CHAPTER – ONE

INTRODUCTION

1.1 Background of the Study

The development of economy necessitates the growth of the productive activities which in turn, is the result of the investment in productive enterprises. "Investment" here means the sacrifice of current money to earn profit in the future, through which the main motto of many country i.e to accelerate their development process and thereby increase the welfare of their people will be achieved. For this it requires gearing up of savings, creating conducive & enabling investment atmosphere and developing efficient capital market to facilitate mobilization of both ownership and debt capital through appropriate instruments.

With the worldwide move towards open and market oriented economic system in the world economy, it has led to growth and expansion of banking and financial system too. As a matter of fact, under this phenomenon increasing development of new financial instruments improved and diversified financial services are taking place. One of the concrete financial services is merchant banking function. The merchant banking services helps to promote capital market, which is crucial for the country's economic development.

Development of capital market in Nepal is linked with the establishment of commercial banks and long-term financing institutions like NIDC, Market Capitalization started in 1994 B.S. with the enactment of the Company Act in 1992 B.S. However, failure of a number of companies within a short time dampened the spirit and for a long period market capitalization took a back seat. Efforts were reinforced in 2033 B.S. with the establishment of Nepal Security Trading Center to make on inroad in expanding the base for capitalization and assertive new companies to float easily. The center also operated in a restricted manner and though revitalizing, the market capitalization process did not take off in a sound manner in the absence of an encouraging environment.

Recognizing these short-comings, along with the pursuance of liberal economic policies the government brought a package of policies including capital market development policies in 2049 B.S. This helped to establish the Stock Exchange Market and the floor for secondary market operation. Within a short period, the market boomed and many new primary issues were also made. This boom, however, did not last long and both the index and the volume of transactions nose-dived after 2051 B.S. The scenario hasn’t turned optimistic so far. In this situation it is useful to analyze the trends and assess the strengths and weaknesses of the Nepal Stock Exchange Market. To meet this very end, this study has been initiated.

The concept of the stock market in Nepal is new. It is still in growing stage though Nepal Bank Limited (NBL) and Biratnagar Jute Mills Limited (BJM) in 1937 B.S. under the Company Act 1936 B.S. began it with the flotation of shares. At that time, the participation on the ownership structure of the corporate sector was restricted mostly to the Rana Family. Consequently, the expansion of capital Market to the desired level had been restricted. No significant attempts had been made in 4-5 year plan to reform the capital market. The establishment of Securities Exchange Center (SEC) in 2038 B.S. was the first and most important attempt made by the government to develop the stock market. Initially the SEC limited its function for trading the Government bond and national saving certificates only. Then it acted as an issue manager for corporate securities and started to list and provided mark for the corporate stocks from fiscal year 1984/1985 under the Securities Exchange Act 1983.Thus the SEC served to promote the primary as well as secondary market for government and Corporate Securities from fiscal year 1984/1985. Although, the growth of stock market is high relative to the growth of economy, the shares of Corporate Sector in the national economy is still very low due to the legible size of the Corporate Sectors.

The incorporation of Securities Board Nepal (SEBON) under the Securities Exchange Act, 1988 and conversion of the SEC into Nepal Stock Exchange (NEPSE) under the government policy on capital market reform has greatly contributed to development of primary as well as secondary market. For the Corporate Securities the rise as stock prices and the market liquidity for Corporate Securities were observed immediately after NEPSE for one year. Only this has positive and immediately impact on the primary market.

As the democracy established in 2007 B.S. the interim government were much busy in advising the measures to recognize the sick industries and gave little attention to initiate the development of stock market until 2033 B.S. when the government owned and operated Security Exchange Center was established. It was established to perform the function of stock exchange (under SEC Act 1983) like broker, issue manager and securities market regulator. But under this arrangement there were no private brokers, dealers, investment banks and securities firms because of all these trading remain insignificant. In 2047 B.S. when democracy was resolved, the interim government is in its short period has initiated banking reformation and had established Citizen Investment Fund (CIF). The establishment of NIDC, Capital Market Limited is also another measure step to improve financial system in Nepal. Under the government Act, SEC was converted into NEPSE in 1993. This is non- profit organization, operating under Securities Exchange Act 1983. The NEPSE commenced operations on January 13th 1994, with government, (HMG/Nepal), Nepal Rastra Bank (NRB) and Nepal Industrial Development Corporation (NIDC) and Licensed members.

In Nepal NEPSE is the only one official stock market where two market makers, two securities dealers, twenty three (23) member brokers and eleven (11) sales & issue managers to provide services of securities. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994.

Market and their Functions

One way in which securities market may be classified is by the types of securities brought and sold there. The broadest classification is based upon whether the securities are new issues or are already outstanding and owned by investors. New issues are available in the primary market securities that are already outstanding and owned by the investors are usually bought and sold through the secondary market. Another classification is by maturity. Securities with maturities of one year or less normally trade in the money market those with maturities of more than one year are brought and sold in the capital market. Needless to say the classification system has many variations.

The existence of markets for securities is of advantage to both issuers and investors. As to their benefit to issuers, securities markets assist business and government in raising funds. In a society with private ownership of the means of production and distribution of goods and services, savings must be directed towards investment in industries where capital is most productive. Government must also be able to borrow or public improvements. Most mechanisms make possible the transfer of funds from surplus to deficit sectors, efficiently and at low cost.

Investors also benefit from market mechanisms. If investors could not resell securities readily, they would be hesitant to acquire them, and such reluctance would reduce the total quality of funds available to finance industry and government. Those who own securities must be assured of a fast fair orderly and open system of purchase and sale at known prices.

The classification of market we are most interested in is the one that differentiates between new and old securities the Primary and Secondary markets. In recent years the secondary markets have been further fragmented, creating “third” and “fourth” market.
Under capital market, market may be categorized into two ways:

- **Primary Market / New Issue Market**
- **Secondary Market**

Securities available for the first time are offered through the primary securities markets. The issue may be a brand new company or one that has been in business for many-many years. The securities offered might be a new type for the issue or additional amounts of a security used frequently in the past. The key is that these securities absorb new funds for the coffers of the issuers, whereas in the secondary markets, existing securities are simply being transferred between parties and the issuer is not receiving new funds. After their purchase in the primary market, securities are traded subsequently in the secondary market.

The organized exchanges by the investors they change lands in the secondary market. There are actually two broad segments of the secondary markets the organized exchanges and the over the counter (OCT) market. The primary middlemen in the secondary markets are brokers and dealers. The distinction between the two is important. The technical difference rests upon whether the person acts as an agent (broker) or as a principal (dealer) in a transaction.

Organized exchanges are physical market places where the agents of buyer sand sellers operate through the auction process. There are a number of organized exchanges. Two are truly national market places and the others one regional or local Secondary market is well known by stock exchange.

1.2 Statement of the Problem

The capital market in Nepal is operating in an immature stage. Capital mobilization is the problem facing by every underdeveloped country and each is trying to raise funds from external sources because of the limitation of self-financing. The capital market is the nerve center for the capital mobilization through which idle and unutilized savings are transferred to the talented and knowledgeable persons who will be willing to take risk in investment. The Nepal Stock Exchange, in Nepal, is also trying to mobilize such funds for the development and industrial purpose. NEPSE provides investors good investments opportunity with fair return and instant liquidity with minimal risk of loss. It helps mobilize financial resources for the investment in development projects and thereby helps to economic development, in turn, further develop the stock market.

People in underdeveloped countries generally prefer to accumulate their savings in the form of precious metal, jewelries etc. The capital mobilization has to encounter this habit. This may be due to the lack of the knowledge, illiteracy, unwillingness to take risks etc. Thus the securities market, in Nepalese context, by retrospection its track-record has got rejuvenation in terms of market capitalization at present, although the market development has not gone parallel with its Asian and African Counterparts categorized at least developed stock markets.

Though the NEPSE is in existence for fourteen years, no effort has yet been made to study the impact of this organization on the economy particularly from the viewpoint of its role in influencing capital mobilization. Nevertheless, the rudimentary nature of the Nepalese Stock Market indicates highly dissatisfaction from the investors. There are no private opened investment companies (mutual funds) operating at the present time. Therefore, government need to create incentives for capital mobilization remove impediments to private sectors development educate investors, and provide basic legal and regulatory reforms. Until now, the stock market development in Nepal has not reaches its full potential for many reasons. To bridge this knowledge gap it is considered appropriate to undertake study in this regard. In view of these, I have carried on in-depth study of the role and significant of

NEPSE in Securities Market. The study has been directed towards answering the following questions:

- Is NEPSE making growth from its initial period to the present time?
- What is the liquidity position of NEPSE?
- What are the current conditions of share price and the turnover of the securities of companies listed in NEPSE?
- What role does NEPSE can play for the overall development of the economy?
- What is the current legal status of securities market?
- Which one is effective in the securities market? Primary market? or Secondary market?
- What type of organizational structure it has followed?

1.3 Need of the Study

Nepal, the capital deficient economy, requires a huge amount of investment to promote productive activities such as industrialization for her rapid economic development. In its absence, the economy cannot live on its own foot. So the need of the long- term finance occurs sharply for to accelerate industrialization .In this respect, security market is an important constituent and core of the capital market. It consists of the various suppliers and users of long – term finance. The stock exchange encourages and mobilizes the savings for investment in profitable projects in the Nepalese economy. This institution plays a notable part in the economic life of the country acting as a free market for securities, where prices are determined by the demand and supply. The function of the stock exchange is not only to provide market for securities but assist in the raising of funds for government and industries. It is most highly centralized and visible institution where already issued securities are brought and sold for investment and speculative purpose. It provides facilities of trading of listed financial securities. Thus, there is a great importance of NEPSE for the smooth development of the stock market and also broaden the scope of industrial development.

But even being such an important subject there are lots of deficient on it *i.e* there has not been done any systematic study on this topic so far. After observing all these things, this study is conducted to throw light on the secondary market performance. The secondary market performance has been broadly classified here on new issue market and stock market, and their in relation to their growth and future prospects is going to be done, which is still in its initial stage.

- To indicate the financial state of concerned market or institutions.

- To find out the view of investors and government and other financial institutions about the stock exchange.

- To find out the problem and prospects in the near future. What policies can be made to develop it and make the market perfect functioning?

1.4 <u>Objectives of the study</u>

The overall purpose of the present study is to examine the role played by NEPSE in promoting Nepalese Securities Market and to point out the existing financial institution set up in the country for providing industrial and the commercial finance to the investors. The securities market performance has been broadly classified here on new issue market and stock market. Along with the analysis of legal aspects, primary market has been reviewed by taking money market into consideration. Similarly, listing of shares, stock trading, market price of shares and market capitalization etc. are included in the study as indicators of secondary market. The basic objective of this study is to enquire into the performances of Nepalese Stock Exchange Market and predict the future scenario. However, the specific objectives of the study are as follows:-

- Introducing security market *i.e* composition of primary and secondary market and their performance behavior.

- To assess the past and present behavior of business operation in the Nepal Stock Exchange Market.

- Analyze on legal provisions relating to protection of investors’ interest.

- To analyze, evaluate and interpret the relationship of stock price with the financial variables such as number of shares traded, amount of capitalization, etc.

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

1.5 Rational of the Study

The rational of the study is to provide general information, ideas about the role and significant of NEPSE in the securities market as well as acquainting the readers and concerned authorities with the finding of this study.

After the study, it is hoped that the readers will get high quality information about the capital market, contribution of investors in securities market, its growth and development in country, problems of secondary market, role of securities board, trading procedure of NEPSE, etc. It is also hoped that this study will be helpful for their further research in this field and many more.

1.6 Limitation of the Study

- The study is done for the fulfillment for MBS degree in Management. So, it is not a comprehensive study and it is focused to analyze certain aspects of stock market in Nepal.

- Time and financial constraint are also the major limitation of the study. The report has to be submitted within the limit period so, this hinders the study to cover a large area.

- The researcher being the beginner in this area, this report cannot remain without flaws. Best effort has been done to make this report without minimum error. Being almost impossible to draw the final product without error, existence of unnoticed errors is also a major limitation of the study.

- Studies and references are extremely limited in the perspective of Nepalese capital market.

- Relevant data and information has been collected from Nepal Stock Exchange Ltd (NEPSE) and concerned organizations and brokers. So, the data may be actual or estimated.

- Up to 5 years data has been used for this purpose.

- The study covers the past and present state of stock market in Nepal hence does not make any projections about the future.

- Only certain companies have been used for the analysis.

1.7 Chapter Scheme

This research report will gain its total shape when it will go through each and every requirement as required for a complete report. But as already mentioned in the limitation section due to some constraints and to give it a total shape this report has been planned to present the following chapter scheme.

Chapter – one - Introduction
Chapter - two - Literature Review
Chapter - three - Research Methodology
Chapter - four - Presentation and Analysis of data
Chapter - five - Summary, Findings and Recommendations

Chapter one consists background of the study, focus of the study, statement of the problem, need of the study, objectives of the study, rational of the study, limitation of the study and finally organization of the study i.e chapter scheme.

Chapter two deals with review of literature, which consists of conceptual framework, review of the books and journals and review from empirical studies.

Chapter three deals with the research methodology, which includes nature of research, nature and sources of data, data gathering procedure & tools for analysis.

Chapter four attempts to analyze and evaluate the data with the help of analytical tools and interpret the result so obtained.

Chapter five sums up the result obtained through analysis and recommend some suggestions. The appendices and bibliography will also be incorporated at the last.

CHAPTER – TWO

REVIEW OF LITERATURE

A. Conceptual Framework

In this chapter an attempt has been made to review of a basic literature pertaining to concept, role and significant of Nepal Stock Exchange (NEPSE) in the securities Market. The relevant literature and articles are reviewed from international and national publications as well as unpublished report available from different libraries and institutions.

2.1 Capital Market

Capital market is an important part of the financial market. It relates to those markets from where government, households, firms and industries secure long term capital needs through the use of a wide variety of long- term financial instrument and other securities. Capital market is an institution where quoted investment (stock and share) may be exchange between buyer and seller. The main objective of the capital market is to create opportunity for the maximum number of people to get benefit from the return obtained by directing the economy towards the productive sector by mobilizing the long term capital. The objective can be fulfilled only by rational and accountable behavior relating to the three sectors of capital market such as institution, mediators and investors. In capital market, financial transition is made for mostly longer period. The capital market is financial relationship created by a number of institution and arrangement that allows the supplier and demanders' long-term fund, funds with maturities of more than one year to make transition.

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

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

In the book 'Business organization and management', C.B. Gupta has commented, "The Capital Market serves as a link between suppliers and users of finance. It is a mechanism for the mobilization of public savings and channeling them in productive invests".

The capital market is known as the trading center for the financial investment in capital market different types of financial securities such as ordinary share, preference share, treasury bills and debenture are traded. The capital market can be divided into two parts-

- **Securities Market &**
- **Non securities Market**

2.2 Securities Market

Securities market is open market where buyers and sellers of securities are unknown to each other. However, they trade through the help of the brokers or dealers. Securities market is the mechanism that allows suppliers and demanders of fund to make transaction. It is the market where securities are traded. It plays a key role in the purchase and sales activities of investors.
Securities market acts as a powerful inducement to save offering prospective investors a wide and varied choice of investment performance. It also provide an easy platform where business house seeking.**"Securities market includes how an individual investors goes about the business is executed, the process of setting the payment and transfer costs, and one hopes the payment of federal personal income taxes on the profit from the transaction." (D.E fisher, 1992)** These securities include equity shares, preference shares and debentures.

The development of a sound securities market with its constituent financial institutions is one of the mechanisms which enable the efficient transformation of savings from the hands of surplus spending units to those of deficit spending ones who can use them move productivity and/or have loss/ risk aversion. (Patic D.Rugh, 1996)

Nepal stock exchange has defined the securities market in the following ways, "The securities market is the place where a large volume of financial securities (shares, bonds, debenture etc.) are traded according to prescribed rules". (Securities Marketing Center, 1978)

According to wheeler, the securities market includes:

1. Activities relating to the organizational distribution and trading in of securities.
2. Organizations, which facilitate these securities.
3. Individuals and institutions, which buy and sell securities.
4. Rules, regulations, customs and practices that control the organization and conduct of business in the market.

According to Weston and Copeland, "stock markets are said to provide at least four economic functions:

1. Security exchanges facilitate the investment process by providing a market place to conduct efficient and relatively inexpensive transaction. Investors thus assured that they would have a place to sell securities that they would otherwise require.

2. They are capable of holding continuous transaction testing the values of securities. The purchase and selling of securities records judgments and values and prospects of companies. Those prospects are judged favorably by the investment community have higher values which facilitate the new financing and growth.

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5. Securities are relatively more stable because of the operation of the security markets. Security market improves liquidity by providing continuous markets that make more frequent but smaller price changes. In the absence of active market price changes are less frequent but more violent.

6. Security Market aids the digestion of new security issues and facilitates their successful flotation. Investors are not interested to invest in new securities, if they had to hold up to maturity periods. Actually stock market provides well functioning secondary market to traded existing securities and assures the purchases of primary securities that they can quickly sell their securities, if the need rises. Stock market also affects economy through creation of liquidity. Only liquid equity markets make the investment less risky and more attractive. It allows saver to acquire an asset and sell quickly and cheaply. The regular inspection in secondary market is also necessary from company side. It helps to attract investment community. Similarly an active stock market has less and frequent price change because it has an efficient market mechanism and information are quickly disseminated to all investors." (Weston & Copeland, 1995)

Securities Market can be divided into two parts:

-Primary market
-Secondary market

2.2.1 Primary Market

The primary market for securities is the new issues market, which brings together the supply and demand or sources and uses for new capital fund (Fisher & Jordon, 1992). The market where by the corporation acquires the long term capital fund by issuing the security to the general public through initial public offering and right issue is known as primary market.

In this market the principal sources of funds is the domestic saving of individual and business, other supplies include foreign investors and government. The ultimate supplies of funds are those sectors with a surplus of current income over expenditures and these funds flow to their ultimate users, economic use securities to finance a surplus of expenditures over their current income.

Securities available for this first time are offered through the primary securities markets. The issuer may be a brand new company or one that has been in business for many years. The securities offered might be a new type for the issuer or additional amounts of a security used frequently in the post. The key is that these securities absorb new funds for the coffers of the issuer.

The primary securities market includes all transactions that result in the accumulation of financial capital by firms, government or individuals to be used in consumption or real capital investment. The participants in this process are many and varied, but and important segment, includes the money brokers who acts as a middleman in the process of exchanging securities for fund.

These brokers provide invaluable services. Their principal role is to assist in the pooling of the funds by the certain of security forms that will appeal to the ultimate investors (Jacob L. Nancy and Pettit R. Richardson,1984)

Primary market transactions are normally effected through the issuance of short and long- term bonds and other debt instruments and through the issuance of common and preferred stock.

Primary markets are distinguished by the flow of funds between the market participants. Instead of trading between investors as in the secondary markets, participants in the primary market buy their assets directly from the source of the asset. Once the assets or securities are sold in the primary market, they begin trading in the secondary market. (Geaffrey A Hirt, 1983)

The contribution of primary market to company financing is direct in the sense that it provides additional funds to the issuing companies either for starting a new enterprise or for expansion or diversification of the existing one. Before the establishment of security market centre, the case of the new issue was very few. Issuing companies themselves undertook the issue management activities.

Before the establishment of Nepal Stock Exchange System, 26 public companies collected a total amount of Rs. 246.5 million form public issue within a period of 13 years starting from 1979/80 A.D. to 1992/93 A.D. (Stock Exchange Record). The progress can be noticed from the collection of Rs.243 million, 204 million and 293 million by 14, 11 and 12 public companies (Excluding NCM Mutual Fund and Citizen Unit Scheme) in the subsequent year 1993/94, 1994/95, and 1995/96. (CEDA, 1997)

2.2.2 Secondary Market

Secondary market also known as the market for seasoned instruments is that market where the once issued stocks of the corporation are traded. The advantage of secondary market is to provide liquidity and investment opportunities to investors and to make certain assets more attractive to buyer and seller. It deals with the previous issued shared mainly traded through the stock exchange, over the counter (OTC) market or direct dealing. The majorities of all capital market transaction occur in the secondary market. The proceeds from the sale of securities in this market do not go to the original issuer *i.e.* it does not create new additional capital but to the owners of the securities. In other words, securities are traded among the individual as well as institutional investors. Transaction is exiting securities represent shifts owners that do not provided additional fund to finance capital formations.

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

If investors could not resell securities readily, they would be hesitant to acquire them and such reluctance would reduce the total quality of funds available to finance industry and government. Those who own securities must be assured of a fast, fair, orderly and open system of purchase and sell at known prices. (Fisher & Jordon, 1992)

Secondary market can be divided into two parts:

- Organized stock exchange
- Over the counter market

Organized stock exchange:

The essential function of a stock exchange is to provide attractive market place for corporate share and other listed securities. The stock exchange plays indispensable role in mobilizing funds in capital market. The various virtues governing stock exchange include enhance marketability of securities, rational allocation of investable funds; facilitate economic growth and wealth generation and proper maturities, liquidity and diversification of investment. The growth of capital market through the vehicle of information about various securities in additional to the sound listing criteria that proved worthwhile to the investors.

