

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

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

Securities markets facilitate the exchange of financial assets by bringing together buyers and sellers of securities. Securities markets provide an effective way of raising money for commercial enterprises and at the same time provide an investment opportunity for individuals and institutions. Securities markets have both theoretical and practical perspectives. Securities markets provide value and significance to the financial assets. Practically, the activities of buying and selling securities on the securities markets are extremely important for the allocation of capital within economies. The securities markets serve as a reliable guide to the performance of companies, and thereby promoting efficiency (Bhattari, 2006:1).

A country's financial system may be bank-dominated or market oriented. Each of these systems has different mechanisms for handling stakeholders' interest

and addressing corporate control issues and agency problems. Though historically countries seem to follow one of these paths for development of its financial system, in recent years, some countries are developing their financial systems through convergence between these two. Empirical studies show that banks and stock market play complementary roles in the initial stage of financial development of a country and neither of these is perfect substitute for the other. Financial system in Nepal is basically bank dominated.

During the last one and half decade the financial sector in Nepal has grown significantly. It is sad that despite a history of almost half a century of developmental efforts under different national plans, conscientious efforts to develop financial sector started quite late in Nepal. Although some efforts were made to develop country's infrastructure during the Rana regime, they were more sporadic and aimed at fulfilling the need and the whims of the then Rana rulers. Efforts to achieve economic growth in the country in a planned way started only in 1956 with the adoption of the First Five – Year Plan by the government. Under different plans the government set targets for economic growth and adopted various policies and programs, which were directed towards developing infrastructure necessary for the creation of national wealth. Unfortunately, these policies and programs failed to take into account the need to develop the financial structure that ought to exist side by side with the development of infrastructure necessary for the growth of real sector. In one sense these policies were lopsided because they sought to enhance growth in physical assets of the nation by suppressing the development of financial sector of the country.

The policy of the government to maintain control of the financial sector by restricting the entry of private sector into financial activities limited the growth of financial sector in the country. As a result the country had limited financial institutions to support its developmental activities for quite a long time. Till early eighties the country had only two commercial banks, two development banks, one provident fund and few insurance companies. As almost all of these

financial institutions were under the government sector they operated more under social welfare concept than under commercial principles. As a result of the restrictive policy of the government, the gaps created in the resources needed for the development of the real sector and the resources available for it were met through foreign grants and loans under different plans. While this increased the country's dependency on the foreign aid, it also made the government less concerned for the need to mobilize resources locally to meet the resource gap. Apparently, this led to tardy development of financial sector of the country where the real sector lagged behind the financial sector.

The process of stock market development in the country actually started in 1976 when the government established Securities Exchange Centre to provide and develop market for securities, both the government bond and corporate securities. However, visible impact on the development of financial sector was observed only when the government changed its restrictive policy and opened up hitherto closed financial sector to private sector and foreign participation in the establishment of banks. With the adoption of privatization and economic liberalization policy the process got further impetus and the financial institutions in Nepal included 25 commercial banks, 78 finance companies, 58 development banks, 25 insurance companies, 5 regional rural development banks and many saving and credit cooperatives, postal saving banks, non-government micro-credit institutions. In addition, there is one Employee Provident Fund, one Credit Guarantee and Deposit Insurance Corporation, and one Citizen Investment Trust (Annapurna Post, September 22, 2008).

During this period some discernible improvements took place in the stock market. In 1993, Securities Board Nepal (SEBO) was established with the objectives to regulate, supervise, and monitor the securities market. Similarly, the Securities Exchange Centre was converted into Nepal Stock Exchange Limited (NEPSE) with the objectives to provide secondary market for securities transaction. In order to modernization the stock market, NEPSE has started automated trading system based on Local Area Network (LAN) with the

financial aid and support of Asian Development Bank (ADB) since 17 August 2007, which substituted open-out-cry system of security trading that NEPSE had been from its period of establishment (Aarthik Abhiyan, August 25-31 2008)

1.2 Statement of the Problem

The relationship between financial development and economic growth, with focus on developmental role of stock markets, has been in debate for some time in the past. Empirical studies suggest that financial development does matter and stock markets do drive economic growth. Unfortunately, in Nepal, despite a history of about half a decade of planned economic activities to develop real sector of the country, little attention was paid to the development of financial sector. Over the past one and half decade, financial sector, despite many problems has developed significantly in Nepal. However, most of the developments were confined to the banking sector. Stock market has mutually remained stalled because of the low priority in the government's financial reform policies.

The stock exchange of Nepal has not so long history and it has faced so many ups and downs during this short period of time. It can be noted that it has a just fifteen year history. However, we must be very proud that it has created a short history for our capital market.

The market has not a long history, however how the stock market indicators are changing in the over the period of time. The researcher is very much curious to study about the following problems of stock market growth:

1. What is the growth position of the primary market?
2. What is the growth position of listed companies in the secondary market?
3. What is the growth position of market capitalization of the secondary market?

4. What is the growth position of NEPSE index in the secondary market?
5. What is the growth position of number of transaction and number of listed securities in the secondary market?

1.3 Objectives of the Study

The main objective of this study is to examine the growth situation of the Nepalese securities market. The other specific objectives of this research are as follows:

- (i) To examine the pace of primary market growth in Nepal.
- (ii) To examine the growth of listed companies in Nepal.
- (iii) To analyze the growth of NEPSE index.
- (iv) To analyze the trend of market capitalization, number of transactions, number of securities traded and number of securities listed etc.

1.4 Significance of the Study

Securities market in Nepal seems in an infancy stage. No long history has developed. Many practices which have done in the developed market have yet to be done. However, in this short history how is it growing and what developments in different sectors, like trading mechanism, trading volume, index etc, have the market achieved till the date, these will be discussed in detail and will be beneficial all the stakeholders of the capital market to sense the development of the market.

1.5 Limitations of the Study

The research is made for the partial fulfillment of the requirements for the Master in Business Studies (MBS) and it is not a comprehensive study about the development of the capital market. The other limitations are:

-) The accuracy of the research solely depends upon the exactness of data used.
-) Variations of data in itself are also found when comparing with different sources.
-) The study is fully based on the student's limited financial resources within a limited time frame.
-) The study is not a final study on the subject.

