movement of stock price in stock market. Hence, assessing with these problems is a major issue in Nepalese stock market.

1.3 Statement of Problems

A company as a corporate venture is incorporated under the Company Act as an artificial person. The fraction of wealth which is used to produce further wealth popularly known as 'Capital' is collected through the issue of shares. When a company is of public limited in nature, it needs to issue ordinary shares for the collection of required capital to commence its business. And those ordinary shares are re-traded in the financial market as secondary goods. In Nepal, NEPSE is one and only authorized stock market where the previously issued securities are traded on an auction basis. Before the trading of securities of any company they need to be listed. Listing guidelines are prepared by Security Board of Nepal (SEBON); the only regulatory body of securities in Nepal.

Over the last few years, Nepalese capital market received a great deal despite the political instability and low economic growth in terms of financial development and investment return. The development of financial market is vital for the development of industrialization in the country because it helps to channelize the fund through financial intermediation. Financial institutions are the primary stake of capital market because the stocks of financial institutions are regarded as 'hot cakes' in the stock market. In fact, financial institutions and stock markets both

contribute in a major way to the transformation of savings into investment thereby enabling financial development and economic growth. However, it is not clear whether these two types of financial intermediaries are complimentary or substitutes of each other. Moreover, the domination of stock of financial institutions in the capital market hinders the real sector development.

As stated above that Nepalese capital market has gained momentum over the past few years, examining the growth trend of NEPSE and the obstacles it faces is a burning topic for different research works. Hence, this research is primarily concerned with how the growth of NEPSE is related with the economic growth? As it is stated that Nepalese stock market is over influenced by securities of financial institutions; an emphasis needs to be given for seeking reasons behind the low representation of real sector's securities in stock market. Similarly, to state the positive relationship between financial development and economic growth an attempt needs to be given to establish a cordial relationship between the return from stock market with the real growth in GDP. In this respect, the movement of NEPSE index with the macroeconomic indicators needs to be examined. Furthermore, the burning issues and challenges of Nepalese capital market would be a topic for research work. Hence, all of these issues are analyzed and examined here in this research work.

The following research questions have been listed out:

-) How the security transactions take place in NEPSE?
-) What is the growth trend of NEPSE Index?
-) What the investors say with regard to the development of capital market in Nepal?
-) What is the relationship between the growth of NEPSE index and other macroeconomic variables?
-) What are the obstacles of Nepalese capital market?

1.4 Objectives of the Study

Once the former exchequer Dr. Baburam Bhattarai in an official visit to NEPSE Complex said, "Capital market is the key to industrialization". This statement shows his commitment towards the development of capital market in Nepal. However he was not satisfied with the dominance of

financial institutions in the market. So further he added, “The dominance of financial institutions should be reduced and more real sectors need to be listed.” (NEPSE News, 2009) This indicates that the capital market of Nepal is dominated by financial sector. Hence, a real sector industries need to be listed for the economic up-liftment of the country. This is highly necessary to seek the reasons behind the low representation of real sector in NEPSE’s listing.

The subsidiary objectives of this research work are as follows:

- To highlight the overview of Nepalese stock market and its security transaction process.
- To study and analyze the overall trend of Nepalese stock market in terms of NEPSE index.
- To study and analyze investor’s perspective with regard to investment on secondary market.
- To examine the relationship between NEPSE index and other relevant macroeconomic variables to analyze the contribution of capital market in the economic development.
- To examine and analyze the obstacles faced by the stock market for stock trading.

1.5 Significance of the Study

Security market or a financial market is a place where securities are traded for the sake of a return. It is an arrangement where trading of financial assets takes place between buyers and sellers of such securities. In our context, the Nepal Stock Exchange Ltd. (NEPSE) is one and only organized security market for the trading of second hand securities. In an organized security market, trading of securities are done under a set of rules and regulations. Nepalese financial/security market is characterized by two types of securities--long term and short term securities. Here an attempt is made with regard to analyze the trend and prospective of Nepalese Stock Market where mostly the long term securities are traded.

In the light of this concept, this research work will be significant to know about the recent trend and perspective of Nepalese stock market. In this report an attempt is made to assess and analyse the growth trend of NEPSE; and to depict the investor's perspectives with regard to the growth of Nepalese stock market. Besides, the methods and process of indexation is also dealt for the

purpose of finding the recent trend and perspective of market index. Moreover, this study is significant to know the answer of following queries:

- What is the trading mechanism of NEPSE?
- What is the trend of Nepalese stock market?
- What are the hurdles and challenges of NEPSE ?
- How does an investor reach upon an investment decision?

1.6 Hypothesis Formulation

After the identification of research problem, the next crucial step for the research work is expressed in the form of a hypothesis. As we know that a hypothesis is a statement about the relationship between two or more variables. This study attempted to analyse the relationship between macroeconomic variables like GDP, EG with the growth of NEPSE index in one hand, and some of the variables which are operating within the capital market itself on the other.

To formulate a good hypothesis, we need a good knowledge of the background of the study which will be possible through a thoughtful review of literatures. After studying the problem and theoretical background of this study a hypothesis has been formulated as:

Null hypothesis: $H_0: \dots = 0$ i.e. the variables are not correlated in the population.

Alternative hypothesis: $H_1: \dots \neq 0$ i.e. the variables are correlated in the population.

1.7 Limitations of the Study

The greatest limitation of this study is -- it is prepared for the academic fulfillment of the requirements for the degree of Master of Business Studies (MBS), 2 years academic program launched by Tribhuvan University under the faculty of management. The data and statistics have been extracted from different published sources—mainly from the official publication of Nepal Rastra Bank (NRB), Security Board of Nepal (SEBON), Nepal Stock Exchange Ltd. (NEPSE) and other publications. Since the accuracy and reliability of data and statistics will concern with the publisher, its findings and solutions may not fulfill common interest of all concerned parties. In deed, it may lack sufficient information and different analytical tools.

These are the limitations of this research work:

- Basically the report is prepared for the academic fulfillment of university program.

- The data and statistics have been derived from different published sources namely— NRB, SEBON and NEPSE.
- The accuracy and reliability of statistics is concern of the publisher itself.
- Time and budget is another constraint for the study.
- The findings and solutions could not be generalized. So this may not fulfill the common interest of all interested parties.
- This study may lack different analytical tools for statistical analysis.

1.8 Organization of the Study

The whole research is divided into five different chapters namely—1) Introduction, 2) Review of Literature, 3) Research Methodology, 4) Data Presentation and Analysis and 5) Summary and Conclusions. Moreover, the report is accompanied by bibliographies and annexure in supplementary section of the report.

A brief description of the above mentioned chapters of the report follows:

Chapter 1: Introduction

The introduction or orientation serves the general idea about the research topic. Hence, it deals with the subject matter of the research work. This chapter focuses on the general area of interest and its scope. The nature and type of the problem, purpose and objectives of the study, focus and significance of the study; and limitations of the study is the primary concern for this chapter while writing a research report.

Chapter 2: Review of Literature

This chapter is primarily concerned with the review of previous writings and relevant studies with regard to the chosen problem. The review is done in two ways; first reviewing the general textbooks and supporting literature to collect references, and particularly quotes and findings. Secondly, the previous research reports and their findings are reviewed to clear out the conceptual framework of the selected problem.

Chapter 3: Research Methodology

Research methodology describes the research design, sources of data, methods of data presentation and analysis, variables to be used and other statistical tools and procedures to accompany with the research topic.

Chapter 4: Data Presentation and Analysis

This is the main body of the research report in which the data are presented into an organized form to find out the major conclusions of the research work. The different chapter in it generally covers presentation of arguments, documentation, ideas or concepts, interpretations and findings. The required data are presented through textual, tabular and graphic devices and are critically analyzed and interpreted in detail.

Chapter 5: Summary and Conclusions

This is the last part of text of the report which is primarily concerned with the summary, conclusions and further recommendations. The summary relates the major findings in a logical and rational manner. Conclusions are drawn through the interpretation of data for the purpose of solving the research problem. Finally, recommendations are capsules for the research problem which is presented based on the theoretical structure and interpretation of data.

CHAPTER 2 REVIEW OF LITERATURE

2.1 Theoretical Reviews

2.1.1 Concept of Market

A market can be understood as a complex network of buyers and sellers in which they come in contact with each other for the purpose of trading of any commodity or service. In a broad sense, it does not refer only place where the goods are being transacted, rather it is a network that facilitates the purpose of buying and selling a good or service for the sake of value. For a market transaction there must be an agreement no matter whether it is formal or informal between

buyers and sellers to purchase or sell something of value. The buyer must be willing to purchase something for a certain market price, and on the other hand, the seller should agree to sell at an agreed price.

Stanton et. al., (1994) defines market as: *in the general context, market encompasses more than the direct consumers of products. A firm's markets include government regulatory agencies, environmentalists, and stockholders. Thus, any person or group with whom an individual or organization has an existing or potential exchange relationship can be considered a market.* Hence, for an excerpt it can be said that a market is a place or network where an exchange takes place without any coercion.

2.1.2 Concept of Financial Market

In the light of the above concept, financial market can be defined as- a complex network between buyers and sellers of financial assets. By the term 'financial assets' those intangible assets have been referred which do not appear in physical existence but yet to be known as 'paper assets'. The owner of such assets get a paper made document to which we call 'security certificates'. To be more specific, financial market refers to a mechanism through which the borrowers and lenders get together for the purpose of lending and borrowing of financial assets.

Gordon et. al., (2001) have explained financial market or security market as – *'a mechanism for bringing together buyers and sellers of financial assets in order to facilitate trading.'* Moreover, they have explained the concept that one of the primary functions of financial market is – 'price discovery'. With regard to this, they stressed that the faster and more accurately price discovery is achieved, the more efficiently financial markets will direct capital to its most productive opportunities.

Security market is a place where securities are traded. It is a central physical location where trading of financial assets takes place between buyers and sellers of such assets. In Nepal's context, the Nepal Stock Exchange Ltd. (NEPSE) is one and only organized security market where securities are traded. In an organized security market, trading of securities are done under a set of rules and regulations. Some examples of such major organized security markets are: New

York Stock Exchange (NYSE) and American Stock Exchange (AMEX) in United States, Tokyo Stock Exchange in Japan, London Stock Exchange in Britain, Bombay Stock Exchange in India, and Singapore Stock Exchange in Singapore. A detail of Nepal Stock Exchange is discussed in the next section of this research work.

2.1.3 Types of Financial Markets

There is no any specific rule of classifying financial market, hence, any attempt to divide it is only arbitrary. *Shrestha & Bhandari (2004)* have classified the types of financial market as 1) Capital market which deals with stocks and long-term debt securities. 2) Money market which deals with the securities having maturity period of less than one year. 3) Primary market which deals with the new issue of securities. 4) Secondary market which deals with the existing or the second-hand securities. 5) Loan and security market dealing with dealing directly with the customers.

Undoubtedly there are different forms of financial markets and each of them performs different but similar functions depending upon their type and nature. For instance, primary market deals with a fresh issue of securities; whereas secondary market deals with the second hand securities previously issued in the primary market. Here in this research work, my attempt is endeavored to examine the growth trend and different challenges faced by secondary market of Nepal. While talking about the secondary market in Nepal, we mean to the Nepal Stock Exchange (NEPSE).

2.1.4 Historical Perspective of Nepalese Security Market

The history of securities market in Nepal dates back to 1937, when the shares of Biratnagar Jute Mills Ltd. (BJM) and Nepal Bank Ltd. (NBL) were floated. Similarly, the introduction of the Company Act in 1964, the first issuance of Government Bond in 1964 and the establishment of Securities Exchange Center Ltd. in 1976 were other significant development relating to Nepalese capital markets. (*NEPSE website*). Later, the center was converted into Nepal Stock Exchange. Before conversion of Securities Exchange Center into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Later, the Government of Nepal (GoN) under a program initiated to reform capital markets converted Securities Exchange

Center into Nepal Stock Exchange in 1993, and the NEPSE started its operation on 13th January 1994. (*NEPSE website*).

The basic objective of NEPSE is to impart free marketability and liquidity of government and corporate securities. The previously set objectives can be obtained through the transactions in its floor through members, market intermediaries, such as brokers, market makers etc. According to NEPSE News, (2009), currently 23 brokers are actively participating in the floor. Similarly, there are 11 sales and issue managers and 2 dealers. The brokers act as agents of investors. Any one who wants to buy or sell securities in the secondary market should go through these licensed brokers. Brokers are not allowed to buy and sell securities for themselves. But they have to trade it on behalf of their customers for a fee or commission. Similarly, dealers in primary market work as issue managers and underwriters, whereas in secondary market they play the role of portfolio manager. Unlike brokers they are allowed to buy or sell securities on behalf of their own account.

After the restoration of democracy in 1990, the interim government initiated financial reform program and with the establishments of two indirect investment organizations – namely Citizen's Investment Fund and NIDC Capital Markets Ltd. The primary purpose of those investment vehicles was to collect the small fractional resources with the collective investment schemes and to channelize the collected funds in the corporate sector. The, then government adopted the policy of privatization and economic liberalization. Then the government felt the need of regulatory body to systematize security transaction in Nepal. Finally, the government established two distinct identities – Security Board of Nepal (SEBON) and Nepal Stock Exchange Ltd. (NEPSE) by dismantling the existing structure of Security Exchange Center (SEC). Since then they are operating as the main constituents of securities market in Nepal.

For the regulation and monitoring of securities transactions SEBON was established on June 7, 1993 as an apex regulator of Securities Market in Nepal with a mission to facilitate the orderly development of a dynamic and competitive capital market. The board was established under the Securities Exchange Act 1983. Currently, it has been regulating and maintaining the credibility,

fairness, efficiency and transparency of security markets under the Securities Exchange Act, 2006.

As per the Securities Related Act, 2006, the major functions, duties, and power of SEBON are as follows:

-) Register securities of public companies.
-) Provide license to operate stock exchanges.
-) Provide license to operate securities business.
-) Permit the operation of collective investment schemes and investment fund programs.
-) Draft regulations, issue directives and guidelines.
-) Supervise and monitor stock exchanges and securities business activities.
-) Conduct research, study and awareness programs regarding securities market.
-) Formulate policies and programs relating to securities markets.

(SEBON Annual Report: 2009)

The more functions of SEBON as per the Security Exchange Act, 2006 have been compiled in the annex of this report.

2.1.5 Trading System of NEPSE

NEPSE is a non-profit making organization established for the purpose of providing three economic functions; viz. determination of fair price for the securities; providing liquidity through the purchase and sale of securities and minimizing total transaction cost by standardizing trades and providing framework for conflict resolutions. (NEPSE website) The securities are required to be listed to trade in NEPSE. Listing means, the registration of securities with the stock exchange which make them eligible for trading on the open floor. The listing of securities in the stock exchange may be of two types – temporary listing and permanent listing. Temporary listings are done for redeemable securities, whereas, permanent listings are done for irredeemable securities. The NEPSE laid down the following conditions for listing of new securities:

- The minimum paid up capital of the company must be Rs. 2.5 million.
- The minimum number of shareholders should be 500.

- Those companies which are listed prior to public subscription need to issue the shares within 2 years of listing.
- The face value of each share should be either Rs. 10 or Rs. 100.
- As per the capital structure of the company the following proportion of shares should aside for public issue.

(www.nepalstock.com)

Proportion of public issue out of issued capital

Issued Capital	Shares for public issue
Up to Rs. 10 million	25%
Rs. 10 million to 50 million	20%
Rs. 50 million to 100 million	15%
Rs. 100 million and above	As per the decision by SEBON and NEPSE.

Table no. 2.1.5.1

(Sources: www.nepalstock.com)

At present, the shares of 157 companies are traded at NEPSE. Amongst the total 78 A – rated companies, 14 are commercial banks, 15 are development banks, 37 are finance companies, 10 are insurance companies and one is related to manufacturing and hydropower. *(NEPSE News: 2009)*

Structurally, NEPSE has its own (BoD) Board of Directors to direct, control and monitor trading activities. As cited by Bhandari & Shrestha (2004), the BoD of NEPSE constitutes 6 directors from Government of Nepal and different institutional investors. The total authorized capital of NEPSE is Rs. 50 million, out of which Rs. 34.91 million is subscribed. The respective holdings of different institutional shareholders of NEPSE are as follows:

Capital Structure of NEPSE

(Rupees in million)

S.N.	Shareholders	Amount	Percentage
1	Government of Nepal	20.48	58.67
2	Nepal Rastra Bank	12.08	34.60

3	NIDC	2.14	6.12
4	Members	0.21	0.61
Total		34.91	100.00

Table 2.1.5.2

(Source: NEPSE Annual Report 2063/064)

Till the middle of 2007, NEPSE adopted the traditional open-out-cry system of trading in which the buying and selling brokers quotes their bid and offer prices by crying in the floor of the exchange. The dealers quote their bid and offer prices on their own board before the floor starts. But in August 2007, NEPSE started trading through Wide Area Network (WAN), and dissemination of information through website. Moreover, the establishment of Over The Counter (OTC) market is another noted development of NEPSE. (*NEPSE website*)

2.1.6 Securities Transaction and Settlement Process

Trading system in NEPSE takes place either on the basis of auction system on the trading floor or a broker-dealer market. However, the former is mechanized with the 'NEPSE Automated Trading System' (NATS) which is a fully automated screen based trading system. Moreover, trading through Wide Area Network (WAN) and live dissemination of information from trading floor through World Wide Web (www) is also in practice. These recent developments show that the NEPSE although lacks different technological enhancements is trying to catch today's ever changing information technology (IT).