Stock exchanges are voluntary association of member who comes together for the purpose of buying and selling for the general public, the securities of the great companies. Only listed securities of the great companies are traded in the exchange are bought and sold by action. Since the member of these exchanges has branches through out the country, the stock exchanges are truly a national market is set to give liquidity to primary issues, and this liquidity is an essential ingredient in the capital formation process of economy. (M.K. Shrestha, 1992)

Over the counter market (OTC):

Over the counter market is the market for those securities, not listed on stock exchange. When company first sells its securities to the public, the securities are traded in the OTC. It includes all transaction in securities other than that taking place on the stock exchange. It parties, however the term is usually limited to the activities of dealers and brokers specializing securities. OTC has very low entry barriers and traders may range in size from very large house doing an international business to one- person firm that trade only in the local market.

Stock market interchangeably known as securities market is the other side of market segment under capital market. It includes all transferable securities issued previously by the corporate bodies such securities are also traded on the Stock Exchange. Here stock Exchange refers to the association, organization, or body of individuals whether in corporate or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities Indian Securities Contract (Regulation) Act

1956.But stock market does not include securities of private companies as they are not capable of being dealt in on stock exchange and are not marketable securities due to the restrictions on transferability. In order to benefit from the securities markets, the corporate bodies should have listed the securities in the stock exchange.

The companies, which have listed their marketable securities on the stock exchange, are known as Listed Companies. This means only the securities of listed companies are traded on the trading floor of the stock exchange. Section 8 of Securities Exchange Act 1983 has laid down the provision of Compulsory listing of securities before trading on the stock exchange. For trading purpose of the debentures or bonds of the companies, the maturity period of such instruments should not be less than two years and debentures having face value of Rs.1000 each can only be trade. A huge number of securities of existing financial, manufacturing, and banking, services, and production entities are traded daily via Nepal Stock Exchange in Nepal.

The securities market involved in both primary and secondary market of securities till 1993, later converted into Stock Exchange (NEPSE) according to Securities Exchange Act 1983, is providing a wide spectrum of securities market services to the varieties of organization so to pave the way for the economic development in the country. Besides this, to safeguard the interest of shareholder, the stock exchange board as designated by the act is performing the roles. The board incriminates the companies or concerned individuals who do not comply with the prevailing rules and regulations. The NEPSE has recently released a report on 21 companies in this connection. (Seha M. Tonic and Richard P.West, 1997)

Capital market apart from the primary market also includes markets which have been issued in the past, is traded. These securities markets are called stock market or stock exchanges. The stock market dominantly deals in stock or equity shares. They enable owners of shares to sell their holdings, readily ensuring liquidity. The securities market enables investors to continuously rearrange their assets while other can use their surplus funds to be acquiring them. Any trade of shares subsequent to its primary market may re-offer the securities to any interested buyers at whatever price is mutually satisfactory. The stock exchange provides a market where such mutually satisfactory prices may be determined. They offer opportunities primarily for trading risk and boost liquidity.

The presence of an active securities market actually promotes the growth of the primary market and capital formation because investors in the primary markets are assured that a continuous market exists and should occasion arise they can liquidate their investment in the stock exchange. Formal trading rules and communication networks for trading in securities link the participants in the secondary markets.

The Nepal Stock Exchange has been equipped with 32 brokers and 6 markets makers but today only is available as market makers. Nevertheless, the growing number of corporate bodies and intensive volume of transactions of securities, primarily stocks, have shown green signal to the capital market.

We have only one stock exchange i.e.”Nepal Stock Exchange” laid down in the initiative of the government with consideration of the limited play ground of the capital market. But in India, there are 21 or more stock exchanges established according to the Securities Contract (Regulations) Act 1956. Now, with the relaxation of laws in India, foreign institutions, not individuals, have also been allowed to operate on stock exchange. Foreign brokers have secured membership in Indian Stock Exchange and several foreign assets management companies are floating mutual funds in India. Indian government has removed several structural problems impeding the inflow of foreign investment in stock market. Bombay Stock Exchange (BSE) has started online trading to bring in efficiency and transparency. “Computerized and satellite-linked Stock Exchange” The National Stock Exchange has been functioning since the year 1994.

In comparison to the Indian Stock Market, we have nothing-countable achievement in the case of secondary market. However, what the Nepalese stocks market did in almost two decades of its establishment is considered a watershed in the history of securities market in Nepal while giving glance over the track records of the London Stock exchange (1773), New York Stock Exchange (1817) and Bombay Stock Exchange (1877).

Securities Exchange act 1983 made it obligatory to trade the securities through the recognized exchange centre or through their licensed brokers. Therefore, the Security Exchange Centre opens its floor for secondary trading of corporate shares in November 1984. Before this, the Sec was restricted to the trading of government bonds. At present, 27 member brokers and two market makers have been operating on the trading floor. The rate of brokerage on equity transactions varies from 1% to 1.5% depending upon the volume of trade. Higher the amount of transactions lower is the percentage of commission. The seller and the buyer both parties have to pay the commission to the broker. However, it takes a very long period of around two months to get the securities transferred and registered in the name of buyer though by laws insists to do the transactions timely.

Along with the formation of Security Exchange Board, His Majesty's Government converted the Security Exchange Centre Ltd. into Nepal Stock Exchange Ltd. (NEPSE) in 1993 with a view to reform the capital market. It is a non-profit making organization operating under Securities Exchange Act 1983. Brokers and market makers operate on the trading floor as per the Securities Exchange Act rules and bylaws of NEPSE. Nepal Stock Exchange started its trading operation on 13th January 1994 through its licensed members.

The Securities Board was constituted in 1993 under Sec.1 of the Securities Exchange Act 1993. Its main objective is to provide essential policy direction for the systematic and regular exchange of securities and develop competitive stock exchange market by protecting and promoting the interest of the investors. Nepal Stock Exchange is a trading (operation) institution, whereas Securities Board is the regulatory body. Before the board came into existence, the Securities Exchange Centre carried on both the functions. Though any corporate body serious to carry out the transaction of securities can submit application to the Board for obtaining the license, till now Nepal Stock Exchange Ltd. alone is presenting the Secondary Market in the country.(News week, 1995)

2.3 Non Securities Market

Non- securities market is that market where financial transactions are carried out between the lender and borrower for a longer period without issuing any securities in the form of share, bond and debenture. Financial transaction between the term lending institution such as development bank and business house or individual between the contractual saving institution and individuals or business houses etc come under non securities market. To ensure sustained price and market, the police level authorities should encourage institutional buyers.

2.4 Stock Exchange and Its Role

The role of financial institutions has been very crucial in the overall economic development of the country. Their role of financial intermediation as well as capital formation is to make lending and borrowing cheaper and to increase liquidity. This in turn encourages investment and may also increase the overall level of spending in the economy. In recent years, and particularly since the advent of democracy in 1990, His Majesty's Government of Nepal (HMG) has begun opening up financial markets as part of its economic liberalization program. The recent boom in the establishment of banks and finance companies, the partial privatization of first ever established government owned commercial banks; the opening of the NEPSE is the major outcome of the liberalization process.

As in the case of financial intermediaries, stock market or the securities market for the equity is also one of the most important components of the financial system. Stock market primarily refers to the securities market for equity stocks issued by various institutions. Stock market plays a very important role in the functioning of the economy by providing liquidity to the equity issued by the various corporations. Due to the availability of such equity market, people are not reluctant to invest in the equities of the corporations, which is so very important for the economy to grow because without such investment no economy can thrive. Due to the presence of equity market, investors can sell their investment in corporations at any time at their own discretion, without which they would have their funds tied up in the corporations forever as equities are redeemed only when the company is wound up. Well functioning of stock market is therefore very important but the functioning of the stock market is itself dependent on various factors.

The stock market is considered as an indicator of the entire economic activities of an economy because the stock market affects various macroeconomic aspects of the economy as well as is affected by various sorts of macro and micro economic variables. Among the various macroeconomic variables, money supply of economy and its relation with the stock price is of great debate in the financial literature.

We know that securities market is an important constituent of capital market. It has a wide term embracing the buyer and sellers' securities and all these agencies and institutions, which assist the sale and resale of corporate securities. Commenting to the importance of securities market, Hugb T.

Patrick in his book, “Financial Development and Economic Growth” write that” the development of a sound securities market with its constituent financial institutions is one of the mechanisms which enables the efficient transformation of savings from the hands of surplus spending ones who can use them more productively and/ or have less risk aversion”. (Hugh D. Patrick, 1966)In this way due to the help of security market idle savings can be canalized to most productive purpose.

Stocks and shares are on of the assets into which money can be invested. This investment further is more attractive to a majority of individual because it is also liquid in character. In the securities market, there is the great importance of demand and supply for price fixation. The stock market affects the functioning of the economy in two principal ways. First, market developments may affect the national income through their influence on the aggregate properties to consume, to save, and to invest. Second, even with a given level of saving and investment, market arrangements can result in a more or less efficient allocation of investment funds.

In the economic life of a nation, stock market has occupied an important place. The main socio-economic role of stock market is the valuing of securities and the allocation of the ownership of an economy’s capital stock. The role is important because of its considerable influence on the assignment of scarce capital resources to various projects. The stock market influence on resource allocation is both direct and indirect. Direct influence is exerted through the new issue and right issues market. Indirect influence is exerted by share price performances and stock market comment.

Many of the Western world’s economies have substantial portions of their assets valued in the stock market. Thus, the proper functioning of stock exchange is vital if their economic welfare functions are to be optimized.

Capital is needed for various governmental and public industries and enterprises in order to extend their economic activities. We know that household sector is the striking factor to broaden the scope of stock market. So, stock market is trying to stimulate the household sector in order to invest their saving on various commercial and industrial purposes through the media of different financial institutions. Thus financial institutions also have to play crucial role far to develop stock market.

In Nepal, up to the period of Second World War no any attempt was made to raise funds for the industrial through the flotation of securities. In the absence of the development of corporate securities market the only securities generally floated in the market are the government securities. So far the government has the virtual monopoly over the securities market. But after the establishment of stock market, it is playing a crucial role for the development of security market.

Evidently, it is widening the scope of stock exchange and also being very helpful to mobilize the idle saving of household sector and canalized them to the most productive purpose. At present, stock market has taken various activities for better management and effective growth of the securities marketing in Nepal. The stock market is playing an active and influential role for the securities instruments by providing market place.

Stock Exchange is the market where second hand securities are brought and sold for investment or speculative purpose. It provides facilities of trading in listed securities. In the recent years authorities are increasingly recognizing the role of stock exchange. Stock Exchange as the market of securities gives everybody access to a number of difference opportunities for capital investment. The function of the stock exchange is to provide equal opportunities to as many buyers and sellers of securities as possible. From a general economic point of view, the stock exchange constitutes the core of the capital market. It has put its finger on the pulse of the economy and gives it diagnoses to the publication in the form of quotation.

Investment is the life-blood of economic development. It is evident that stock exchange will continue to fulfill their vital function in the national economy. So long as a private enterprise exists, we know that the stock exchange is the place where stocks and shares are bought and sold. The substantial competition in innumerable buyers and sellers determines the prices with a measure of precision that cannot be obtained in other unorganized market to such as the property market where activities are of a spasmodic nature. (Rekha Pantha, 2000)

The stock exchange is intricately interwoven in the fabric of the nation’s economic life. As well author Mr. W.T.C says, “Without the stock exchange the savings of the community the sinews of economic progress and production efficiency would be used much less completely and much more wastefully then they are now.” The task of mobilizing and distribution of saving could be attempted in the old days by a much or less specialized institutions than the stock exchange. But as business percentage industry expanded and the economy assumed a more complex nature the need for a permanent finance arouse. Investors wanted liquidity the facility to convert their investments into cash at any given time. The answer was a market for investment and thus was how the stock exchanges into being formatted.

Thus institution plays a notable part in the economic life of a country acting as a free market for securities, where prices are determined by the forces to supply and demand. The function of the stock exchange is not only to provide a market for securities but also assist in the raising of funds for government and industry. Thus a free and active in the stock and shares have become a perquisite for the mobilization and distribution of a nation's savings as to support modern business.

The Securities Board is among other things responsible for the supervision of NEPSE, its members, disclosure requirements for listed companies, and the licensing of - i) Issue managers, ii) Underwriters, iii) Portfolio managers, iv) Market-makers and v) Stock brokers under the Securities Exchange ACT 1983.Under the Securities Investment Trust Act of 1997, the Securities Board is also responsible for the registration and supervision of investment funds. At present time, the Securities Board is drafting regulations under the Securities is also responsible for the registration and supervision of investment funds. At present time, the Securities Board is drafting regulations under the Securities Investment Act for consideration by the Minister of Finance. Under a new Securities Exchange Act, as proposed, NEPSE would function as a self-regulatory organization under the oversight of the Securities Board. (Agriculture Development Report, 1998)

In this way, we can say that Stock Exchange has a vital role to play in helping industries to raise necessary finance. They have supremacy important function to perfume in developing a stock capital and to enable government to raise loans. They're servicing as indispensable in the operations by the authority for the regulation of the country's credit. It is generally through that a stock exchange serves only those who have money to invest and securities to sell. This is an understatement for a stock exchange benefits the whole community in a variety of ways. By enabling producers to raise capacity it indirectly gives employment to millions of people and helps consumers to get goods needed by them.

2.5 Participants in the Stock Exchange

- **Stock Brokers**

Brokers are agents or middlemen, who facilitate the buying and selling of securities for investors. They take buy or sell orders from the investors in their own office and execute the transactions in the floor of the exchange. Besides the basic service of executing orders, brokers also provide services such as holding securities for safe keeping, providing information and advice relating to investment alternatives, extending margin loans and facilitating short sales.

A stockbroker, as a member of stock exchange and sub-broker as any person who acts on behalf of stockbroker as an agent or otherwise assisting the investors in buying, selling or dealing in securities through such brokers. (Bharat Prasad Bhatta, 1998)

During interview, most of the brokers complained that they have to go through a lot of paper works for transactions and settlements. Stock Exchange, to some extent, has computerized its activities, with a view to decrease paper works, and brings efficiency in supervision, settlement and reconciliation. Most of the brokers believed that Stock Exchange could also help its members to computerize their activities at least by developing compatible and uniform computer software.
Conditions for granting of certificate to Stockbrokers:

The rules stipulate the registration is necessary for acting as broker or sub-broker.
The conditions for grant of a certificate of registration to act as stock brokers are:

a) He holds the membership of a Stock Exchange Act.

b) He shall abide by the rules, regulations and bye-laws of the Stock Exchange of which he is a member.

c) He shall pay the amount of fees for registration.

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

- ## Security Dealer

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

Members are permitted to act both as brokers and dealers. No member can enter into a contract as a principal with any person other than a member of a recognized stock exchange unless he secures the consent or authorization of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal. In such cases, it is obligatory under the Stock Exchange bye-laws and regulations that the price at which the transactions are completed should be fair and reasonable and justified by the condition of the market.(Charles P. Jones, 1998)

More than seven thousands brokers and dealers have registered with the SEC to make markets in OTC securities. A dealer in a particular security issue must maintain firm bid and differing prices and must stand ready to buy or sell (for his own account), a given number of units at quoted prices. Usually the minimum quantity for which a given bid or ask quote is assumed to be valid is based on the securities normal trading unit. For stocks, this is 100 shares, whereas for bonds it is equivalent to five $1,000 par bonds.

Dealer bid ask quotas are viewed as wholesale, or inter dealer prices, when, however, an OTC broker or dealer receives a customer order for a security in which a market is not normally maintained. The customer will pay a retail price, which includes a mark up over the wholesale price. To accomplish the transactions, the broker normally consults a NASDAQ (National Association of Securities Dealers Automatic Quotation) computer terminal. NASDAQ lists, at any point, in time, all the dealers who make markets in particular stocks and their respective bid-ask quotes. The next step involves contacting the dealer listed by NASDAQ as offering the best quote for the transactions. The customer who placed the order then pays the wholesale price quoted by the dealer plus the retail commission to the broker.

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

On the basis of the functions relating to transactions in securities, the security dealers are classified into two types of members:

a) Security Dealer (Primary Market)
b) Security Dealer (Secondary Market)

Security Dealer (Primary Market)

The security dealers (Primary Market) are the dealers who provide pre-issue and post issue services for the sales management of securities which are being newly issued by a corporate body through a public issue or the circular method, underwrite the purchase of unsold shares, or perform other related functions.

Security Dealer (Secondary Market)

The secondary dealer (Secondary Market) are the dealers who deal in securities through brokers in the name of the investors or in his own name with the objective of managing investments in securities presented at the Stock Exchange for transactions in his own name or by concluding investment management contracts according to the current law.(CEDA, 1997)

The security dealer specializes in buying and selling securities, i.e., securities issued by government and public bodies like NIDC, Citizenship Fund and Credit Development Banks etc. They act mainly as a jobber and prepare to take risk inherent in the ready sale of securities to meet current requirements. The market is an OTC market and each purchase and sale has to be separately negotiated. The market, therefore, tends to be restricted. In India these activities are done by Central and State governments and by statutory public bodies such as Municipal Corporations, Investment Trust, and Electricity Boards.

There are about half a dozen active firms of security dealers in Bombay and the number elsewhere is more limited. They are in daily contact with the Reserve Banks as well as with Commercial Banks, the Life Insurance

Corporation and other financial centers, and results of their activities enjoy the benefit of extremely fine quotations. The opening of debt market segment and trading in government securities including Treasury bills on NSE has completely altered the character of the market.

The security dealer specializes in buying and selling gilt-edged securities, i.e. securities issued by the Central and State governments and by statutory public bodies such as Municipal Corporation, Improvement Trusts and Electricity Boards. He acts mainly as jobber and is prepared to take risk inherent in the ready purchase and sale of securities to meet current requirements. The gilt-edged market is OTC market and each purchase and sale has to be separately negotiated. The market, therefore, tends to be restricted. Moreover, as a result of their active touch with RBI as well as with Commercial Banks, the LIC and other institutional investors, gilt-edged securities enjoys the benefit of extremely fine quotations. (V.K.Bhalla, 1983)

- **Market Makers**

Market makers are the institutional members. They are well-organized institutions and are considered an expert in the area of analyzing financial statements and controlling and regulating the market through market mechanism. Therefore, these organizations are allowed making buy and sale in and from their own account. So in the process of market making, they are allowed quoting both the bid and asking price. The spread between these two is income for market makers. They are not allowed to deal with general investors. It is expected that they will buy when there is excess demand. In the case of excess supply, the price will come down and when there is excess demand price will increase. Doing the above said market practice they will control the probable artificial increase and decrease of market price. Market brokers are their clients.

NEPSE had licensed six organizational market makers. The number goes decreasing. Market makers quite the job of market making of corporate securities when NRB puts investment ceilings by publishing directives. Now a day there is no market maker operating in the market. (Kiran Thapa, 2006)

Market makers, also known as specialist, facilitate the trading of securities by maintaining inventory in particular securities. They are similar to dealers in many ways except that they always stand ready to buy and sell securities at their bid and asked price for which they are market makers.The market maker is any company or corporate body which deals in securities at the Stock Exchange in its own name or under its name on the basis of a pledge to provide liquidity to the securities issued by HMG, as well as to the securities listed at the Stock Exchange by concluding necessary contracts with the concerned corporate bodies or to the securities of at least three corporate bodies, shall be granted membership a securities Market maker.

2.6 <u>Order Collections and Maintenance of Client Records</u>

It is often referred to as 'back office operations' those two functions are usually performed by brokers. Order collection can be thought of as the starting point of a transaction in which a broker receives instructions from a client and notes those instructions either in writing or direct to a computer record. The main client records kept are a record of client instructions regarding transactions, ledger entries of money and security transfer and balances, the name in which securities are registered and the location and form in which they are held, any lines or charges over the securities and details of any authority or power vested in the broker by the client relating to the clients assets. Traditionally all these records have been kept manually but now computerized in all but the smallest broker's office.

- **Order Routing**

This is the first step of the transactions process outside the broker's office. It is the process of transmitting a client's order to the correct place for execution. This might be to the broker's trading representative on the floor of a local or distant stock exchange to an automatic small order execution system, or to an off-exchange market such as a computerized over-the-counter (OTC) market or privately negotiated upstairs market. It can be done *via* physical delivery of an instruction slip, *via* telephone or computer link to the broker's booth on the trading brokers on the floor itself, by direct entry to a computer based market, where the order is instantly displayed, or to an automated switching mechanism which to transact the order. Such order routing facilities are commonly provided by stock exchanges but sometimes by independent IT providers.

- **Quotation Display and comparison**

On reaching the trading place, a client's buy or sell orders as brought together with other orders to begin the price setting process which is the corner stone of a securities market. They are displayed according to price priority and compared with each other to identify where as trade may be possible. In an order driven market, the bid and ask prices of investors are displayed, while in a quote driven market, the buy and sell quotes of market makers are displayed. At least the highest bid and offer price plus the last sell prices are given, and on some computer systems, the highest five or ten bid and asks are quoted sometimes, together with their associated buy or sell quantities. Order stock exchanges or similar market operators provide display and comparison systems. They may be centralized like a stock exchange or computer trading room, or they may be distributer on a computer network.