1.6 Organization of the Study

The study has been divided into following chapters:

- (i) Introduction
- (ii) Review of Literature
- (iii) Research Methodology
- (iv) Presentation and Analysis of Data
- (v) Summary, Conclusions and Recommendations.

The first chapter is about the background of the development of stock market in Nepal, problem of the study, objective of the study, importance of the study, limitations of the study.

The second chapter has been concentrated upon review of literature and will be subdivided into various sections such as conceptual framework, review from different studies, review from journals, articles, magazines and review of previous master's thesis.

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

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

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

CHAPTER - II

REVIEW OF LITERATURE

This chapter devotes to review some of the existing literature concerning the stock market in Nepal. In this regard, various books, journals and articles concerned to this topic have been reviewed. The first part of the chapter deals with the conceptual framework of the study and the second part is concern with the review of articles and dissertation.

2.1 Conceptual Framework

This section mainly focus on securities market and its type, stock market development and long term growth, historical background of Nepalese stock market, Nepal Stock Exchange, Securities Board of Nepal and stock broker.

2.1.1 Securities Markets

Securities market is the market where financial instruments are traded. It brings together buyer of the securities and holder of the securities and facilitate transaction between them. (Bhattari, 2008:7)

Securities are traded in a market called securities markets. Although securities markets are concentrated in few locations, they refer more to mechanism, rather than to place, designed to facilitate the exchange of securities by bringing buyers and sellers of securities together. In other words, people and organizations wanting to borrow money are brought together with those having surplus funds in the securities markets. Securities, such as equities, short and

long-term debt instruments, derivatives etc. are the products that are traded in the markets, institutions such as investment bankers and securities firms, securities issuing institutions such as government and corporate bodies and participants of the securities markets. Securities markets' major function is to provide line between savings and investment thereby facilitating the creation of new wealth (Baral, 1999: 8-9).

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

Securities market is a mechanism created to facilitate the exchange of financial securities of assets by bringing together buyer and sellers of securities. It provides an effective way of procuring an long-term funds by issuing Shares and debenture of bond for corporate enterprises and government and at the same time provide an investment opportunities for individual and institutions. Thus the market place for these financial assets is called securities market which is subdivided into primary and secondary market. The former market denotes the market for newly issue securities to the public where as the latter market refers market for second hand securities, traded previously in the market (Gurung, 2004:85).

2.1.2 Primary Market

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

the market where primary issue of securities are traded for the first time (Shrestha, Poudel and Bhandari. 2003:36)

The main function of primary market is to make the financial capital available to make new investment in building, equipment and stock of necessary goods. It is the market for new securities. The security market transfers the funds from the saver to investors through the primary market. Hence, the transaction of securities issued for the first time take place in this market. (Thapa, Bhattari and Basnet, 2006:20).

Primary market is used to denote for the market for the original sale of securities by an issuer to the public. The volume of common stock is directly related to market conditions. When the market is high, the rising toe number of new issue being offered to the public rises and when the market is low or falling, the number declines. (Cheney and Moses, 1992:64)

2.1.3 Secondary Market

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

Secondary market is the market for existing securities. It provides liquidity to those securities which are issued from primary market and listed in the concerned stock exchange. It facilitates transaction of buyer and sellers from stock exchange. The price of the securities is determined by the interaction between demand and supply of the stock (Pradhan and Khatiwoda, 2006:70).

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

The **over-the-counter** (OTC) exchange is not an organization but an intangible market for the purchasers and sellers of securities not listed by the organized exchanges. A sophisticated telecommunication network lists active traders in this market. The prices at which securities are traded “over-the-counter” are determined by competitive bids and negotiation. The OTC, in addition to create a resale market for outstanding securities, is a primary market in which new public issues are sold (Lohani, 2002:29).

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

2.1.4 Building a Dynamic Stock Market

Nepalese financial system is characterized by small but growing capital market. During past 14 years of its operation, securities market has witnessed three

market phases of ups and downs. The latest upswing started from the fiscal year 2002/03 and is continuing. During this phase, Npse index, the market indicator climbed from 205 to 621 (July 10, 2007). The market capitalization of the listed stocks climbed from Ts. 35.24 billion to Rs. 169.05 billion during the same period. During the past five years, capital mobilized through public issue and rights offerings has been in the tune of Rs. 8.4 billion from 109 issues. In the fiscal year 2006/07 alone, capital worth of Rs. 2.8 billion has been mobilized from 34 issues.

In spite of expansion in size the securities market is yet to make quality transformation gaining depth and maturity. The market lacks sectoral diversification of performing listed companies, access to secondary trading services is limited, transparency and efficiency of the issuer and market is not sufficient capacity of the regulator, exchange and the players is limited, the market is featured by active individual investors and the institutional investors are conspicuously absent. The market infrastructures supporting the trading, clearing and settlement are not sufficient. Thus the effort to building a dynamic market is going to be an ardent task requiring a lot of commitment and efforts of the government, regulator, market place, market players and the investors.

The stock market is bullish and getting to new peaks. This would have been good news if the sustainability of the market was not a serious question. For the given performance of listed companies, the growth trend and future prospects, the market is higher than an analyst would justify. This may be attributable to a number of reason including higher liquidity and absence of other investment opportunities, absence of institutional investor to make the market more stable and rational and more investment awareness of investors on the risk return and market to increase market depth, it is necessary to increase the supply of securities.

In order to enhance the supply of securities, a new securities registration and disclosure regulation is in the making that would bring major regulatory changes. This regulation sets the disclosure for going public through IPO or secondary offering through stock exchange. This disclosure based regulation is believed to encourage closely held companies to come to the capital market and entrepreneurs to sell their holding in favor of the general public. Besides, this regulation enables the issue of variety of instruments. However, this could be meaningful once the accounting standards and auditing practices assure full financial disclosure.

The vision for a new Nepal has to have an important place for a dynamic capital market. It should be a market where issuers have choice to tap the funds at lower cost while people have choice to invest in the securities with different risk and return. In essence, securities market is a mechanism that delivers public access to ownership and share benefits from the investment. The fund requirement to finance the establishment and expansion of corporate sector can conveniently come from capital market as these entities venture to tap the opportunities in the economy.

The vision of vibrant capital market assumes that a country has responsible level of and visible progress in country's governance. Some aspects of governance like rule of law effective tax administration and political stability to ensure consistency and continuity of economic policies, directly impact the confidence of domestic and foreign investors in the market. The governance parameter, particularly the market related ones, should be improved so as to make a meaningful breakthrough in the capital market sector.