Trading on equities takes place on all working days of week except Saturdays and government holidays as declared by the authorities of the NEPSE in advance. The odd lot trading takes place on every Friday for 12:00 hours to 13:00 hours. On the other days market opens at 12:00 hour and closes at 15:00 hours. However, the exchange may close the market on days other than schedule holidays in one hand and on the other may open the market on those days originally declared as holidays in special circumstances. And the NEPSE deserves all the rights to extend, advance or reduce the trading hours whenever it seems necessary. (*NEPSE website*)

Any type of security which is listed on the stock exchange is eligible for trading. However, NEPSE facilitates trading in the following instruments: (*NEPSE website*)

1. Shares
 - Equity shares
 - Preference shares
2. Debentures
3. Government bonds
4. Mutual funds

The above mentioned security instruments are traded at broad lot, which refers to the minimum number of securities tradable in the exchange. The NEPSE, has set the size of lots of securities as 10 shares for those stocks which have face value of Rs. 100 and the size is 100 if the face value is Rs. 10. Similarly, the tradable lot is of 100 if the face value of a bond is Rs. 100 and 10 if the face value is Rs. 1000. This is to notify that no securities are traded in fraction. However, the odd lot (like 9 shares) is traded on Friday only. (*NEPSE website*)

In NEPSE, trading can be done through two ways –they are NEPSE's trading floor and Broker's own office within Kathmandu valley. And the trading process is facilitated with sophisticated technology so that a broker can deal with trading activities remotely from his/her office located within the Kathmandu Valley. This remote trading facility was started from 1 November 2007. It is already discussed that the trading takes place when the sell order matches with the purchase order. However, an order may match partially with another order thereby producing multiple orders. The best match of an order takes place with the highest price for buy order and with the lowest price for a sell order. Then the settlement process takes place. (*NEPSE website*)

NEPSE has adopted a T+3 settlement system. Settlement will be carried out on the basis of paper versus payment. The trading is done at "T" and at T+1; the buying brokers have to submit bank vouchers for settlement with covering letter. At T+2, the selling brokers must submit share certificate with covering letter. At T+3, NEPSE prepares billing for payment and this will be forwarded to the bank. Once the settlement is done the buying brokers with the consultation of the clients must decide and present the purchased shares if they want to record it as blank transfer. This must be completed within T+5. (*NEPSE website*)

2.1.6.1 Blank Transfer (BT)

Under this mechanism an opportunities to derive the market benefit is provided. But presently, the buying brokers must complete the BT process within T+5. The transactions that are executed can be recorded in different way and NEPSE has considered all possible retention. The followings are the major key points to be considered. (*NEPSE website*)

1. This is related only with buy of the securities.
2. The buyer may decide to have market benefit either to have capital gains or to minimize the loss.
3. In order to do this s/he may partly send for name transfer or may register it in blank transfer.
4. If s/he register total purchase in blank transfer and can put for sale and if only the part of the shares are subscribed then s/he can handover the part and the part can be forwarded for name transfer to the concerned company. In order to do this s/he has to cancel the blank transfer for that portion.

2.1.6.2 Brokerage Commission

The commission charged by the brokers differs as per the type of security and the volume of securities being traded. The rate of commission charged by brokers follows:

Brokerage for Government Bond

S.No.	Trading Amount	Brokerage %
A	Up to 5,00,000	0.20
B	> 5,00,000 & < 50,00,000	0.10
C	> 50,00,000	0.05

Table 2.1.6.1

(Source: *NEPSE website*)

Brokerage for equity

S.No.	Trading Amount	Brokerage %
A	Up to 50,000	1
B	> 50,000 & < 5,00,000	0.9

C	> 5,00,000 & < 10,00,000	0.8
D	> 10,00,000	0.7

Table 2.1.6.2

(Source: NEPSE website)

Brokerage for other stocks

S.No.	Trading Amount	Brokerage %
A	Up to 50,000	0.75
B	> 50,000 & < 50,00,000	0.60
C	> 50,00,000	0.40

Table no. 2.1.6.3

(Source: NEPSE website)

2.1.7 Stock market index

In general market index is an indicator of general price level. A stock market index is a method of measuring a section of the stock market. This refers to a single figure obtaining from the average price of a group of securities which indicates the movement of prices of stocks from time to time in the security market. The significance of market index is immense to an investor as it provides a guideline to investigate on the process of making investment decision. This is because a standard market index provides a complete and to some extent accurate information about the behavior of different stock prices. (Bhandari & Shrestha: 2004) In this regard, this is often considered as a barometer to measure the nature and temperature of the stock market to help investors make a rational decision regarding investment on different securities. Moreover, market index is used to measure the historical trend of return of stocks being traded on the security market. (Thapa: 2006) The information regarding the relevant market indexes are broadcasted through electronic and print media.

An index may also be classified according to the method used to determine its price. As per the differences in application and sentiments of the user market index of security can be calculated in different ways. Mainly there are four weighing methods of calculation of market indexes. They are as follows: (Bhandari & Shrestha: 2004)

1. Price weighted index
2. Value weighted index
3. Equally weighted index
4. Geometric mean index

A short description of these indexes follows:

2.1.7.1 Price weighted index

Under price weighted index, the market index is calculated based on the market price of securities. This index helps know the trend in stock price which ultimately helps investors determine the probable prices of securities. While calculating market index under this method, all the stock prices are added and the total sum of prices is divided by the total number of securities included. Dow Jones Industrial Average, [Amex Major Market Index](#), the [NYSE ARCA Tech 100 Index](#) are some of the examples of Price-weighted indices. Under this method, the price of each component stock is the only consideration when determining the value of the index.

This can be computed by using following formulae:

$$I_t = \frac{\sum_{i=1}^n P_{i,t}}{\text{Divisor}(d)}$$

Where,

I_t = Index at time 't'

$P_{i,t}$ = Price of ith stock at time 't'

n = Number of stock at time 't'

2.1.7.2 Value weighted index

Under value weighted index, the market index is calculated based on the total market value of securities. This method of calculating market index is also referred as market capitalization method as it considers the total market value of securities. Capitalization or value is the product

of market price of securities and their respective number of securities included. The total market value of securities for current year is divided by the total market value of the base period.

This can be computed by using following formulae:

$$I_t = \frac{\sum_{i=1}^n P_{i,t} \mid N_{i,t}}{\sum_{i=1}^n P_{i,0} \mid N_{i,0}} \mid \text{Base year index}$$

Or,

$$I_t = \frac{MV_t}{MV_0} \mid I_0$$

Where,

I_t = Index at time 't'

$P_{i,t}$ = Price per share of i^{th} stock at time 't'

$N_{i,t}$ = Number of i^{th} stock at time 't'

$P_{i,0}$ = Price per share of i^{th} stock at time '0'

$N_{i,0}$ = Number of i^{th} stock at time '0'

n = Number of stock at time 't'

MV_t = Market Value at time 't'

MV_0 = Market value at time '0'

I_0 = Index at time 0 or base period.

2.1.7.3 Equally weighted index

As the name suggests the required index is calculated by giving each security the same weight regardless of its price or market value. This process follows the daily price relatives of the relevant stocks in the index being constructed. Furthermore, this process consists of simple arithmetic mean method of calculating index.

This can be computed by using following formulae:

$$I_t = \frac{\sum_{i=1}^n PR_{i,t}}{n} \mid \text{Previous day's index}$$

Where,

$PR_{i,t}$ = Price relative of i^{th} stock at time t

N = Number of stock included in the index calculation

And, the price relative (PR t) = Today's Price/Previous day's price

2.1.7.4 Geometric mean index

This is also known as multiplicative method of calculating market index. Under this method a daily index is constructed by multiplying the previous day's index by the geometric mean of the daily price relative of stocks included in the index.

This can be computed by using following formulae:

Index (It) = Average price relative | Previous day's index

2.1.8 Market trend

A market trend is a tendency of a financial market that shows a movement in a particular direction over a specified period of time. We have to take into account the data of a series of time period to find out the trend of a market. For instance, the data over 5 years has been considered to analyse the market trend of Nepalese stock market in this research work. The relevant market trends are classified into different classes such as secular market trend (long term), primary market trend (mid-term) and secondary market trend (short-term). In stock market behavior the concept of a market trend is used in technical analysis and is inconsistent with the efficient-market hypothesis. (www.wikipedia.org)

To be more specific about financial market, it is necessary to know the purpose and objective of the financial market. If there were no financial markets, the borrowers would have difficulty finding lenders themselves. Hence, intermediaries such as banks and financial institutions help in the process of transformation of funds. These financial institutions take deposits from those who have more funds and want to save. They can then lend the collected funds to those who seek to borrow. Financial banks and financial institutions lend money in the form of [loans](#) and [mortgages](#). When the transactions become more complex than a simple bank deposit and lending then it requires markets where lenders and their agents can meet borrowers and their agents for

the purpose of lending and borrowing. A good example of a financial market is a [stock exchange](#). A company can raise money by selling [shares](#) to [investors](#) and its existing shares can be bought or sold. The relationship between lenders and borrowers can be explained through the following table.

Relationship between lenders and borrowers			
Lenders	Financial Intermediaries	Financial Markets	Borrowers
Individuals Companies	Banks Insurance Companies Pension Funds Mutual Funds	Inter bank Stock Exchange Money Market Bond Market Foreign Exchange	Individuals Companies Central Government Municipalities Public Corporations

Table No. 2.1.8.1

(www.wikipedia.org)

Many individuals are not aware that they lend their sums but everyone does it through financial intermediaries as the financial intermediaries collect the scattered funds from different individuals and lend the collected fund to individuals/institutions.

A proper analysis of international market trend is another important aspect of market analysis. In today's global market scenario, it is important to realize the benefits and consequences of a global financial market as a ripple effect would occur globally when any incident happens in the global market. For example, when bank failures in the United States, the rumor will spread everywhere in the world and the world market would be affected by it.

While analysing the market trend of security market, first of all we need to know what the market trend is all about. Here, market trend is concerned with the tendency or a prevailing course of movement of prices of financial securities being traded in a particular financial market. These market trends are classified as primary trends, secular trends and secondary trends. The concept of a market trend is used in technical analysis and is inconsistent with the efficient-market hypothesis. According to that standard view, which is the foundation of financial

economics, the performance of the market over any time period is not correlated with that over any previous time period - in statistical terms, it is random.

Here, in this research work the concern is to analyse the trend and challenges of the Nepalese stock market. Stock market deals with various kind of security instruments. In our context, both the long-term debt and equities are dealt under the only one security market popularly known as NEPSE. So we don't have separate bond market in Nepal. And the issuance of bond and debentures are not familiar as of equity securities.

2.2 Review of journals and articles

A review of relevant literature is crucial for the assessment of research problem. This helps to eliminate the duplication of what has already been done with regard to the similar topic. Here in this research work attempt is to analyse the influence of macroeconomic indicators on the growth and performance of stock market. To state the research problem, different journals, newspapers and articles written by different experts and market analysts have been consulted; which helped to derive appropriate findings and solutions. There have been a huge numbers of studies conducted nationally and internationally on the stock market. Hundreds of writers and experts have given their views and evidences for the performance of stock market. The findings of some of those research works are as follows:

The indicators of stock market development reflect the development of an economy. It is important to predict the course of the national economy because economic activity affects corporate profits, investor attitudes and expectations and ultimately security prices. The key for the analyst is that overall economic activity manifests itself in the behavior of stock price or the stock market. This linkage between economic activity and the stock market is critical (Fisher and Jordan, 1990, reviewed by Poudel: 2008)

Demirguc-Kunt and Maksimovic (1996) empirically explored the effect of financial market development, particularly stock market development on the financial choices of firms. They measured stock market development by the ratio of total value traded to GDP, and the ratio of total value of shares traded to market capitalization. Taking all the countries in the sample

together, they found that there is a statically significant negative correlation between stock market developments, as measured by market capitalization to GDP. There is also a statistically significant positive relationship between the size of the banking sector and leverage. The negative linear relationship between leverage and stock market development loses statistical significance when they controlled for variables that have been identified in the corporate finance literature as determining firm's financial structure. *(Reviewed by Neupane: 2008)*

Rajan and Zingles (1998) examined whether financial development facilitates economic growth by scrutinizing one rationale for such a relationship: that financial development reduces the costs of external finance of firms. They have developed a new methodology in their paper to investigate whether financial sector development has an influence on industrial growth. Apart from the methodological contribution, they had the following findings. First, their research suggests that financial development has a substantial supportive influence on the rate of economic growth and this works, at least partially, by reducing the cost of external finance to financially dependent firms. *(Reviewed by Neupane: 2008)*

Wagle (2002) studies the development of stock markets in terms of its size (market capitalization) annual turnover and also studies about the ratio of Market Capitalization to GDP and annual turnover to GDP. But the study has been fairly descriptive regarding the factual information. *(Neupane: 2008)*

Sindurkar (2004) studied about the relationship between stock market and economic growth, particularly at the role of stock market in economic growth. He found that the significant relationship does not exist between GDP and NEPSE index. However, the relationship of GDP with market capitalization and number of listed companies is significant. The correlation between economic growth rate and turnover velocity is unexpected and insignificant. *(Neupane: 2008)*

As depicted by Bhattarai (2008) in his article entitled "Problems, Challenges and Prospects of Nepalese Capital Market" that the Nepalese capital market is dominated by individual speculators. Hence, the market is becoming quite difficult to disseminate the information

equally. The rules and regulations state that the priority for the execution of order should given on time and price priority. But the speculators always gather around the stock exchange premises and get information as soon as the market closes but the investors who do not come in the stock exchange premises get information from the next day's newspaper and they remain always behind the speculators.

Gurung, (2004) conducted a research work on '*Growth and Performance of Securities Market in Nepal.*' In his research work he studied and analyzed the growth trends and performance of Nepalese securities market. This finding showed an unstable and poor performance of securities market.

As cited by Poudel, (2008), Shrestha (1992) in his book "Shareholder's Democracy and AGM Feedback" has focused various issues related to protection of shareholder's expectation. "Success of companies directly depends on the protection of their owners. But how can this be accomplished is main question. Thus, it is necessary to develop a possible guidance for enhancing the efficiency for public limited companies to contribute directly in the growth of national economy on one hand and ensuring handsome return to the shareholders on the other hand to make their investment meaningful and worthwhile. At present, the overall shareholders' democracy in terms of the protection of their interest is basically focused on the payment of satisfactory dividend and the maximization of shareholders' wealth by appreciating the value of shares they hold".

Shrestha, further indicated why the share market is inactive and what problems are the main causes for inactiveness and what measures should be done etc. are carefully defined. Similarly, how the securities frauds and manipulations have occurred and to what extent they can be overcome would be highlighted to draw adequate feedback to the regulating and controlling authorities to devise suitable laws to prevent such frauds and minimize manipulation in share price.

Poudel, (2008) indicated that the downfall of share market is mainly due to the unfair share market practices that went indicted for a long period in Nepal's share market. There has been a growing tendency to sell worthless and fraudulent securities since promoters were not questioned regarding their moral standing and honest integrity of professionalism. In practice, a handful of Banniya traders (Canny people) began to dominate the share market as they are very little exposed to the managerial and institutional culture of managing share market activities by honest and fair dealings.

Mahat (2000) in his book "*Capital Market, Financial Flows and Industrial Finance in Nepal*" (1981) said, "There is absence of secondary market to ensure liquidity to the securities on demand. Any attempt to stimulate investment in industrial sources would naturally depend on the extent to which the securities are salable in the market. Only the existence of a Stock Exchange can enable the security holders to sell their securities for cash and purchase alternate securities if they wish. In Nepal, in the absence of such a stock market, an industrial security is an illiquid form of asset, even more illiquid than the real estate for all practical purpose". (Cited by Poudel: 2008)

2.3 Review of previous thesis

There are numerous theses prepared by different scholars on this topic in the past years. They set different hypothesis for the analysis of different aspects of stock market. Mostly, the study has conducted to analyse the recent trend and performance of Nepalese stock market. Some scholars have attempted to analyse the price volatility of securities being traded in the Nepalese stock market. Some of which are reviewed in this chapter.

Khatri (2009) has conducted a research work on "*A Study on Trend of Stock Price Movement of Commercial Bank in Secondary Market of Nepal*" for the analysis of price movement of the shares of commercial banks in the secondary market of Nepal.

The some of specific objectives of the research were as to study the trend of stock price movement, to examine the relationship of MPS with other financial indicators, with various financial indicators and to evaluate the risk proportion of stocks of various commercial banks.

In his study, he found that the quantitative factors also played a great role for the determination of prices of the stocks. The demand of the shares of commercial banks in the secondary market remained higher all the time throughout the examination period than that of the shares of other sectors. Moreover, the rate of returns of all commercial banks were too higher than the required or equilibrium rates of returns being calculated for the research purpose. This indicates that the prices of the stocks of commercial banks are not correctly priced; they are underpriced and hence, rewarding for investment to the individual investors.

Subedi (2009) has conducted a research work on “*Current Position of Nepal Stock Exchange in Nepalese Capital Market*” for the analysis of roles of NEPSE and SEBON in the development of capital market in Nepal. Besides, the study focused on the study of roles of NEPSE and SEBON, analysis of market trend with regard to the annual turnover and NEPSE Index and finally to examine the quantity and number of total traded shares of different listed companies in the NEPSE.

The major findings of his research work were the large block of shares being traded in the stock exchange was captured by the shares of commercial banks. Trading, manufacturing and processing as well as other real sector's participation was nominal. Even though the total number of transaction has been increased during the study period, the large portion of it was covered by the stocks of commercial banks. The NEPSE index reflected the aggregate volatility of the share price of the companies being listed and traded in the NEPSE.

Poudel (2008) has conducted a research work on “*Stock Market Growth in Nepal*” for the examination and analysis of the recent growth trend of Nepalese stock market (primary as well as secondary).

In his study, he found that the market capitalization value of listed securities has been increased tremendously in recent years, even though it was negative in 2001/02; which shows the growth trend of primary market. Similarly the traded companies in the stock market reached 130 in the year 2007/08 from 38 in the base year 1993/94 thereby depicting the growth of secondary market. However, there has been an inconsistency in the average daily turnover in NEPSE during

the study period. The average turnover in the year 2007/08 is has reached 97.11 million from the turnover Rs. 3.65 million in the year 1993/94.

The market day is quite consistent as compared to average daily turnover. In the initial year 1993/94 the total transaction day was 121. The highest number of market days was 246 days in the year 2001/02. However, the growth rate remained negative in the year 2004/05 over 2005/06 due to the historic people's movement and other political disturbances. The NEPSE index was highest in the year 2007/08 with 963.36 with a growth rate of 40.85 percent over the previous year index.

Moreover, the study showed that the stock market in Nepal is in developing stage, and the majorities of the respondents were not satisfied with the growth trend of the market. The majority of the Nepalese investors did not possess sufficient knowledge about investment. However, the marketability and profitability of stocks were major motivating factors for investments in securities. As the primary market possess lower degree of risks, concentration of investors was attracted by primary market. And the majority of the respondent preferred to invest in banking and financial sectors due to the marketability and profitability of securities.

Neupane (2008) conducted a research on "*Relationship between Stock Market and Economic Growth*" to analyse the importance of stock market for the overall development of the economic system. Other specific objectives of her study were to measure the relationship between stock market and economic growth, and further to analyse how the development of stocks market can accelerate the rate of economic growth.

The major findings of her study were; more and more individual as well as institutional investors were involved in security transaction in subsequent years as a result of which the size of the primary stock market in Nepal was gradually increasing over the study period. Similarly, the size of the secondary stock market, as measured by NEPSE index was has also been increased in the study period although it was in downturn in the fiscal year 2002/03, but afterward it was in increasing trend.