- **Order Matching and Selection**

A deal is struck, when, as a first step, a selling order is matched with a buying order and, second, the two are selected as the two sides of a trade. Matching is price based; the buy price must equal the sell price. Selections criteria are more varied and depend on the nature of the market. Order or quote driven, automated or manual, continuous or call auction. One method is automatic selection by time priority, in which quotes all the same price are executed in order from the first one entered into the system to the last one entered. This is common in continuous auction automatic execution system. A second method is where brokers exercise some discretion, so that from within a group quoting the same price rather than having to deal strictly in time priority, they are able to trade with selected counter parties because of the convenience of the quantities involved or because of considerations such as greater or lesser degree in floor based, or computer assisted manual markets. A third computer based or manual calls auctions, which do not account for time priority. Instead, they execute the largest possible volume of trades by calculating a single strike price derived from the bids and offers in the system at the time of the call. And finally, a quote driven market displays the bid and asks spreads of the market makers rather than bid and offer prices of investors. In this case, client orders matched with the market maker's quote.

- **Order Execution**

A deal is struck when matched buy and sell orders are executed one against the order. This may be done automatically or manually. Manual executions require a decision and on action by both the buy and sell brokers. The decision is acceptance of the terms of the trade and of each other as counter parties, the action is commitment of those decisions to a permanent record of their own and of the exchange, and display of the new sale price of it is different to the last one displayed. In floor based systems, the brokers may each write a sale slip which they deposit immediately for collection by the exchange, keeping a copy for themselves, or they might each write the details in their own trade book and signal to an exchange official that the trade has been executed so that the official can also record the details of the trade. In a floor-based system, these actions can be supported to a greater or lesser degree by computerization. In a non-floor based system, brokers may strike a deal by communicating directly via the linked computer terminals which also display the bids and offers, or they may use ancillary telephone or fax communications, they may record their decision separately in their own records and those of the market provider or the records may be generated automatically by the computer network. Fully automatic executions on computer based systems remove the decision to consummate the trade from the control of the brokers and instead execute the trade automatically once order is matched.

2.7 Trading Procedure Of NEPSE

Securities market trading has traditionally been conducted by traders gathering at a central point to quote buy and sell prices and to strike a deal when prices matched. Early forums for such gathering were coffee-houses and curb-sides but there gradually gave away to the trading posts of stock exchange floors around which traders gathered to trade the stocks listed on each post. Stock exchanges began, as associations of such traders who wished to gather together to trade because of shared interests and mutual trust. (Pardy Robert, 1992)

There are two basic type of trading system-order driven and quote driven. The quotes, which drive the trading process may be the bid and offer prices specified in investors' orders or they might be the spread, quoted by market makers. The first is called an order driven market, the second, and a quote driven market.

Presently NEPSE the only Stock Exchange in Nepal has introduced fully automated screen based trading since 24th August, 2007. The NEPSE trading system is called NEPSE automated Trading System (NATS) is a fully automated screen based trading system, which adopts the principle of an order driven market. NEPSE facilitates trading in the instruments as Shares (Equity shares, Preference shares), Debentures, Government bonds and Mutual funds.

Market Timings

Trading on equities takes place on all days of week (except Saturdays and holidays declared by exchange in advance). On Friday only odd lot trading is done.

The market timings of the equities are:-

Market Open: - 12:00 Hours
Market Close: - 15:00 Hours

Odd Lot Trading is done on Fridays. For Odd Lot Trading Market Timings are:-

Market Open: - 12:00 Hours
Market Close: - 13:00 Hours

Settlement

NEPSE has adopted a T+3 settlement system. Settlement will be carried out on the basis of paper verses 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.

Lot or Board Lot

It is the minimum number of shares NEPSE has fixed that once the transaction is done at least the fixed quantity must be bought and sold. As mentioned above, NEPSE has linked the minimum tradable lot with its par value. Generally, in case of regular lot, any shares more than minimum board lot are allow to trade and in case of odd lot transactions any shares less than market lot will be allowed to trade.

In the regular transactions, the minimum number of securities that must be traded is known as market lot and board lot. This lot is fixed on the basis of par value of the securities. If the par value of the securities is Rs 100, the tradable lot is 10 shares and if it is of Rs 10, then the trading lot is 100 shares. In the case of debentures or corporate bonds, the minimum tradable lot is 10 debentures worth of Rs.10, 000.

2.8 Clearing and Settlement

A financial instrument is commonly considered liquid if it is traded in a market with a sufficient number of participants to make feasible purchase and sale on short notice at price near the contemporaneous equilibrium value of the instrument. (Kenneth. D. Garbade, 1979)

If trading is at the heart of a securities market, then clearance and settlement are the veins and arteries. Each executed trade is completed only after share is exchanged for payment. As a consequence, the way in which the clearance and settlement process is organized has a great impact on the efficiency, fairness and stability of system as a whole.(Degemmaro P. Raman, 1999)

Clearing and settlement system are systems providing the process of presenting and exchanging data or documents in order to calculate the obligations of the participants in the system to allow for the settlement of these obligations, and the process of transferring fund and/or securities.(International Organization of Securities Commission, 1998)

A clearance system determines what securities trading counterparties owe and what they are due to receive. It consists of comparison of the details of a trade as reported by each party to determine if they agree, and then calculation of the amount owed to each. Clearance is followed by settlement the exchange of securities and funds to complete the transactions. (Pardy Robert, 1992)

Clearance and settlement consists of four-post trade function, trade comparison, and conformation, netting and calculation of obligation, exchange of securities and payment and registration of title. The last is not strictly part of clearance and settlement but is commonly linked to it. It can be seen that important contractual obligation and rights to title on involved in the process of clearance and settlements, and when it is remembered that much transactions must be cleared each day, the importance of efficient and reliable system is obvious.

2.9 Function of Stock Exchange

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

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

The efficient functioning of the stock exchange creates a climate conductive for an active and growing primary market for new issues. An active and healthy securities market in existing securities leads to a better psychology of expectations.

Some basic functions of NEPSE are:
-Trading
-Listing
-Clearing and settlement
-Market surveillance

2.10 Functions of (SEBO/N)

SEBON was established by the government of Nepal on June 7, 1993 as an apex regulator of securities market in Nepal. It has been regulating the market under the Securities Exchange Act, 2006. Its main function is to regulate, control and to monitor the entire capital market of the country. It is an organization, which works under ministry of finance. The government of country executes its policy related with capital market through the organization. The board is striving from the very beginning as a market developer and the regulator. The main objective of SEBO/N is to regulate and promote the securities market and protect the interest of investors.

SEBO/N has its own boards of directors for the accomplishment of its objective. The board of directors consists of seven members which represents government line ministries and institution as well as private sector. The chairman of SEBO/N is appointed by government of Nepal for tenure of four years. Other members of the board include representative one each from ministry of finance, ministry of law, justice and parliamentary affairs, ministry of industries, commerce and supply. Nepal Rastra Bank, federation of Nepalese chamber of commerce and industries and association of chartered accountants of Nepal. SEBO/N develops the policies for the development of the market; issue licenses to established and operate stock exchange, registration of public issue and others.

Since its establishment SEBO/N has been continuously concentrating its effort to improve the legal and statutory frameworks, which are the bases for the healthy development of the stock market. SEBO/N has been concentrating its effort to improve the legal and statutory framework, which are the bases for the healthy development of the stock market and to enhance the degree of investor’s protection. SEBO/N’s regulatory interventions were targeted to discipline the market and consolidate its position as central securities market regulator. SEBO/N started to sponsored investor education program on capital market through Nepal television from 1997-01-22.

SEBO/N is basically relying on government grant to financial its activities. Other financing sources of SEBO/N include registration of corporate securities, renewal of stock exchange and the registration, renewal of market intermediaries and the income from the mobilization of its revolving fund.
The function, duties and power of SEBO/N as per securities ordinance are as follows:

- The offer advice to GN on matters with the development of the capital market.
- To register the securities of corporate established with the authority to make a public issue of its securities.
- To regulate and systematize the issue, sale and exchange of registered securities.
- To give permission to operate a stock exchange to any corporate body desirous of doing so subject to this ordinance or the rules and bye rates framed under this ordinance.
- To supervise and monitor the function and activities of stock exchange.

- To inspect whether or not any stock exchange is executing its function and activities in accordance with this ordinance or the rules and bye rules framed under this ordinance and to suspend or cancel the license of stock exchange, which is not found to be doing so.
- To issue license to conduct the business of dealing in securities, subject to this ordinance or the rules and by the rules framed under this ordinance to companies or institutions desirous of conducting the business of dealing in securities.
- To grant permission to operate collective investment schemes and investment fund program and to supervise and monitor them.
- To supervise and monitor the function and activities of securities dealers.
- To systematize the task of clearing account related to transactions in securities.
- To supervise whether or not security dealers are behaving in the manner prescribed in this ordinance or the rule and bye rules framed under this ordinance, 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 accordingly.
- To view or make arrangement for reviewing the financial statements submitted by the corporate bodies issuing securities and security dealer and issue directives deemed necessary in that connection to the concerned corporate body.
- To discharge or make arrangements for discharging such other function as are necessary for the development of securities and the capital market.

2.11 <u>Need of Securities Market to the Less Developed Countries</u>

Securities market is recognized as an effective way of raising capital for commercial enterprise, and at the same time providing investment opportunities for individual and institution. The activities of buying and selling securities in the securities market are extremely important for the efficient allocation of capital within economies. The securities market is a requisite for the sound development of an economy because it not only provides stable long terms capital companies and an effective saving vehicle for the public but also function as an efficient tools for resource allocation. Mass participation in country’s industrialization process is possible only through the efficient mechanism of securities market as it promotes efficient collection of small and scattered saving from the investors and provides return to them in the form of dividend. (Sharma Suresh, 2007)

The development of the securities market is a necessary factor for modern day economy. There should be no doubt regarding the significance of securities market as it is clear that countries have developed securities market, mechanism are developed and country with poor securities market mechanism are underdeveloped.

In the view of many economist capital is regarded not only central positions to the process of economic development but also as strategic. According to Dr. R.S. Mahat "Capital which is itself the product of the human labor with the collaboration of the nature in the past is one of the ingredients in the process of production. It is required to start and run any productive operation. It is more so in industry where the capital intensity is normally higher than in agriculture".(Dr. R.S. Mahat, 1981)

We know that capital formation is playing a key role for economic development. But capital formation capacities of Nepalese are very poor. On the other hand, they expenses collected savings on the unproductive channels such as real estate, precious metals, inventories, jewelries, foreign exchange etc. in place of financial assets. The individuals who hold such assets are not necessarily those who are willing or capable to hold productive assets because ownership of productive fixes assets entail entrepreneurial and managerial function as well. Therefore, they will not use it for productive purposes. In this condition the security market helps to canalize the unproductive issues to the productive one.

One of the tasks of monetary authorities in development is to support the gradual extension and proliferation off the machinery commercial banks, savings banks, investment banking, insurance companies, government bond markets, private bond and share market etc. which links surplus deficit spending units.

Economic development demands transformation of savings or invertible resources into actual investment. But, people who initiate actual investment are not necessarily those who have funds for the purposes. As the process of industrial development starts in modern lines self-financing becomes insufficient to support it. Private means of finance becomes not only limited but also even uneconomic therefore, it becomes necessary funds. On the other hand there are other people generally households who have surplus funds but do not have the desire and or capability to utilize them for investment activity.

Under such situation the need for a market mechanism that facilitates the transfer of funds from surplus spending units (the units whose current income exceeds current expenditure) becomes obvious. The market, which performs this function, is the capital market laving ton an authority of British Capital market opines that its function is to enable control over resources to pass into the hands of those who can employ them most effectively there by increasing productive capacity.

In underdeveloped countries generally comes across a situation where entrepreneurs do not find resources or productive investment while savers invest their money in real assets or relatively low social productivity. The financial institutions remedy such a situation by soliciting the resources from savers by offering them a variety of financial securities differentiated in maturity, yield provide them to the most efficient users. Thus a more efficient allocation of inventible funds results.

The need of securities market is still greater in an underdeveloped country like Nepal where a host of traditional social and psychological consideration conspire against the direct transaction between surplus units and deficit units. Thus, securities market assumes a grater role and significance in the present day economies.

2.12 Problems of Secondary Market (NEPSE)

Until now, the stock market development in Nepal has not reaches its full potential due to many reasons, which are described below:

i) Unfavorable Macro Economic Condition

Although Nepal has changed really since 1950, it is still at an early stage of economic development. It is one of the poorest countries in the world. 40% of GDP, over 80% of population live in the countryside. The absolute size of state sector is small.

ii) Political Instability

The establishment of parliamentary democracy in 1990 opened the way for sweeping economic reform and a program of great scope was carried out between 1991 and 1994. This embraced policies on finance, foreign and domestic trade and investment, industry and foreign exchange, and a start to privatization. A change of government then led to hiatus in privatization and set back macro economic stabilization. Thus, political instability changes the investors' expectations about the prospects for the economy in a certain environment.

iii) Low Investors Confidence

Investors' confidence in the Nepal stock market is relatively because of stock market volatile, low return on investment, inadequate information on which to base investment decision, lack of understanding about the operation of financial markets and instruments and a general perception that the stock market is not adequate to restore investor's confidence.

Investors put in their money in stock equities for return. Such return in the form of both dividend rate and market gain must be reasonable enough to attract them. Therefore, transparency and openness of transaction, quality professional services, adequate corporate financial disclosures and improved legal, regulatory and supervisory frameworks are the dire needs of investors in Nepal Stock Market today.

iv) Weak Tax System

Tax policy has an important role on the methods and cost of capital. In Nepal, tax policy appears to have contributed to the high cost of capital for private sector and the over reliance on short-term debt financing. Tax policy has hindered the development of stock market by increasing transaction cost and creating a disincentive for investment is the equity bond market.

In Nepal, capital gain on securities transaction are taxed as ordinary income to corporations and individual investors while most emerging markets capital gains on investment in stocks and bonds are not taxed.

Also, there need to rationalize tax policies towards capital formation, to encourage private sector and secondary market transaction. There is the high level of taxation of transaction executed on the stock exchange. Stockbrokers pay about one third of commission earned in the form of transaction taxes or fee to the Nepal Stock Exchange (NEPSE). High transaction costs and capital gain taxes discourage investment in the stock market and tend to reduce market liquidity.

v) Slow Privatization Process

During the past decade, one of the major economic reforms that have taken place in the global economy has been the decisive shift towards the privatization of state owned enterprises in most countries. In general government privatization policies in both the industrial and the developing countries has resulted in the role of stock owned enterprises to private investors in order to:-

- Widen the ownership base of the national economy.
- Reduced demand placed on government is fiscal resources.
- Ensure greater economic efficiency at enterprises level.
- Encourage foreign investment in order to provide needed foreign exchange resources: to facilitate technological transfer.

In Nepal, the Nepalese government first launched a privatization program in 1992. A recent World Bank report on Nepal told that the privatization program has been delayed for diverse reasons, including: "frequent government changes, philosophical difference with regard to the objectives and modes of privatization are lack of technical capacity within the government".

Privatization should aim at developing stock markets but in Nepal, Stock Market has been used to a limited extend to achieve privatization. A long-term strategy needs to be developed that more closely links the privatization program to the further development of Nepal Stock Market. In order to improve stock market, infrastructure and regulatory framework one clearly needed to enhance investor's confidence and prepare the stock market for privatization. But there is also a need to provide investors with a favorable investment experience through privatization process.

vi) Inadequate Institutional Investor Base

In Nepal, the institutional investor base is small. Banking sector have dominated the financial sector. There are six types of institutional investors that are prominent in both developed and emerging market economics: 1) Government sponsored provident funds 2) Collective investment fund 3) Private pension funds 4) Bank/Trust institutions 5) Insurance companies 6) Venture capital firms.

Each type of institutional investors potentially offers a large pool of funds that could be invested in the money and stock market.

vii) Investment of saving in Bank Deposits and Government Securities.

In Nepal, the stock market is new and the investors' do not properly understand the risk and reward of investing in the stock market because of this both individuals and institutions are putting their savings into bank deposits and fixed interest government securities. Thus long–term savings (stock market) are going into short-term instruments.

viii) Lack of Improved Prospectus to Investors

In order to make informed decisions; investors must have access to accurate and timely information. Banks, some finance companies and insurance companies are perceived to provide meaningful information to investors on a timely basis; disclosure to investors is not adequate for many non-financial listed companies. The lack of accurate and timely information is one of the important reasons why investors to a considerable extent have lost confidence in the Nepalese Stock Market.

In Nepal, except private commercial banks, the prospectus issued by individual companies does not contain all the information are vague. There is also no clear enforcement power to SEBO (Securities Board) regarding prospectus by public companies under the existing Securities Exchange Act.

ix) Weak Legal Affairs for Stock Market Regulation and enforcement.

At present time there are twelve Acts, Regulations and guidelines related to the stock market activities in Nepal, which are as follows:-

1. Securities Exchange Act, 1993.
2. Securities Exchange and Regulation 1993.
3. Company Act, 1974
4. Commercial Bank Act, 1974
5. Finance Company Act, 1985
6. Foreign Exchange Act.
7. Foreign Investment and Technology Transfer Act, 1992.
8. Membership of Stock Exchange and Transaction Bye-Law, 1993.
9. Secondary Listing Bye-Law, 1996.

10. New Issue Management Guidelines, 1997.
11. Securities Allotment Guidelines, 1994.
12. Securities Registration and Issue approval Guidelines, 1995.

Even though, the securities regulatory system is seriously deficient because it lacks in whole or in part, a number of safe guards essential for investor's protection. Accordingly, a new securities act and supporting regulations are required.

x) Restriction on Foreign Portfolio Investment in Nepal

In Nepal, there are restrictions on foreign portfolio investment in the local stock market. In many developed and Emerging Securities market, foreign institutional investors are an important source of professional portfolio management for financial markets infrastructure. Institutional investment and external capital flows in the form of international portfolio investment can contribute to Stock market volatile and the long-term benefits to the economy.

Besides this, foreign accounting and auditing professionals are not permitted to practice in Nepal because of this; there is little opportunity for the transfer of technical and skills which is often available in developing countries at any early stage of stock market development.

xi) Need of Credit rating Agencies

A credit rating agency is essential to the successful operation of a money and bond market for private issuers. A credit rating is an opinion about credit risk, or an assessment of the ability of an issuer of debt securities to make timely payment of principal and interest on a security over the life of the instrument. In order to establishing a credit rating agency in Nepal, it will be necessary to take steps to further develop the infrastructure for the money and bond market and improve the availability of accurate and reliable information about public and private business enterprises that could be rated. Credit rating agencies are also able to rate the claims paying ability of insurance company and the solvency of banks and other financial institutions. Therefore, there is an urgent need to lay groundwork for the establishment of Nepalese Credit rating agency.

xii) Lack of Money and Bond Market

The development of a money and bond market in Nepal is essential in order to have a critical mass of financial instruments that is needed for an economic viable securities market. The development of money market in commercial paper and other negotiable debt instruments would provide an alternative source of funding for the private sector and would foster greater competition in the financial sector.

In Nepal, there are four mainly types of debt instruments issued by Nepal Rastra Bank (NRB) and HMG 1) Treasury bills 2) Developments bonds 3) National saving bonds 4) Special bond. Today, there is an absence of private money market debt instrument and corporate debt securities in Nepal. Because of this, there has been a tendency for banks to dominate the primary market in government debt instruments with secondary market normally being inactive.

2.13 Guidelines to Investors in Nepal

Several procedures and facts need to be taken into account before buying and selling of securities. They are:

1. **Placement of orders**

   The investors must submit written buy and sale orders to the brokers to conduct the trading of proposed securities in prescribed formats.

2. **Points to be included in the order**

   The buy and sale orders the investors must consists the name of securities, its type, quantity price (i.e fixed/maximum/minimum or as deemed appropriate by the brokers) and the validity of the order in prescribed formats. If the tenure is not specified in the orders it will be valid for 15 days only.

3. **Obtaining receipts for the registration of orders**

   The investors must obtain receipt against the deposit of orders in which the broker members must state date, time and registration number.

4. **To obtain notification for the purchase and sale of securities**

   After the transactions as per the orders are done the brokers must acknowledge the clients either on the same or next day in prescribed format.

5. **To submit either purchase value or certificates**

   The investors after getting the notification from the brokers must submit total amount required, in case of purchase and certificate of securities, in case of sales, within five working days from the date of transactions.

6. **Commission of the brokers**

   The commission for his/her service ranges from 1 to 1.5 percent based on volume of trading.

7. **To receive the amount or share certificate**

   The brokers have to submit the amount and share certificate within five working days from the date of transactions and they will be eligible to get payment and certificate on the 8^{th} days. On the 6^{th} days stock exchange will do the crossing of documents and prepares bill and makes payments to the brokers on 7^{th} day.

8. **The tenure for the blank transfer**

   The decision of the investors needs to be executed through the brokers. If the investors make decision to register the purchased securities as blank transfer it will be wise to continue this decision before the closure of fiscal year or before the book closure whichever is earlier.