It is well understood that large number of intermediaries, institutions and professionals are the players and advisors active in capital market. Regulations and laws governing the capital market are diverse, numerous and complex too. At this point of time, Nepalese capital market is focusing on reforming the laws

regulations and policies, building institutional capacity, above all visualizing a dynamic capital market in order to tap the inherent potential and managing the cross border issue and trading of securities. This article intends to highlight important reform initiatives and some critical aspects of capital market development in Nepal (Kafle, 2007:1).

2.1.5 Historical Background of Nepalese Stock Market

The rapid development of any country in this modern era depends to a large extent on the level of financial activities. Financial activities play a role of catalyst in the process of economic development of a country but for the rapid growth on volume of financial activities, enterprises need a huge amount of funds. Capital is the means for development and productivity entities to increase gross domestic product .One of the mechanism of financing the industries from the external source in modern time is the capital market, through which the industrial enterprises with corporate organization assembles the funds by issuing various form of securities from the surplus spending units directly and/via financial intermediaries (Mahat,1981, 25). For the mobilization of invest-able resource capital market is an important intermediary through which effective bridging of the deficits and surplus units can be ensured. Capital market institutions are engaged in mobilization of saving from surplus units and supply funds into the deficit units for productive investment. Capital market directly provides liquidity to the investors who provide funds for the establishment of the productive enterprises and on the other, encourage savers to save more and enterprising economic units to start productive venture (Bhatta, 1997:1). The development of capital market is closely related with the modernization and the development of the financial system. So, the development and expansion of capital market are essential for the rapid economic growth of the country. Capital market helps for economic development by mobilizing long-term capital and by creating liquidity, which is needed for productive sector .

The history of capital market in Nepal dates back to 1936 in which year the shares of Biratnagar Jute Mills Ltd. were floated. In 1937, Tejarath was set up to facilitate loans to the government employees and was converted into Nepal Bank Ltd.

HMG Nepal introduced the Company Act in 1964 and the first issue of government bonds made in the same year through Nepal Rastra Bank to collect the developmental expenditures. It carried 6 percent rate of interest and had the maturity period of five years. HMG Nepal announced the Industrial Policy in 1974 and under this policy an institution named Securities Marketing Center (SMC) was established to deal in government securities-development bonds and national savings bonds, and corporate securities of few companies. The government has the virtual monopoly over the security market. Then, Securities Exchange Center (SEC) was established in 1976 with an objective of facilitating and promoting the growth of capital market. It was the only capital market institution in Nepal. Securities Exchange Act came into force in 1984. Since then, SEC started to operate under this act. The purpose of this act was to provide systematic and favorable market environment for securities ensuring and protecting the interest of individuals and institutional investors as well as to increase the public participation in various firms and companies.

SEC had provided facilities to trade the government securities and few of corporate securities like shares and debentures. Only the shares of 10 companies were listed in SEC and there was involvement of no broker and dealer in the securities market. So, SEC itself was undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services (NEPSE 1998). Apart from this, there was the absence of effective secondary market to ensure liquidity to the securities.

The interim government (1990/91) initiated financial reform program and two indirect investment vehicles-Citizen's Investment Fund and NIDC Capital Markets Ltd.-were established with the collective investment schemes in the corporate sector (Gurung 1999). Then, due to the world whim of privatization and economic liberalization, the operation of SEC was felt to change to make it compatible with the changing economic system. As a result, HMG Nepal brought about change in the structure of SEC by dividing it into two distinct entities-Securities Board, Nepal (SEBO/N) and Nepal Stock Exchange Ltd. (NEPSE) at the policy level in 1993. Since then they are operating as the main constituents of securities market in Nepal.

SEBO/N was established on June 7, 1993 with its mission to facilitate the orderly development of a dynamic and competitive capital market and maintain its credibility, fairness, efficiency, transparency and responsiveness under the Securities Exchange Act 1983 (SEBO, 2001). It is an apex regulator of the securities market in Nepal. It registers the securities and approves the public issues. Moreover, SEBO frames the policies and programs required to monitor the securities market, provides license to operate stock exchange business and stock brokers and supervises and monitors the stock exchange operations and securities business persons.

NEPSE Ltd. is a non-profit organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as brokers and market makers, etc. (Gurung, 2004:86).

2.1.6 Present Status of Nepalese Stock Market

At present, stock market has been performing more strongly than in the earlier years. The improvement in the equity market has been attributed to various

factors including good prospect of corporate earnings and broader household participation in the stock market. Investors not only rely on the statement of the brokers, but they also have a concern over the financial information of the concerned company. Therefore, the shares of companies with better prospects of dividend, capital increment and growth have normally higher prices in the stock market. At present, the stock market in Nepal has witnessed its strength surprisingly, and this has raised hopes for sustained growth of corporate undertakings.

By the end of fiscal year 2007/08 the financial sector in Nepal included 25 commercial banks, 78 finance companies, 58 development banks, 25 insurance companies, 5 regional rural development banks and many saving and credit cooperatives, postal saving banks, non-government micro-credit institutions. In addition, there is one Employee Provident Fund, one Credit Guarantee and Deposit Insurance Corporation, and one Citizen Investment Trust (Annapurna Post, September 22, 2008).

During this period some discernible improvements took place in the stock market. In 1993, Securities Board Nepal (SEBO) was established with the objectives to regulate, supervise, and monitor the securities market. Similarly, the Securities Exchange Centre was converted into Nepal Stock Exchange Limited (NEPSE) with the objectives to provide secondary market for securities transaction. In order to modernization the stock market, NEPSE has started automated trading system based on Local Area Network (LAN) with the financial aid and support of Asian Development Bank (ADB) since 17 August 2007, which substituted open-out-cry system of security trading that NEPSE had been from its period of establishment (Aarthik Abhiyan, August 25-31 2008)

In the fiscal year 2007/08 NEPSE has bring significant change on its transaction. Mid of the August of this fiscal year the transaction on the trading

floor has computerized under Local Area Network (LAN) and had expanded by the mid of the fiscal year to Wide Area Network (WAN). With this, it is possible for transaction from the office of the member brokers.