This study has shown the positive relationship between the financial markets and real activities in the economy. As she found the correlation coefficients of market capitalization (MC), the stock market variable with various economic growth related variables: gross domestic product

(GDP), saving (S), investment (I), and capital formation (CF) were highly significant and positive during the study period. Similarly, there was a positive relationship between the value traded (VT) the stock market variable with various economic growth related variables: GDP, S, I and CF.

Rimal (2008) conducted a research on "*Problems of Stock Market in Nepalese Perspective*" to identify and analyse the problems of Nepalese stock market with respect to the overall development of the economic system.

While studying the aforementioned objectives he found that the stock market in Nepal is in developing stage although the growth trend of the stock market was not satisfactory. As the major portions of Nepalese investors do not have sufficient knowledge about investment, they have little knowledge about the capital market. Marketability and profitability were the major motivating factors of investment for investors as the majority of the investors make purchase decision without analyzing the financial performance of the company.

Even though the volume of trading has been increased during the study period, the trading pattern was infrequent thereby dominating the market floor by the securities of commercial banks and other financial institutions. He concluded that the reason behind this might be traditionally guided investors return principle where most earnings of investors have been in the form of dividend rather than capital gains. As the regular and high dividend was provided by banks and financial institutions, it became the only potential investment destination comparing to the stocks of other trading and manufacturing companies.

Gurung A. B. (2008) has conducted research on "*Brokers' Performance and Services in Secondary Market*" to study and analyse the service offered to the general investors by the brokers in the secondary market.

The major findings of his studies are summarized as:

Nepalese investors' habit in investing in stock market is very short. Investors prefer ownership transfer of securities to hold for long time and capital gain will reduce the dynamism of securities market. Investors follow the fundamental and technical analysis of the security while investing to some extent. According to him brokers are providing trading services with little informational services. Information dissemination and awareness campaign activities should be increased. Major of the investor are not satisfied with the brokerage services. Except few, listed companies will not provide realistic information to the general public. Mutual trading, pool, churning, cornering, matching have the greater role for stock market disorder. Most of the brokers have below average performance. Only few brokers are participating in brokering activities actively. The system followed by the NEPSE is not time and technology friendly.

Similarly, Mainali (2006) has conducted research on "*A Study of Share Price Behavior of Listed Companies*" for the analysis of stock price behaviour through the examination of stock price trend and volume of stock traded on the secondary market.

In her study, she concluded the Share trading system in share market is still uncivilized even in this age of science and technology. Though the volume of trading has increased substantially, the number of brokers has not increased. Therefore, for the systematic operation of the share market, the number of brokers should be increased according to the volume of trading. Similarly, the automation system has to put into practice to make the share market effective and competitive.

The public investors not direct their savings in share haphazardly. They should at least analyze or get suggestion from experts about financial position and the level of risk prior to taking and investment decision. Because of the persistence in the stock price movements professional traders either institutional or individual can be beat the market. Thus it is suggestion that the investors should be alert to exploit the opportunities. (Reviewed by Rimal : 2008)

Khanal (2003) has prepared a thesis on "*Growth, Problems and Prospects of Nepalese Stock Market*" for the analysis of growth and performance of Nepalese stock market. He further, clarified the objectives of the research as the examination of investor's awareness, the examination of the performance of stock broker's and other related institutions.

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

Neupane (2004) had carried-out a research study on “*An Empirical Study on Broking Services in NEPSE*” to analyze the performance and effectiveness of Broking Services. His study was based on both primary as well secondary stock market data. In the study he found that the Nepalese stock market is in infant stage. Both the investors and brokers are not satisfied with the brokering services of NEPSE. Investors are not getting adequate information and services from the brokers regarding the securities and the stock market. Due to the different types of market disorders like – mutual trading, wash sales, cornering the market, inside trading, churning, pool had increased the level of market disorder.

Moreover, the effective brokering service helps to increase the transaction and thereby helps to create the liquidity of stocks. It would also help to create the efficiency in the price of the shares. If there are shortages in the brokering services, it will not help to create the effective price of the share in the stock exchange and the prospective investors will find it hard to obtain securities at reasonable price, which ultimately adversely affect economy of the nation. The effective price setting of the share is one of the major requirements for the development of the stock market.

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

CHAPTER 3

RESEARCH METHODOLOGY

Pant, (2009) “The process of searching again and again to come closer to the truth is known as research”. It is a systematic process that investigates something to find out the solutions of a particular problem. Thus, we can now define research as an organized, systematic data based,

critical scientific enquiry or investigation into a specific problem which ultimately generates new knowledge, built a theory, helps to develop policies that support for a rational decision making. Moreover, this can also be defined as a knowledge building process which will be undertaken through a systematic organized methodology into a specific problem for the purpose of finding some genuine answer(s) to a specific problem.

This chapter deals with various tools and techniques that have been adopted while studying and analyzing the problem with certain objective in view. Research Methodology is a chapter in which the methods and process applied in the entire research work are examined. As per the aim and purpose of this study to evaluate the market efficiency and increasing trend of Nepalese Stock Market, the study tries to recommend the useful and meaningful points so that all stakeholders can have the relevant knowledge. The study follows the research methodology describe in this chapter.

3.1 Research Design

When the problem is identified, and the related literatures are reviewed the next step prevails which is called the ‘Research Design’. *Research design is like a philosophy of life; no one is without one, but some people are more aware of theirs and thus able to make more informed and consistent decisions. Similarly, every type of empirical research has an implicit, if not explicit, research design. Because a design always exists, it is important to make it explicit, to get it out in the open where its strengths, limitations, and implications can be clearly understood* (Maxwell, 2005). Moreover, a research design is a master plan that specifies the methods and procedures for collecting and analyzing the needed information. This is an organized approach for the collection and analysis of data, which guides the researcher in formulating, implementing and controlling the study. Research design is the plan, structure, and strategy of investigation conceived so as to obtain answers to research questions and to control variance that have been used in research work.

This research work is descriptive in nature because it is a fact – finding operational research work. My aim is not to make prediction and implications of the study rather it is to describe the trend of Nepalese capital market by accumulating relevant facts and figures. Moreover, it is a

trend study because the data and information has been collected at interval spread over a specified period of time. This research work provides information regarding the trend and challenges of Nepalese stock market which ultimately may predict what will happen in future.

3.2 Population and Sample

'Population or universe refers to the entire group of people, events, or things of interest that the researcher wishes to investigate. For example, if you are interested in investigating the smoking habits of employees in a chemical factory, then all employees in that factory will form the population.' Pant, (2009) The population for this study comprised of 157 listed companies whose shares were traded in the Nepal Stock Exchange (NEPSE). The required data and information have been collected from the various sources covering a period of 1993/94 to 2008/09.

Similarly, *'A sample is a collection of items or elements from a population or universe'* Pant, (2009). In this study the data of at least five years of period has been taken as samples. And to know the investor's perception regarding the growth and performance of Nepalese stock market; 64 respondents are taken as sample from different areas out of the total unknown population.

3.3 Nature and Sources of Data

The collection of data is considered as an integral part of the research activity. The sources of information are generally classified as primary and secondary. (Joshi, 2003),

Primary data are generally used in those cases where the secondary data do not provide adequate basis for analysis. (Joshi, 2003) Here in this research report the investor's perception and public awareness with regard to the growth and performance of Nepalese stock market has been collected through the questionnaire under the primary sources of data. 64 respondents are taken as sample, out of total unknown population.

Primarily, this research work is based on secondary sources of data. The study has covered the period of at least 5 year upto the year 2008/09. Nepal Stock Exchange Ltd. and Securities Board Nepal are the main institution which provides most of the secondary data required for the study. Moreover, other additional information and data have been extracted from the official publication of Nepal Rastra Bank (NRB), Security Board of Nepal (SEBON), Nepal Stock

Exchange Ltd. (NEPSE) and other publications. The official web sites of NEPSE www.nepalstock.com, SEBO www.sebonp.com and NRB www.nrb.org.np are the major sources of secondary data. Besides, required data have been collected from the annual reports of the above mentioned authorities too.

3.4 Data Collection Technique

For the collection of the secondary data, published materials have been viewed in various spots such as books by different authors, unpublished thesis reports, journals, world wide websites, online library, AGM reports of different listed companies, NEPSE, SEBON, NRB and so forth. To collect these secondary data, the researcher visited campus library of Lumbini Banijya Campus, Butwal; TU central library; official library SEBON and other public libraries too. On the other hand, the primary data collected through scheduled questionnaire.

3.6 Data Processing and Analysis

Until and unless the collected data are processed and arranged in a systematic manner, it has no meaning at all. Hence, data processing technique is one of the most important parts of the research study. The researcher should adopt that data processing technique to process the information and data which is suitable and feasible according to nature and objects of the research study. In this regard, the obtained data and information should be presented in such a way that it should be easily understood.

'Collecting data is the connecting link to the world of reality for the researcher.' (Pant, 2009)

The data presentation and analysis is one of the main parts of research work. Essential data should be completed and processed as per the laid objective of the study. Hence, in this report my attempt was to arrange the available data in tabular and graphic form so that the possible conclusion can be drawn easily. The data and statistics covered the period of at least five years for the purpose of study.

Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic. This study mostly based on the

analysis of secondary data with the help of different statistical tools like Trend analysis, Percentage, Tabulation and Diagrammatic presentation etc. Besides, the statistical tools like correlation coefficient and hypothesis test have been conducted for the empirical examination of secondary data. The empirical results have been extracted in this study by using annual data of listed companies from 1993/94 to 2008/09.

3.6 Statistical Tools and Tests

This section of the research report contains the different statistical tools and techniques of analyzing and interpreting the collected data and information. The secondary and primary data collected from different sources, need to be presented in a systematic manner through the use of statistical tools which helps to analyse the presented data in an effective manner.

The primary task of this study is concerned with testing the relationship of stock market with economic growth. Various related tools and techniques have been used for this purpose. To draw the conclusion by analyzing the collected data and information simple statistical tool like arithmetic mean, multiple bar diagram, trend analysis, percentage etc. are used and tabulation are made to implicit the comparative results.

3.7.1 Karl Pearson's Coefficient of Correlation

Correlation is the measure of relationship between two or more characteristics of a population or a sample. This simply measures the relationship between the two variables with respect to the changes between the phenomenon. For instance, it helps to study the manner between which two quantities vary in a related path accompanied by the movement –an increase or decrease in one trend or the opposite direction. The limits of correlation vary form -1 to +1.

The Karl Pearson's coefficient correlation is denoted by "r" and computed by using following formula, where the variable "x" and "y" represents two different variables.

$$\text{Correlation } (r_{xy}) = \frac{n \sum xy - \sum x \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

3.7.2 Testing of Hypothesis

"Hypothesis means the presumption or quantitative statement of the population parameter which may be true or false." Sthapit, et. al. (2006) Testing of hypothesis is conducted in order to make a proper decision about the quantitative analysis of data. In this research report, hypothesis (t-Test) for the significance of sample correlation coefficient has been conducted to test the whether the variables in the population are correlated. The test follows the given formula of test statistic.

$$\text{Test statistic (t)} = \frac{r}{\sqrt{1 - r^2}} \sqrt{n - 2}$$

Where,

"t" denotes the test statistic.

"r" denotes the coefficient correlation between two variables.

"n" denotes sample size (pairs)

The hypothesis has been formulated in two ways:

Null hypothesis: $H_0: r = 0$ i.e. the variables are not correlated in the population.

Alternative hypothesis: $H_1: r \neq 0$ i.e. the variables are correlated in the population.

$H_1: r > 0$ i.e. there is positive correlation in the population or the variables are positively correlated.

$H_1: r < 0$ i.e. there is negative correlation in the population or the variables are negatively correlated.

Level of significance: The level of significance has been set at $\alpha = 5\%$.

Critical value: Tabulated or critical value has been extracted as "t" at α % level of significance for (n-2) degrees of freedom from "t"-tables.

Sthapit, et. al. (2006)

3.7.3 Multiple Bar Diagrams and Graphs

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

than two sets of data. Diagrams are in different types. Out of these various types of diagram one of the most important form of diagrammatic presentation of data is multiple bar diagram which is used in cases where multiple characteristics of the same set of data have to be presented and compared.

3.7.4 Percentages

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

CHAPTER 4 PRESENTATION AND ANALYSIS OF DATA

This is an important chapter of research which is primarily concerned with the analysis and presentation of data in an understandable form. *'The analysis of data consists of organising, tabulating, performing statistical analysis and drawing inferences'* (Pant: 2009). Moreover, this chapter puts forward the analysis of secondary and primary data along with their results and interpretations. The general purpose of this chapter is to examine the process through which the collected data are presented and analysed. This chapter starts with the tabulation of data and placing them in a presentable form by the use of figures and tables. The process begins with the

analysis of secondary data concerned with the Nepalese Stock Market and its growth, followed by the analysis of primary data collected through questionnaire survey to know the general perception of ordinary people.

4.1 Overview of Nepalese Stock Market

4.1.1 Overview of Nepalese Economy

The growth rate of world economy was 3.2% in 2008 which was declined from 4.9% as compared to the growth rate of the year 2007. Similarly, the growth rate was estimated to turn negative by 1.3% in the year 2009. The global economy however, is estimated to grow up by 1.9% in the year 2010. (World economic outlook, April 2009) The global recession that has been started from the end of 2007 has a crippling effect on the global economy. The downturn started with the fall of the world's leading banks in the United States has shaken Nepalese economy too.

As shown by the preliminary estimates of Central Bureau of Statistics (CBS), the real growth rate in 2008/09 was 3.8% at base price and 4.7% at producer's price as compared to 5.3% at both base and producer's prices in 2007/08. The low and even negative growth rate of agriculture and non-agriculture sectors has decelerated the overall growth of Gross Domestic Product (GDP). However, the consumer inflation rate was increased to double digit of 13.2% in 2008/09 as compared to 7.7% in the year 2007/08. This year the inflation rate has been estimated to be at least 11%.

The Gross National Disposal Income (GNDI) increased by 21.2% in 2009, mainly due to the remarkable growth in worker's remittances and other transfer income. But the recent reports by different national and international authorities have shown the decline trend of remittances and other transfer incomes.

4.1.2 Overview of Nepalese Security Market and its Trading Process

The security transaction in Nepal started from 1937 when the shares of Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. were floated, for the first time in Nepal. The introduction of the Company Act in 1964 facilitated the establishment of Securities Exchange Center Ltd. Later the Government of Nepal under a program initiated to reform capital markets which proposed the

conversion of the then Securities Exchange Center into Nepal Stock Exchange in 1993. The basic objective of NEPSE is to impart free marketability and liquidity of securities through the transaction of government and corporate securities in its floor through members, market intermediaries, brokers, market makers. Currently, the transaction is done through the assistance of 23 brokers in the floor. Similarly, there are 11 sales and issue managers and 2 dealers which assist either for the primary issue or the secondary market trading.

In spite of the stock exchange there is another apex body which regulates and monitors the stock market through the issuance of proper guidelines, rules and regulations. The body is popularly known as Security Board of Nepal (SEBON). The SEBON was established in 1993 as an apex regulator of securities market in Nepal with a mission to facilitate the orderly development of capital market. The board was established under the Securities Exchange Act 1983.

As a non-profit making organization NEPSE is established for the purpose of determining fair price of securities. Any security will be liable for the trading when it is listed or registered in the stock market. It means, the securities are required to be listed in NEPSE for the purpose of trading in the open floor. Listing means, the registration of securities with the stock exchange. Trading system in NEPSE takes place either on the basis of auction system on the trading floor or a broker-dealer market. Mainly the trading pattern follows open-cry-out system in Nepal. In recent days trading follows a fully automated screen based trading system. Moreover, trading through Wide Area Network (WAN) and live dissemination of information from trading floor through world wide web is also in practice.

The securities transaction takes place on all working days of week except Saturdays and government holidays. The trading process is facilitated with sophisticated technology so that a broker can deal with trading activities remotely from his/her office located within the Kathmandu Valley. This remote trading facility was started from 1 November 2007. The trading takes place when the sell order matches with the purchase order. However, an order may match partially with another order. The best match of an order takes place with the highest price for buy order and with the lowest price for a sell order. Then the transaction takes place and the settlement process follows. The trading is done at "T" and at T+1; the buying brokers submit

bank vouchers for settlement with covering letter. At T+2, the selling brokers must submit share certificate with covering letter. At T+3, NEPSE prepares billing for payment and this will be forwarded to the bank. Once the settlement is done the buying brokers with the consultation of the clients must decide and present the purchased shares if they want to record it as blank transfer. This must be completed within T+5.

4.2 Analysis of overall trend of Nepal Stock Exchange through NEPSE Index

This part of the chapter reveals the development and performance of Nepalese stock market in terms number of companies listed, number of companies traded, NEPSE Index, sectorwise index etc through the analysis of five years' statistics.

4.2.1 Comparison of listed and traded companies in NEPSE

The statistics related to the number of listed companies and number of traded companies in NEPSE throughout fiscal year 2061/62 to 2065/66 has been presented in the given schedule:

Number of Listed and Traded Companies

Year	No. of Listed companies	No. of traded companies
2004/05	125	102
2005/06	135	110
2006/07	135	116
2007/08	142	136
2008/09	159	149

Table no. 4.2.1.1

(Source: Various annual reports of SEBON)

As shown in the above schedule, the total number of listed companies in the year 2004/05 was 125. One year latter the number reached to 135 thereby increasing by 8%. However, the number remained the same for the year 2006/07. This was mainly due to the historical people's

movement for the political change in the country. Then the number of listed companies in the year 2007/08 reached to 142, and finally the number reached to 159. There has been a substantial increase in the number of listed companies only due to the introduction of numbers of banks and financial institutions in the country after the Peace process began in the country in 2006.

Similarly, the total number of traded companies in the year 2004/05 was 102. One year latter the number reached to 110 thereby increasing by 7.8%. Although the number of listed companies remained the same for the year 2006/07, the number of traded companies reached to 116 in the same year. Then after, the number reached to 136 and finally the traded companies reached to 149 in the year 2008/09. This substantial increment in the number of traded companies was due to the establishments of additional banks and financial institutions in the country.