9. **Receiving and making payments through cheques**

   The investors must make payments or receive payments from brokers either by bank transfer or through cheques.

10. **To be careful in risks involved in securities transactions**

    Investing in securities is not gambling. Certain principles are there and the investors must be aware of the existing risks involved in trading and investing in securities. So before making investments decisions the investors must consult financial statements of the concerned company and price study.

11. Compensation from the deposits of the brokers

Each and every broker has to submit the bank guarantee and cash deposit in stock exchange. The stock exchange will make payments if stock exchange identify any fraud committed by brokers an also incase of default of the brokers or in any other case of like nature.

12. My world is my bond

The service of the brokers based on the principle “My world is my bond”. The brokers should not be deviated from the principle. The investors must support the principle of the brokers.

13. To have knowledge about trading, settlements and clearing procedures

The investors must have thorough knowledge about trading, clearing and settlement procedures. If they do not have thorough idea about these procedurals aspects different confusions, conflict and dilemma may take place.

14. Duty and rights of the investors

It is the right and duty of the investors to inform the stock exchange authority about the problems faced by him while making investment. It is his right to get the problem solved and it is also his duty to protect other investors from facing the same problem.

2.14 Present Status of Stock Market in Nepal

Equity Market has shown impressive recovery from the sharp fall in 1994 with the lag effect elongated till late 1998. At present, it has been performing more strongly than in the earlier years. The improvement in the equity market has been attributed to various factors including good prospect of corporate earnings and broader household participants in the stock market. Investors not only relay on the statement of the brokers; but they also have a concern over the financial information of the concerned company. Therefore the shares of companies with better prospects of dividend; capital increment and growth have normally higher prices in the stock market. At present, the stock market in Nepal has witnessed its strength surprisingly, and this has raised hopes for sustained growth of corporate under takings. Stock market in Nepal has been growing gradually both in terms of turnover as well as the capital investment. From 79 listed companies in 1994/95 they grew to 135 in 2006/ 2007. During this period, their paid up capital surged up from Rs. 296.18 million to Rs. 2179.88 million. Market capitalization and total annual turnover of listed shares has been rising continuously, except with a few cases of volatility.

Table No.1

Stock Market Indicator

(Rs. in million)

Fiscal Year End Mid July	**No. of Listed Companies**	**Paid up Value of Listed Companies**	**Market Capitalization**
1994/95	79	296.18	1296.30
1995/96	89	335.85	1229.50
1996/97	95	447.65	1269.80
1997/98	101	495.98	1428.90
1998/99	107	648.74	2350.80
1999/00	110	734.74	4312.33
2000/01	115	816.52	4634.94
2001/02	96	968.50	3470.39
2002/03	108	1256.01	3524.04
2003/04	114	1340.49	4142.48
2004/05	125	1677.18	6136.59
2005/06	135	2000.86	9681.37
2006/07	135	2179.88	18630.13

***Source* :** Trading Report of NEPSE 2006/07.

B. Review from International Context

Vast numbers of research studies have been performed internationally on the stock market. The findings of some of the research studies are as follows:-

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

The study conducted by the U.S Department of Commerce on stock prices and the business cycle, 1948-84 has found that the general correspondence between stock prices and business cycle, where weighted moving average of a stock price index is mapped against the peaks and troughs of business cycle since 1948. The market has reflected all the recessions in the economy since 1948 (Kimpton, 1985).

The indicator of stock market development reflects 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, 1990; Jordan, 1990).

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

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

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

Ross Levine, at his same study, has found that stock market liquidity rather than stock market size and volatility of stock market matters for growth. He has shown that with taking examples of 38 countries with more liquid stock markets in 1976 grew faster than those economics with less liquid stock market in 1976 between 1976 and 1993. Thus, stock market liquidity, viz. value traded ratio, turnover and the value-traded ratio divided by stock price volatility. The study has revealed that countries that had more liquid stock markets in 1976 enjoyed both faster rates of capital formation and greater productivity over the next 19 years, because liquid stock markets encourage more investment (Levine, 1996).

Kersi D. Doodha has shown the casual connection between deficit finance, money supply, and the general level of price and the share prices. The relationship being positive and in the same direction, it can be deducted that, ceteris paribus, if the deficit finance is low, money supply increase will be small, the general price level will be little and, therefore, the growth in stock market prices will be small (Doodha, 1962).

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

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

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

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

C. Review from Nepalese Context

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

- **Review of Regulation of Capital Market and Intermediaries**

i) Policy Framework for Capital Market Development

The economic, institutional, and regulatory framework provides the underpinnings for capital market development. At the early stage of an emerging market economy, it is important that the Government create the right policy environment to facilitate the creation of a critical mass of financial instruments, issuers, and investors. Government can also create incentives for capital mobilization, remove impediments to private sector development, educate investors, and provide basic legal and regulatory reforms. Until now, Nepal’s capital market development has not reached its full potential for several reasons, including:

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

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

In most emerging market, the securities commission has a legal mandate to facilitate capital market development. Government policies must facilitate rather than impede capital market development. In particular, sound macroeconomic policy can lay the foundation for the development of long-term capital market instruments. Tax policy should encourage long-term investment through the capital market. In Nepal, the overall policy environment has not been conductive to the development of the capital market even though the Government has taken concrete steps to encourage the creation and development of the stock exchange and legal framework.

In Nepal, the main impediments have been the following:

a) Tax policy that discourage investment in capital market instruments issued by the private sector.
b) The channeling of most savings to state-owned banks, and government debt.
c) Institutional arrangements that seem to discourage contractual savings and institutional investment flows into the capital market and
d) Lack of investors' confidence in the stock market since many listed companies do not trade on a regular basis, or hold annual meetings and provide disclosure information to investors on a timely basis. Also there is a need for a strategic plan to link privatization policy to the growth and development of the capital market.

ii) Regulation of Capital Market and Intermediaries

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

Nepal, there is a need to establish a regulatory body to supervise private provident funds.

Under the Finance Company Act and the Banking Act, the NRB supervises and regulates finance companies and commercial banks. In Nepal, these organizations are also permitted to provide investment banking type services. In this regard, it is noteworthy that the risks associated with investment banking activities are quite different from those associate with commercial finance companies. In obtaining a license from the Securities Board, however, certain minimum capital requirements must be met by anyone proposing to act as issue manager, underwriter, market-maker, portfolio manager, or store broker.

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

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

The Board of Directors of the NEPSE consists of seven members. The chairman of the Board is an official of the Ministry of Finance. Two board members represent NRB bank and one member is appointed by Nepal Industrial Development Corporation. Two licensed stockbroker members of the Exchange also serve on the Board of directors. Finally the General Manager of the NEPSE is a member of the Board.

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

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

In recent years, self-regulation has become an important regulatory tool in the near by-Asia region. In Sri Lanka, Thailand, and Malaysia, self-regulation is viewed as relatively successful whereas in Bangladesh and the Philippines self-regulation historically has not performed up to expectations. In recent years, the Philippines and Bangladesh have endeavored to improve self-regulations in reorganization of its importance to protections of investors. In Thailand, the Securities and Exchange Commission has delegated certain regulatory responsibilities to the Stock Exchange of Thailand. The role of SEC is to establish overall regulatory policy and to approve the major stock exchange regulations with much of the on-going supervision of the market delegated oversight by the Securities Commission also plays an important role in the regulation of the Malaysian Securities Market.

In Sri Lanka, the Colombo Stock Exchange (CSE) serves as a self-regulatory organization under the oversight of the Sri Lankan Securities and Exchange

Commission, which must approve all of the rules of the stock exchange. The CSE monitors securities company's prudential standards, review financial reports field with the exchange by its members and conduct on-sight examinations under the oversight of the Sri Lankan SEC. The stock exchange is also responsible for market surveillance and trading practices.

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

Under the Privatization Act, several methods of Privatization are provided for:-i) Sale of shares to the general public, employees workers and other interested parties; ii) Formation of a co-operative; iii) Selling the assets of an enterprise; iv) Leasing the assets of an enterprise; v) Seeking private management of a public enterprise; vi) or by other methods deemed appropriate by the Committee. The Act also specifies the factors that should be taken into account for the purpose of evaluating proposals submitted to the Government by interested parties following the announcement of a proposed privatization.

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

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

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

- **Theoretical Review**

The scholars create books under so many practices. So, it is considered to be here to put scholars' view in regards with the investors' protection. What they have spelled out and in what way investors should be protected in the capital market is picked-up from the books like below:-

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

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

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

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

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

Dr. R.S. Mahat in his book "Capital Market, Financial Flows and Industrial Finance in Nepal" (1981) has said, "There is absence of secondary market to ensure liquidity to the securities on demand. Any attempt to stimulate investment in industrial sources would naturally depend on the extent to which the securities are 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 purposed".
The investors are losing faith on the performance of share market since companies are not providing timely and adequate disclosure of information and the continuous violence of shareholders' rights by the company management. This is responsible for losing faith of general public to buy and sell shares of such companies (Shrestha, 1996).

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

- The first that is relatively easy for the individual investors to make substantial returns by investing according to some simple rules so that he can make prediction about the market mechanism and its growth prospects.

- The second point is that the individual investors is manipulated or exploited by the financial institutions to such extent that investing in the common stock is intolerably hazardous. This means, the simple rules regarding the prediction of market mechanism whether it is growing or not, for investments cannot be expected to produce extra ordinary returns. Nor is the small individual investor at a substantial disadvantage as compared with the professional investors or the financial institutions.

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

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

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

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

SEBO also made some improvements in the statutory and regulatory framework of the capital market to be revised to rationalize and simplify the regulatory system. Such improvement contributes to the development of capital market in the following ways.

The improvements are:

- Brings clear demarcation in the role and responsibilities born by the securities board and other regulatory agencies i.e. stock exchange, NRB, ORC etc.
- Reduces the duplication in the role and responsibilities of Board and other regulatory agencies.
- Shows the ways of co-ordination between the services Board and other regulatory agencies.
- Promotes public confidence in the regulatory system and market structure.
- Introduces a system of recognizing self-regulatory bodies by encouraging them to share and take responsibilities in certain areas.
- Establishes securities board as a central markets regulator and rest it with wider investigation and enforcement power.
- Empower the securities board to audit the registered corporate bodies, mutual funds, as custodians and clearing houses in relation to their financial reporting issues.
- Promotes the development of 'full-survive' securities houses and,
- Gives focused attentions for the establishment and up grading of necessary legislative infrastructure to address on going needs.

The implementation of this policy involves:

i) Enactment of new securities act and sub-coordinated legislation there on,
ii) Amendment of securities investment trust act and a sub-coordinate legislation there on and

iii) Preparation of new guideline and directives to accommodate changing needs and circumstances under the new provisions.

Development of a widely participated capital market securities board has a vision of Nepalese capital offers a wide range of financial services and instruments. It also has to provide the opportunity for a large number of investors to participate directly or through mutual savings schemes, which ultimately enhances the bread and the debt of the capital market. While implementing this policy the securities board:

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

- **Review of Articles**

The research articles published in various well-known journal and magazine, which are relevant to this study, have been reviewed here. There are very limited numbers of journal available in the field of management in Nepal and is hard to find any research article relevant to this study. Despite the situation, some articles of Nepalese researcher are also reviewed. Hence the research article published in both national and international journals is taken into consideration. Especially the articles related in favor of the protection of investors in the capital market of Nepal are reviewed here.

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

There is an urgent need for proficient development of the market standard and information dissemination system focused mainly on corporate financial disclosure practices and transparency, corporate accounting and auditing securities markets practices and transparency, corporate accounting and auditing securities markets regulation and corporate governance. To implement the above, Security Board has a great responsibility as to reviewing and developing regulatory standers to make them a relevant with the need of issuers, investors along with promoting efficient capital formation". (Business age, April 1999:15)

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

Now the latest slums in the secondary market, despite a pretty good performance by commercial banks, make it more apparent that investment in the past was done on whim. Even officials at the stock exchange and the securities board, refuting investors' allegations of the market manipulation and insiders' trading of last February, discreetly claimed that Nepalese Stock Market is in a nascent stage. And that, investment are made more on an impulse, rather than through market study and credit rating." (Business age, June 2001:25).

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

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

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

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

The revival of the share market requires minimum fulfillment of the responsibilities and the accountabilities among company management to be shareholder-focused. Time has come for company management to respond to shareholders expectation of return their investment in the shares of companies. Management should make it a habit to change attitude to think what is good for shareholders is good for the company as a whole. “According to the Nepalese Stock market, An Introduction, “These days the interest of the investors is gradually fading away. Investors have been discouraged with the shares market running at a snail’s pace. There is no room for satisfaction for investors. Although the country has adopted the liberal market policies to receive the economy, it has not been applied into concrete actions in Nepalese context. Brokers have been reporting since long about Nepal’s stock market position, however, no action has been taken from the government. The government has not been able to regulate the companies, and the corporate culture is also not being developed among companies, brokers observed.”

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

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

Prof. M.K Shrestha in the book “Shareholders democracy and annual general meeting (AGM) feedback”1992 has focused to safeguard the investors; interest. ” The encouraging and growing confidence of share holders over their investment seek an independent inquiry of disclosed contents of prospectus. This help to satisfy a minimum standard of faith on investment in shares through relying on the pros and cons of prospectus, which could reasonably influence the mind of the prudent investors. Various annual general meeting by different public limited companies reveal a greater gap between discloser made in the prospectus and the annual result, which were reported in this contest the expression of disclosure philosophy and investigation of frauds in prospectus need to be reconciled to check the growing problem in the development of the capital market in Nepal”.

- **Review of Dessertation**

The post studies conducted as a thesis for the partial fulfillment of Master Degree by various researchers have been reviewed here:

One of the study entitled- ***"Dynamics of stock market in Nepal"*** Submitted by Bharat Prasad Bhatta on 1998, is based in the performance of 10 listed companies' data from 1990 to 1995. The objectives of the research were as follows:

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

The main conclusion of his research was:

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

Lack of value judgment to determine the stock prices are the serious problem of the Nepalese stock market. This is mainly due to the inability of the regulatory bodies of the stock market to regulate market mechanism and failure to win the faith of investors. This problem can be solved only when the real determination of stock prices are diagnosed and identified.

Lastly Bhatta recommended the following point to improve the Market Efficiency:

1. Developed institutions to consult investors for risk minimization.
2. Establish an information channel in Nepal Stock Exchange and
3. Make proper amendment on trading rules.

The study fails to explain the proper cause and reasons for the absence of liquidity in the stock market except that of financial sectors. As well it doesn't explain the methods of overcoming such problems.

Another research has been performed by Rekha Pant in 2000 entitled ***"Current Problem and Prospects of Securities Market in Nepal"*** which defines the trend of the Nepalese stock market and present state of primary and secondary market as well as problems and prospects of Nepalese stock market. Panta used only five years data and focused her study mainly on secondary source of data.

The main findings of her study were:

- The development of stock market primarily depends on program and their implementation.
- In Nepal, the overall policy environment has not been conductive to the development of stock market. Therefore, it is difficult to develop more efficient secondary market, trading system for both equity and debt security.
- Restriction on foreign portfolio investment hindered market development.
- NEPSE does not have appropriate policies, membership and fee structure to attract members outside the Kathmandu.
- In Nepal, banks dominate primary market in government debt instruments. OTC trading is not permitted; therefore, secondary market is totally inactive.
- Lack of necessary provisions in the laws and regulation for the privatization and automatics of stock exchange as well as for the establishment of central depository of securities (CDS).

She did not point out the transparency and openness of transaction, quality professional serves, in adequate. Corporate financial disclosures and improved legal, regulatory, and supervisory framework are the urgent needs of Nepalese stock market. Therefore, it is important that the basic assumption in any effort for protecting investors interest or boosting their confidence or developing the stock market is that business, which should be enable to operate in an environment that remains conductive to growth and expansion but complete replication of any tailor made model, as applied anywhere, may not work because the specific in Nepalese stock market is different from other developed market.

***"S*tock price behavior in Nepal"** conducted by Mr. Surya Chandra Shrestha on 1999, aims to examine the efficiency of the stock market in Nepal.

The specific objectives of the study were:

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

While conducting the study, all the companies listed in the stock exchange were considered as total population. Out of them, the companies that are existing and doing transaction in the NEPSE were considered as the sample for the study. For the purpose of presenting and analyzing the available data tools such as trend bar, bar diagram, multiple bar diagram, ratio analysis were used.

The main findings of his study were the dependence in the series of price changes observed simply that the price changes in future market will not be dependent from the price changes of the previous days. It implies that the information of the past price changes is helpful in predicting future price changes in the way that the speculation through technical analysis can make higher expected profit than they would be under native buy-and-hold policy *(i.e* average market return). Therefore, opportunities are available to sophisticated (both institutional and individual) investors to earn higher return in the market.

He finally concluded that the NEPSE is not efficient in pricing shares even in its weak form. Shrestha too had used autocorrelation and run test to detect the dependence among the stock price series. The outcomes of both the models were found to be similar and rejecting the null hypothesis that the successive price changes is independent. Though his research was not based on the total market return movement, the result drawn from analyzing the movement of major stocks traded in the market can be generalized for efficiency level of overall NEPSE. Moreover this research work with the analyses of total market return and banking sector stock return will be useful to verify his findings as well.

<u>"A Study on the Behavior of Stock Market Prices in Nepalese Security Market</u>" conducted by Rekha Gautam on 2005, presents the main objective of the research to analyze and examine the fluctuation of the stock market in Nepalese security market. There is a gap between the theory and practice of investment in Nepalese stock market due to the lack of proper analysis of stock market for the smooth operation of the secondary market. Various measures of stock market development indicate that the stock market in Nepal is underdeveloped and has failed to show impact on the overall national economy. Small market size has made it vulnerable to manipulate and price rigging. Investors tend to avoid stock market because they do not have options to invest in securities according to their risk-return preferences. Similarly, firms shun it because stock market is less reliable source of raising funds for them. Due to this financial system, Nepal has remained basically bank-dominated.

She also concluded that Nepal Stock Exchange Limited is analyzing stock market behavior in very few areas regarding the stock market so experts should be recruited and analyze market behavior in efficient way so that all parties interested with stock market can get benefit from this. The data analysis showed that Nepal Stock Exchange is not providing facilities for investors such as general awareness about investment, investment procedure for general public and movement of stock trend in different periods and their cause are not explained. Most of the investors are complaining that the market makers, brokers and Nepal Stock Exchange Limited Staffs are making coalition for fraudulent activities towards investors. So, Nepal Stock Exchange should clear this type of change for the development of stock market.

“Analysis of securities trading system in Nepal” conducted by Bishnu Lamsal on 2007, presents the main objective of the research to examine the securities trading system in Nepal. He analyzed different companies listed in Nepal Stock Exchange using statistical tool used as Correlation Coefficient and Time Series Analysis. Secondary source was used for data collection.

Conclusions that can be derived from his study are as follows:

- Most of the companies did not have significant correlation coefficient between the share price and amount traded or turnover. It shows that the share trading is not affected by the change in the stock price, which indicates the immaturity of the securities trading system in NEPSE.
- Stockbrokers and market makers are not being much active to create investment in NEPSE. Most of the investors are influenced through media only, not through market makers and stockbrokers.
- The NEPSE is not being able to create continuous market. It may be because of dominance of the individual investors in stock market. The volatile and rudimentary nature of NEPSE indicates high dissatisfaction among the investors. It may be mainly due to the lack of awareness amongst the investors, low habit of investing in stocks and holding strategy of the investors.

He also concluded that poor governance, political instability, lack of strict and favorable policies to follow in practice, lack of commitment to implement the policy and the lack of investors’ awareness are affecting the effectiveness and efficiency of NEPSE. The problems and challenges need to be overcome shortly in order to have pace in the development of the securities which will be a pre-requisite to the economic development of the country.

“Investors’ Awareness in Nepalese Securities Market” submitted by Suresh Sharma on 2007, the main cause of the study was to find out the major factors that influence the investors’ mind in decision making regarding securities trading besides it also aims to find out the investors are conscious in the stock market. The research was based upon seven different Commercial Banks listed under NEPSE. Both primary and secondary data were used.

He recommended following points:

- Investors should be aware about the rules and regulation and the function of stock exchange and capital market to protect them from being exploited of the investors by the market intermediaries and to stop manipulation practices. Effective measure should also be taken to make the market more efficient.
- Investors should analyze the financial performance of the company, its current position and future plan before investing in its securities.
- Since there is only one stock exchange in Nepal and it's located in the capital and there is no other alternative available, participation of investors from outside valley is very low so branch of Nepal stock exchange Ltd. should be established out of valley indifferent cities.
- In this age of digital technology NEPSE is still following "Open out cry system" of trading. The trading system of NEPSE needs to be modernized.

Different financial statistical tools have been used for the analysis of data as:- Market Price of Stock, Qualitative Analysis, rate of Return on Common Stock, required rate of return, risk free rate, standard deviation of stock return, variance of stock, co-variance, beta, percentage analysis, correlation analysis and regression.

Correlation between MPS and index of all commercial banks taken were positively related. The marginal relationship between independent variable (MPS) and dependent variables (index) of all the seven commercial bank taken, as sample was very low. This study can be helpful for the investors willing to invest in securities as well as commercial banks taken as sample.