Similarly NEPSE has also started over-the-counter (OTC) market form beginning of May 2008 for trading of the securities that are de-listed from the stock exchange or are not eligible to be listed.

Likewise, NEPSE has unveiled an ambition program to bring about a number of reforms. NEPSE is going to calculate and publish new NEPSE index based on the total number of share listed. The need for the new index was being felt for a long period as the existing indexes fails to measure the market momentum since almost 70 percent of the listed share owned by promoters of the companies and are not available for trading in the market.

In another important announcement, NEPSE has promised to start derivative market for trading right of the right share issued by the companies. In another purposed reforms, NEPSE is going to create necessary infrastructure to allow non-resident Nepalese and foreign institutional investors to invest in the secondary market.

Likewise NEPSE is also going to recommend for increase in the number of licensed brokers as after floor automation, there will be a space to accommodate 50 brokers. After implementation of Wide Area Networking (WAN) technology it will be possible to allow open entry and open exit to the broker (New Business Age, August 2007).

The equity market activities grow with the development and reform in the financial sector. Over the past 15 years the stock market of Nepal has made some progress. For example, between the fiscal year 1993/94 and 2007/08, the number of listed companies in NEPSE increased almost two-fold from 62 to 142 and the market capitalization value rose from Rs. 14 billion to Rs. 366.25 billion, likewise, during the same period the number of securities listed with the

exchange increased to 321131 and the number of annual transactions increased to 150800. During this period NEPSE index jumped from its base value of 100 to 963.36. Despite these progresses stock market in Nepal is still at a developing stage and has to make visible impacts on the economic growth of the country.

2.1.7 Nepal Stock Exchange (NEPSE)

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

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

Nepal Government, under program initiated to reform capital market, converted Securities Exchange Centre into Nepal Stock Exchange in 1993. Nepal Stock Exchange, in short NEPSE, is a non-profit making organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994 through licensed members. Nepal Government, Nepal Rastra Bank, Nepal Industrial Development Corporation and Licensed Members are the shareholder of the NEPSE.

Board of Directors

The Board of Directors of NEPSE consists 9 (Nine) directors in accordance with Securities Exchange Act, 1983, Six directors are nominated by HMG/N and different institutional investor. Two from the licensed members and the General Manager of the NEPSE is EX-Officio Director of the Board.

Capital Structure

The authorized capital of the exchange is Rs. 50 million. The issued capital is Rs. 30 million of this Rs. 26.39 millions is subscribed by Gov/Nep, Nepal Rastra Bank, Nepal Industrial Development Corporation and licensed members.

Members

Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 23 member brokers and 2 market maker who operate on the trading floor as per the Securities Exchange Act, 1983, rules and byelaws of the exchange.

Besides these NEPSE has also licensed to dealer (primary market) and dealer (secondary market). Dealer (primary market) operates as a manager to the issue and underwriter whereas dealer (secondary market) operates as a portfolio manager. Presently, NEPSE licensed to 11 dealers (primary market) and 2 dealers (secondary market).

Trading

NEPSE the only Stock Exchange in Nepal 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.

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:-

Table - 1
Stock Trading Days and Hours

Trading Days	Trading Hours	Type of Trading
Sunday – Thursday	12 noon – 3 p.m.	Regular
Friday	12 noon – 13 p.m.	Odd lot

Source: NEPSE Annual Report 2007/08

Note:- The exchange may however close the market on days other than schedule holidays or may open the market on days originally declared as holidays. The exchange may also extend, advance or reduce trading hours when it deems fit necessary.

Board Lot

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

NEPSE facilitates trading in the following instruments

- A. Shares
 - Equity Shares
 - Preference Shares
- B. Debentures
- C. Government Bonds
- D. Mutual Funds

Circuit Breakers

NEPSE has implemented index-based circuit breakers with effect from 2064/6/4 (21 September 2007). In addition to the circuit breakers, price range is also applicable on individual securities.

Index-based Circuit Breakers

The index-based circuit breaker system applies at 3 stages of the NEPSE index movement, in both way viz. 15 points, 20 points and 25 points or 3%, 4% and 5%, whichever is breached earlier. These circuit breakers when triggered bring about a trading halt in all equity.

- In case of 15 points or 3% whichever is reached earlier in either way, there would be a market halt for 15 minutes if the movement takes place before 13:00 hours. In case this movement takes after 13:00 hours there will be no trading halt at this level and market shall continue trading.
- In case of 20 points or 4% whichever is reached earlier in either way, there would be a market halt for half an hour if the movement takes place before 14:00 hours. In case this movement takes after 14:00 hours there will be no trading halt at this level and market shall continue trading. In case of 25 points or 5% whichever is reached earlier in either way, trading shall be halted for the remainder of the day.

Price Range

Price Range is applicable on individual securities. The trading of the individual securities are not halted but allowed to trade within the price range. The price band is 10% of previous close on either way. During the ATO session the range is 5% on either way of Previous Close Price. After the band is 2% on either way of the Last traded price till it reaches to 10% of the previous close.

Trading Location

The trading can be done either from NEPSE's trading floor or from the broker's office. NEPSE uses sophisticated technology through brokers can

trade remotely from their office located inside the Kathmandu valley. This remote trading facility was started from 1 November 2007.

Trading System

NEPSE operates on the 'NEPSE Automated Trading System '(NATS), a fully screen based automated trading system, which adopts the principle of an order driven market.

Order Matching Rules

The system adopts principle of order driven market. The best buy order is matched with the best sell order. An order may match partially with another order producing multiple trades. For order matching the best buy order is the one with the highest price and the best sell order is the one with the lowest price. This is because the system views all buy orders available from the point of view of the sellers and all sell orders from the point of view of the buyers in the market. So, of all buy orders available in the market at any point of time, a seller would obviously like to sell at the highest possible buy price that is offered. Hence, the best buy order is the order with the highest price and the best sell order is the order with the lowest price.

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.

Blank Transfer

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

1. This is related only with buy of the securities.
2. The buyer may decide to have market benefit either to have capital gains or to minimize the loss.
3. In order to do this s/he may partly send for name transfer or may register it in blank transfer.

If s/he register total purchase in blank transfer and can put for sale and if only the part of the shares are subscribed then s/he can handover the part and the part can be forwarded for name transfer to the concerned company. In order to do this s/he has to cancel the blank transfer for that portion (www.nepalstock.com).