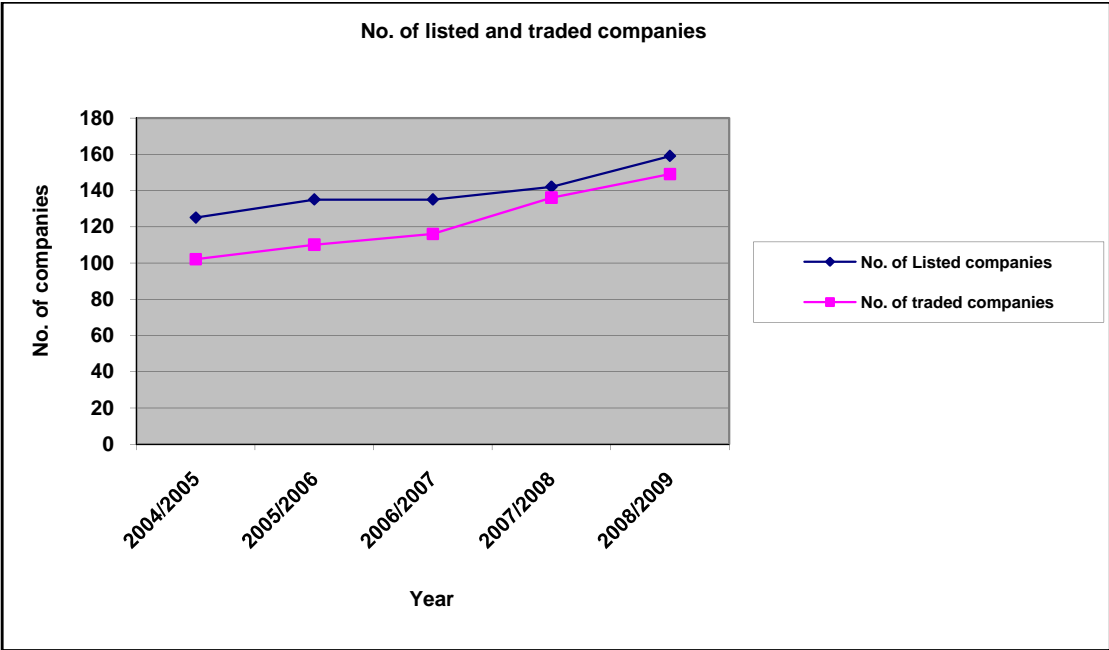


Figure no.

4.2.1.1: Comparative presentation between listed and traded companies.

As depicted by the above diagram both the lines representing the number of listed and traded companies go almost parallel. The upward sloping line indicating the total number of traded companies is below the line representing the total number of listed companies. This indicates that every year the number of traded companies is less than the no. of listed companies. But the movement of both of the lines is in same direction indicating that the movement between number

of listed companies with respect to the number of traded companies move in the same direction. Both the numbers of listed and traded companies increased by a substantial proportion from the year 2004/05 to 2005/06 as compared to the next two additional years.

4.2.2 Analysis of Overall NEPSE Index

An index is an indicator which indicates the changes in the values between two distinct time periods, a base time period and another particular point of time. A security market index is a number which indicates the movement of the overall securities prices throughout a certain point of time with respect to the base period. NEPSE Index is calculated by considering all listed securities of all listed companies in Nepal Stock Exchange.

Market Index is used to determine the relationship between historical price movements and economic variables thereby determining the systematic risk for individual securities. The market index is taken as a measuring tool which indicates whether the price of stocks is increasing or decreasing in the market. The highest index suggests the increase in market price of the stocks and implies the better performance of companies and vice-versa. Thus the NEPSE index shows the behavior of stock prices of Nepalese capital market.

The index can be computed by following different methods one of which is stock price based index. The stock price based index can be computed by using following formulae:

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

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

Where,

P_{01} = NEPSE Price Index

P_1 = Today's Stock Price

P_0 = Base year price

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

Q_0 = Base Listed Shares.

In this section we analyse the overall growth trend of NEPSE Index throughout the year 2004/05 to 2008/09.

Analysis of growth of NEPSE Index

Year	NEPSE Index *	% Growth
2004/05	286.67	29.10
2005/06	386.83	34.90
2006/07	683.95	76.80
2007/08	963.36	40.90
2008/09	749.10	-22.20

Table no. 4.2.2.1

(Source: Various annual reports of SEBON)

* Index presented in above table is taken from last date of each fiscal year.

The above schedule shows the growth trend of overall NEPSE Index throughout the year 2004/05 to 2008/09. As we can see the NEPSE index was 286.67 in the year 2004/05. The index has reached to 386.83 in the year 2005/06. Similarly, the NEPSE index has risen by a substantial amount by reaching 683.95 in the year 2006/07. The index was highest in the year 2007/08 thereby reaching 963.36, however the growth has declined in the year 2008/09 to 749.10.

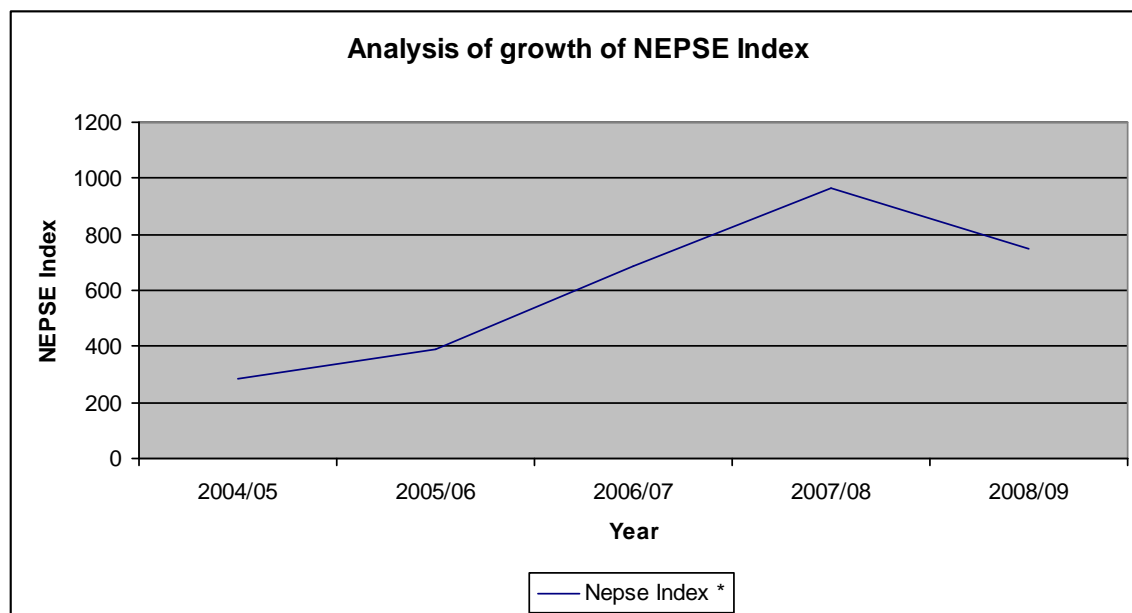


Figure no. 4.2.2.1:**Analysis of growth of NEPSE Index**

As depicted by the above figure, the NEPSE index was 286.67 points in the year 2004/05. The index was 348.43 in the year 2000/01. The index was slightly increased in the year 2005/06 thereby reaching to 386.83 points at the end of the fiscal year. Then after the growth rate was substantial upto the year 2007/08 thereby reaching at the highest point i.e. 963.36. Finally, the growth trend declined during the year 2008/09.

4.2.3 Analysis of NEPSE index trend during a fiscal year

As it has already been discussed, NEPSE index is calculated based on the values of listed securities of all listed companies in Nepal Stock Exchange for trading. This shows the overall movement of securities prices over a certain period of time. During the year 2008/09, the NEPSE index was in decreasing trend as other secondary market indicators. The following schedule has been constructed on the basis of last trading day of each month throughout the fiscal year 2008/09 (2065/066).

NEPSE index trend during the year 2008/09

Month/Year	NEPSE Index
July 08	1034.02
Aug 08	1175.38
Sep 08	962.55
Oct 08	881.86
Nov 08	750.71
Dec 08	695.5
Jan 09	658.83
Feb 09	677.52
Mar 09	664.13
Apr 09	647.78
May 09	707.89
Jun 09	662.63

Table no. 4.2.3.1

(Source: NEPSE Annual Trading Report 2008/09)

As shown in the above schedule the index started with 1034.02 in the first closing month of the fiscal year 2008/09. After reaching at the highest point at the end of August 2008 at point 1175.38, the index started to decline thereafter. This shows the downward trend of NEPSE index throughout the year. The diagrammatic representation of the above schedule follows:

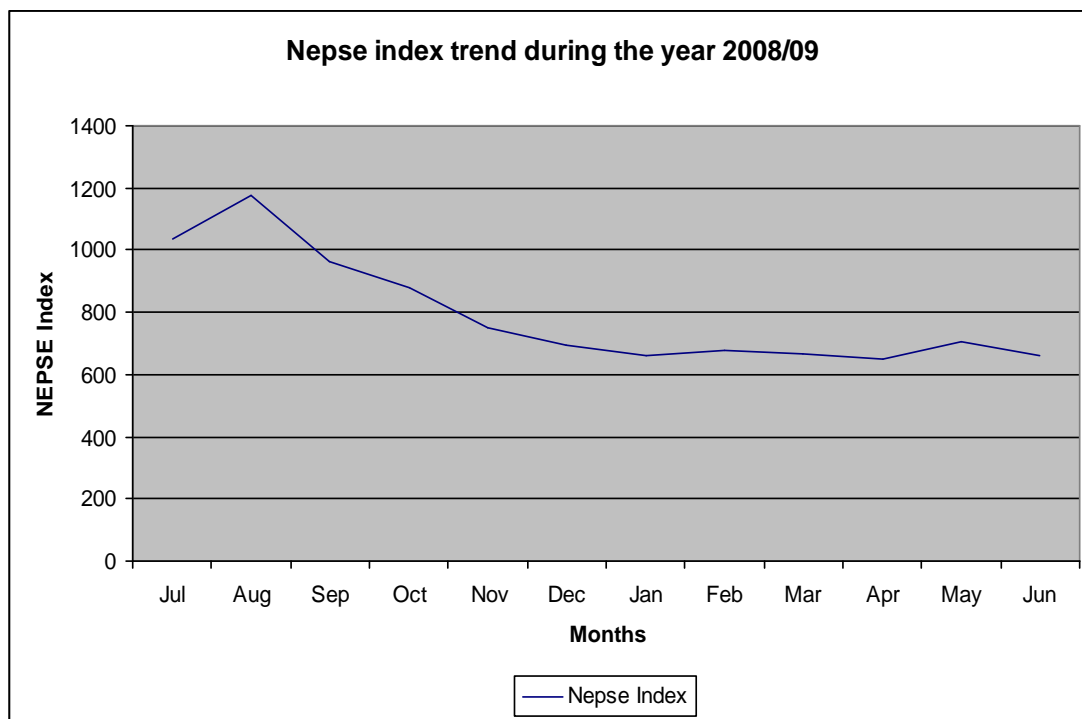


Figure no. 4.2.3.1 **NEPSE index trend during the year 2008/09**

As shown by the above figure, the NEPSE index was in decreasing trend most of the time during the fiscal year 2008/09. However, it reached to the highest point of 1175.38 at the end of August 2008 (i.e. on 15th Bhadra 2065). Similarly, the lowest point throughout the year was recorded at the end of April 2009 based on the month-end index.

4.2.4 Analysis of sector-wise index

The Nepal stock exchange has categorized the listed companies/securities into different sectors depending upon their specific nature of the business. In this regard, the companies are divided into different groups as commercial banks, development banks, finance companies, insurance

companies, hotels, etc. In this section, an attempt is made to analyse the sector-wise index for at least five years' period of time.

Sector-wise Index for various years

Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sector	(2004/05)	(2005/06)	(2006/07)	(2007/08)	(2008/09)
Commercial Banks	304.64	437.49	789.21	985.65	780.87
Development Banks	237.86	294.40	539.66	1171.86	772.56
Finance Companies	228.39	261.37	471.82	1074.60	697.61
Insurance Companies	320.24	381.25	612.46	862.78	656.41
Mfg. & Processing	276.50	301.11	348.63	423.66	434.32
Hotels	178.00	180.77	251.47	370.88	367.42
Trading	123.20	148.11	155.37	204.08	295.83
Other	347.65	410.00	818.12	768.26	738.99
Hydropower	-	-	847.93	1223.99	1044.81

Table no. 4.2.4.1

(Source: Various annual reports of NEPSE)

As said in the previous section, index is an important indicator of secondary market which ultimately considers the overall economic growth of the nation. Here, the sector-wise or group-wise index consists of various indices which are calculated on the basis of market capitalization. While considering the group index of commercial banks, we found the indexes were in increasing trend upto the point 985.65 in the year 2007/08, however the index declined during the year 2008/09. The same is the case for the group index of development banks and finance companies too. But the growth rate of index for latter two groups were the highest during the year 2007/08, i.e. the index reached to 1171.86 points and 1074.60 points with respect to development banks and finance companies respectively.

On the other hand, the group index for manufacturing and processing industries increased throughout the whole period of five years. The index was 276.50 points in the year 2004/05, which ultimately reached to 434.32 points in the last fiscal year 2008/09. The NEPSE index for hotel industries rose very slightly during the year 2005/06 thereby reaching to 180.77 points. The group-wise NEPSE index for the same group reached to 370.88 in the year 2008/09, which was the highest throughout the analysis period. Finally, the index declined during the year 2008/09. The index of trading group followed the same pattern that of the manufacturing and processing group. Similarly, the index of other sector was 347.65 in the year 2004/05. This has increased upto 818.12 points in the year 2006/07, after which the index declined continuously upto the last year. Finally, the analysis of the index of hydropower group for three year states that the pattern for the last three year followed the same pattern of the index of banks and financial sectors.

The statistics of the above schedule has been presented in the following diagrams:

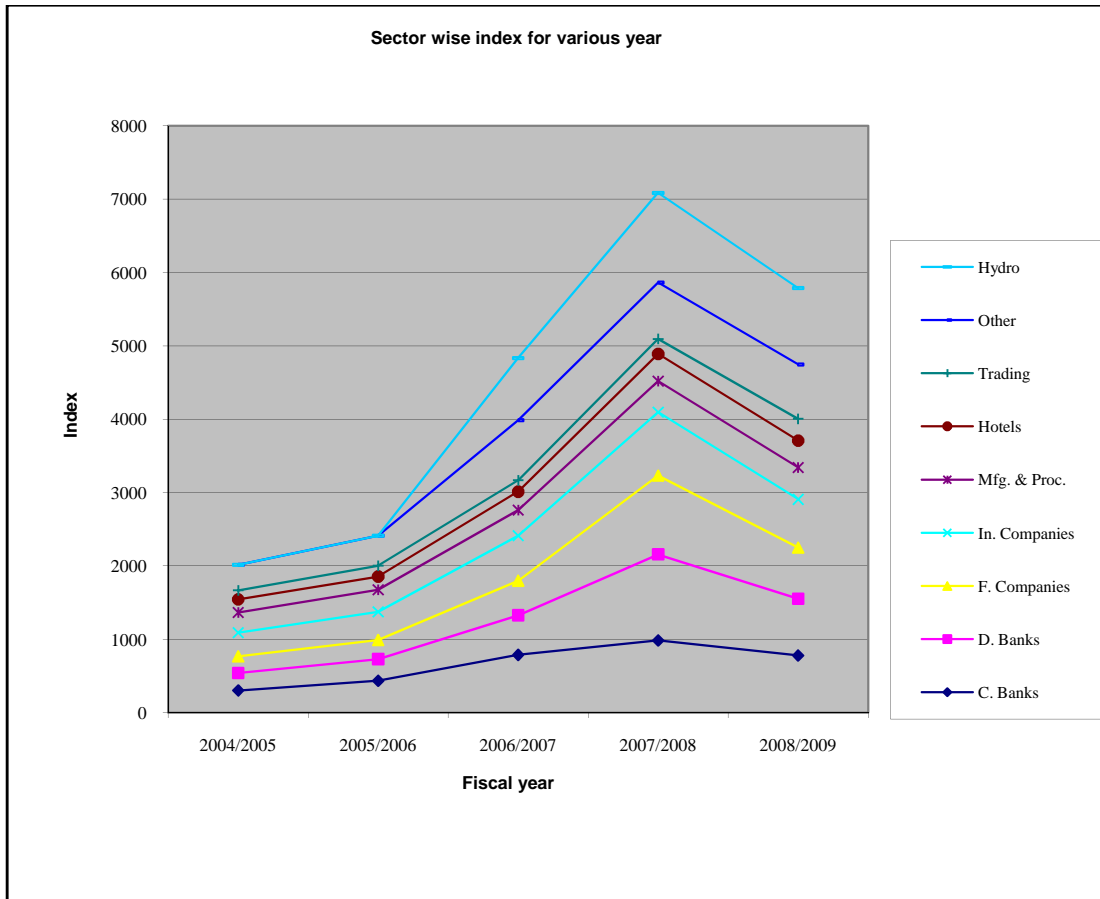


Figure no.

4.2.4.1: Sector wise index for various years

In the above figures, various fiscal years have been presented in the x-axis, whereas the value of group-wise index has been presented in the y-axis. Various lines showed the group indexes of different category viz. commercial banks, development banks, finance, insurance, manufacturing and processing and so forth. Almost all of the lines are upward sloping to the certain point of time thereby showing an increment in the index, whereas after a certain period of time the line fell downward thereby showing a downturn during the last fiscal year. However, the index of manufacturing & processing and trading group followed the same increasing trend throughout the analysis period, i.e., 2004/05 to 2008/09.

Presentation and Analysis of Primary Data

4.3 Analysis of investor's perspective with regard to investment in secondary market

For the analysis of investor's perception with regard to the growth and performance of Nepalese stock market, the researcher conducted the field survey taking 80 respondents from different areas such as banking, insurance, teaching, trade and commerce and so forth. The result has been shown in the following section.