"Stock price movement of listed companies on securities market of Nepal" submitted by Devaki Pathak on 2006, the objectives were as follows:

- To analyze the trend of the Nepalese stock market.
- To examine the stock market situation in Nepal .
- To examine and study the impact of the signaling factors on the stock price with the help of NEPSE index.

The study was based upon secondary data. She used trend bar, bar diagram, multiple bar diagram, ratio analysis, percentage and t-test plus F-test for presenting and analyzing data. She found positive relationship between

NEPSE index with volume of stock traded and number of listed companies. Similarly, while applying the regression model, she found that the relationship between NEPSE index with the volume of stock traded and the number of listed companies is positive and significant. Also the t-value and f-value are significant at 10% level of significant.

Lastly, she recommended following points:

- NEPSE index plays a major role for creating investment opportunity. So for removing stock markets difficulties such transaction facilities, investor’s interest and investment facilities should be managed in effective way by formulation investor’s protection policies.
- Foreign investors (Individual as well as institutional investors) should be encouraged and promoted to invest in the Nepalese stock market.
- Signaling factors should be analyzed by the members of NEPSE as well the industries so that future movements of price can be determined from the side of analyst and from the side of investors.
- Current manual method of securities trading should be substituted by computer-based technology, which enhances the pace of trading activities.

“Corporate Dividend Practices in Nepal” conducted by Mr. Nabaraj Adhikari on 1999, defines the objectives of the research to assess corporate dividend practices in Nepal. He also attempted to examine the relationship between dividend and stock prices. Hence, it becomes clear that he used dividends as information variable to see the effect of it to share price.
The study of relationship between dividends and stock prices was accomplished by collecting data on market price per share, dividend per share, retained earning per share and lagged earning price ratio of 22 companies for the period of 1992 to 1997. Out of 22 companies, 13 companies were from finance sector and remaining 9 companies were from non-finance sectors. Analysis of data was done using regression model.

His research analysis revealed that there is a positive relationship between dividends and stock prices in the sampled companies. Overall, the study suggested that the relationship between dividend and stock prices is in conformity with the relation as assumed in the developed capital markets.

"Role of Nepal Stock Exchange in Securities Market" submitted by Jyoti Joshi on 2003, her major objectives of research work were as follows:

- To prescribe ways and means by which secondary market would be more effective and meaningful.
- To assess the past and present behavior of business operation in the Nepal Stock Exchange market.
- Study on legal provisions relating to protection of investors' interest.

She recommended following points:

- Government needs to amend the rules and regulation regarding stock market time to time and to make the policies that protect the individual investors' right.
- Privatization process needs to be carried out effectively in order to develop Nepalese stock market through the widespread distribution of shares to public investors.
- The existing laws and regulations relating to stock market have to be revised to rationalize and simplify the regulatory system.
- Tax system should be reformed and encourage and stimulate capital information.
- Improvement should be done in the systems of the Company Registar's office.

Only certain selected companies were used for the analysis and the data used were of 5 years only. Data were presented in tabular form and interrelated in percentage and simple average, simple bar diagram and graphic presentation had been depicted.

"Impact of Rights Share Issue On Nepalese Stock Price" conducted by Rup Kumar Thapa on April 2008, his major objectives of research work are as follows:

- To analyze the practical aspects of rights share in Nepal.
- To test the significant different between the stock price movement before and after the announcement of rights share.
- To compare the theoretical stock price with its market price after announcement of the rights share.
- To identify the problems of rights share practice in Nepal.

The major findings of the study were:

- Large number of rights share issue is under subscribed. Low performance of the related company, lack of investors' awareness, lack of effective information, poor economic condition of Nepalese investors, lack of transferable rights and low economic development of the country are the major causes of under subscription of rights share in Nepal.
- Nepalese investors prefer the banking/financial sector's rights share rather than other sectors because of the better performance of these sectors.
- Legal provisions about rights share in Nepal are insufficient. There is no clear and easy provision regarding the sale of under subscribed rights share. There is not any separate rules and regulation about rights share in Nepal.
- To practice the rights share in Nepal, there are no large corporate firms.

He used primary as well as secondary data. To conduct the study, he had used the correlation coefficient, Coefficient of determinants, regression analysis, t-test and financial formula. T-statistics was used to test if there was significant change in share price before and after the issue of rights. Only rights issuing commercial banks are taken as the sample companies to test the price effect and share price movement.

This study may be an important effort to inform the shareholders and companies regarding the rights issue practice in Nepal.

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CHAPTER-THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter relates to the overall approach to the research process.

Research means to search the problems again and again to find out something more about the problems.

Similarly, methodology refers the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind it. Thus, research methodology is the way to solve systematically about the research problems.

In this regards, this chapter explains not only talk of the research methods but also consider the logic behind the methods, which are used in the context of our research study. This chapter deals to the research methodology adopted and implied for the resources used in achieving the predetermined objectives as stated in the earlier chapter. Thus this chapter contains- Research design, Sources of data and information, data collection techniques, and finally statistical tools used.

The stated objectives in mind, both the descriptive and analytical type of research are employed. A descriptive analysis is used because the secondary sources of empirical data have been employed to analyze the using variables, which is related to condition and growth and prospects of secondary market. According to the topic “Nepal Stock Exchange; its Role and significant in the securities market”, Primary and Secondary data are used to show the present trend and market responses, present situation of market.

3.2 Research Design

Generally research design means definite procedure and technique which gives to study and provide ways for research viability. It means an overall framework or plan for the collection and analysis of data.

Research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure”. (Claire Selltiz and associates, 1962)

This study is conducted with a view of gaining somewhat clear outlook about the measure role and significant of Nepal Stock Exchange in the Securities market. This study seems to entailing investigation by the use of financial and statistical models to explain the whole phenomenon of the role and significant of Nepal Stock Exchange in the Securities Market and have predetermined aims of measurement, analysis and evaluation of all the relevant details and information collected in an efficient manner as possible from Nepal Stock Exchange, SEBO and other sources.

It includes nature of data, specification of the method of the proposed study and detail plan for carrying out the study with various empirical data for the analysis of problems, etc. First the data are presented in table (or diagram), second presented data are analyzed by using various financial and statistical tools and at last analyzed data are compared and interpreted for the conclusion.

3.3 Nature and Sources of Data

With the view of fulfilling the predetermined objectives, that are set up for the study both primary as well as secondary sources are included. Primary sources of data are mainly based on interviews and queries and secondary data are mainly based on Booklets. The monthly NEPSE Index is derived from various annual reports and trading report published by Nepal Stock Exchange.

The libraries of various authorities as well as from the office, copies of the publications maintained by the Exchange have also been consulted for the collection of additional information in completing this study more steadily. The website of Nepal Stock Exchange and SEBON as well as other websites were also used for reference.

3.4 Data Collection Techniques

In order to collect the necessary information and data for the present analysis, a systematic process has been employed as follows:

1. First of all, need of the study has been identified.

2. On the basis of need identification, nature of data has been identified.

3. In order to collect some data and information, most pertinent organization and official authorities has been identified.

4. Personal approach has been made to collect the required data and information.

5. On the basis of such information and data, analysis has been done.

3.5 Populations and Sample

When some of the elements are selected with the intention of findings out, something about the population from which they are taken, the group of element is referred as a sample. This research study is base on totally confined to the institutions listed in the Nepal Stock Exchange *i.e* 135 with 8 different sectors. These listed organizations according to their nature of business are categorized into eight groups also called sector presented as-

Table No.2

Serial No.	Sector	No. Of Co. Listed	No.Of Sample Co.	Sample Company
1	Commercial Bank	15	2	-Nepal Investment Bank Ltd. -Everest Bank Limited.
2	Development Bank	16	2	-Nirdhan Utthan Bank Ltd. -Development Credit Bank.
3	Finance Company	53	2	-Universal Finance Ltd. -Lumbini Finance Ltd.
4	Insurance Company	16	1	-Nepal Life Insurance Co.Ltd.
5	Hotel	4	1	-Soaltee Hotel Ltd.
6	Manufacturing &Processing Company	21	1	-Bottlers Nepal (Terai)Ltd.
7	Trading Company	5	1	-Salt Trading Corporation.
8	Other Company	5	1	-Nepal Film Dev. co. Ltd.

The Sampling data have been taken from 11 companies among the 135 listed companies of the fiscal year 2006/07, whose shares were transacted in the fiscal year 2006/07. The samples are taken from each sector, which have five-year data including the data of base year.

3.6 Methods for Analysis and interpretation

The main purpose of analyzing the data is to change it from an unprocessed form to an understandable presentation. Method of analysis is applied as simple as possible. Results are presented in tabular form and clear interpretations on it are given simultaneously. Detail calculations are presented in appendices at the end of this study. The method of analysis, employed in this study, consists of two types of analytical tools and techniques.

- **Statistical Tools**
- **Financial Tools**

3.6.1 Statistical Methods

Statistical methods are the mathematical techniques used to facilitate the analysis and interpretation of numerical data secured from groups of individual or groups of observation from a single individual. The figures provide detail descriptions and tabulate as well as analyze data without subjectivity but only objectivity.(P.R.Joshi, 2002)

Data have been simply presented in tabular form and interrelated in percentage and simple average, simple bar diagram, and graphic presentation have also been depicted in the text. On the basis of historical data, using both financial and statistical tools performs detail analysis of different variables.

3.6.1.1 Market Price of Stock

One of the major data of this study is market price of stock. There were three prices records available (i.e. high, low and closing price of each year). So, two approaches either average price of high and low price or the closing price can be used. The main argument of average price may be that it represents the price of the whole year.

It was very difficult to obtain and include these all information and average of high and low price may not be reliable and representative information. Hence, the closing price is used as market price of stock, which has a specific time span of one year and the study has focused in annual basis.

3.6.1.2 Qualitative Analysis

Regarding the primary data, the qualitative analysis is done, rather than quantitative analysis. Qualitative analysis is restricted only up to classification and portions the view of the respondents. As qualitative analysis, the issue relating to the subject matter is discussed according to the theoretical accepted standard and the support formed through the data collected from field survey to form a rationalized implementation of the issues. The issues are categorized using weighted average score where ever felt essential.

Further, all mention tools are supported with the tabular and graphical presentation where ever necessary.

3.6.1.3 Return

The concept of return has different meaning to different investor. Some investor seek near term cash inflows and give less value to more distant return such a investor might purchase the stock of other firm that pays a large cash dividends. Other investors are concerned primarily with growth. They would seek projects that the promise of long term, higher than average growth of sales, earning and capital appreciation.

With the most investments, an individual or business spends money today with the expectation of earning even more money in the future. The return is income received by investors in his investment in the firm a dividend or capital gain or both. Thus, the concept of return provides investor with a convenient way of expressing the financial performance of an investment.

One way of expressing an investment return is in rupees terms. The rupees return is simply the total rupees received from investment fewer amounts invested.

3.6.1.4 Return of Common Stock Investment (R)

Return is the income received on an investment plus any change in market price, usually expressed as a percent of the beginning market price of the investment.

The return is the total gain or loss experienced on an investment over a given period of time. It is commonly measured as the change in value plus any cash distributions during the period, expressed as a percentage of the beginning-of-period investment value.(Lawrence J. Gitman, 2001) Symbolically, return (R) can be expressed as follows:-

$$R_j = \frac{(P_t - P_{t-1}) + D_t}{P_{t-1}}$$

Where,

R_j = Actual rate of return on common stock j at time t
P_t = Price of a stock at time t
D_t = Cash dividend received at time t
P_{t-1} = Price of stock at time (t-1)

3.6.1.5 Expected Return of Common Stock (R)

The study also aims to find out the expected return on investment in common stock. Usually this rate is obtained by Arithmetic Mean of the past year's return. Symbolically, R can be expressed as follows:

$$R = \frac{\sum R}{n}$$

Where,

R = Expected rate of return
n = Number of year that the return is taken
$\sum$ = Sign of Summation

3.6.1.6 Required Rate of Return

The required rate of return on an individual security is represented by a risk-free rate of interest plus a risk premium. Capital market theory shows the risk premium to be equal to the market premium, E [(R_m)-R_f], weighted by the index of the systematic risk, b, of the individual security. The required rate of return is calculated to find out the status of the share of the company by comparing it with the expected rate of return of the company. The expected rate of return is the average return of the company whereas the required rate of return is calculated as:

Required rate of return = $R_f + [E(R_m)-R_f].bj$

3.6.1.7 Calculation of Risk Free Rate

Calculating the effective annual interest rate on Treasury Bills by Nepal Rastra Bank does the calculation of Risk Free Rate. Adding the five years total rate and then dividing by the number of years, which are five in this case, calculating the average risk free rate. The effective annual interest rate is calculated as under to convert the 91 days treasury bills rate to the annual risk free rate. The risk free rate and the market risk premium (The excess of the market return over the risk-free rate) are economy wide measure.

Effective annual Risk Free Rate of Return = $(1+ \text{Periodic Rate})^4 -1$

3.6.1.8 Risk

Risk is defined as the variability of the returns of a period. The one-period rate of return is the basic random variable used in measuring an investment's risk. The greater the variability of the returns, the riskier the project.(Kiran Thapa, 2006)

Risk can be understood as the possibilities of meeting danger or of suffering harm or loss. "Risk is like pornography. It is hard to define but you know where you see it".

Risk and return are the determinant for the valuation of securities. However, risk means that we do not know what is going to happen even though we occasionally have a good idea of the range, of possibilities that we face. In other words, when the firm should recognize that the forecast return may or may not be achieved. This is the element of risk in the decision-making process. Therefore, risk may be defined as the likelihood that the actual return from an investment will be less than the forecast return. Stated differently, it is the variability of return from an investment.(John Hampton, 1996)

In the most basic sense, risk is the chance of financial loss. Assets having greater chances of loss are viewed as more risky than those lesser chances of loss. More formally, the return risk is used interchangeably with uncertainty to refer to the variability of return associated with a given asset.

Risk is defined Webster's as "a hazard; a peril; exposure to loss or injury". Thus, risk refers to the chance that some unfavorable event will occur. If anybody engage in skydiving, such people are taking a chance with his life. Skydiving is risky.(Eugene F. Brigham, Louis C. Gapenski, and Michael C, 2001)

There are many ways to measure risk. But in our study Standard Deviation and Coefficient of Variance is calculated.

3.6.1.9 Standard Deviation (±)

This is a measure of the dispersion of forecast returns when such returns approximate a normal probability distribution. It is a statistical concept and is widely used to measure risk holding a single asset. The standard deviation is derived so that a high standard deviation represents a large dispersion of return and is a high risk. On the other hand, a low deviation is a small dispersion and represents low risk. The Standard Deviation is the square deviation is an estimate of the likely divergence of an actual return from an expected return. It is statistical measure of the variable of a distribution of return around its mean. Mathematically, it is denoted by σ.

It is a statistical measure of variability of a distribution of return around its mean. It is the square root of the variance and measures the unsystematic risk of stock investment. Symbolically, can be expressed as follows:

Standard Deviation (σ) = $\sqrt{\dfrac{\sum(R_j - \overline{R_j})}{n-1}}$

Where,
σ = Standard deviation of returns on stock J during the time period n
R = expected return

A standard deviation can sometimes be misleading in comparing the risk or uncertainty surrounding alternatives if they differ in size. To adjust for size, the standard deviation can be divided by expected return to concept the coefficient of Variance.

3.6.1.10 Variance of Stock

The variance is a measure of the dispersion from the average value. It is the squared deviation from the mean deviation divided by the number of observations less one.

One divided by (n-1) since the deviations are measured from the mean, so one degree of freedom is lost.

Variance (σ^2) = $\dfrac{\sum\left(R_j - \overline{R_j}\right)^2}{n-1}$

3.6.1.11 Coefficient of Variance (CV)

The coefficient of variance, CV is a measure of relative dispersion (Risk) that is useful in comparing the risk of assets with differing expected returns. The higher the coefficient of variance, the greater the risk. Symbolically, CV can be expressed as follows:

Coefficient of Variance (CV) = $\dfrac{\pm}{\overline{Rj}}$

Where,
CV= Coefficient of variance
σ = Standard Deviation of returns on stock ‘J’
R= Expected rate of return on stock ‘J’.

3.6.1.12 Covariance

Covariance is a statistical measure of relationship between two random variables. It measures how two random variables such as returns on securities j and market return are related to each other. A positive value for covariance indicates that the securities returns tend to move in the same direction with other. A negative covariance indicates a tendency for the returns to offset one another. A relatively small or zero value for the covariance indicates that there is little or no relationship between the returns for the two securities. It is calculated as:

$$\text{Covariance Rm, Rj} = \frac{\sum\left(Rj - \overline{Rj}\right)\text{X}\left(Rm - \overline{Rm}\right)}{n-1}$$

3.6.1.13 Correlation

The Greek letter ‘rho’ denotes the correlation coefficient between return on two securities. The correlation coefficient is defined as the covariance between the dependent and independent variables, divided by the product of their standard deviations. When assets have zero correlation with each other, they are unrelated in anyway and have zero variance. Positive correlation implies positive covariance.

$$\text{Correlation (Pij)} = \frac{Cov.\left(Rm, Rj\right)}{\pm_{Rj}\text{X}\pm_{Rm}}$$

The correlation coefficient (Pij) is relationship between market return and stock return. It also rescales the covariance to facilitate comparison with corresponding values for other pairs of random variables. It always lies between -1 and +1. A value of -1 represents perfect negative correlation and a value of +1 represent perfect positive correlation.

3.6.1.14 Calculation of Beta

Beta is considered as a measure of undiversified risk. Although not exactly the same as b^2Var(Rm), which is the exact definition of undiversifiable risk. Beta is a measure of individual risk because for a given Var. (Rm), it provides a one-for-one correspondence. If the return on the individual investment fluctuates by exactly the same degree as the returns of the market as a whole, the beta for the security is one.

In this situation the required return of an individual investment is the same as the required return on the total market. If the undiversifiable or systematic risk in the return of an individual investment is greater than for the market portfolio, then the beta of the individual investment is greater than one, and its risk adjustment factor is greater than the risk adjustment factor for the market as a whole. The required return on an investment depends on the size of its beta, which measures the covariance of its returns in relation to the returns on the market.

Beta measures the systematic risk of a company's stock. It assumes that the total market risk is equals to 1. Beta indicates the risk associated with the company's stock in comparison with the market risk. If the beta is positive, it indicates that the company's risk and return tend to move positively with the market risk and return with calculated percentage.

If the beta is negative, it indicates that the company's risk and return tends to move negatively with the market risk and return with calculated percentage. Beta is denoted by bj. Beta is a measurement of risk. It captures systematic risk common to the entire economic system, the market. It measures the sensitivity of a stocks' return on the market portfolio. Beta is a famous statistic in finance. It is functionally related to the correlation and covariance between the security and the market portfolio in the following way.

It is calculated as under:

$$\text{Beta } (bj) = \frac{Cov.(Rm, Rj)}{Var.(Rm)}$$

3.6.1.15 Trend Analysis

Trend analysis is one quantitative method used to determine patterns in data collected overtime. It is also known as time series analysis. It is used to detect patterns of change in statistical information over regular intervals of time. In our study, graphic method is used for determining trend.

Graphic Method

This method has no any formal statistical criterion. In our study, by proceeding following steps, straight- line trend is obtained by the following method.

i. Plotting a time series on a graph.

ii. Examining carefully the direction of trend based on the plotted dots (information)

In this study, this method is used to show the clear picture on growth of NEPSE Index.

3.6.2 Financial Methods

3.6.2.1 Percentage Analysis

The percentage analysis is done to compare the two of more data for general information. It is used as a method to divide the opinions of the related sectors into two or more sectors.

In this study, to show the performance of NEPSE in the securities Market we have analyzed in the different headings, which are as follows:-

1. Analysis of Yearly volume and Value of traded stock and NEPSE Index.
2. Sector-wise Paid-up value in fiscal year 2006/07.
3. Analysis of Turnover.
4. Price Analysis.
5. Analysis of Secondary Market Development.
6. Analysis of Transactions.
7. Inter-Sector comparison.
8. Paid-up value and Market capitalization of Listed Stocks in NEPSE.
9. Stock Price Index of Nepal Stock Market.
10. Comparison with Market.

3.7 Limitations of the Methodology

The problem of unavailability of consistent data is one of the major limitations of the study and, therefore, where not available provisional data have been used. The limitations of the Statistical tools and techniques have been ignored.

Due to time constraint the study has not Devine deeper in some areas of the study, which needs further research.

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CHAPTER–FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Background

This chapter deals with the analysis of data collected and their presentation. The data has been analyzed using both descriptive and diagnostic approach. Under the descriptive analysis the responses regarding stock exchange market development and descriptive view regarding regulatory aspects have been discussed. Under the diagnostic analysis; analysis of the yearly volume and the value of traded stocks and NEPSE index, proportion of sector wise turnover to total turnover in yearly basis, number of shareholders of listed companies, inter-sector comparison, comparison with market, yearly volume and value of traded stocks have been used. Detail data, NEPSE index of each industry is presented and their interpretation and analysis is done. With reference to various readings and literature review in the proceeding chapter, effort is made to analyze and diagnose the recent Nepalese Stock Market movement. Different tables and diagrams are drawn to make the result more simple and understandable.