2.1.8 Stock Brokers

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

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

Conditions for granting of certificates to stockbrokers:

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

- a) He holds the membership of a Stock Exchange Act.
- b) He shall abide by the rules, regulations and buy-laws of the 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 in manipulations and practices.

) Commission Broker

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

) Floor Broker

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

Floor brokers may be described as brokers. They are simply members of the exchange not brokers for a member firm. At peak activity periods, they will accept orders from other broker, execute them, and receive part of the commission in return. Floor brokers are useful in that they present backlogs of orders, and they allow many firms to operate with fewer exchange memberships than would be needed without their services.

) **Security Dealer**

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

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

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

) **Market Makers**

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

The market maker is any company or corporate body which deals in securities at the Stock Exchange in its own name or under its name on the basis of a pledge to provide liquidity to the securities issued by 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, and not to let to occur improper instability in the prices of such securities, shall be granted membership of securities market maker.

With the change in the legal provision, out of six market makers, five market makers so far registered with the Nepal Stock Exchange have left the business of market making and confined their activities as dealers in primary market (new issue market) and as dealers in secondary market they did not operate as market makers. At present, there is purely only one market maker, Nepal share market. Similarly, there is only one company dealing as primary dealer and market maker, which is known as Nepal Merchant Banking and Finance. At present, thirteen companies have received license to operate in the primary market and four security dealers have received license to carry on activities as dealers in the secondary markets.

2.1.9 Securities Board Nepal (SEBO/N)

Securities Board of Nepal (SEBON) was established by the Government of Nepal on June 7, 1993 as an apex regulator of Securities Markets in Nepal. It has been regulating the market under the Securities Exchange Act, 2006. The functions, duties and powers of SEBON as per the Act are as follows.

-) To offer advice to Government on matters connected with the development of the capital market.
-) To register the securities of corporate bodies established with the authority to make a public issue of its securities.
-) To regulate and systematize the issue, transfer, 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 Act or the rules and bye-rules framed under this Act.
-) To supervise and monitor the functions and activities of stock exchange.
-) To inspect whether or not any stock exchange is executing its functions and activities in accordance with this Act or the rules and bye-rules

framed under this Act, and to suspend or cancel the license of any stock exchange which is not found to be doing so.

- J To issue licenses to conduct the business of dealing in securities, subject to this Act, or the rules and the bye-rules framed under this Act, to companies or institutions desirous of conducting the business of dealing in securities.
- J To supervise and monitor the functions and activities of securities-dealers.
- J To grant permission to operate collective investment schemes and investment fund programs, and to supervise and monitor them.
- J To approve the bye-rules concerning transactions in securities framed by stock exchanges and institutions engaged in the business of dealing in securities, and, for the purpose of making necessary provisions concerning the development of the capital market and protecting the interests of investors investing in securities, issue orders to have necessary alterations made in such bye-rules of stock exchange and institutions engaged in the business of dealing in securities.
- J To systematize the task of clearing accounts related to transactions in securities.
- J To supervise whether or not security dealers are behaving in the manner prescribed in this Act, or the rules and the bye-rules framed under this Act, while conducting business of dealing in securities, and suspend the license to conduct the business of dealing in securities in case any securities dealer is not found to be behaving accordingly.
- J To make or ensure necessary arrangements to regulate the volume of securities transacted and the procedure of conducting such transactions in order to ensure the promotion, development and clean operation of stock exchanges.
- J To make necessary arrangements to prevent insider trading or any other offenses relating to transactions in securities in order to protect the interest of investors in securities.

- J To review or make arrangement for reviewing the financial statements submitted by the corporate bodies issuing securities and security dealers, and issue directives deemed necessary in that connection to the concerned corporate body.
- J To systematize and make transparent the act of acquiring the ownership of a company or gaining control over its management by purchasing its shares in a single lot or in different lots.
- J To establish coordination and exchange cooperation with the appropriate agencies in order to supervise and regulate matters concerning securities or companies.
- J To discharge or make arrangements for discharging such other functions as are necessary for the development of securities and the capital market.

The Governing Board of SEBON is composed of seven members including one full time chairman appointed by the Government for tenure of four years. Other members of the Board include joint secretary of Ministry of Finance, joint secretary of Ministry of Law, Justice and Parliamentary Affairs, representative from Nepal Rastra Bank, representative from Institute of Chartered Accountants of Nepal, representative from Federation of Nepalese Chambers of Commerce and Industries, and one member appointed by the Government from amongst the experts pertaining to management of securities market, development of capital market, financial or economic sector.

There are seven departments and sixteen sections in the organization of SEBON. Under the Management Department, there are two divisions namely Human Resources Section and Finance Section. There are also four sections under the Planning and Development Department namely Research Section, Training Section, Information Technology Section and International Affairs Section. There are also two sections under the Corporate Finance Department namely, Public Issue Section and Collective Investment Scheme Section. Likewise, Under the Regulation Department, there are two sections namely,

Stock Exchange Regulation Section and Market Intermediaries Regulation Section. There are also four sections under the Surveillance Department namely, Stock Exchange Surveillance Section, Market Intermediaries Surveillance Section, Trading Surveillance Section and Corporate Surveillance Section. Finally, under Legal Department, there are two sections Research and Investigation Section and Enforcement Section.

The major financial sources of SEBON are the government grant, transaction fee from the stock exchange and registration fee of corporate securities. Other financing sources include registration and renewal of stock exchange and market intermediaries and the income from mobilization of its revolving fund (www.sebonp.com).

2.2 Review of Articles

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

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

The study conducted by the U.S. Department of Commerce (1985) 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.

Pena and Alana (2003) test if stock index price follows random walk in the Spanish Stock Market by means of variance ratios. By using daily, weekly and monthly price return auto correlation in Spanish Stock Market for the two indexes (IGBM and IBEX35) and for individual securities by means of variance ratio test. They found that positive string auto correlation for both IGBM and IBEX35 index daily returns can't reject the random walk hypothesis for the period March 31, 1997 to 2000, significant position of auto correlation especially in daily and weekly period. The positive index auto correlation monthly returns are not significant at returns show weekly positive auto correlation. Even though index monthly return positive auto correlation and low, there is no strong evidence of monthly return cross-correlation at one lag (a month) between portfolios based on size. In particular, large stock portfolios lead to the small stock ones.