4.3.1 Know how about stock market

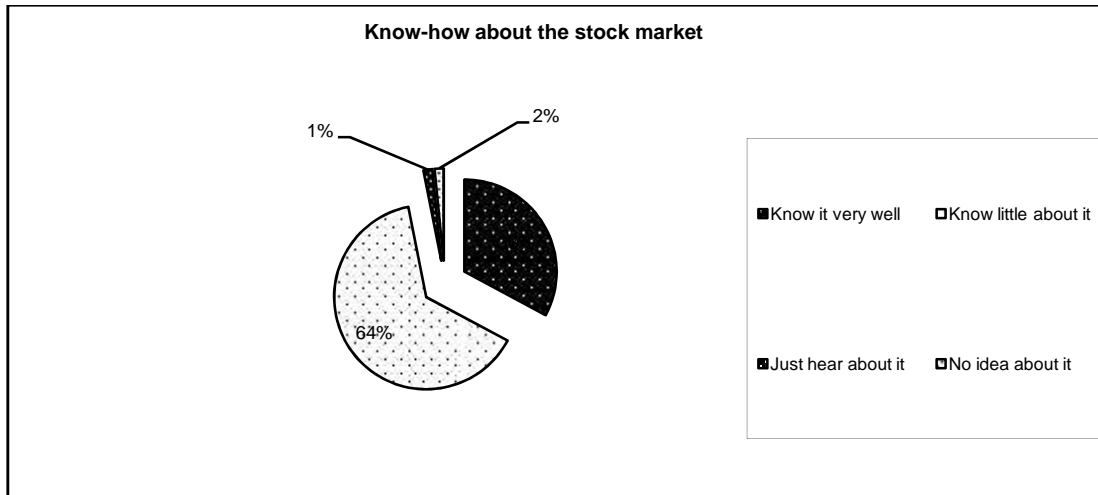
Know-how about the stock market

S n.	Alternatives	No. of respondent	% of respondent
a	Know it very well	21	32.8
b	Know little about it	41	64.0
c	Just hear about it	1	1.6
d	No idea about it	1	1.6
Total		64	100.0

Table no. 4.3.1.1

(Source: Field Survey, 2010)

As shown in the above table, out of total 64 respondents 41 are with a view that they have little idea about the stock market. This shows that most of the general public are not aware with the stock market. Only 21 respondents out of 64 have good knowledge about the stock market.



Figure

no. 4.3.1.1: Know-how about the stock market

The diagrammatic representation of the above information shows that the 32.8 percent respondents have very good knowledge regarding the stock market. But the majority of the respondents have little idea about it, this account for 64 percent. However, the unknown and illiterate are of 1.6 percents respectively.

4.3.2 Investment in corporate stock

Investment in corporate stock

Sn.	Alternatives	No. of respondent	% of respondent
a	Yes	42	65.6
b	No	22	34.4
Total		64	100

Table no. 4.3.2.1

(Source: Field Survey, 2010)



Figure no. 4.3.2.1: Investment in corporate stock

As the question has been asked with regard to the investments in corporate stock, 42 respondents have some investments in corporate stock which accounts for 65.6 percent, whereas 22 respondents don't have any investment in corporate stock which accounts for 34.4 percent.

4.3.3 Factors influencing for investment in corporate stock

Factors influencing for investment in corporate stock (IPOs)

Sn.	Influencing variables	No. of respondent	% of respondent
a	Marketability and profitability of stock	32	50
b	Liquidity of stocks	4	6.2
c	Limited opportunity of investment in other sector	12	18.8
d	Appreciation in share prices	16	25
e	If other, please specify	-	-
Total		64	100

Table no. 4.3.3.1

(Source: Field Survey, 2010)

While analysing the factors influencing investment in IPOs, 32 respondents (i.e. 50 percent) are with a view that they prefer investment in the primary issue of securities due to the marketability and profitability of the stocks. Similarly, 16 respondents are with a view that they prefer

appreciation in stock prices. The rest follows, limited opportunity of investment in other sectors and the liquidity of stocks respectively.

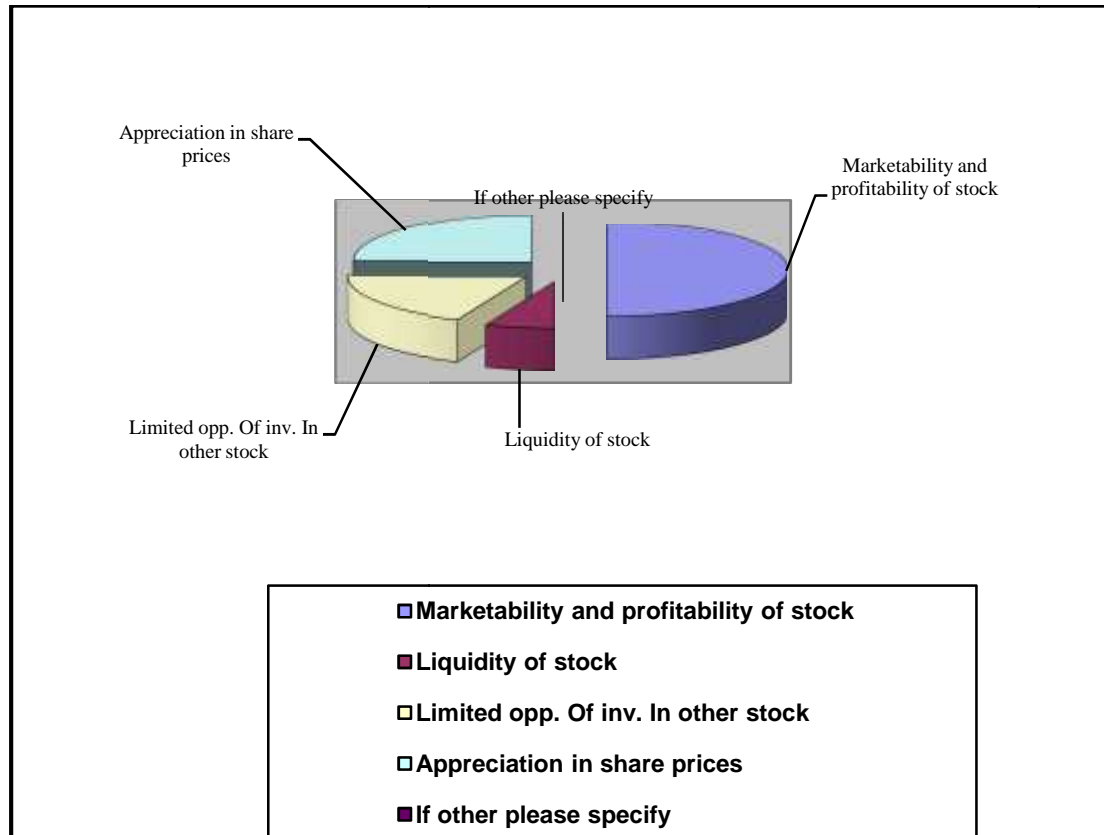


Figure no. 4.3.3.1: Factor influencing investment in corporate stock

The diagrammatic representation of the above mentioned information shows the major portion of the pie-chart covers with the marketability and profitability of the stocks. This means regarding the factors influencing for investment in IPOs, 50 percent of the respondents invest in stock for its marketability & profitability of the stocks. This shows that the majority of Nepalese investors are more profit concerned. However, there are other motivating factors too. In this regard, 25 percent respondents invest for the purpose of reaping benefit from the appreciation of stock prices. Thirdly, 18.8 percent of respondents viewed that, they invest in stock due to limited opportunity to invest in other sector. Rest of the respondents are motivated by the liquidity of stocks which accounts for 6.2 percent.

4.3.4 Motivating factors for purchasing share of a company

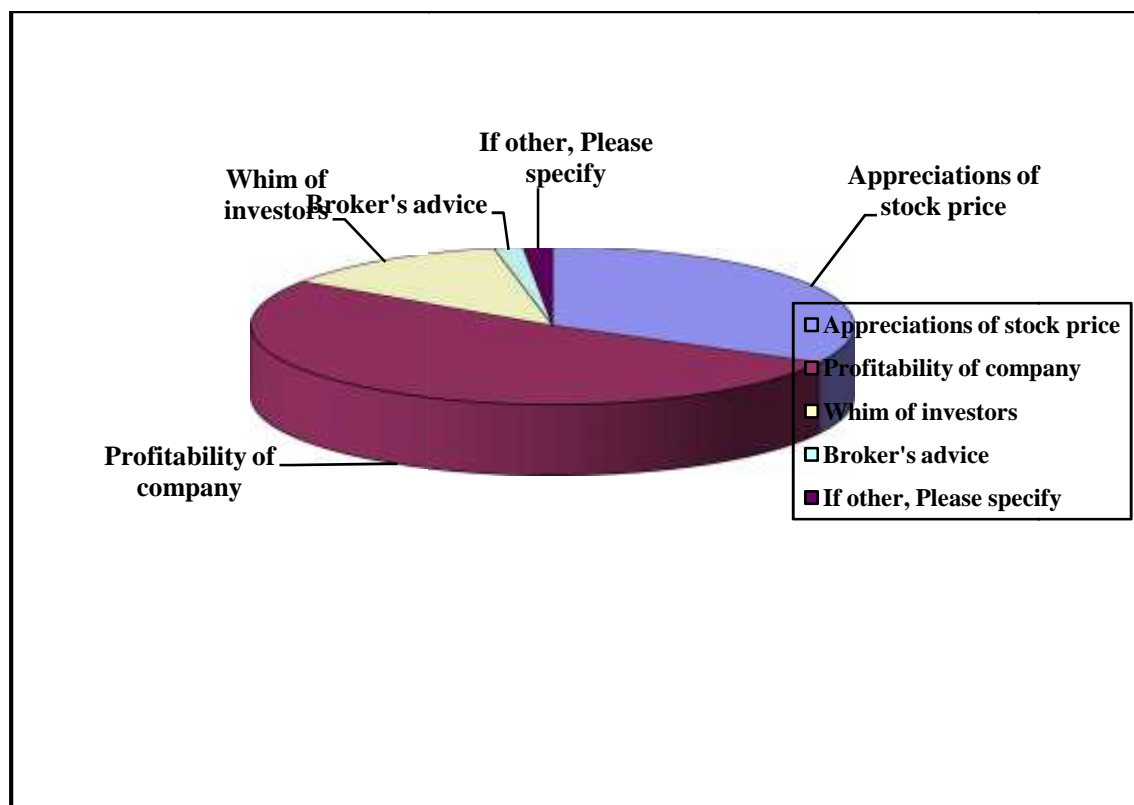
Motivating factors for purchasing share of a company

Sn.	Motivating variables	No. of respondent	% of respondent
a	Appreciation of stock price	21	32.7
b	Profitability of company	33	51.6
c	Whim of investors	8	12.5
d	Broker's advice	1	1.6
e	If other, please specify	1	1.6
Total		64	100

Table no. 4.3.4.1

(Source: Field Survey, 2010)

What factor motivates you to purchase a share of a particular company? While analysing this question through investor's perception, it has been depicted by the above table that the majority of the respondents agree with the profitability of the company. Really, this attitude can be seen in banking and financial sectors too. The over concentration of investment in the stock of banks and finance companies is the result of profitability of the business. Profitability has been followed by price appreciation and whim of investors.



Figure

no. 4.3.4.1: Motivating factors for purchasing share of a company

The above diagram shows 51.6 percent of respondents purchase due to the profitability of the company. Similarly, 32.7 percent invest in share of a particular company expecting the price appreciation of share in future. Rest of 12.5 percent purchase due to whim of investors followed by a least of broker's advice accounted for 1.6 percent.

4.3.5 Reason for concentration on banking and financial sector

Reason for concentration on banking and financial sector

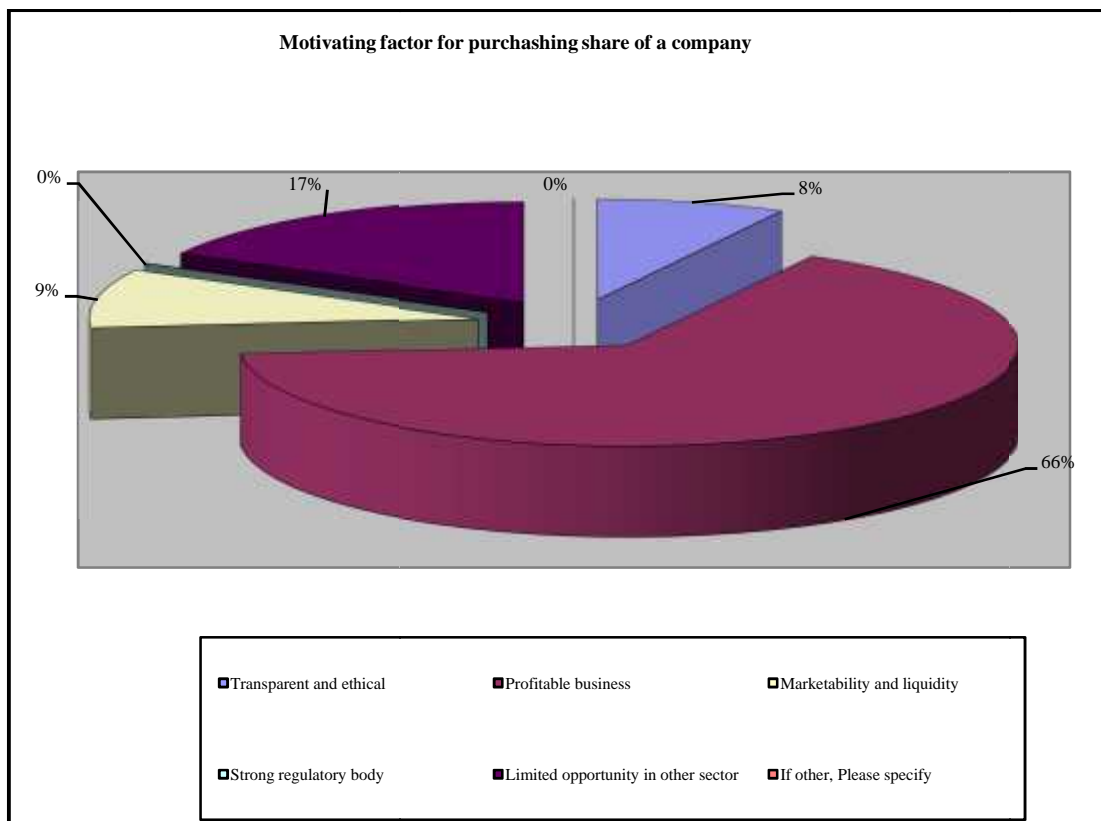
Sn.	Reasons	No. of respondent	% of respondent
a	Transparent and ethical	5	7.8
b	Profitable business	42	65.6
c	Marketability and liquidity	6	9.4
d	Strong regulatory body		
e	Limited opportunity in other sector	11	17.2

f	If other, please specify	-	-
Total		64	100

Table no.4.3.5.1

(Source: Field Survey, 2010)

As shown by the above schedule, with regard to the question about over concentration of investment in stocks of banks and financial institutions, 42 respondents are in a view that this is because of the profitable business. The next reason for overemphasis in this sector is limited opportunity in other sector for investment.



Figure

4.3.5.1 Motivating factor for purchasing share of a company

As shown by figure 4.3.5.1, Nepalese investors give more emphasis to investment in banking and financial sectors; mainly investment in commercial banks, development banks and finance companies than in real sectors like trading, manufacturing and tourism industries. Regarding the reason for attraction of financial sectors for Nepalese investors, 65.6% of the respondent marked that, investment in financial sector is more profitable business than others. Likewise 17.2%

prefer these sectors due to lack of opportunities in other sectors for the investment. Similarly, 9.4% of respondents give preference for marketability and liquidity; whereas another 7.8% of the respondent chose it because of transparent and ethical business.

4.3.6 Performance of Nepalese stock market

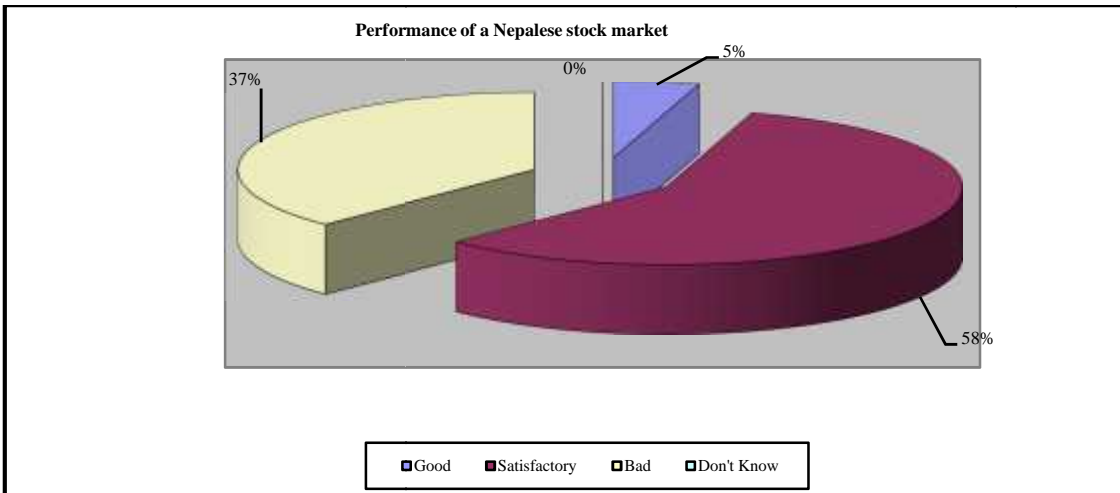
Performance of Nepalese stock market

Sn.	Alternatives	No. of respondent	% of respondent
a	Good	3	4.7
b	Satisfactory	37	57.8
c	Bad	24	37.5
d	Don't know		
Total		64	100

Table no. 4.3.6.1

(Source: Field Survey, 2010)

With regard to the performance of Nepalese stock market majority of the respondents are satisfied with the performance of Nepalese stock market. 37, respondents are satisfied. Similarly, 24 respondents do not agree with the performance of it, whereas only 3 respondents feel its performance good.



Figure

no. 4.3.6.1 Performance of Nepalese stock market

The above diagram shows the majority of the respondents, i.e. 57.8 % are satisfied with the performance of NEPSE. About 37.5 percent of the respondents are not satisfied with the performance of NEPSE, whereas the extremely satisfied respondents are 4.7 percent only.