In this chapter the relevant and available data of eleven listed companies, which had been taken as sample from the eight sectors as categorized by NEPSE, were analyzed to study the investors' awareness in the securities market. Acquiring the information by using the questionnaires from the investors did the analysis of relevant questions. Appropriate statistical and financial tools had been used to perform the analysis as described in the research methodology chapter.

4.2 Descriptive Analysis

4.2.1 Responses Regarding Stock Exchange Market Development.

i) About Establishment of NEPSE, Performance and their Development trend.

Majority of brokers accepted the beginning of stock exchange in Nepal at a right time because it started its operation when the government is pursuing liberal and open market policies. But the broker also complained about poor performance of the Stock Exchange Market although infrastructure set up like having his or her own building and computerized system could be considered as its achievement but the absence of efficient manpower has hampered the development of an effective administration mechanism.

Brokers are of the opinion that the present bearish trend in the share market is natural because in the beginning fluctuation in prices and transactions took place on the basis of rumors. It was not realistic due to lack of proper information and research. Heavy transactions and price increase without foundation resulted in the market to fall and the bearish trend persisted. But they are optimistic. If the government pays attention and handles it into right track, its future is not dark as some might perceive.

Brokers opined that there is no proper and authentic information available and tax system is not clear which creates low liquidity in the market. All brokers complained that government and the Stock Exchange are staying ideal watching the poor performance of the capital market, not taking any treasures to correct the situation. According to brokers there is no co-ordination among the companies. So, information is missing in time. Yet here is not penalty and punishment from the government. Legal framework is inadequate which is weakening concerned departments.

The overall business trend of Stock Exchange shows relatively larger transaction of shares of banking sector due to its remarkable performance but information is absent in other sectors. Only banking sector has been providing profits and dividends to the investors. The investors lost faith in the manufacturing, trading and other sectors.

4.3 Descriptive View Regarding Regulatory Aspects.

i) Brokers Complains Regarding Rules and Regulation

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

Brokers have complained about the existing legal provisions to operate Stock Exchange market. They suggested that: a) paperwork should be reduced, b) transfer of ownership should be completed within seven days after it is sent to the concerned companies, c) stick rules for information dissemination, d) should have good share transfer laws, e) punish inside trading and f) require companies to disclose financial information, (which are hindering the development of Stock Exchange market in Nepal). Some brokers cited; i) explanation of section 53 of Companies Act 2053, ii) keeping Business Income and Capital gain at per in the income Tax Act, iii) Section 83 of Companies Act is not comprehensive iv) more details are required in the annual report, v) Companies Act 2053 (1997)is still not comprehensive. They strongly suggested that the government should try to simplify them gradually and make it flexible depending upon the changing time and situation.

In the context of primary share issue, there should be strict time frame for allotment of share, refund of money, distribution of share certificate and listening of shares. There should be strict punishment if the prospectus is misleading and investor is affected by misleading prospectus. So, there should be a provision of comparing the prospectus with actual situation.

The brokers do not have problem with each other in share transaction and settlement. But they have experienced conflicts in buying and selling of shares, mostly in signature verifications, and cash payments. Investors do not pay when price falls and do not accept share price when price rise. Shouting system is not effective because sometime the board marker (person who writes in the board placed in the wall) may not listen to the first broker’s quote and writes another broker’s number in the board. It creates conflicts in the floor.

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

4.4 Research Analysis

4.4.1 Analysis of Yearly volume and Value of Traded Stocks and NEPSE Index.

Table No. 4.3

(Rs. in ten million)

Year	**No.of companies**	**Market Capitalization**	**No.of Transaction**	**Paid up value**	**Yearly Nepse Index '000'**	**Annual Turnover**
2002/03	108	3524.04	69163	1256.01	204.86	57.58
2003/04	114	4142.48	85533	1340.49	222.04	214.43
2004/05	125	6136.59	106246	1677.18	286.67	450.77
2005/06	135	9681.37	97374	2000.86	386.83	345.14
2006/07	135	18630.13	120510	2179.88	683.95	836.01

Source: Trading Report of NEPSE 2006/07.

Table 4.3 shows the yearly volume and values of traded stocks are fluctuating except in case of Fiscal year 2005/06 and 2006/07. We can see the same number of companies listed *i.e* 135 in fiscal year 2005/06 and 2006/07 due to the listing of 12 additional companies and delisting of 12 listed companies in fiscal year 2006/07. However, there is a sharp rise in the volume of traded stocks in 2006/07. The major reason for the sharp rise may be attributed to heavy transactions of banking sectors. Similarly, NEPSE Index in 2006/07 is also in increasing trend.

4.4.2: Sector- wise Paid up Value in fiscal year 2006/2007.

Table No. 4.4

(Rs. in million)

Serial No.	**Sector**	**Paid Up Value(Rs)**	**Percentage**
1	Commercial Bank	9281.9	42.58
2	Development Bank	1630.9	7.48
3	Finance Co.	3100.2	14.22
4	Insurance Co.	1286.7	5.90
5	Hotel	1552.9	7.12
6	Manufacturing & Processing Co.	2602.3	11.94
7	Trading	62.2	0.29
8	Other	2281.7	10.47
9	Total	21798.8	100.0

Source: Annual Report of SEBO/N 2006/2007.

Above table shows the paid up value of listed securities increased and reached to Rs.21798.8million by the end of fiscal year 2006/2007.The value was Rs.19009.58 in F/Y 2005/06. Among all the sectors, Commercial Bank has the highest percentage of paid up capital (*i.e* 42.58 percent) and trading sector has the lowest percentage of paid- up capital (*i.e* 0.29 percent). This shows the increasing trend of secondary market as at a perfect condition.

4.4.3 Analysis of Turnover

Annual Turnover

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

Besides this, a turnover ratio serves as an important indicator for assessing the stock market condition in a given year. A turnover ratio of 100% means that each of the listed shares were traded once during the year and one of 50% means that it was traded once every two years.

Table No. 4.5: Annual Turnover of Differential Sectors in Fiscal Year 2006/2007.

(Rs. in million)

Sector	Annual Turnover	Percentage
Commercial Bank	5563.5	66.55
Development Bank	577.5	6.91
Finance Co.	713.6	8.54
Insurance Co.	205.0	2.45
Hotel	7.0	0.08
Manufacturing & Processing Co.	24.3	0.29
Trading	10.4	0.12
Other	1258.8	15.06

Source: Annual Report of SEBO/N 2006/2007.

From above table, it is clearly shown that the overall turnover of the market shows the erratic trend. Commercial bank has dominated over other group in terms of amount *i.e* its position in stock exchange, their performance in financial term and in shareholder relation has earned the confidence of investors. Finance Co. came in second place. Similarly, Development Bank posted good rate of growth on the basis of turnover while insurance company, hotel, manufacturing & processing co. and trading posted relatively moderate rate of growth.

Table No. 4.6: Sector-wise Turnover of NEPSE in Fiscal Year 2006/2007.

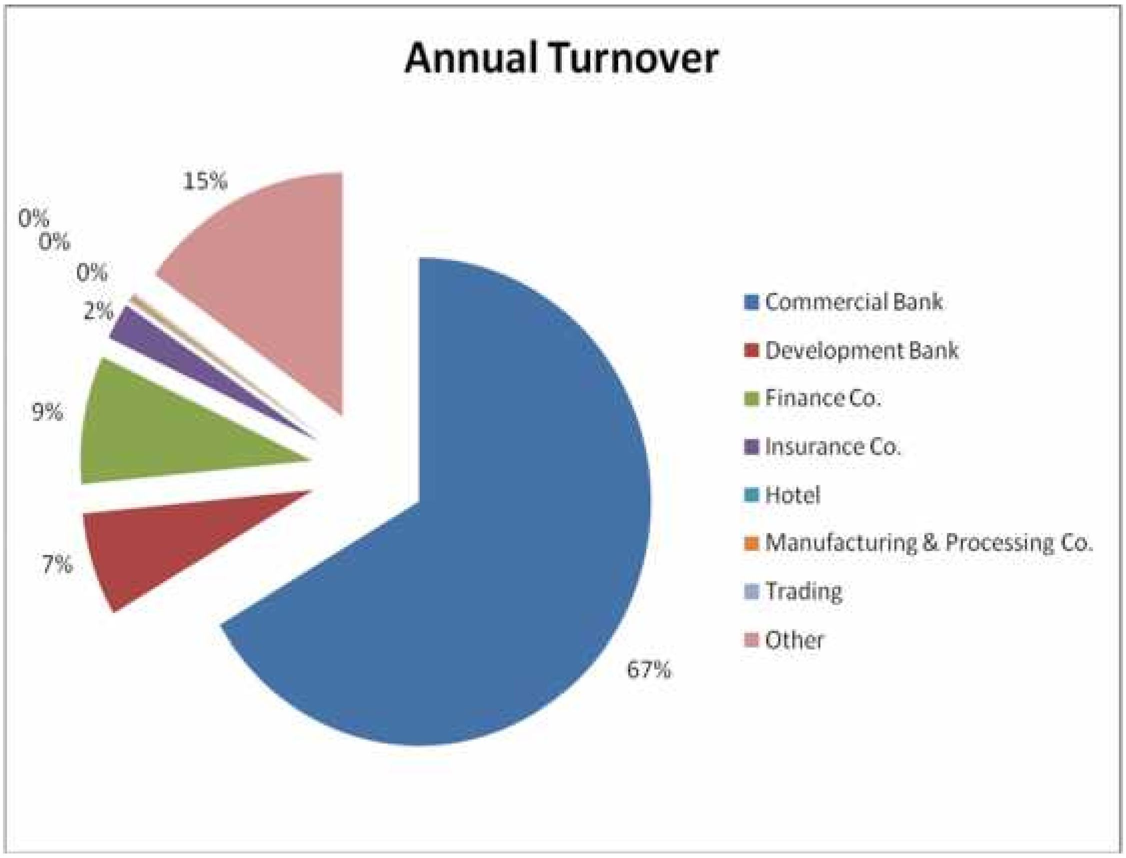
(Rs. in million)

Sector	Annual Turnover	Percentage
Commercial Bank	5563.5	66.55
Development Bank	577.5	6.91
Finance Co.	713.6	8.54
Insurance Co.	205.0	2.45
Hotel	7.0	0.08
Manufacturing & Processing Co.	24.3	0.29
Trading	10.4	0.12
Other	1258.8	15.06

Source: Annual Report of SEBO/N 2006/2007.

Sector–wise turnover of NEPSE in FY 2006/07 (Table 4.6) is presented by the Pie-chart 1.

Figure 1
Sector-wise Turnover in FY 2006/07



In above figure No.1 Pie Chart is splited according to the percentage gained by different sectors such as Commercial Bank 67%, Development bank 7%, Financing Co. 9%, Insurance Co.2%, Hotel 0%, Manufacturing & Processing Co 0%, Trading 0% and Other 15% (Rounding Figure) On which Commercial Bank dominates all other sectors.

Monthly Turnover of NEPSE during FY 2006/07

The monthly turnover of NEPSE during FY 2006/07 is presented in the following table.

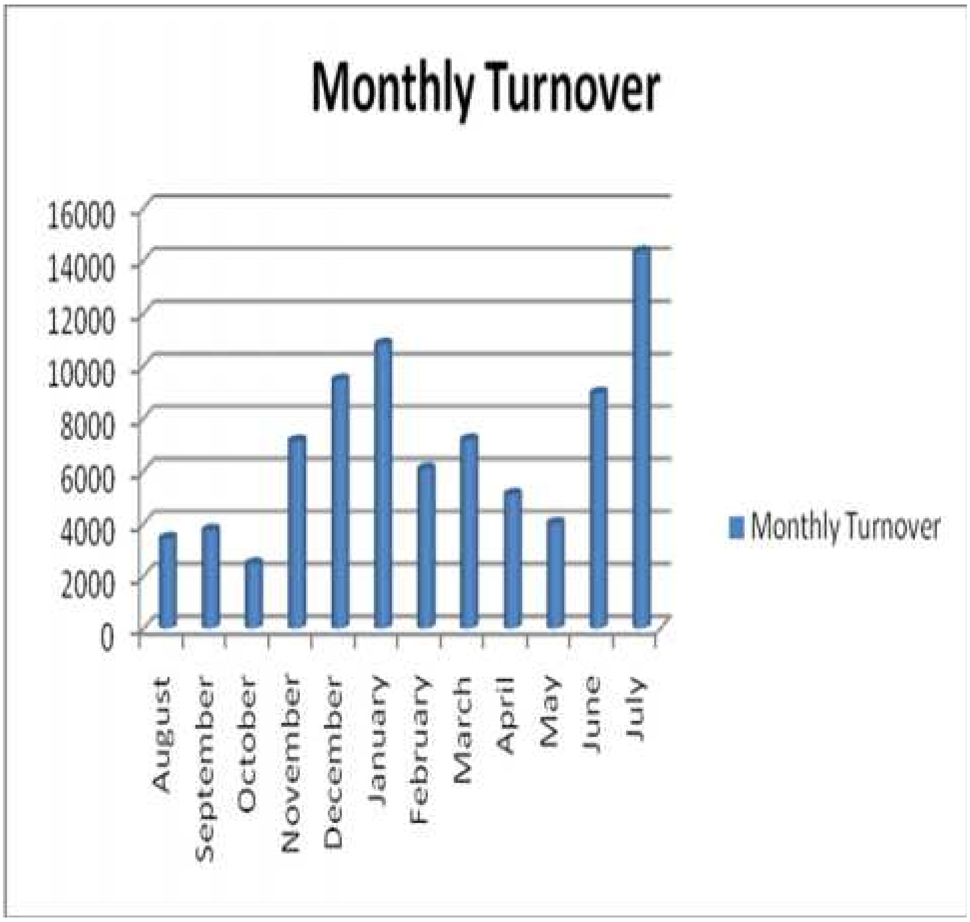
Table 4.7
Monthly Turnover during FY 2006/07

Months	**Turnover (Rs in million)**
August	3424.2
September	3740.8
October	2458.6
November	7117.6
December	9444.8
January	10816.7
February	6077.5
March	7164.2
April	5102.3
May	4000.4
June	8942.9
July	14320.6

Source: NEPSE, Trading Report 2006/07

Figure 2

Monthly Turnover of NEPSE during FY 2006/07



As stated in the table and figure, the turnover of NEPSE in the month of August, was 3424.2million at the end of July, it reached 14320.6million. The turnover was lowest at the month of October *i.e* 2458.6million. The highest turnover was at the month of July *i.e* 14320.6million. So, it can be concluded that the turnover is in increasing trend.

4.4.4 Price Analysis

In this section the pricing of the shares of the sample companies' are analyzed and interpreted. The result derived from the calculation by using Security Market Line equation is presented here, studying the period of 2002/03 to 2006/07.

Table No. 4.8

SN	Sector	Name of Co.	Required rate of return	Expected rate of return	Growth rate of MPS	Status of the stock of Co.
1	Commercial Bank	-Nepal Investment Bank Ltd.	18.06	20.535	16.81	Undervalued
2		-Everest Bank Limited.	23.19	43.79	40.43	Undervalued
3	Development Bank	-Nirdhan Utthan Bank Ltd.	16.78	-1.112	1.924	Overvalued
4		-Development Credit Bank.	29.63	48.47	40.72	Undervalued
5	Finance Company	-Universal Finance Ltd.	17.90	4.93	5.922	Overvalued
6		-Lumbini Finance Ltd.	20.31	10.992	8.6	Overvalued
7	Insurance Company	-Nepal Life Insurance Co.Ltd.	22.88	52.67	10.933	Undervalued
8	Hotel	-Soaltee Hotel Ltd.	38.94	14.73	-3.6	Overvalued
9	Manufacturing &Processing Company	-Bottlers Nepal (Terai)Ltd.	11.095	-2.812	1.613	Overvalued
10	Trading Company	-Salt Trading Corporation.	11.53	2.32	46.118	Overvalued
11	Other Company	-Nepal Film Dev. co. Ltd.	13.46	-5.238	-3.32	Overvalued

***Source*:** Nepal Stock Exchange Trading Report 2006/07.

Commercial Bank	2 Undervalued
Development Bank	1 Overvalued 1 Undervalued
Finance Co.	2 Overvalued
Insurance Co.	1 Undervalued
Hotel	1 overvalued
Manufacturing & Processing Co.	1 overvalued
Trading Co.	1 overvalued
Other Co.	1 overvalued
Total	4 companies Undervalued and 7 companies Overvalued

From Table No.9 it was found that among two Commercial Banks taken as samples, both two were found underpriced. Likewise, among two development banks taken as sample one was found underpriced and one was found overpriced.

The status of the sample companies taken from Finance both were found overpriced. Insurance was found underpriced and other Manufacturing & Processing, Trading and Other were found Overpriced

So, in total among the eleven companies taken as sample, four Companies were found Underpriced and seven Companies were found Overpriced. The detail calculation of the value of the shares are presented in the appendices No. 1 to 11

The development of the stock market could best be interpreted by analyzing the growth rate of annual turnover and the growth rate of the NEPSE index in general.

The following table suggests an eagle eye view of the current development of the Stock Market in Nepal.

Table No. 10: Development of the Stock Market in Nepal.

.

Year	Listed Company	Percent of Turnover to Market Capitalization	Percent of Turnover to Paid Up Value
2002/03	108	1.63	4.58
2003/04	114	5.18	16.00
2004/05	125	7.35	26.87
2005/06	135	3.57	17.29
2006/07	135	4.48	38.35

Source: SEBO/N, Annual Report 2006/07

Table No. 11: Development of the Stock Market in Nepal in Terms of Amount

(*Rs.in million)*

Year	Market Capitalization	No.of Transaction	Yearly NEPSE Index'000'	Annual Turnover(Rs)
2002/03	35240.4	69163	204.86	57.58
2003/04	41424.77	85533	222.04	214.43
2004/05	61365.89	106246	286.67	450.77
2005/06	96763.74	97374	386.83	345.14
2006/07	18630.13	120510	683.95	836.01

Source: SEBO/N, Annual Report 2006/07

Growth rate of Annual Turnover from the Fiscal Year 2002/03 to 2006/07.

$$= AT\ 02/03(1+g)^n = AT\ 06/07$$
$$Or,\ 57.58(1+g)^5 = 836.01$$

Therefore, the growth rate of annual turnover of five-year period was 70.76 percent.

Growth rate of NEPSE Index from the Fiscal Year 2002/03 to 2006/07

$$= NI\ 02/03\ (1+g)^n = NI\ 06/07$$
$$Or,\ 204.86(1+g)^5 = 683.95$$

Therefore, the growth rate of NEPSE Index of five-year period was 27.27 percent.

Growth rate of Market capitalization from the fiscal Year 2002/03 to 2006/07

$$=MC\ 02/03(1+g)^n = MC\ 06/07$$
$$Or,\ 35240.4(1+g)^5 = 186301.3$$

Therefore, the growth rate of Market Capitalization of five-year period was 39.52 percent.

Table No. 12: Status of the Growth Rate of the Market Price of the Shares of the Sample Companies.

Growth rate of NEPSE index at the same period = 27.27 percent.				
S.N	**Sector**	**Name of the Company**	**Growth rate (in percent)of market price**	**Remarks**
1 2	Commercial Banking	-Nepal Investment Bank Ltd. -Everest Bank Ltd.	16.81 40.43	Unsatisfactory Satisfactory
3 4	Development Banking	-Nirdhan Uthan Bank Ltd. -Development Credit Bank	1.924 40.72	Unsatisfactory Satisfactory
5 6	Finance Company	-Universal finance Ltd -Lumbini Finance Ltd.	5.922 8.6	Unsatisfactory Unsatisfactory
7	Hotel	-Soaltee Hotel Ltd.	10.933	Unsatisfactory
8	Manufacturing & Processing Co.	-Bottlers Nepal (Terai) Ltd	-3.6	Unsatisfactory
9	Trading	-Salt Trading Corporation	1.613	Unsatisfactory
10	Insurance	-Nepal Life Insurance	46.118	Satisfactory
11	Others	-Nepal Film Dev. Co.Ltd	-3.32	Unsatisfactory

Source**:** SEBO/N Annual Report 2006/07

4.4.5 Analysis of secondary Market Development

Table No. 4.13

(Rs. in million)

Year	Listed Co.	Annual Turnover	Market Capitalization	Market Capitalization as % of Nominal GDP
2002/03	108	57.58	35240.4	8.09
2003/04	114	214.43	41424.77	8.77
2004/05	125	450.77	61365.89	12.06
2005/06	135	345.14	96763.74	17.35
2006/07	135	836.01	18630.13	27.78

***Source*:** Economic Surveys of HMG/Nepal, Annual Report of SEBO/N and NEPSE

The trend of secondary market (table no. 4.13) shows that there is an enormous growth of the secondary market in terms of number of listed companies, market capitalization and the ratio of market capitalization to gross domestic product. The number of listed companies has increased from 108 to 135 in Fiscal Year 2006/07. Similarly, market capitalization, which was recorded Rs. 35240.4 million in Fiscal Year 2002/03, has increased to Rs. 18630.13 in the Fiscal Year 2006/07. The market capitalization as percentage to nominal GDP is also increased to 27.78 in the Fiscal Year 2006/07.