No sufficient research studies have been available regarding the stock market growth in Nepalese context. However, some articles, books, dissertations etc. related to stock market are consulted and reviewed.

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

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

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

Mahat (2000) in his book "Capital Market, Financial Flows and Industrial Finance in Nepal" (1981) 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 purpose".

According to the journal of SEB named as "Meeting the Challenges Ahead (2054-2069)": clearly defined the policy development regarding to the growth of the market. As an apex regulatory body for the Nepalese Securities Market. The securities board has adopted following set of strategies policies to handle

the strategic issues that are inhibiting the growth and development of the market. These policies consist of:

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

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

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

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

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

Nepal Stock Exchange Ltd. (NEPSE) is to see a significant change in its organizational and functional structure in the near future, thanks to Government's finally starting the process of privatizing the country's only stock exchange, though after a considerable gap of good eight years from the conception of the idea.

As a initiation of the process, Corporate and Financial Governance (CGF) Project of Ministry of Finance issued a public notice in May 2001 calling interested and qualified firms to submit an Expression of Interest for providing support for institutional strengthening of the Securities Board, privatization of Nepal Stock Exchange (NEPSE), and establishment of a Central Depository System (CDS), among others.

Concerned authorities and securities brokers seem happy from the initiation of the government. "It is the need of the hour", says Dambar Prasad Dhungel, Chairman of Securities Board, the regulatory body of the country's securities market. He hopes the privatization will enhance the efficiency of NEPSE. "Dependency syndrome will minimize. Decision making process will be faster.

Generating additional capital will be possible. The institution may return into profit-making organization. Ownership of NEPSE will be restricted” (New Business Age, June 2001).

One of the new things introduced in Nepal before India did the same was the concept of Market Maker in the stock market. But the failure of such institution to live up to the expectations is partially to blame for the twists and jerks in the securities market. The basic concept of the market sorted out and conducive environment should be created, say policy makers implementing agencies, regulators and brokers.

A market maker is an institution responsible for providing liquidity to the stocks listed in the stock exchange. It takes the risk of being a buyer (or seller) of last resort.

The government had introduced the provision of market maker in Nepali securities market seven years ago but till to date no achievement have been gained from the new provision. When the system was introduced, it was supposed that the market makers would create and maintain securities market stable, and protect inventors’ interests. But the dream has completely been shattered as things stand today (New Business Age, May 2001).

Arrangement will be made to allow Non Resident Nepalis (NRNs) and Foreign Institutional Investors (FIIs) to invest in secondary market, as promised in last year’s budget.

However, the finance ministry has not yet forwarded any regulation or modality on how to allow NRNs and organized foreign investors to invest in the sole secondary market.

“The draft Act for FIIs is ready but it has reached nowhere due to political instability”, said a senior official at the finance ministry, adding that the

ministry had also done homework on modalities of how to allow NRNs to invest in the secondary market, Nepal Stock Exchange Ltd (NEPSE).

It is not only an economic but a political issue also. Political instability has pushed it back as it has to be passed by the parliament”, he added.

Experts opine that investment by FIIs and NRNs will fuel the capital market as they will bring more capital to the market that has more than Rs 3 trillion market capitalization. “It will create institutional investors as well, something that our capital market lacks”, they also pointed out.

Chairman of Securities Board Nepal (Sebon) Dr Chiranjivi Nepal said Sebon had prepared a preliminary draft and submitted it to the finance ministry. “Nepal Rastra Bank (NRB) needs to change some of its regulations”, he said adding that the basic infrastructure for NRNs and FIIs to allow invest in secondary market is paperless trading, i.e. installation of Central Depository System (CDS). “The private sector is interested in helping NEPSE install CDS. Most probably, the installation of CDS will be mentioned as a priority item in the present budget”, the Sebon chief said (The Himalayan Times, July 31, 2008).

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Nepal has recently started OTC market to make transaction of share of de-listed company in stock exchange. Share of different company which are de-listed from stock exchange or are not eligible for listing in organized stock exchange are traded in OTC. If we take some example from international stock market, Tokyo Stock Exchange, NASDAQ are not listed the share of those company who do not distribute at least 10 percent bonus. But the shares of those companies are traded at the OTC market.

To provide liquidity in investment and make easy available capital for those company Nepal has been started OTC market, Nepal Stock Exchange said (Aarthik Abhiyan, July 7-13 2008).

Nepal Dhitopatra Board is the regulatory body and Nepal Stock Exchange Ltd. the only market for share trading in Nepal. One of the primary functions of both these institutions is to develop the share market in the country. But except carrying out the regular functions, neither of these institutes has been able to play a role of catalyst in the promotion of the share market. A new lad on stock exchange is long overdue. The authorities used to say last year that the new law would be implemented after approval from the parliament. But the law is not ratified by parliament as yet. Perhaps this is enough to prove the ineffectiveness of these institutions because they can not pursue the bills.

The other major issue that the private sector has been raising for the last two years is a demand for opening up the brokers market for the newcomers. The country has adopted the liberal economic policy. But this principle does not apply in this market. A year ago the Board of Directors of Nepal Stock Exchange had formed a committee headed by one of the directors, which had submitted the report, which basically suggested opening the license in order to induct more quality brokers in the market. Why was the committee formed if the report was not to be put for the implementation at all? It is heard that again a committee formed at Nepal Stock Exchange to study this matter further (New Business Age, June 2002).

2.3 Review of Previous Thesis

There are not sufficient dissertations concerning with this particular topic but the researches more or less related with the topics are reviewed here.

Bhatta (1997) has conducted a research on the topic of “Dynamics of Stock Market in Nepal”. He concludes in his research that, the stock market and economic activities move in similar direction. They influence each other. The development of the former is reflected in the latter. The stock market raises and mobilizes the invest-able resources to finance the long-term large projects in the economy. The stock market, therefore, can be regarded as a heart of economy.

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

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

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

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

Panta (2000) in her thesis “Current Problems and Prospects of Securities Market in Nepal”, studied 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. 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 conducive to the development of stock market. Therefore, it is difficult to develop more efficient secondary market, trading system for both equity and debt security.
-) Lack of investor’s confidence in stock market since many listed companies resulted not trading on regular basis or hold AGM.
-) Restriction on foreign portfolio investment hindered market development.
-) NEPSE does not have appropriate policies, memberships and fee structure to attract member 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 point out the transparency and openness of transaction, quality professional services, 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 able to operate in an environment that remains conducive 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.