4.3.7 Growth of Nepalese stock market

Growth of Nepalese stock market

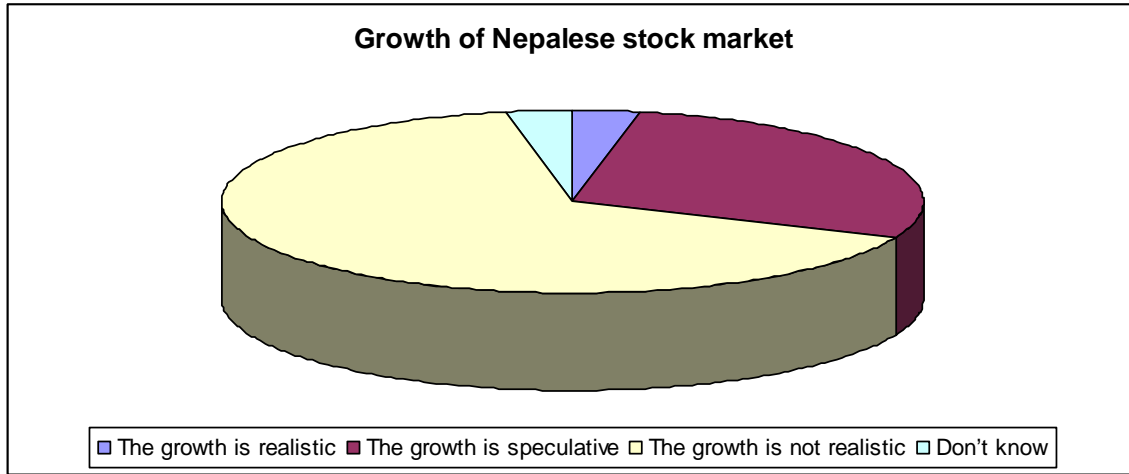
Sn.	Alternatives	No. of respondent	% of respondent
a	The growth is realistic	2	3.1
b	The growth is speculative	18	28.2
c	The growth is not realistic	42	65.6
d	Don't know	2	3.1
Total		64	100

Table No. 4.3.7.1

(Source: Field Survey, 2010)

Regarding the growth of Nepalese stock market, the majority of the respondents said that the growth rate is not realistic. 42 respondents out of 64, do not satisfy with the growth of NEPSE. Besides, 18 respondents said that the growth is speculative. This is speculative in the sense that

the daily transaction of NEPSE is influenced by the brokers. The investors are lacking adequate market information. Only 2 people feels the realistic growth of NEPSE, and 2 are constant with regard to this question.



Figure

4.3.7.1: Growth of Nepalese stock market

As depicted by the above figure, almost 67 percent of respondents are not satisfied with the growth of NEPSE, they are with a view that the growth is not realistic. The reason behind this may be the uncorrelated nature of real sector growth and the growth of the stock market. Likewise, about 28 percent respondents say that the growth is speculative. Overall, the growth trend is not realistic, this means, the growth of NEPSE is not compatible with the growth of real sector economy.

4.3.8 Correlation with economic growth

Correlation with economic growth

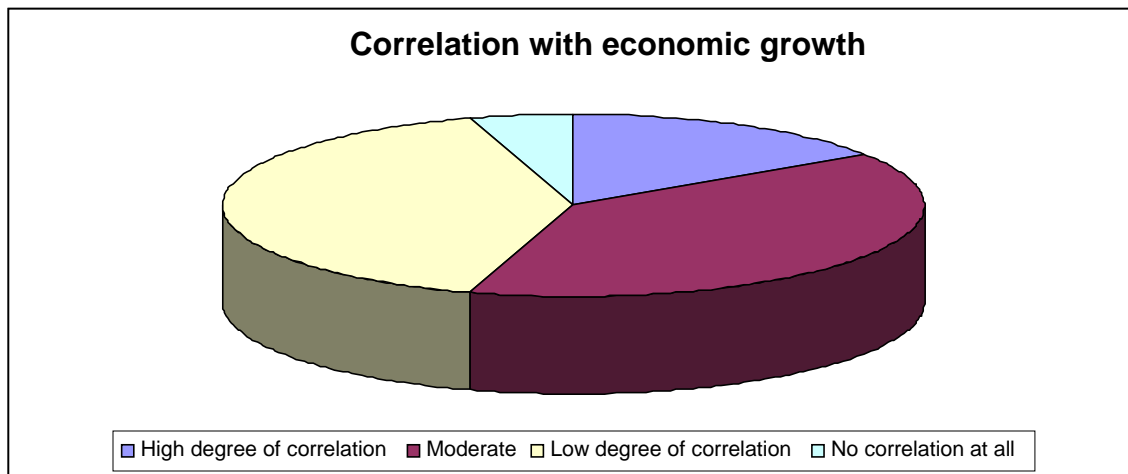
Sn.	Alternatives	No. of respondent	% of respondent
a	High degree of correlation	10	15.6
b	Moderate	25	39.1
c	Low degree of correlation	26	40.6
d	No correlation at all	3	4.7

Total	64	100
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Table No. 4.3.8.1

(Source: Field Survey, 2010)

While analysing the correlation of the growth of Nepalese stock market with the economic growth, most of the respondents agree with the moderate and low degree of correlation. In this regard, 25 respondents believe the moderate degree of correlation, whereas another 26 believe in low degree of correlation. Hence, undoubtedly, it can be said that stock market and economy is not highly correlated, rather they refer low degree of correlation.



Figure

4.3.8.1:

Correlation with economic growth

The above diagram shows that the portion of pie over moderate and low degree of correlation between the growth of NEPSE and economy is larger than others. About 39 percent respondents agree with the moderate degree of correlation. Similarly, about 41 percent respondents agree with the low degree of correlation. Only 15.6 percent believe the high degree of correlation, the rest 4.7 percent feel there is no correlation at all between these elements. However, to sum up, it can be said that the growth of Nepalese stock market is not highly correlated with the economic growth of the nation.

4.3.9 Sufficiency of existing stock market for security trading

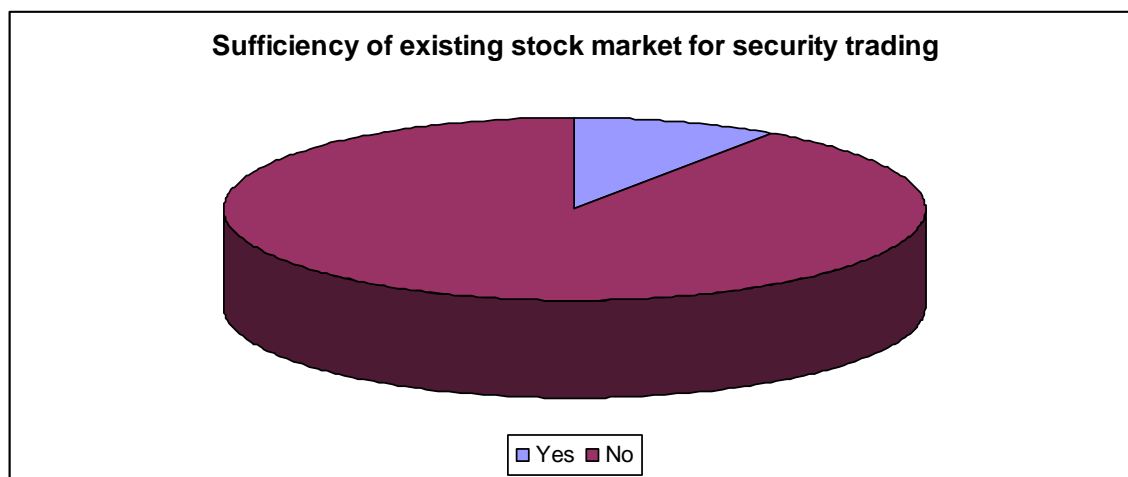
Sufficiency of existing stock market for security trading

Sn.	Alternatives	No. of respondent	% of respondent
a	Yes	6	9.4
b	No	58	90.6
Total		64	100

Table 4.3.9.1

(Source: Field Survey, 2010)

While analysing the sufficiency of existing stock market for the trading of securities almost about more than 90 percent respondents feel the need of another security market in Nepal. Out of 64 respondents, 58 are in a view of establishing another stock market. Some of respondents realise the region-wise stock market for the trading of securities.



Figure

4.3.9.1: Sufficiency of existing stock market for security trading

As shown in the diagram 4.3.9.1, 90.6 percent respondents feel the need of another stock exchange in Nepal, whereas, the rest 9.4 percent are with a view the present stock market is sufficient for stock trading.

4.3.10 Need of another security exchange

Need of another security exchange

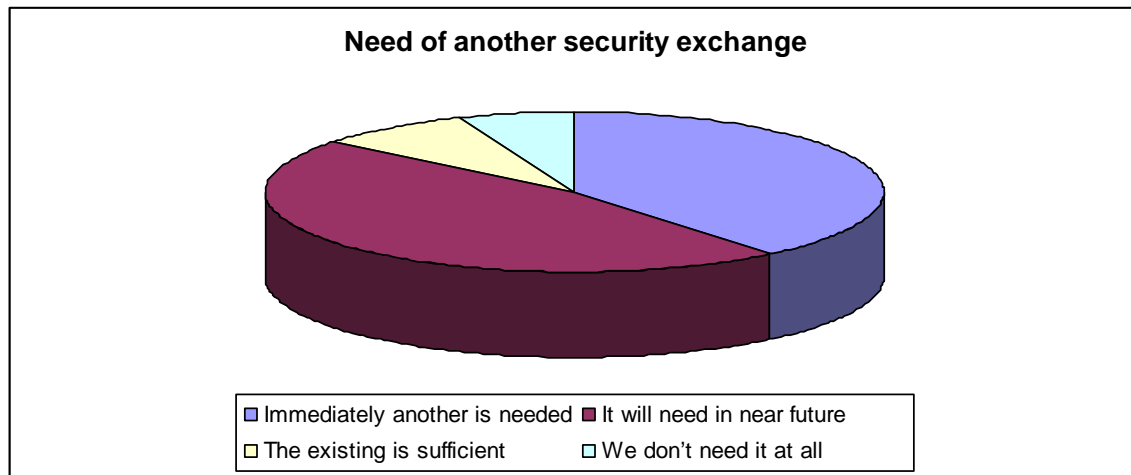
Sn.	Alternatives	No. of respondent	% of respondent
a	Immediately another is needed	25	39.1

b	It will need in near future	30	46.8
c	The existing is sufficient	5	7.8
D	We don't need it at all	4	6.3
Total		64	100

Table No. 4.3.10

(Source: Field Survey, 2010)

As shown in the above schedule, immediately the need of another stock exchange is realised by 25 respondents, whereas the need is realised in near future by 30 respondents. On the other hand, 5 respondents say that the existing market is sufficient for stock trading, and the next 4 respondents don't either realise the need of it at all.



Figure

4.3.10:

Need of another security exchange

The above diagrammatic representation shows, about 48 percent respondents realise the need of another stock exchange in near future. Likewise, another 39 percent stresses the need of it immediately. Whereas, 14 percent respondents are against the view that we need another stock exchange, out of which 8 percent say that the existing is sufficient and another 6 percent say that we don't need it at all. Undoubtedly, it can be concluded that the existing stock exchange is not sufficient for the trading of securities. Some people are in a view that a region-wise exchange is needed to uplift the growth of stock market in Nepal.

4.3.11 Problems of Nepalese security market

Problems of Nepalese security market

Sn.	Reasons	No. of respondent	% of respondent
a	Shortcomings of rules and regulation	10	15.6
b	Lack of modern technology	7	10.9
c	Lack of awareness among investors	15	23.5
d	Lack of proper coordination between authorities		
e	Lack of professional skills among financial intermediaries	5	7.8
f	All of the above	27	42.2
Total		64	100

Table No. 4.3.11.1

(Source: Field Survey, 2010)

Regarding the problems of Nepalese security market, most of the respondents remarked all of the above mentioned drawbacks are facing by the Nepalese stock market. However, lack of awareness among investors comes first while ranking the aforementioned drawbacks and followed by the shortcomings of rules and regulations. Lack of modern technology and professional skills among financial intermediaries are other important problems of NEPSE. The diagrammatic representation of the above schedule follows:

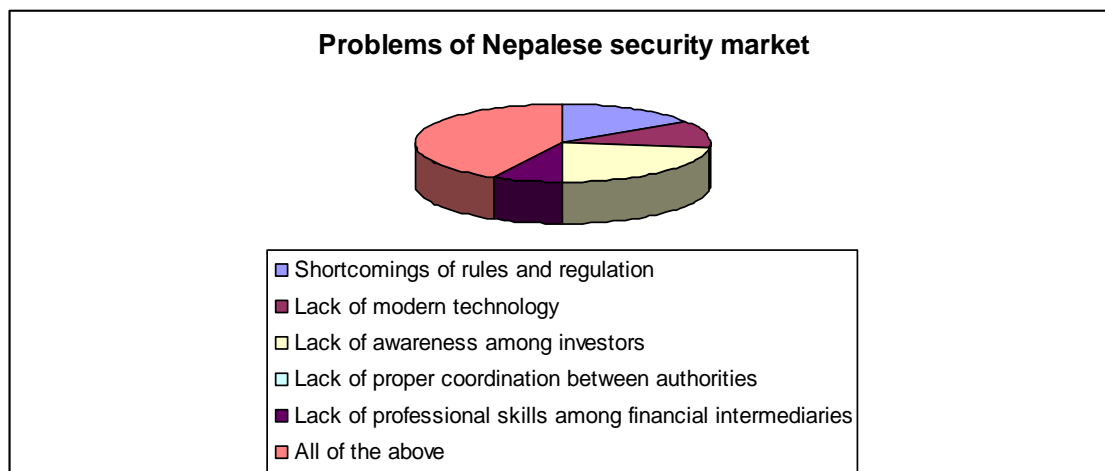


Figure 4.3.11.1

Problems of Nepalese security market

Regarding the problems of Nepalese stock market, majority of the respondents agree that the Nepalese security market lacks all of the problems mentioned above. This accounts for about 42 percent. Besides, 15 respondents agree on lack of awareness among investors which accounts for 23 percent. Similarly, another 10 respondents agree on shortcomings of rules and regulations. Similarly, lack of modern technology and the professional skills among the financial intermediaries are other major drawbacks of Nepalese stock market.

4.3.12 Remedial measures to boost up Nepalese stock market

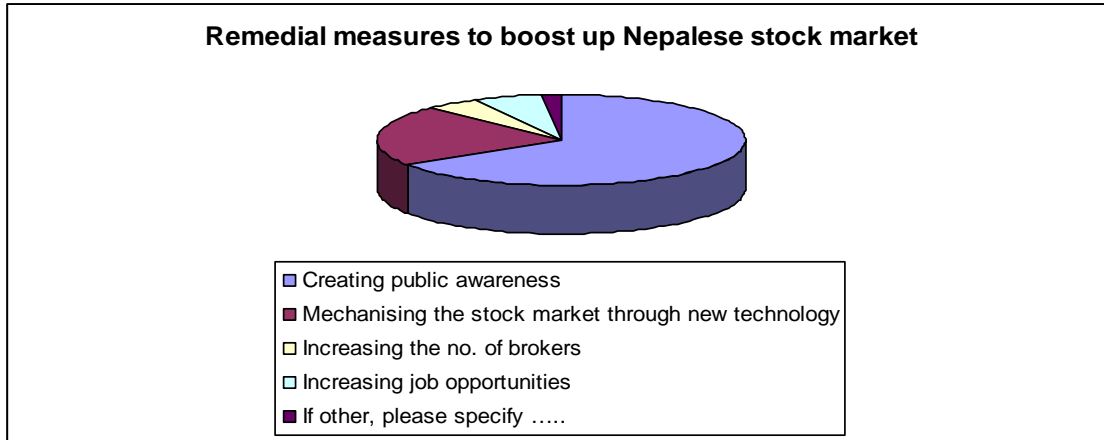
Remedial measures to boost up Nepalese stock market

Sn.	Variables	No. of respondent	% of respondent
a	Creating public awareness	42	65.6
b	Mechanising the stock market through new technology	14	21.8
c	Increasing the no. of brokers	3	4.7
d	Increasing job opportunities	4	6.3
e	If other, please specify	1	1.6
Total		64	100

Table No. 4.3.12.1

(Source: Field Survey, 2010)

The diagrammatic representation of the above schedule follows:



Figure

4.3.12.1 Remedial measures to boost up Nepalese stock market

While analysing the remedial measures for the growth and expansion of Nepalese stock market, majority of the respondents agree on creating public awareness. Almost 66 percent believe on creating public awareness is one of the major factor to boost up Nepalese stock market. Similarly, the next important remedial measure is mechanising the stock market through new technology. This accounts for about 22 percent. On the other hand increasing the number of brokers and creating job opportunities could bring the security trading in the forefront of the economy.

4.3.13 Respondent opinion regarding Nepalese stock market

While collecting the above information some of the respondents share their views with regard to the problems of the existing security market in Nepal. Some of their views and suggestions are listed out below:

1. The operation of NEPSE is not transparent and ethical
2. NEPSE index is not representing the actual index of NEPSE after listing huge number of right shares of different financial institutions.
3. Basically big investors and stock brokers influence stock market for their own sake.
4. There is not efficient information system and much delay in providing company's financial status.
5. Brokers do not provide proper advice and suggestions to the clients rather they influence investors.

6. Stock market should be decentralized and region-wise stock exchange need to be established.
7. The securities board should monitor and regulate the stock market through its controlling mechanism and appropriate penalty system.
8. Investors should be provided with investment guidelines.

4.4 Analysis of the growth of NEPSE index with other variables

4.4.1 Relationship between NEPSE Index and other relevant macroeconomic variables

The economic dimensions of an economy are: gross domestic product (GDP), Economic growth (EG), annual turnover of securities, inflation rates (I), per capita income (PCI) personal consumption and expenditure, and so forth. Here in the chapter my attempt would be to analyse the relationship between the growth structure of NEPSE index with some of macroeconomic variables (viz. GDP and EG)

4.4.1.1 Gross Domestic Product (GDP)

Gross domestic product (GDP) is the total sum of all the goods and services produced by nationals in a year. This is the total income earned by the individuals inside the country but excluding the income earned by the foreigners inside the country. Hence, GDP is the total value of all the products and services produced within the domestic territory of the country within an accounting year.

4.4.1.2 Annual Turnover

As we know that the secondary market is created by the trading of second-hand securities after the primary issuance of such securities. Normally, the transactions take place either in organised or over the counter market. Here in our context, the transactions take place in NEPSE. Here, turnover of securities represent the total volume of securities in amount. This means to say that the total amount of securities being traded in the security exchange. After the implementation of

Automated Trading System (ATS) in 2007 by NEPSE, the trading volume as well as the number of transactions has increased significantly during the period of last fiscal year.

4.4.1.3 Economic Growth (EG)

EG is another important macroeconomic indicator which measures the overall growth of the economy.

4.4.1.4 NEPSE Index

As explained earlier, NEPSE index is an indicator of the movement of prices of securities being traded in the stock exchange. A security market index is a number which indicates the movement of the overall securities prices throughout a certain point of time with respect to the base period.

4.4.1.5 Comparison and analysis of NEPSE index with reference to annual turnover, GDP and EG

In this section, the growth of NEPSE index is analysed with the overall growth of the GDP and EG. This is to findout that by how much the NEPSE index is grown with respect to the overall growth in the economy as measured by GDP and EG.