4.4.6 Analysis of Transactions

Shares are traded in a specific lot of certain face value in the market. NEPSE has fixed the board lot of 10 shares if the face value is Rs. 100 or 100 shares if the face value is Rs. 10. The transactions on regular trading are occurred on at least one board or lot. The transaction of less than 10 shares is permitted only on odd lot trading hours. Thus, the number of transactions is the times that the transactions occurred during a certain period.

Table No. 4.14: Number of Shareholders of Listed Companies from 16 July 2006 to 16 July 2007.

Sectors	**No.of Companies**	**No.of Shareholders**	**Percent**
Commercial Bank	15	42848	35.18
Development Bank	16	39413	32.36
Finance Company	53	18879	15.49
Insurance Company	16	16203	13.30
Hotel	4	393	0.322
Manufacturing & Processing Company	21	135	0.11
Trading Company	5	42	0.034
Other Company	*5*	3898	3.20
Total	135	121811	100

Source: Trading Report of NEPSE 2006/07.

Table no. 4.14 shows the group wise number of Shareholders in NEPSE during the study period. The Commercial Bank dominates over all other groups in terms of number of shareholders. The number of shareholders in Development Bank is also considerable. This implies that the investment in companies of Commercial Bank as well as Development Bank is highly attractive and liquid. The number of shareholders of the Manufacturing & Processing Company and Trading Company is the lowest even if the number of listed companies is more in case of Manufacturing & Processing Company. This indicates that the investment in Manufacturing & Processing Company and Trading Company is less attractive and illiquid.

4.4.7 Inter-Sector Comparison

Here, a comparison is made on the size of industry to make the analysis simple as well as understandable. For this purpose, Table no. 4.15 is prepared that shows the market capitalization of each sector (industry).

By the end of Fiscal Year 2006/07, the market capitalization of listed security was Rs.18630.13 million. The capitalization was 9681.37 million in the fiscal year 2005/06. The percentage of market capitalization of commercial bank on the market capitalization is the highest (72.78 percent) as compared to other sector. The contribution of different sector on total market capitalization is as under.

Table No. 4.15: Market capitalization of each sector

(Rs. in million)

Sector	**Market Capitalization**	**Percentage**
Commercial Bank	135588.4	72.78
Development Bank	6010.6	3.23
Finance Co.	9889.3	5.31
Insurance Co.	8059.8	4.33
Hotel	3261.1	1.75
Manufacturing & Processing Co.	6200.0	3.33
Trading	796.4	0.43
Other	16495.7	8.85

Source: Annual Report of SEBO/N 2006/2007.

Market capitalization identifies the fluctuations in number of companies listed and also results the change in market capitalization. Although it indicates the relationship between price and the number of shares listed if keeping other things remaining constant and listed shares increased, then the market capitalization also increases. Again if the price increased and the shares are splited then also market capitalization increases.

The Commercial Bank group again stood first at contribution to market capitalization *i.e* (72.78 percent) whereas the Trading Company got the lowest market capitalization (0.43 percent).

4.4.8 Paid up value and Market Capitalization of Listed Stocks in NEPSE

Total paid up value is the function of the number of listed shares and companies and paid up value per listed share. Thus, the total paid up value is derived by multiplying number of listed shares of these traded companies by the paid up value of all them. Similarly, multiplying the number of listed shares of all these companies by the closing market price of corresponding shares and summing up them derive the market capitalization. Thus, the market capitalization is directly or proportionately related to the closing price of the stocks.

Paid up value indicates the actual amount of the investment in assets whereas market capitalization indicates the present value of the investment. It means the value of market capitalization differs from the value of paid up capital, because the value of market capitalization is related with market price of the share. The value of the market capitalization changes due to the changing sentiments of capital market. If the market condition is favorable, the market value of assets increases substantially so that the face value of the company is increased and vice versa. The increased market value further suggests the good performance of the concerned companies. So, the investors are highly interested to such companies.

Paid–up value and market capitalization both serves as a means to evaluate the importance of stock market. In Nepal, both paid-up value and market capitalization has increased since fiscal year 2002/03. In fiscal Year 2002/03 paid-up value of listed shares was Rs. 1256.01million. And it has reached to Rs.21798.88million in fiscal year 2006/07. Similarly, in fiscal year 2002/03, market capitalization was Rs.35240.4million and it reached to Rs.18630.13million in fiscal year 2006/07. This shows in table No.4.16

Table No.4.16: The paid-up value and market capitalization from fiscal year 2002/03 to fiscal year 2006/07

(Rs. in million)

Fiscal Year	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**
No.of Co.Listed	108	104	125	135	135
Paid-up value	1256.01	1340.49	1677.18	2000.86	2179.88
Market Capitalization	3524.04	4142.48	6136.59	9681.37	18630.13

Source: Trading Report of NEPSE 2006/07

4.4.9 Stock Price Index of Nepal Stock Exchange

Market indexes have always been of great importance in the world of security analysis and portfolio management. Both individual and institutional investors use the market indexes as a benchmark against which they evaluate the performance of their own or institutional portfolio. Market indexes are used to determine the relationship between historical price movements and economic variables and to determine the systematic risk for individual securities and portfolios. Technical analyst usually uses price movements to predict future movements in the stock market.

Stock market indexes are used to study the trend of growth pattern in the economy, to analyze as well as to forecast business cycles and to correlate stock market indexes to economic activities. However, index is a device designed to measure the change in group of related variables over a period of time. Here, the index is taken as a measuring tool whether the performance of stock market is good or not. This clearly focuses on the price of stocks that is increasing or decreasing in the market. Because the prices of stocks go up and down in a particular period compared to the previous period as disclosed by index. The highest index suggests the increase in market price of the stocks and implies the better performance of companies and vice versa. Thus the NEPSE index shows the behavior of stock prices in the capital market.

Stock price index reflects market trends because it takes all issues listed on the Exchange on account. NEPSE follows the standard and Poor's Index method while calculating index of stock prices. According to this, the computation formula for price index is as follows:

$$Each\ day's\ index = \frac{Each\ day's\ total\ market\ value}{Base\ day's\ total\ market\ value} \mathrm{X}\,100$$

$$P_{01} = \frac{\sum P_1 \mathrm{X} Q_1}{\sum P_0 \mathrm{X} Q_0} \mathrm{X}\,100$$

Where,

P_{01} = NEPSE Price Index
P_1 = Today's Stock Price
Q_1 = Listed Shares (i.e No. of shares outstanding)
P_0 = Based Market Price
Q_0= Base Listed Shares

After the initiation of trading floor, NEPSE started to calculate the NEPSE index. For the purpose of calculation of index, NEPSE has taken 2002/03 as a base period. The base period value for the index was initially set at 100. Thus, 100 multiply the ratio of current market value to base period market value. The comparatively monthly index of NEPSE for five years shows that the low and closing market index is not available for first year. For the purpose of the analysis, only high market index has been used in this year.

In the year 2002/03, market index remained at 204.86 point. Then it started to move up and reached to a peak level of 683.95 point in the fiscal year 2006/07.

4.4.10 Comparison with Market

Market Risk and Return

There is only one stock exchange in Nepal. His Majesty's Government, under a programmed initiated to reform capital markets converted Securities Exchange Center into Nepal Stock Exchange in 1993. Nepal Stock Exchange in short NEPSE, is a non-profit organization operating under Security Exchange Act 1983.

Country's overall market movement is represented by market index or NEPSE index. Market Return, its Standard Deviation and Coefficient of Variance are shown in the Table no. 4.17. NEPSE index movement and market return movement is shown in Figure 3 and Figure 4.

Table No. 4.17 Market Return, Standard Deviation and Coefficient of Variance

Fiscal Year	NEPSE Index	$R_m = \frac{NEPSE_t - NEPSE_{t-1}}{NEPSE_{t-1}}$	$R_m - \overline{R_m}$	$\left(R_m - \overline{R_m}\right)^2$
2002/03	204.86	-	-	-
2003/04	222.04	0.0839	-0.21448	0.04600
2004/05	286.67	0.291	-0.00738	0.00005446
2005/06	386.83	0.349	0.05062	0.00256
2006/07	683.95	0.768	0.46962	0.2205
Total Average		**1.4919**		**0.269**

Source**:** Trading Report of NEPSE 2006/07.

We have,

Expected Return on market (R_m) = $\frac{\sum R}{n}$

$$= \frac{1.4919}{5}$$

$$= 0.29838$$

Standard Deviation (σ_m) $= \sqrt{\frac{\sum (R_m - \overline{R_m})^2}{n-1}}$

$$= \frac{0.269}{5-1}$$

$$= 0.06725$$

$$= 0.2593$$

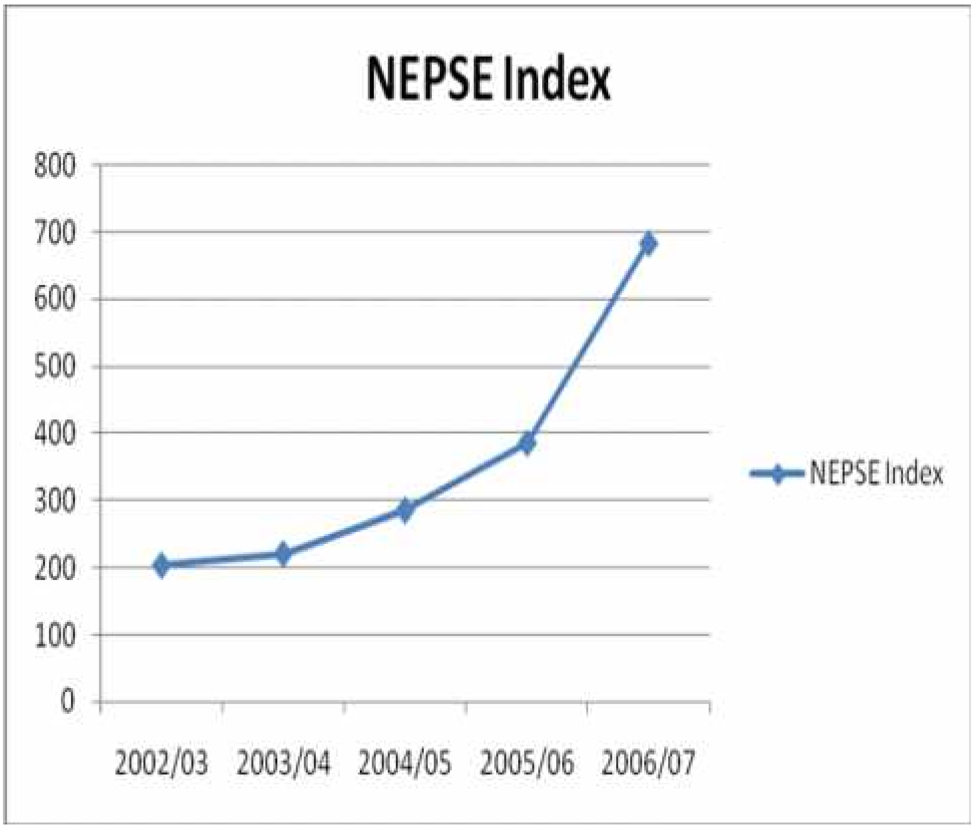
Coefficient of Variance (CV) = $\frac{\pm_m}{\overline{R}_m}$

$$= \frac{0.2593}{0.29838}$$

$$= 0.869$$

$$= 86.90\%$$

Figure -3 : NEPSE Index Movement



Above figure shows that by the end of fiscal year 2006/07, NEPSE Index reached to 683.95 which was 204.86 in fiscal year 2002/03. Overall the figure shows the positive trend of NEPSE Index.

Figure 4: Market Return Movement

Figure 4. shows the market return movement. It was 0.0839 in FY 2003/04, 0.291 in FY 2004/05, 0.349 in FY 2005/06 and reached to 0.768 in FY 2006/07 which represents the positive trend.

4.4.11 Questionnaire Analysis

One of the important methods of primary data collection is questionnaire method and under this method, important questions were set and provided to the related parties to make their opinion about the stock market. The questions raised through the means were of two types:

- Yes/No questions
- Multiple-choice questions

Questionnaire format has shown in appendix-A. Their responses have been analyzed as follows:

-Regarding the sector of investment, different investors, NEPSE staffs and brokers gave different view. 60% of respondents selected to Banking Sector, 30% to Finance & Insurance and rest 10% to Manufacturing.

-Regarding timely information to Nepalese investors, 50% of respondents said 'Yes' and 50% of them said 'No'.

-Regarding return which they got from the investment in stock, 60% said 'Yes' and 40% said 'No'.

-Regarding the question of trading system of NEPSE *i.e* open out cry system, 80% of respondents said 'No' and 20% said 'Yes'.

-Regarding the source of idea to invest in shares, different respondents replied differently. 50% of respondents said from friends 20% from newspaper, and 30% from Investor Education program organized by concern authorities.

-For question regarding factor that drives them towards the investment in stocks rather than other sector, 34% gave their view to company's goodwill as the driving factor, 46% to DPS and 20% to social status.

-Regarding the question to protect the interest of public shareholder in Stock Market, 45% supported to regular flows of information through different Medias, 35% to public awareness programs by government authorities and 20% to increase shareholders activism on their rights.

-Regarding the level of role played by Stock Exchange in the Securities Market, 33% said very high, 45% said high and 22% said moderately.

-Regarding question about current performance of Stock Market in Nepal, 68% said satisfactory, 32% said excellent.

-Regarding the major influencing factor for the stock price, different respondents gave different views on their own ideas. 14% gave their view to company profit, 20% gave their view to company's performance, 30% said to company's dividend, 24% as signaling factors and rest 12% to above all.

-Regarding the suitability trend of stock price movement, different investors, NEPSE staff and brokers gave different opinion. 80% of them displayed their opinion towards bullish trend, nobody provided their opinion to Bearish trend, 8% to optimum trend and 12% to none of above.

-Regarding the international environment effect on the Nepalese Stock Market, different individual investors, institutional investor, brokers, NEPSE staffs and others gave their own idea. Among them 70% respondents said ‘Yes’, 16% said ‘No’ and 14% said they are unknown about this.

- Regarding the investors awareness analysis, 22% of the respondents said high, 73% said moderate 5% said low.

-Question regarding the underwriters honesty in the Nepalese Stock Market, 38% of the respondents said ‘Yes’ 44% said ’No’ and 18% said they are unknown about this.

-Regarding the trading difficulties in shares in Nepalese Stock Market, 16% of the respondents said ‘Yes’ 60% said ’No’ and 24% said they are unknown about this.

CHAPTER-FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary and Conclusion

Development of Stock Exchange is one of the major factors for the development of the economy. Most importantly, they encourage investment by providing places for buyers and sellers to trade securities. This investment, in turn, enables companies to obtain funds to expand their businesses. Therefore, stock exchange needs to be studied and analyzed by the experts regularly. But in the Nepalese context, it is not being properly analyzed hindering the growth of the smooth operation of secondary market. So, the investment in NEPSE has not yet been able to tap the theoretical investment potential of the country.

This research, conducted with a view keeping main objective to analyze the role and significant of Nepal Stock Exchange in the securities market, its function and its importance. Put forward sub objectives such as to study the trend of number of listed companies in NEPSE, analysis of yearly volume and value of traded stock and NEPSE index, analysis of turnover, price analysis, inter sector comparison, Paid up value and Market Capitalization of listed stock in NEPSE, etc.

To accomplish the above mentioned objectives, this research was based upon the secondary data for the quantitative assessment. For this, annual reports of NEPSE, SEBON, daily newspapers, library search, magazines, bulletin and other journals were especially considered. For this analysis 11 companies among 135 listed companies were randomly selected as the sample for the study. The secondary data were presented by the use of different tables and analyzed with different statistical tools like correlation, coefficients, bar diagrams, pie chart and trend analysis with detail interpretation as per the requirement of the study.

Major Findings

- This research was based on the recent historical data furnished by the NEPSE and SEBON and has covered 14 years from 1993/94 to 2006/07. The data showed that the number of listed companies in NEPSE is in an increasing trend but the rate of increment is fluctuating yearly.

- The development of NEPSE primarily depends on the Government's policies and programs and their proper implementations.

- There is a close relationship between indicators of NEPSE and economic development of the country. The underdevelopment of Nepalese economy is reflected in NEPSE and vice-versa.

- While analyzing the annual trends of turnover, market capitalization and NEPSE index, it can be expected that the situation will improve as the increasing pattern is witness in all of these indicators. Thus, it can be inferred that the development of NEPSE will be pace in the coming years.

- Out of the listed companies, the companies traded are also increasing annually, a good indicator in the development of securities market in the country.

- Out of the companies the securities of which traded in NEPSE, the securities of Banking Sector are traded mostly, but other sector as Hotel, Trading Companies and Other Companies are not so good. So, an attempt should be made to increase the trading of securities of these sectors as well.

- The commercial banking sector which has attracted maximum number of investors as observed in the sector wise turnover of NEPSE in FY 2006/07, contribute 66.55% in total turnover and 72.78% to total market capitalization of NEPSE.

- Percentage of Turnover to Paid-up value was 4.58 in FY 2002/03 and it increased to 38.35 in the FY 2006/07.

- Market Capitalization as % of Nominal GDP was 8.09 in FY 2002/03 and it reached to 27.78 in FY 2006/07.

- Numbers of shareholders were also more in Commercial bank i.e 42848.

- Among the eleven sample Companies taken four were found Undervalued and seven were found Overvalued.

- From Questionnaire view of different investors, NEPSE staffs and brokers were gathered which proved me very much helpful to know more about NEPSE and its role.

Stock Exchange is the backbone of any economy and Nepal is not an exception. Development of vivacious and dynamic stock exchange is the pre-requisite for the upliftment of the economic conditions of the country. Hence, the development of efficient stock exchange becomes essential to assist in the development of the whole economy. So the promotion of the stock exchange in a sizeable extent would promote the economic development through increased mobilization of saving and their channeling into productive sectors, and thereby creating suitable economic outcomes in the economy.

Nepal Stock Exchange Limited (NEPSE), which is the only stock exchange of Nepal, has present the history of about 14 years. The transactions turnover reveals various ups and down. However, from the past 4-5 years, the performance of the market is on increasing trend. So, we can expect that this increment in the performance of NEPSE will further continue in the future which will boost the development of securities market in the country.

On the other hand, it can be said that, in comparison to the stock exchange of other countries, only a dim shape of the stock market has been visualized in national scenario in Nepal. As NEPSE is growing in the nascent stage, the turnover of stocks, market capitalization, number of transactions and volume traded are still very thin. It has not been able to create continuous market. Still lots of things need to be done for the entire growth of the Nepalese capital market so that it will, to an extent, stand in international standard. It can be said that economic development will be possible only by mobilizing sufficient amount of internal and external capital. People will invest their money when they feel that the market is efficient and transparent. So, the market needs to be more transparent with the availability of different investment alternatives and sufficient systems should be developed to control the possible fraud and errors. However there are many problems in NEPSE. The major conclusions derived from the study could be grouped as follows:

- The political instability, the unstable policies and other law-related issues are the prominent factors for the underdevelopment of the NEPSE. Due to political instability, investors are not willing to invest not only in share market but also in all other sectors.

- Stockbrokers and market makers are not being much active to create investment environment in NEPSE. Most of the investors are influenced through media only, not through market makers and stockbrokers.

- The NEPSE is not being able to create continuous market. It may be because of dominance of the individual investors in stock market. The volatile and rudimentary nature of NEPSE indicates high dissatisfaction among the investors. It may be mainly due to the lack of awareness amongst the investors, low habit of investing in stocks and holding strategy of the investors.

- One of the essential ingredients that is required for the efficient functioning of NEPSE is fair and timely disclosure of the information. Information deficiency may be one of the reasons for determination of share price by speculation. Regulatory submission and disclosure of information by the listed companies are meant for ensuring good corporate governance, transparency and investors protection. But it is found that most of the listed companies do not submit these kinds of information to NEPSE.

- The government has introduced so many programs for efficient and effective functioning of NEPSE through Tenth Plan which are still not implemented by the end of 2007.

- The development of the manufacturing sector becomes the backbone of an economy which, in turn, assists to foster the banking and finance and insurance sectors. Unfortunately, manufacturing sector does not have a good performance record in the Nepalese economy. Almost all firms in this sector have sustained loss. The investment in banking sector is considered secured. This may be one of the reasons that people invest in banking sectors. Thus, the government should make and implement policies for the development and growth of manufacturing sectors as well.

- The government policies are always determinant factors to influence the NEPSE. Some of the reasons for the low level of activity in NEPSE may have to do with tax regulations. However, there are no strict regulations to mitigate the problems of insider trading and manipulation of market. Thus, due to lack of effective law prohibiting such abuses and due to ineffective enforcement of existing laws, NEPSE is lacking fair game.

It can be concluded that poor governance, political instability, lack of strict and favorable policies to follow in practice, lack of commitment to implement the policy and the lack of investors' awareness are affecting the effectiveness and efficiency of NEPSE. The problems and challenges need to be overcome shortly in order to have pace in the development of the securities market which will be a pre-requisite to the economic development of the country.