Regarding political instability, she was absent to indicate the Maoist activities which have made the status / condition of country very poor. These activities have not only affected the political environment but also have affected the tourism; hotel management etc. or we can say that all financial as well and non-financial activities within the country are very poor.

Aryal (1999) has conducted research on “The General Behavior of Stock Market “. The specific objectives of this study were:

-) To discuss theoretically the movements of stock market prices as predicated by the random walk model.
-) To develop the empirical probability distribution of successive price changes of an individual common stock and a stock market as a whole.

-) To examine whether the successive price changes of stocks market are independent to each other or not.

The main findings of the Study were:

-) On the basis of run tests and serial correlation, it seems that the independent assumption of random walk model in stock prices is rejected by the collected sample data of 21 companies at least as a description of price behavior in Nepal Stock Exchange.
-) The stock price changes are dependent on each other.
-) The random walk of security speculative price behavior has been refuted at least in the Nepalese context, which clarifies that the knowledge of the past becomes useful in predicting the future movements of stock market price.
-) The securities in the past were incorrectly priced either over or under valued, as actual market prices of securities do not reflect their intrinsic value. In other words, in case of sample securities, they are incorrectly adjusted those past information to the present market prices.
-) There exists frequent persistence than reaction in the general stock market climate because of the investors' irrational behavior that causes the irrational movement of prices of stock.
-) The general stock market of Nepal for the initial period appeared to be inefficient in incorporating the possible appearance of information into the successive price changes. Therefore, the investing public are not aware of the information available publicly, appropriate in adjusting with the actual market price.

His research revealed NEPSE to be an inefficient market. He performed a test of weak form efficiency by examining whether the stock price behavior follows a random walk or not. He concluded that the knowledge of the past is useful in predicting the future movements of stock market prices. Therefore, investors on the floor of the exchanges for securities can make higher than expected profits

in the future based solely on the historical prices series under the existing trading mechanisms than they would be under buy and hold strategy.

Joshi (2001) has conducted research on “Role of Nepal Stock Exchange in the secondary Market”. The main objectives of this study were:

-) To assess the past and present behavior of business operation in the Nepal Stock Exchange Market.
-) To forecast the future trends of business and economic activity in the NEPSE in terms of quality, value and volume.
-) To prescribe ways and means by which secondary market would be more effective and meaningful.

The main recommendations in her study were:

-) NEPSE should introduce digital technology and online marketing in its trading procedure.
-) The rules and regulations should be up to date.
-) Privatization process needs to be carried out effectively in order to develop Nepalese stock market.
-) Tax system should be reformed which should encourage and stimulate capital formation.

Neupane (2004) had carried-out research study on the topic “An Empirical Study on Broking Services in NEPSE” with following objectives:

-) To analyze the performance and effectiveness of Broking Services.
-) To analyze the general investors’ opinion on Brokering Services.

Mr. Neupane’s study was based on both primary as well secondary data. To collect primary data, he had distributed 135 questionnaires - 115 to investors and 20 to brokers. He had got the response from 61 people – 47 investors and 14 brokers. His study was mainly based on the data and information obtained

from this questionnaires survey. He had used different analytical tools for the processing of obtained data.

In his study Mr. Neupane said – Nepalese stock market is in infant stage. Both the investors and brokers are not satisfied with the brokering services of NEPSE. Investors are not getting adequate information and services from the brokers regarding the securities and the stock market. Due to the different types of market disorders like – mutual trading, wash sales, cornering the market, inside trading, churning, pool had increased the level of market disorder.

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

Gurung (2008) has conducted research on “Brokers’ Performance and Services in Secondary Market” to study service offered to the general investors by the brokers in the secondary market. The major findings of his studies are summarized in the following words.

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

brokering activities actively. The system followed by the NEPSE is not time and technology friendly.

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

CHAPTER- III

RESEARCH METHODOLOGY

This chapter describes the methodology employed in this study. Research methodology is the systematic method of finding solution to a problem i.e. systematic collection, recording, analysis, interpretation and reporting of information about various facts of a phenomenon under study. The chapter describes research design, population, sampling procedure, sources of data and analysis of data.

3.1 Research Design

A research design is a plan, structure, and strategy to obtain the objectives of the study. The research is based on the secondary data and information. Primary data also included to know recent growth of stock market. Hence, the historical and descriptive and analytical research design has been used.

3.2 Population and Sample

The population for this study comprised of all listed companies whose shares were traded in the Nepal Stock Exchange (NEPSE) and Securities Board of Nepal (SEBON). The required data have been collected from the various sources covering a period of 1993/94 to 2007/08. All the companies listed in the stock exchange are taken as samples. And to know the view of public about recent growth of stock market 40 respondents are taken as sample from different areas.

3.3 Nature and sources of data

This study is primarily based on secondary sources of data. Primary data are also collected to know the views of investors about the stock market growth through the use of questionnaire. Nepal Stock Exchange Ltd. and Securities Board Nepal are the main institution which provides most of the secondary data required for the study. The web site of NEPSE <http://www.nepalstock.com>, and the web site of SEBO <http://www.sebonp.com> and its annual reports are the major sources of secondary data. Besides, these necessary data are also collected from the annual reports of the selected companies.

3.4 Analysis of data

Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic. This study mostly based the analysis of secondary data with the help of different statistical tools like Trend analysis, Percentage, Tabulation and Diagrammatic presentation etc. The empirical results have been extracted in this study by using annual data of listed companies from 1993/94 to 2007/08.

Statistical tools

To draw the conclusion by analyzing the collected data simple statistical tool like arithmetic mean, multiple bar diagram, trend analysis, percentage etc. are used and tabulation are made to implicit the comparative results.

Arithmetic mean average

The central values that represent the characteristics of the whole distribution or the values around which all items of the distribution tend to concentrate are called average. Arithmetic mean or arithmetic average is one of the important

statistical measures of average. The arithmetic mean of a given set of observation is their sum divided by the number of observations that is denoted by

Multiple Bar- diagrams and graphs

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

Percentage

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

CHAPTER – IV

PRESENTATION AND ANALYSIS OF DATA

This chapter puts forward the analysis of secondary and primary data along with their results and interpretations. The chapter starts with the analysis of secondary data concerned with the Nepalese Stock Market and its development, followed by the analysis of primary data collected through questionnaire survey.