Analysis of NEPSE Index with Turnover, GDP and EG

Year	2061/62 (2004/05)	2062/63 (2005/06)	2063/64 (2006/07)	2064/65 (2007/08)	2065/66 (2008/09)
NEPSE Index	286.67	386.83	683.95	963.36	749.10
Annual Turnover (in million)	4508	3451	8360	22821	21681
GDP(in million)	463165	486435	493604	519574	539319
Economic growth	3.1	2.8%	2.5%	3.91%	3.5%

Table No. 4.4.2.1 (Source: Economic Review, NRB/Annual Report, NEPSE, CBS)

As shown in the above schedule, the NEPSE index was 286.67 points in the year 2004/05, in which the annual turnover was Rs. 4508 million. The total GDP at basic price was Rs. 463165

million in the same year. Finally, the economic growth rate was 3.1 %. The next year was positive in terms NEPSE index as it reached to 386.83 points, whereas, the annual turnover declined to Rs. 3451 million. Even though, the GDP increased by Rs. 23270 million, the economic growth declined to 2.8% in the same year. In the year 2006/07, the NEPSE index increased by about 76% whereas, the growth of annual turnover climbed upto 142% in the same year. But the overall economic growth declined to 2.5%, however, there was a slight increment in total GDP. All the figures were in increasing trend during the year 2007/08. This year the economic growth reached to 3.91%. Similarly, the GDP reached to Rs. 519574 million. Both NEPSE index and the annual turnover increased by a substantial amount thereby reaching index to 963.36 points and the turnover to Rs. 22821 million. Finally, there was a slack in year 2008/09 in terms of index, turnover and economic growth. The economic growth remained 3.5%, whereas, the projected GDP was Rs. 539319 million in the same year. The NEPSE index declined to 749.10 and the annual turnover remained at Rs. 21681 million in the same year.

Growth rate of NEPSE, turnover, GDP and EG

(Figure in %)

Variable\Year	2004/05	2005/06	2006/07	2007/08	2008/09
NEPSE Index	29.11	34.94	76.81	40.85	-22.24
Annual Turnover	110.26	-23.45	142.25	172.98	-5.00
GDP	3.23	5.02	1.47	5.26	3.80
Economic Growth	3.10	2.80	2.50	3.91	3.50

Table No. 4.4.2.2

(Calculated as per annex)

As we can see in the above schedule, the growth trend of GDP and EG are to some extent parallel with each other. During the year 2004/05, the Growth rate of GDP was 3.2% whereas, the economic growth rate was 3.1%. Similarly, the growth rates of NEPSE index and annual turnover for the same period were 29.1% and 110.3 % respectively. This simply shows that the uncorrelated relationship between such indicators. The next year, the index grew by almost 35%, whereas, the total turnover declined by 23%. However, there was a 5% growth in total GDP and the economic growth remained at 2.8%. Thereafter the growth rate between these macroeconomic variables was not similar, the same pattern follows for the next three years too.

Statistical Analysis

4.4.2. Karl Pearson's Coefficient of Correlation

Correlation is the measure of relationship between two or more characteristics of population or a sample. This simply measures the changes between the phenomenon. Moreover, this simply says by what manner two related quantities vary with each other. If the relationship between these variables is direct, the correlation is said to be positive and vice versa. Hence, it lies between +1 to -1, thereby representing perfectly positively correlated to perfectly negatively correlated. If the value comes in zero (0), this is said to be non correlated with each other. Here in this research work my attempt would be to analyse the simple correlation between the percentage growth between the NEPSE index and other macroeconomic variables (viz. GDP and EG).

4.4.2.1 Correlation between NEPSE index and annual turnover

Here, NEPSE index was denoted by (X) and annual turnover is denoted by (Y).

Correlation (r_{xy})

$$\begin{aligned} &= \frac{n \sum xy - \sum x \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}} \\ &= \frac{5 \sum 465711.56 \sum 3069.91 - 608.21}{\sqrt{5 \sum 2188818.04 - (\sum 3069.91)^2} \sqrt{5 \sum 109298.49 - (\sum 608.21)^2}} \\ &= \frac{461407.84}{1232.78 \sum 420.20} \\ &= 0.89 \end{aligned}$$

The above calculated coefficient of correlation between the NEPSE index and the annual turnover of securities shows the positive correlation between such variables. This means to say that there exist, high degree of positive correlation between index and annual turnover thereby showing a rapidly increasing trend between the variables in the same direction.

4.4.2.2 Correlation between NEPSE index and GDP

Here, NEPSE index was denoted by (X) and GDP is denoted by (Y).

Correlation (r_{xy})

$$\begin{aligned}
 &= \frac{n \sum xy - \sum x \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}} \\
 &= \frac{5 \mid 1563084.29 - 3069.91 \mid 2502.10}{\sqrt{5 \mid 2188818.04 - (3069.91)^2} \mid \sqrt{5 \mid 1255607.86 - (2502.10)^2}} \\
 &= \frac{134199.64}{1232.78 \mid 132.42} \\
 &= 0.822
 \end{aligned}$$

The above calculated coefficient of correlation (r) between the NEPSE index and the GDP shows the positive correlation.

4.4.2.2 Correlation between NEPSE index and Economic growth (EG)

Here, NEPSE index was denoted by (X) and EG is denoted by (Y).

$$\begin{aligned}
 \text{Correlation } (r_{xy}) &= \frac{n \sum xy - \sum x \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}} \\
 &= \frac{5 \mid 10070.26 - 3069.91 \mid 15.81}{\sqrt{5 \mid 2188818.04 - (3069.91)^2} \mid \sqrt{5 \mid 51.24 - (15.81)^2}} \\
 &= \frac{1816.02}{1232.78 \mid 2.50} \\
 &= 0.59
 \end{aligned}$$

This shows correlation between NEPSE index and the economic growth is positively correlated. This means to say that there exist moderate degree of positive correlation between NEPSE index and EG.

4.4.3. Testing of hypothesis

The above calculated figures of correlation coefficient between NEPSE index and the macroeconomic variables such as: GDP and EG has been tested using t-distribution test to examine how significantly the variables are correlated with each other.

4.4.3.1 t-Test between correlation coefficient of NEPSE index and annual turnover

The calculated value of coefficient correlation between NEPSE index and annual turnover i.e. "r" = 0.89, the level of significance is supposed to be 5%; and the degree of freedom (n-2) would be (5-2) = 3.

$$\begin{aligned}
 \text{Test statistic (t)} &= \frac{r}{\sqrt{1-Zr^2}} \sqrt{n-2} \\
 &= \frac{0.89}{\sqrt{1-Z(0.89)^2}} \sqrt{5-2} \\
 &= \frac{0.89}{0.456} \sqrt{3} \\
 &= 3.38
 \end{aligned}$$

Hypothesis formulation:

Null hypothesis: $H_0: \rho = 0$ i.e. the variables are not correlated in the population.

Alternative hypothesis: $H_1: \rho \neq 0$ i.e. the variables are correlated in the population.

Critical value: Tabulated or critical value of "t" at 5% level of significance for the degrees of freedom 3 is, 3.182.

Decision: Since the critical value of "t" (3.182) is less than the calculated value of "t" (3.38), the alternative hypothesis (H_1) is accepted. This shows that the population or the variables are correlated with each other. Moreover, it can be concluded that variables are significantly correlated with each other.

4.4.3.2 t-Test between correlation coefficient of NEPSE index and GDP

The calculated value of coefficient correlation between NEPSE index and the growth of GDP i.e. "r" is 0.822, the level of significance is supposed to be 5%; and the degree of freedom (n-2) would be (5-2) = 3.

$$\begin{aligned}
 \text{Test statistic (t)} &= \frac{r}{\sqrt{1-Zr^2}} \sqrt{n-2} \\
 &= \frac{0.822}{\sqrt{1-Z(0.822)^2}} \sqrt{5-2} \\
 &= \frac{0.822}{0.569} \sqrt{3} \\
 &= 2.50
 \end{aligned}$$

Hypothesis formulation:

Null hypothesis: $H_0: \rho = 0$ i.e. the variables are not correlated in the population.

Alternative hypothesis: $H_1: \rho \neq 0$ i.e. the variables are correlated in the population.

Critical value: Tabulated or critical value of "t" at 5% level of significance for the degrees of freedom 3 is, 3.182.

Decision: Since the critical value of "t" (3.182) is greater than the calculated value of "t" (2.50), the null hypothesis (H_0) is accepted. This shows that the population is not correlated with each other. This means to say that the correlation between NEPSE index and GDP is insignificant which indicates the unrealistic growth of NEPSE index.

4.4.3.3 t-Test between correlation coefficient of NEPSE index and EG

The calculated value of coefficient correlation between NEPSE index EG i.e. "r" is -0.53, the level of significance is supposed to be 5%; and the degree of freedom (n-2) would be (5-2) = 3.

$$\text{Test statistic (t)} = \frac{r}{\sqrt{1-Zr^2}} \sqrt{n-2}$$

$$\begin{aligned}
&= \frac{0.59}{\sqrt{1 - (0.59)^2}} \sqrt{5} \\
&= \frac{0.59}{0.81} \sqrt{5} \\
&= 1.26
\end{aligned}$$

Hypothesis formulation:

Null hypothesis: $H_0: \rho = 0$ i.e. the variables are not correlated in the population.

Alternative hypothesis: $H_1: \rho \neq 0$ i.e. the variables are correlated in the population.

Critical value: Tabulated or critical value of "t" at 5% level of significance for the degrees of freedom 3 is, 3.182.

Decision: Since the critical value of "t" (3.182) is greater than the calculated value of "t" (1.26), the null hypothesis (H_0) is accepted. This indicates that the variables in population are not correlated with each other or, the correlation between such variables is insignificant.

4.5 Obstacles for stock trading

Under this section an attempt is made with regard to determine and analyse the obstacles faced by Nepalese capital market. Nepalese capital market is a market for long-term fund through which the entrepreneurs raise scattered savings by issuing different types of securities. Till today, there is only one stock exchange in Nepal. Recently, the NEPSE has extended its service on a regional basis. Some of crucial hurdles and obstacles of Nepalese capital market follows:

4.5.1 Influence of individual investors

The trading of securities in NEPSE is dominated by individual investors directly. A very few big individual investors influence the trading pattern and market price of securities, hence, it has been quite difficult to disseminate the correct and reliable information about the market equally. The trading rules and regulations of NEPSE state that the execution of an order should be based on the time and price as approached by the investors through their brokers. But the speculators

always gather around the stock exchange premises and get information as soon as the market closes but the real investors had to wait for the next day's newspapers for this.

4.5.2 Lack of institutional support and coordination

The influence of institutional investors plays crucial role for the balanced growth of stock market. But the existence of investment companies and mutual funds is negligible in Nepalese stock market. There is only one closed end mutual fund, even though the fund is inactive itself. On the other hand the taxation on the return for institutional investors is higher than that of the individual investors. This also created hurdles for the growth of institutional investors in the stock market.

Similarly, the development of entire stock market also depends on the group cooperation by concerned authorities. The major authorities are Nepal Stock Exchange, Security Board of Nepal and Nepal Rastra Bank. SEBON is the apex regulatory body of NEPSE. On the other hand the role of central bank (NRB) for providing directives and guidelines through the publication of rules and regulations to banks and financial institutions could play vital role for the growth of NEPSE. These related authorities should be supportive for the growth of the market which is lacking in our context.

4.5.3 Lack of modern technology

The breakthrough in physical science and innovation of modern technology has influenced the day-to-day life in every facets. The basic principle of stock exchange operation is to execute the trade on the principle of time and price priority. But due to the traditional open-out-cry system of trading some human error occurs while dealing with the transaction. Brokers knowingly or unknowingly sometimes violate the rule while quoting the price on the board by quoting one's price instead of other. This type of human error may occur while dealing with the transaction manually.

By realizing this fact, NEPSE has started electronic trading system these days through the introduction of automated trading system.

4.5.4 Lack of investable instruments

Nepalese stock market is lacking the variety of investable instruments. The capital market is over-dumped with common stock for trading and followed by a few preferred stocks and countable debentures. This means to say that only ordinary shares are the primary means of security for trading in the secondary market. In fact, this is almost only the permanent source of capital in Nepal. Besides, the trading of government securities is negligible. Similarly, regarding the common stocks too, the promoters hold majority of the stock, which need to be traded in a bulk as it is treated in different category, Besides, the institutional investors and the rich investors do not sold their holdings as they treat this as fixed assets.

4.5.5 Lack of awareness among investors

The public awareness is lacking with regard to the security market and its function. The general people do not know about the stock market. Most of the people are living in villages and suburbs where they don't have any idea about corporate stocks and government securities. Only people living in urban areas and having access with corporate culture knows about stock market and its trading pattern. Hence, an effort needs to be enhanced for creating public awareness among the general public for the growth of Nepalese capital market. In the research questionnaire as presented above showed that out of 64 respondents, 42 are in a view to create public awareness for the growth of Nepalese stock market.

4.6 Major findings of the study

The major findings of the study from the analysis primary as well as secondary data have been listed in the following points:

1. The growth rate of world economy was 3.2% in 2008 which was declined from 4.9% as compared to the growth rate of the year 2007. The real growth rate in 2008/09 was 3.8% at base price and 4.7% at producer's price. However, the consumer inflation rate was increased to double digit of 13.2% in 2008/09 as compared to 7.7% in the year 2007/08. This year the inflation rate has been estimated to be at least 11%.
2. The security transaction in Nepal started from 1937 when the shares of Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. were floated. Then the Securities Exchange Center was

established for security trading. Then the Center was converted into Nepal Stock Exchange in 1993 to impart free marketability and liquidity of securities through the transaction of government and corporate securities. Currently, the transaction is done through the assistance of 23 brokers in the floor.

3. The total number of listed and traded companies was 125 and 102 in the year 2004/05 respectively which has been increased upto 159 in the year 2008/09.
4. The NEPSE index was 286.67 points in the year 2004/05. The growth rate of NEPSE index was highest during the year 2007/08 thereby reaching at the highest point i.e. 963.36. Finally, the growth trend declined during the year 2008/09 thereby declining to 749.10 points.
5. The analysis of NEPSE index for the year 2008/09 shows that the index started with 1034.02 in the first closing month of the fiscal year 2008/09. At the end of August 2008 the index reached at the highest point to 1175.38, the index started to decline thereafter.
6. As the analysis of sector-wise index shows the highest growth of index was in commercial banks, development banks and finance companies. Similarly, the last three years statistics of hydropower sector showed the highest point of index in the year 2007/08 was 1223.99 which was declined thereafter as of other sector's index.
7. On the other hand the growth rate of index for manufacturing and processing sector has been continuously increased from the year 2004/05 to 2008/09 from 276.50 to 434.32. However, the growth rate was steady.
8. It is found that the stock market in Nepal is in developing stage, however, majorities of the respondents are not satisfied with the growth trend of the market.
9. The majority of the respondents say that they have little knowledge about the stock market. Almost about 65 percent of the respondents have investment in corporate stock.
10. Majority of respondents say that they invest in securities for the profitability and marketability of stock. Regarding the over concentration of investment in banking and financial sectors, the majority of respondents are in a view that this sector are profitable than other sectors.

11. Most of the respondents say that the performance of Nepalese stock market is just satisfactory, whereas the remaining says it is not performing well. And more than 65 percent of the respondents are in a view that the growth rate of Nepalese stock market is not realistic.
12. As the marketability and profitability are the major motivating factors of investment for investors; majority of investors make investment decision without analysing the financial performance of the company and without consulting the financial experts.
13. The correlation coefficient between the growth of NEPSE index and other macroeconomic variables is positive. The correlation between NEPSE index and the annual turnover of securities (0.89) is highly positive. Likewise the correlation between NEPSE index and GDP (0.822); and NEPSE index and EG (0.59) is which indicates positive relationship between such variables.
14. Even though the coefficient correlation between NEPSE index and other macroeconomic variables was positive. The result of hypothesis test has shown the mixed relationship between such variables. The coefficient correlation between NEPSE index and annual turnover of securities is positively correlated, whereas, it is insignificant in between NEPSE index and GDP; and NEPSE index and EG. This indicates that the growth of the NEPSE index is not realistic with reference to the overall economic growth of the nation.
15. Lack of awareness among investors, lack of proper coordination institutional support, influence of individual investors, lack of modern technologies are some of the important obstacles of security trading in Nepal.

CHAPTER 5

SUMMARY AND CONCLUSIONS

5.1 Summary

The concept of security transaction in Nepal started from 1937 when the shares of Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. were floated, for the first time in Nepal. Thereafter the establishment of Securities Exchange Center Ltd in 1976 facilitated the security trading in Nepal. Later the Government of Nepal converted the existing Securities Exchange Center into Nepal Stock Exchange in 1993. The basic objective of NEPSE is to impart free marketability and liquidity of securities through the transaction of government and corporate securities. The trading is done on the floor of NEPSE through members, market intermediaries, brokers, and market makers. Currently, the transaction is done through the assistance of 23 brokers, 11 sales and issue managers, and 2 security dealers. The security transaction is regulated and governed by Security Board of Nepal (SEBON). The SEBON was established in 1993 as an apex regulator of securities market in Nepal with a mission to facilitate the orderly development of capital market.

The securities are required to be listed in NEPSE for the purpose of trading in the floor. Listing means, the registration of securities with the stock exchange. Mainly the trading pattern follows open-cry-out system in Nepal. However, in recent days trading follows a fully automated screen based trading system popularly known as ATS, side by side the NEPSE has introduced the technology for trading through Wide Area Network (WAN) and live dissemination of information from trading floor. The trading takes place when the sell order matches with the purchase order. When transaction takes place on the floor the settlement process follows and will be settled within the 5th days of trading. The stock market growth is one of the important issues in Nepalese capital market. Capital market facilitates the exchange of financial assets by bringing together buyers and sellers of securities. This study mainly aims to examine the trend and challenges of Nepalese stock market.

The total number of listed companies in the year 2004/05 was 125. One year later the number reached to 135. However, the number remained the same for the year 2006/07. Finally the number of listed companies reached to 159 in the year 2008/09. Similarly, the total number of traded companies in the year 2004/05 was 102. One year later the number reached to 110. Finally, the number reached to 136 in the year 2007/08. This substantial increment in the number of traded companies was due to the establishments of additional banks and financial institutions in the country. The NEPSE index was 286.67 in the year 2004/05 which finally reached to 749.10 in the year 2008/09. However, the index was at the highest point at the end of August 2008 at point 1175.38. Similarly, the sector-wise index was highest for development banks thereby reaching upto 1171.86 points.