5.2 Recommendations

Resource mobilization has a vital role in the developing economy like Nepal. The development of the stock market is a must for the resource mobilization. There are various problems of the Nepalese stock market, which have checked the resource mobilization in the economy. The following measures are recommended to overcome the existing problems of Nepalese stock market on the basis of the findings of the study and the conclusion drawn from the entire topic.

- Generally, Nepalese investors are not aware of their investment scheme. Therefore, they should be made aware of the investment scheme on the basis of proper analysis of risk and return. Investors should always be aware of their strength, weakness and risk-taking capabilities so that superior forecasting and sound understanding of stocks may give winning edge to them.

- In the age of digital technology NEPSE is trading on open-out cry system. The trading system of NEPSE should be modernized. Effective information channel should be launched. Data available on website of NEPSE should be up-to-date and the concept of on line trading should be developed.

- NEPSE should regularly update the information furnished by the listed companies and analyzed timely. If any company is found working against NEPSE rules, the company should be immediately take into action. The NEPSE should have high speed settlement and clearance system, investor-friendly environment, well-equipped office, computerized system and efficient staff. NEPSE should also focus towards the possibility of substitution of present trading mechanism by electronic trading system.

- Government needs to amend the rules and regulation regarding stock market time to time and to make policies that protect the individual investors' right. On the other hand, Government needs to implement such rules properly and to monitor from time to time.

- The existing laws and regulations relating to stock market have to be revised to rationalize and simplify the regulatory system.

- There need to provide the opportunity for a large number of investors to participate directly or through mutual saving schemes which ultimately enhance the breadth and depth of the stock market.

- Investors should be encouraged to invest in non-banking sectors as well for this, the non-banking companies should think about their policy regarding the dividends on their stocks.

- Some companies don't review their license of registration at NEPSE. NEPSE should take action on such companies.

- The market should be made transparent with the prompt dissemination of information to meet the expectations of investors of different parts of the country so that the involvement of the investors outside the valley could be enhanced.

- The NEPSE should adopt appropriate policies, membership and fee structure to attract members outside Kathmandu, including brokers that need not be present on the floor or carry customers' account. All types of securities firms, including broker-dealers, issue managers and full service securities firm should be eligible for membership.

- NEPSE should establish an Arbitration committee to handle unresolved investor complaints. The NEPSE bye-laws should be amended to establish procedures governing the process of arbitration.

- Should give the Securities Board the power to require the stock exchange to discharge its responsibilities for ensuring compliance by public issuers with their continuing disclosure obligation.

- On of the major problem cited in the Nepalese Stock Exchange is the suspected of insider trading system which is one of the worst flows in stock trading. Such a system must be immediately discouraged and total review of brokers appointing system should be made further, if any practices are noticed, immediate action must be initiated.

- Investments in the manufacturing and other sector should be enhanced. The government should think of the financial status of the firms in the manufacturing industries so as to make the appropriate policies and programs for raising the rate of return on investments.

- Nepalese security market is heavily regulated and controlled by various regulatory bodies regarding the issue of securities e.g. SEBO/N and CRO. So high powerful regulator with responsibilities to regulate the market should be developed in order to develop the window policy.

In brief, this study recommends that the transparency and openness of transactions, flow of reliable and sufficient information, presence of professional entrepreneurs, brokers plus investors' increased awareness about the market, political stability, peaceful environment and the government commitments to create and implement policies and programs friendly for the development of the securities and should give attention for the faster development and sound growth of NEPSE.

5.3 <u>Directions for Future Avenues</u>

The study focuses on the Role and Significant of Nepal Stock Exchange in the securities market. This study has accomplished its purpose; however, a further investigation in the other facets of the area is sought. The following points have been identified as the prospective areas of further research and study.

1. Nepalese stock market is highly dominated by the banking sector. Manufacturing and trading sector have managed to have nominal contributions to overall activities of NEPSE. So, a sectorial analysis of banking and non banking securities can be carried out to draw the real scenario of security market in Nepal.

2. A growing awareness about investing in shares can be felt with the volume expansion of the security market day by day. While the only security exchange of Nepal, NEPSE has been operating in Kathmandu so far,

prospects of NEPSE can be explored in the context of outside-the valley markets.

3. Different market disorders were felt to be in existence at different situations in NEPSE, which hamper the effective information of price of the stock. So, special research should be carried out to help the concerned authorities to feel the possibilities of stock market disorders and to control the situation in more proactive way.

4. The brokers, in Nepal Stock Exchange, are unable to provide the expected types of services to the investors apart from trading the shares. So, the research should be carried out to find out how they could be in a condition to provide different types of services to the investors in Nepalese context. Likewise, the research should be carried out to find out the best possible and effective way to change the irrational investors into rational investors.

Appendix No:1

Value Calculation By Using The SML Equation

COMPANY : Everest Bank Limited

Year	**MPS**	**Index**	**Risk Free**
2001/02	430	227.54	-
2002/03	445	204.86	14.66
2003/04	680	222.04	12.25
2004/05	870	286.67	10.21
2005/06	1379	386.83	11.85
2006/07	2430	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	445	204.86		14.66		3.49		-9.97
2003/04	680	222.04		12.25		52.81		8.39
2004/05	870	286.67		10.21		27.94		29.11
2005/06	1379	386.83		11.85		58.51		34.94
2006/07	2430	683.95		10.04		76.21		76.81
			ΣRf	59.01	ΣRj	218.96	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	43.792	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 806.10

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 28.39

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

=32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)] \text{X} [Rm - E(Rm)]}{n-1}$

= 755.0656

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= 0.7093

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 23.1919

Since required rate of return on stock J is 23.1919 but the expected return is 43.792 So, the Stock is undervalued.

Appendix No:2

Value Calculation By Using The SML Equation

COMPANY : Nepal Investment Bank Limited

Year	MPS	Index	Risk Free
2001/02	760	227.54	-
2002/03	795	204.86	14.66
2003/04	940	222.04	12.25
2004/05	800	286.67	10.21
2005/06	1260	386.83	11.85
2006/07	1729	683.95	10.04

Year	MPS	Index		Rf		Rj		Rm
2002/03	795	204.86		14.66		4.605		-9.97
2003/04	940	222.04		12.25		18.24		8.39
2004/05	800	286.67		10.21		-14.89		29.11
2005/06	1260	386.83		11.85		57.5		34.94
2006/07	1729	683.95		10.04		37.22		76.81
			ΣRf	59.01	ΣRj	102.675	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	20.535	E(Rm)	27.86

$$\text{Var(Rj)} = \frac{\Sigma[Rj - E(Rj)]^2}{n-1}$$

= 789.69

$$\text{Var(Rm)} = \frac{\Sigma[Rm - E(Rm)]^2}{n-1}$$

= 1064.495

$$\text{S.D. (Rj)} = \sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$$

= 28.10

$$\text{S.D. (Rm)} = \sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$$

= 32.63

$$\text{Cov(Rm.Rj)} = \frac{\Sigma[Rj - E(Rj)] \text{X} [Rm - E(Rm)]}{n-1}$$

= 420.37

$$\text{Bj} = \frac{Cov.(Rm.Rj)}{Var(Rm)}$$

= 0.39

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 18.06

Since required rate of return on stock J is 18.06 but the expected return is 20.54 So, the Stock is undervalued.

Appendix No:3

Value Calculation By Using The SML Equation

COMPANY : Nirdhan Utthan Bank Limited

Year	MPS	Index	Risk Free
2001/02	120	227.54	-
2002/03	100	204.86	14.66
2003/04	90	222.04	12.25
2004/05	100	286.67	10.21
2005/06	100	386.83	11.85
2006/07	110	683.95	10.04

Year	MPS	Index		Rf		Rj		Rm
2002/03	100	204.86		14.66		-16.7		-9.97
2003/04	90	222.04		12.25		-10		8.39
2004/05	100	286.67		10.21		11.11		29.11
2005/06	100	386.83		11.85		0		34.94
2006/07	110	683.95		10.04		10		76.81
			ΣRf	59.01	ΣRj	-5.56	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	-1.112	E(Rm)	27.86

$$\text{Var(Rj)} = \frac{\Sigma[Rj - E(Rj)]^2}{n-1}$$

=148.81

$$\text{Var(Rm)} = \frac{\Sigma[Rm - E(Rm)]^2}{n-1}$$

= 1064.495

$$\text{S.D. (Rj)} = \sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$$

= 12.199

$$\text{S.D. (Rm)} = \sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$$

= 32.63

$$\text{Cov(Rm.Rj)} = \frac{\Sigma[Rj - E(Rj)] \mathrm{X} [Rm - E(Rm)]}{n-1}$$

= 332.911

$$\text{Bj} = \frac{Cov.(Rm.Rj)}{Var(Rm)}$$

= 0.31

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 16.78

Since required rate of return on stock J is 16.78 but the expected return is -1.112 So, the Stock is overvalued.

Appendix No:4

Value Calculation By Using The SML Equation

COMPANY : Development Credit Bank

Year	**MPS**	**Index**	**Risk Free**
2001/02	130	227.54	-
2002/03	145	204.86	14.66
2003/04	167	222.04	12.25
2004/05	305	286.67	10.21
2005/06	390	386.83	11.85
2006/07	800	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	145	204.86		14.66		11.54		-9.97
2003/04	167	222.04		12.25		15.17		8.39
2004/05	305	286.67		10.21		82.63		29.11
2005/06	390	386.83		11.85		27.87		34.94
2006/07	800	683.95		10.04		105.13		76.81
			ΣRf	59.01	ΣRj	242.34	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	48.47	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

=1818.58

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 42.644

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)] \mathrm{X} [Rm - E(Rm)]}{n-1}$

= 1178.94

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= 1.11

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 29.63

Since required rate of return on stock J is 29.63 but the expected return is 48.47 So, the Stock is undervalued.

Appendix No:5

Value Calculation By Using The SML Equation

COMPANY : Universal Finance

Year	**MPS**	**Index**	**Risk Free**
2001/02	170	227.54	-
2002/03	150	204.86	14.66
2003/04	130	222.04	12.25
2004/05	130	286.67	10.21
2005/06	181	386.83	11.85
2006/07	200	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	150	204.86		14.66		-11.76		-9.97
2003/04	130	222.04		12.25		-13.33		8.39
2004/05	130	286.67		10.21		0		29.11
2005/06	181	386.83		11.85		39.23		34.94
2006/07	200	683.95		10.04		10.497		76.81
			ΣRf	59.01	ΣRj	24.637	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	4.93	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 460.95

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 21.47

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)] X [Rm - E(Rm)]}{n-1}$

= 399.598

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= 1.11

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 29.63

Since required rate of return on stock J is 29.63 but the expected return is 48.47 So, the Stock is undervalued.

Appendix No:6

Value Calculation By Using The SML Equation

COMPANY : Lumbini Finance

Year	MPS	Index	Risk Free
2001/02	105	227.54	-
2002/03	108	204.86	14.66
2003/04	100	222.04	12.25
2004/05	90	286.67	10.21
2005/06	115	386.83	11.85
2006/07	163	683.95	10.04

Year	MPS	Index		Rf		Rj		Rm
2002/03	108	204.86		14.66		2.86		-9.97
2003/04	100	222.04		12.25		-7.41		8.39
2004/05	90	286.67		10.21		-10		29.11
2005/06	115	386.83		11.85		27.77		34.94
2006/07	163	683.95		10.04		41.74		76.81
			ΣRf	59.01	ΣRj	54.96	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	10.992	E(Rm)	27.86

Var(Rj) = $\dfrac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 518.11

Var(Rm) = $\dfrac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\dfrac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 22.76

S.D. (Rm) = $\sqrt{\dfrac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\dfrac{\Sigma[Rj - E(Rj)]\text{X}[Rm - E(Rm)]}{n-1}$

= 565.9

Bj = $\dfrac{Cov.(Rm.Rj)}{Var(Rm)}$

= 0.53

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 20.31

Since required rate of return on stock J is 20.31 but the expected return is 10.992 So, the Stock is overvalued.

Appendix No:7

Value Calculation By Using The SML Equation
COMPANY : Soaltee Hotel

Year	MPS	Index	Risk Free
2001/02	100	227.54	-
2002/03	75	204.86	14.66
2003/04	65	222.04	12.25
2004/05	50	286.67	10.21
2005/06	57	386.83	11.85
2006/07	126	683.95	10.04

Year	MPS	Index		Rf		Rj		Rm
2002/03	75	204.86		14.66		-25		-9.97
2003/04	65	222.04		12.25		-13.33		8.39
2004/05	50	286.67		10.21		-23.08		29.11
2005/06	57	386.83		11.85		14		34.94
2006/07	126	683.95		10.04		121.05		76.81
			ΣRf	59.01	ΣRj	73.64	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	14.73	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$
= 3774.98

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$
= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$
= 61.440

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$
= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)]\mathrm{X}[Rm - E(Rm)]}{n-1}$
= 1800.31

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$
= 1.69

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj
= 38.94

Since required rate of return on stock J is 38.94 but the expected return is 14.73 So, the Stock is overvalued.

Appendix No:8

Value Calculation By Using The SML Equation

COMPANY : Bottlers Nepal (Terai)

Year	**MPS**	**Index**	**Risk Free**
2001/02	450	227.54	-
2002/03	480	204.86	14.66
2003/04	456	222.04	12.25
2004/05	413	286.67	10.21
2005/06	400	386.83	11.85
2006/07	400	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	480	204.86		14.66		6.67		-9.97
2003/04	456	222.04		12.25		-5		8.39
2004/05	413	286.67		10.21		-9.43		29.11
2005/06	400	386.83		11.85		-3.15		34.94
2006/07	400	683.95		10.04		0		76.81
			ΣRf	59.01	ΣRj	-10.91	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	-2.182	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 36.13

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 6.01

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)]\mathrm{X}[Rm - E(Rm)]}{n-1}$

= 47.243

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= -0.044

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 11.095

Since required rate of return on stock J is 11.095 but the expected return is -2.182
So, the Stock is overvalued.

Appendix No:9

Value Calculation By Using The SML Equation

COMPANY : Salt Trading

Year	**MPS**	**Index**	**Risk Free**
2001/02	290	227.54	-
2002/03	300	204.86	14.66
2003/04	315	222.04	12.25
2004/05	315	286.67	10.21
2005/06	315	386.83	11.85
2006/07	325	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	300	204.86		14.66		3.448		-9.97
2003/04	315	222.04		12.25		5		8.39
2004/05	315	286.67		10.21		0		29.11
2005/06	315	386.83		11.85		0		34.94
2006/07	325	683.95		10.04		3.17		76.81
			$\Sigma\, Rf$	59.01	$\Sigma\, Rj$	11.618	$\Sigma\, Rm$	139.3
			E(Rf)	11.802	E(Rj)	2.32	E(Rm)	27.86

Var(Rj) = $\dfrac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 4.99

Var(Rm) = $\dfrac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\dfrac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 2.233

S.D. (Rm) = $\sqrt{\dfrac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\dfrac{\Sigma[Rj - E(Rj)]\,\mathrm{X}[Rm - E(Rm)]}{n-1}$

= 18.1314

Bj = $\dfrac{Cov.(Rm.Rj)}{Var(Rm)}$

= -0.017

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 11.53

Since required rate of return on stock J is 11.53 but the expected return is 2.32 So, the Stock is overvalued.

Appendix No:10

Value Calculation By Using The SML Equation

COMPANY : Nepal Life Insurance

Year	**MPS**	**Index**	**Risk Free**
2001/02	100	227.54	-
2002/03	115	204.86	14.66
2003/04	162	222.04	12.25
2004/05	304	286.67	10.21
2005/06	427	386.83	11.85
2006/07	766	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	115	204.86		14.66		15		-9.97
2003/04	162	222.04		12.25		40.87		8.39
2004/05	304	286.67		10.21		87.65		29.11
2005/06	427	386.83		11.85		40.46		34.94
2006/07	766	683.95		10.04		79.39		76.81
			ΣRf	59.01	ΣRj	263.37	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	52.67	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 911.22

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 30.186

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)] X [Rm - E(Rm)]}{n-1}$

= 730

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= 0.69

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 22.88

Since required rate of return on stock J is 22.88 but the expected return is 52.67 So, the Stock is undervalued.

Appendix No:11

Value Calculation By Using The SML Equation

COMPANY : Nepal Film

Year	**MPS**	**Index**	**Risk Free**
2001/02	50	227.54	-
2002/03	45	204.86	14.66
2003/04	42	222.04	12.25
2004/05	42	286.67	10.21
2005/06	38	386.83	11.85
2006/07	38	683.95	10.04

Year	**MPS**	**Index**		**Rf**		**Rj**		**Rm**
2002/03	45	204.86		14.66		-10		-9.97
2003/04	42	222.04		12.25		-6.67		8.39
2004/05	42	286.67		10.21		0		29.11
2005/06	38	386.83		11.85		-9.52		34.94
2006/07	38	683.95		10.04		0		76.81
			ΣRf	59.01	ΣRj	-26.19	ΣRm	139.3
			E(Rf)	11.802	E(Rj)	-5.238	E(Rm)	27.86

Var(Rj) = $\frac{\Sigma[Rj - E(Rj)]^2}{n-1}$

= 24.48

Var(Rm) = $\frac{\Sigma[Rm - E(Rm)]^2}{n-1}$

= 1064.495

S.D. (Rj) = $\sqrt{\frac{\Sigma[Rj - E(Rj)^2}{n-1}}$

= 4.95

S.D. (Rm) = $\sqrt{\frac{\Sigma[Rm - E(Rm)^2}{n-1}}$

= 32.63

Cov(Rm.Rj) = $\frac{\Sigma[Rj - E(Rj)] \mathrm{X} [Rm - E(Rm)]}{n-1}$

= 110.163

Bj = $\frac{Cov.(Rm.Rj)}{Var(Rm)}$

= 0.103

Therefore Required Rate of Return = Rf + (Rm-Rf)Bj

= 13.46

Since required rate of return on stock J is 13.46 but the expected return is -5.238 So, the Stock is overvalued.

Appendix No: A

Survey
On
Nepal Stock Exchange; Its Role and Significant in the Securities Market

Respected Respondent
You are requested to provide me your valuable time to fill up this questionnaire, which has been prepared for the research work entitled ”Nepal Stock Exchange; Its Role & Significant in the Securities Market” for the partial fulfillment of the requirement of Masters of Business Studies. I would also like to state you all that your response will be kept confidential and will be used only for the purpose of this study.

Neeru Karki
MBS Student
Bhairahawa Multiple Campus

Name of the respondent (Optional): ………………………………………………
Address: ………………………………………………….
Sex: ………………………….   Age: ……………….

Please, Tick mark ( ) any one in your correct opinion.

Q 1) which Sector is your preference for investment?
a. Banking ( )   b. Finance and Insurance ( )
c. Manufacturing ( )   d. Others ( )

Q 2) Do you think Nepalese investors are getting sufficient and timely information regarding the listed companies?
a. Yes ( )   b. No ( )

Q 3) Are you satisfied with the return, you are getting from the investment in stock?
a. Yes ( )   b. No ( )

Q 4) Are you satisfied with the present trading system (open out cry system) adopted by NEPSE?
a. Yes ( )   b. No ( )

Q 5) From which source do you get idea to invest in share at first?

a. Brokers ( ) b. Friends ( )

c. Relatives ( ) d. Newspaper ( )

e. Investor Education program organized by concern authorities ( )

Q 6) Which factor drives you towards the investment in stocks than other sector?

a.MPS ( ) b. DPS ( ) c. Social Status ( )

d. Goodwill of the company ( ) e. Participation in AGM ( )

Q 7) In your opinion, what is to be done to protect the interest of public shareholder in Stock Market?

a. More representation of public in board of Directors ( )

b. Regular flows of information through different Medias ( )

c. Public awareness programs by government authorities ( )

d. Regular interaction with top level executives ( )

e. Increase shareholders activism on their rights ( )

Q 8) What is the level of role played by Stock Exchange in the Securities Market?

a. Very low ( ) b. Low ( ) c. Moderately ( )

d. High ( ) e. Very high ( )

Q 9) What do you think about current performance of Stock Market in Nepal?

a. Satisfactory ( ) b. Poor ( ) c. Excellent ( )

Q 10) What is the major influencing factor for the stock price?

a. Company Profit ( ) b. Company Performance ( )

c. Company dividend ( ) d. Signaling Factor ( )

e. Above all ( )

Q 11) In your opinion, which of the following trend of the stock price movement is suitable for Nepalese security market?

a. Bullish trend ( ) b. Bearish trend ( )

c. Optimum trend ( ) d. None of above ( )

Q 12) Does international environment effects the Nepalese stock market?

a. Yes ( ) b. No ( )

c. Don’t know ( )

Q 13) What is the level of investor's awareness in securities market in Nepal?

a. Very low ( ) b. Low ( ) c. Moderately ( )
d. High ( ) e. Very high ( )

Q 14) Do you think, the underwriters in the Nepalese market are honest?

a. Yes ( ) b. No ( ) c. Don't know ( )

Q 15) Are there any difficulties for trading in the secondary market?

a.Yes ( ) b. No ( ) c. Don't know ( )

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