The analysis of primary data shows that about 50% respondents are in a view that marketability and profitability of the stock is the primary factor that influences investment in corporate stock. Similarly, about 52% say that the profitability of the company is the primary motivational factor for the purchase of security of a particular company. The next important motivating factor is the price appreciation of share in future, which accounts for about 32%. Regarding the over emphasis of investment in the securities of banking and financial sectors; more than 65% of the respondent marked that, investment in financial sector is more profitable business than others. With regard to the performance of Nepalese stock market majority of the respondents are satisfied with the performance of Nepalese stock market. However, most of the respondents are not satisfied with the growth of NEPSE. They marked that the growth of NEPSE is not realistic, as it is not relevant with the board macroeconomic indicators. Almost about 67 percent of respondents are not satisfied with the growth of NEPSE, they are with a view that the growth is not realistic. Other said the growth is speculative. About 39 percent respondents agree with the moderate degree of correlation between NEPSE index and the economic growth. Similarly, about 41 percent respondents agree with the low degree of correlation between these variables. Overall, the growth trend is not realistic, this means, the growth of NEPSE is not compatible with the growth of real sector economy. Regarding the sufficiency of existing security market in Nepal, about 90% respondents felt the need of another stock exchange in Nepal.

The annual turnover of securities was Rs. 4508 million in the year 2004/05. The total GDP at basic price was Rs. 463165 million in the same year. Finally, the economic growth rate was 3.1

% . The GDP increased by Rs. 23270 million, the economic growth declined to 2.8% in the next year. In the year 2006/07, the NEPSE index increased by about 76% whereas, the growth of annual turnover climbed upto 142% in the same year. But the overall economic growth declined to 2.5%, however, there was a slight increment in total GDP. Finally, there was a slack in year 2008/09 in terms of index, turnover and economic growth. The economic growth remained 3.5%, whereas, the projected GDP was Rs. 539319 million in the same year. The NEPSE index declined to 749.10 and the annual turnover remained at Rs. 21681 million in the same year.

While analysing the correlation of the growth of Nepalese stock market with the broad macroeconomic indicators viz. GDP and economic growth, undoubtedly, it is found that the coefficient of correlation between the growth of NEPSE index and the annual turnover of securities was +0.89, which shows significant relationship between NEPSE index and annual turnover during the examination period of five years. On the other hand, the analysis shows that the correlation between NEPSE index and the growth rate of GDP was +0.822, this also indicates the positive relationship between such variables. Similarly, the correlation coefficient between NEPSE index and the overall economic growth (EG) was found to be +0.59. This means to say that there exist moderate degree of positive correlation between NEPSE index and EG.

But the hypothesis test of above calculated coefficient correlation between NEPSE index and other macroeconomic variables shows the mixed result. This means to say that, the test between NEPSE index and annual turnover of securities is significantly correlated, whereas, it is insignificant in between NEPSE index and GDP; and NEPSE index and EG. This indicates that the growth of the NEPSE index is not realistic with reference to the overall economic growth of the nation.

5.2 Conclusions

Basing on the findings of the study, it can be concluded that the security transaction took place after the establishment of Security Exchange Center in 1976 in Nepal. Beforehand, the issuance of shares of Biratnager Jute Mills Ltd. and Nepal Bank Ltd. in 1937 introduced the need of

security market in Nepal. The very first security transaction took place in the year 1984/85 when the SEC came into existence under the Securities Act 1983. Later the Government of Nepal converted the existing Securities Exchange Center into Nepal Stock Exchange in 1993. The primary objective of NEPSE is to facilitate the security transaction thereby creating free marketability and liquidity of securities. The exchange deals with the government and corporate securities. The whole security transaction process and the functioning of the NEPSE is regulated by the apex regulatory body popularly known as Security Board of Nepal (SEBON) which is established in 1993. The concern of the board is to facilitate and manage the orderly development of capital market in Nepal.

The opinion of general people regarding the Nepalese stock market is appreciable. Most of the respondents remark the need of public awareness for the better performance of Nepalese capital market. Similarly, they are in a view that an effort should be made to diversify the centrally situated stock market into region-wise basis for smooth trading of securities nation-wide. Hence, it can be concluded that the existing stock exchange is not sufficient for the trading of securities. Immediately, another region-level security market is needed for smooth trading of shares.

Similarly, the existing numbers of brokers are not sufficient to cope with the existing securities in Nepal. Generating more employment opportunities could boost up the income level of people, and finally they can invest in securities market even their small scale of investment. This creates investment habit, rather than holding a small sum of money at home or in a bank account. Due to liquid and instable political situation of the nation, the real sector of the economy is lagging far behind. The real sector industries like manufacturing, processing and the like could not flourished during the period of this decade. As a result of which, the existing security market is dominated by banks and financial sectors.

Despite the large volumes traded on stock exchanges many listed stocks trade infrequently; or their balance of trading is not sound. For example, in NEPSE mostly the shares of commercial banks, development banks and some finance companies are transacted. The reasons behind this huge investment in the securities of banks and financial sectors; is the expectation of high return from such companies in terms of dividends and capital gains. The capital gains could be realised

by the expectation of appreciation of prices of securities in future. Some of the banks and financial institutions in the past days are distributing dividends regularly and in increasing rate too, but the financial positions of such institutions is not very strong these days. Hence, a careful measure should be adopted by analysing the financial positions and profitability of the company before investment. The capital market is the key to industrialization in the country. Hence, the dominance of financial institutions needs to be reduced and more real sector participation needs to be encouraged through the process of industrialization. The reasons behind the low participation of real sector need to be sought out, and the government should gradually leverage the concept of capital market in order to bring industrialization in the nation.

Despite the history of about more than 15 years 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. The growth of financial sector will be measured by around 175 financial institutions operating in Nepal. Similarly there exist positive correlation between the growth of Nepalese stock market with the broad macroeconomic indicators viz. GDP and economic growth. Undoubtedly, it is found that there was a significantly high degree of coefficient of correlation between the growth of NEPSE index and the annual turnover of securities. Similarly, the relationship between NEPSE index and the GDP; and NEPSE index and EG was too positive which indicates moderate degree of positive correlation between such variables.

But the hypothesis test of coefficient of correlation between such variables shows the mixed result. This means to say that, the test between NEPSE index and annual turnover of securities is significantly correlated, whereas, it is insignificant in between NEPSE index and GDP; and NEPSE index and EG. This indicates that the growth of the NEPSE index is not realistic with reference to the overall economic growth of the nation.

Moreover, it can be said that the growth of NEPSE is speculative to some extent and the performance of NEPSE is not really stable and appreciable. This measure of stock market development indicates that the stock market in Nepal is underdeveloped and has failed to show

impact on the overall national economy. The small market size has made the performance of security market vulnerable thereby resulting manipulation and price speculation. Similarly, the volatility of stock prices and high concentration ratio in a particular sector indicate that the stock market in Nepal is highly illiquid and risky. Hence, the seemed growth of NEPSE index is not realistic with respect to the indicators of overall growth of the economy. Besides, the Nepalese stock market is suffering from a number of obstacles, out of which some are—lack of proper coordination between the authorities, lack of sufficient modern technology, dominance of individual investors, lack of public awareness and so forth.

5.3 Recommendations

To cope with the above mentioned obstacles and to maintain the smooth growth of capital market, the following recommendations will be helpful if adopted.

-) The regulatory body should regulate NEPSE and other financial institutions adequately, appropriately, effectively in order to ensure the ethical business activities.
-) The securities Board in co-ordination with other associated government authorities should create public awareness among investors with regard to capital market and its transaction process.
-) The authorities should tighten the regulatory and financial requirements of listed firms in order to make the investors aware about their exact financial position. So that the investors can make investment decisions based on fundamental analysis of the firm.
-) The government should make appropriate policies and programs for the enhancement of the entrepreneurship development in the Nepalese economy.
-) The real sector participation in the capital market needs to be enhanced by the establishment of real manufacturing and processing industries.
-) The dominance of financial sectors in the NEPSE should be reduced through the means of industrialization and more companies representing the real sector of the economy need to be listed.
-) The influence of big investors and stock brokers should be reduced and the investor judgement for investment needs to be implemented.

-) An efficient information system needs to be developed so that the fast dissemination of information can take place without any delay.
-) The number of Brokers needs to be increased for the smooth operation of stock market.
-) Stock market needs to be decentralized and region-wise stock exchange need to be established to facilitate the trading of securities nation-wide.
-) Investors should be provided with investment guidelines and manuals so that they can be aware about the process and procedures of investment in security market.

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ANNEXURE

Annex 1

Research Questionnaire

Dear Respondent,

I am endeavoring to prepare a research report on "**Trends and Challenges of Nepalese Stock Market**" in Partial fulfillment of the requirements of the degree of **Master of Business Studies (MBS)**. The questionnaire given below will be a key milestone for my research work. Hence, I kindly request you to give sincere and unbiased response with respect to the given questionnaire. Moreover, the information you provide hereby will be kept confidential and be solely used for this research purpose only.

Thanking you for your kind co-operation!

.....
Rajendra Lamsal
(Supervisor)

.....
Manikar Karki
(Researcher)

Questions:

1. Do you know about the Security/Stock Market?
 - (a) Yes, I know it very well []
 - (b) I know little about it []
 - (c) I just hear about it []
 - (d) I have no idea about it []
2. Do you have any investments in corporate stocks?
 - (a) Yes [] (b) No []
3. Which of the following factors motivates you to make investment in IPOs of corporate stock?
 - (a) Marketability and profitability of stocks []
 - (b) Liquidity of stocks []

- (c) Limited opportunity for investment in other sector. []
- (d) Appreciation in share price []
- (e) If other, please specify..... []
4. What do you think about the performance of Nepalese Stock Market?
- (a) Good [] c) Satisfactory []
- (b) Bad [] d) Don't Know []
5. What do you think about the recent growth trend of Nepalese Stock Market?
- (a) The growth is realistic []
- (b) The growth is speculative []
- (c) The growth is not realistic []
- (d) Don't Know []
6. What is the reason behind the huge investments in bank and financial sectors than in real sectors?
- (a) Transparent and ethical []
- (b) Profitable business []
- (c) Marketability and liquidity []
- (d) Strong regulatory body []
- (e) Limited opportunity in other sector []
- (f) If other, please specify
7. Which of the following factor makes you decide to buy the share of a particular company?
- (a) Price appreciation of stock. []
- (b) Profitability of the company. []
- (c) Whim of investors. []
- (d) Brokers' advice. []
- (e) If other, please specify.
8. Which of the following problem that the Nepalese stock market has been facing?
- (a) Shortcomings of rules and regulations. []
- (b) Lack of availability of modern technology. []
- (c) Lack of awareness among investors. []
- (d) Lack of proper coordination between authorities []
- (e) Lack of professional skills among financial intermediaries. []
- (f) All of the above. []
9. Do you think the existing Nepal Stock Exchange is sufficient for security trading?

(a) Yes [] (b) No []

10. Do you feel the need of another stock exchange in Nepal?

(a) Immediately another is needed []

(b) It will need in near future []

(c) The existing is sufficient []

(d) We don't need it at all []

11. To what extent the Nepalese Stock Market is correlated with the economic growth?

(a) High degree of correlation []

(b) Moderate. []

(c) Low degree of correlation []

(d) No correlation at all []

12. What remedial measures can be adopted to boost up the Nepalese stock market?

(a) Creating public awareness among the investors. []

(b) Mechanizing the stock market through new technology. []

(c) Increasing the number of brokers for trading. []

(d) Increasing job opportunities. []

(e) If other, please specify

Annex 2

The functions, duties and powers of SEBON as per the Act are as follows:

- J To offer advice to Government on matters connected with the development of the capital market.
- J To register the securities of corporate bodies established with the authority to make a public issue of its securities.
- J To regulate and systematize the issue, transfer, sale and exchange of registered securities.
- J To give permission to operate a stock exchange to any corporate body desirous of doing so, subject to this Act or the rules and bye-rules framed under this Act.
- J To supervise and monitor the functions and activities of stock exchange.
- J To inspect whether or not any stock exchange is executing its functions and activities in accordance with this Act or the rules and bye-rules framed under this Act, and to suspend or cancel the license of any stock exchange which is not found to be doing so.
- J To issue licenses to conduct the business of dealing in securities, subject to this Act, or the rules and the bye-rules framed under this Act, to companies or institutions desirous of conducting the business of dealing in securities.
- J To supervise and monitor the functions and activities of securities-dealers.
- J To grant permission to operate collective investment schemes and investment fund programs, and to supervise and monitor them.
- J To approve the bye-rules concerning transactions in securities framed by stock exchanges and institutions engaged in the business of dealing in securities, and, for the purpose of making necessary provisions concerning the development of the capital market and protecting the interests of investors investing in securities, issue orders to have necessary alterations made in such bye-rules of stock exchange and institutions engaged in the business of dealing in securities.
- J To systematize the task of clearing accounts related to transactions in securities.
- J To supervise whether or not security dealers are behaving in the manner prescribed in this Act, or the rules and the bye-rules framed under this Act, while conducting business of dealing in securities, and suspend the license to conduct the business of dealing in securities in case any securities dealer is not found to be behaving accordingly.
- J To make or ensure necessary arrangements to regulate the volume of securities transacted and the procedure of conducting such transactions in order to ensure the promotion, development and clean operation of stock exchanges.
- J To make necessary arrangements to prevent insider trading or any other offenses relating to transactions in securities in order to protect the interest of investors in securities.
- J To review or make arrangement for reviewing the financial statements submitted by the corporate bodies issuing securities and security dealers, and issue directives deemed necessary in that connection to the concerned corporate body.
- J To systematize and make transparent the act of acquiring the ownership of a company or gaining control over its management by purchasing its shares in a single lot or in different lots.
- J To establish coordination and exchange cooperation with the appropriate agencies in order to supervise and regulate matters concerning securities or companies.
- J To discharge or make arrangements for discharging such other functions as are necessary for the development of securities and the capital market.

(Adopted from the official website of SEBON)

Annex 3

Schedule II

Correlation between NEPSE index and annual turnover

Year	Index (X)	Turnover (Y) (in million/ 00)	X ²	Y ²	X.Y
2004/05	286.67	45.08	82179.69	2032.21	12923.08
2005/06	386.83	34.51	149637.45	1190.94	13349.50
2006/07	683.95	83.60	467787.60	6988.96	57178.22
2007/08	963.36	228.21	928062.49	52079.80	219848.39
2008/09	749.10	216.81	561150.81	47006.58	162412.37
Total	3069.91	608.21	2188818.04	109298.49	465711.56

Schedule II

Correlation between NEPSE index and GDP

Year	Index (X)	GDP (Y)(in million/ 000)	X ²	Y ²	X.Y
2004/05	286.67	463.17	82179.69	214521.82	132775.51
2005/06	386.83	486.44	149637.45	236619.01	188167.65
2006/07	683.95	493.60	467787.60	243644.91	337600.46
2007/08	963.36	519.57	928062.49	269957.14	500536.81
2008/09	749.10	539.32	561150.81	290864.98	404003.86
Total	3069.91	2502.10	2188818.04	1255607.86	1563084.29

Schedule III

Correlation between NEPSE index and EG

Year	Index (X)	EG (Y)	X ²	Y ²	X.Y
2004/05	286.67	3.10	82179.69	9.61	888.68
2005/06	386.83	2.80	149637.45	7.84	1083.12
2006/07	683.95	2.50	467787.60	6.25	1709.88
2007/08	963.36	3.91	928062.49	15.29	3766.74
2008/09	749.10	3.50	561150.81	12.25	2621.85
Total	3069.91	15.81	2188818.04	51.24	10070.26

Schedule IV

Calculation of Growth rate of NEPSE, turnover, GDP and EG

Variable	Year					
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
NEPSE Index	222.04	286.67	386.83	683.95	963.36	749.1
Annual Turnover (in million)	2144	4508	3451	8360	22821	21681
GDP (In million)	448654	463165	486435	493604	519574	539319
Economic Growth		3.1	2.8	2.5	3.91	3.5

Schedule V

Variable\Year	Growth rate in %					
	2004/05	2005/06	2006/07	2007/08	2008/09	
NEPSE Index	29.11	34.94	76.81	40.85	-22.24	
Annual Turnover	110.26	-23.45	142.25	172.98	-5.00	
GDP	3.23	5.02	1.47	5.26	3.80	
Economic Growth	3.10	2.80	2.50	3.91	3.50	

RESUME

Personal Details:

Name: Manikar Karki
Permanent Address: Chanakhu – 3, Ramechhap, Janakpur, Nepal.
Temporary Address: Butwal - 7, Rupandehi, Lumbini, Nepal.
Date of Birth: October 03, 1985. [Aswin 17, 2042 B. S.]
Marital Status: Single
Sex: Male

Educational Details:

Degree	Institution	Baord	Year of Passing	Specialization	Per. (%)	Remarks
M.B.S.	Lumbini Baniya Campus	TU	2009	Finance	75.2	Thesis remained
B.B.S.	Kathmandu Model College	TU	2006	Finance	66.43	First Class
Intermediate	Classic Academy	HSEB	2003	Commerce	76.3	Distinction
S.L.C.	Pragati Secondary School	Government of Nepal	2001	-	76.88	First Class

Working Experience:

- ❖ Two year's working experience as an accountant at Alliance Academy, Annamnagar, Kathmandu.
- ❖ Working at Butwal Finance Limited as an Officer in various departments (viz. Account, Loan and Administration) and assisting Company Secretary for secretarial works since one and a half year.

Responsibilities Borne

- ❖ Maintaining books of accounts for a private boarding school.
- ❖ Preparation of final accounts for a private firm.

- ❖ Preparing vouchers and maintaining financial accounts for a financial institution.
- ❖ Preparation of NRB Reports.
- ❖ Preparation of credit proposal, proceedings of loan documents for lending purposes.
- ❖ Administrating operational works and managing human resources.
- ❖ Construction of physical infrastructure and office layout for new branch offices.
- ❖ Arranging meetings for Board of Directors and different formal and informal official programs.
- ❖ Preparation of Board Minutes, NRB letters, press releases, and other official documents.
- ❖ Preparation of different official reports for SEBON, Nepal Stock Exchange, Company Registrar Office etc.

Previous Research Works:

-) A project work on "*Money Market Instruments in Nepal*" (2006) for the partial requirement of degree of Bachelor of Business Studies (B.B.S).
-) A project work on "*An Approach to Project Formulation*" (2006) for the partial requirement of degree of Bachelor of Business Studies (B.B.S).

Further Trainings:

- ❖ Basic Computer Course form National College of Computer Studies (NCCS)
- ❖ System Support Training of FAO-GTZ Micro Banking System(MBWin).
- ❖ Training on "*NRB Directives and its Compliances*" by BTI.

Extra Curricular Activities:

- ❖ Participation on school level quiz and debate competitions
- ❖ Work shop on time management.
- ❖ Use to write articles for newspapers in recent political-economic issues.

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