4.1 Presentation and Analysis of Secondary Data

This part of the chapter has been reveal the development of Nepalese stock market in terms of issued approved, market capitalization, NEPSE index, no. of transaction, market day per year, no. of listed companies, no. of share traded, no. trading companies, and no. of listed securities etc. with different years.

4.1.1 Sector Wise Listed Companies

The position of sector wise listed companies at the end of fiscal year 2007/08 is presented bellows.

Table -2
Sector Wise Listed Companies in Fiscal Year 2007/08

Type of Listed Companies	Number of Listed Companies	% of Listed Companies
Commercial Bank	17	11.97
Development Bank	23	16.20
Finance Company	55	38.73
Insurance	17	11.97
Manufacturing & Processing	18	12.68
Hotel	4	2.82
Trading	4	2.82
Hydro Power	3	2.11
Other	1	0.70
Total	142	100

Source: NEPSE Annual Report 2007/08

At the end of fiscal year 2007/08, 17 commercial banks, 23 development banks and 55 finance companies are listed in stock exchange (NEPSE). It covers more than 66 percent of the total listed companies. Beside this, 17 insurance companies, 18 manufacturing & processing, 4 hotel, 4 trading companies, 3 hydro power companies and 1 other sector company (Nepal Telecom) are listed in stock exchange.

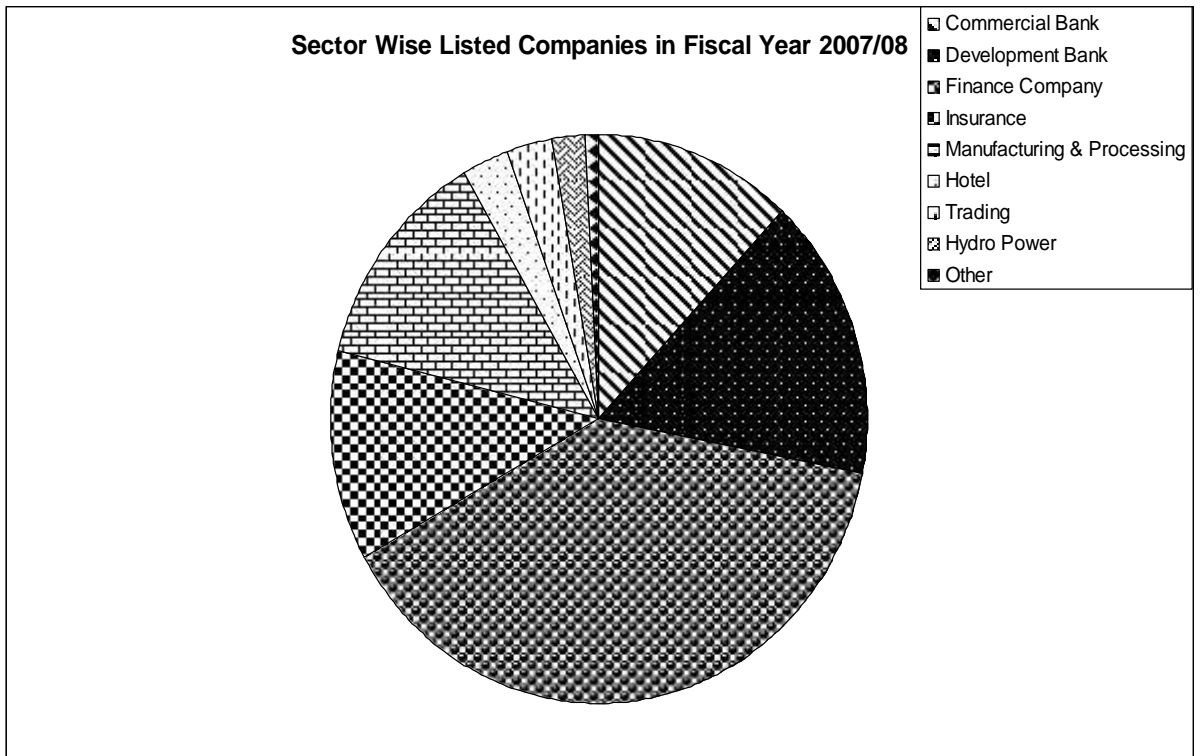


Figure-1

Nepalese stock market is dominated by banking and financial sectors, which include commercial bank, development bank and finance company. More than 66 percent companies are belongs to banking and financial sectors. Likewise insurance company, manufacturing & processing, hotel, trading, hydropower and other sectors cover 11.97 percent, 12.68 percent, 2.82 percent, 2.82 percent, 2.11 percent and 0.70 percent respectively.

4.1.2 Market Capitalization in NEPSE

The situation of market capitalization in NEPSE is presented in Table-3.

Table - 3
Market Capitalization in NEPSE

Fiscal Year	Market Capitalization (Rs. in million)	% Increased in Market Capitalization	% of Turnover to Market Capitalization
1993/94	13872	-	3.18
1994/95	12963	-6.55	8.13
1995/96	12295	-5.15	-1.75
1996/97	12698	3.28	3.28
1997/98	14289	12.53	1.42
1998/99	23508	64.52	6.38
1999/00	43123.3	83.44	2.68
2000/01	46349.4	7.48	5.06
2001/02	34703.87	-25.12	4.44
2002/03	35240.40	1.55	1.63
2003/04	41424.77	17.55	5.18
2004/05	61365.89	48.14	7.35
2005/06	96763.74	57.68	3.57
2006/07	186301.28	92.53	4.49
2007/08	366247.56	96.59	6.23

Source: Various Annual Reports, NEPSE

The market capitalization of listed securities in the fiscal year 2007/08 is Rs. 366247.56 million and it has increased by 96.59 percent as compared to the fiscal year 2006/07 which was Rs. 186301.28 million. The market capitalization was highest decreased in fiscal year 2001/02 by -25.12 percent. It

was due the decreased in NEPSE index by highest rate (-34.70%) in that year during the 15 year's of NEPSE. The highest increase in market capitalization rate was 96.59 in the fiscal year 2007/08 and it was due to the increase in NEPSE index.

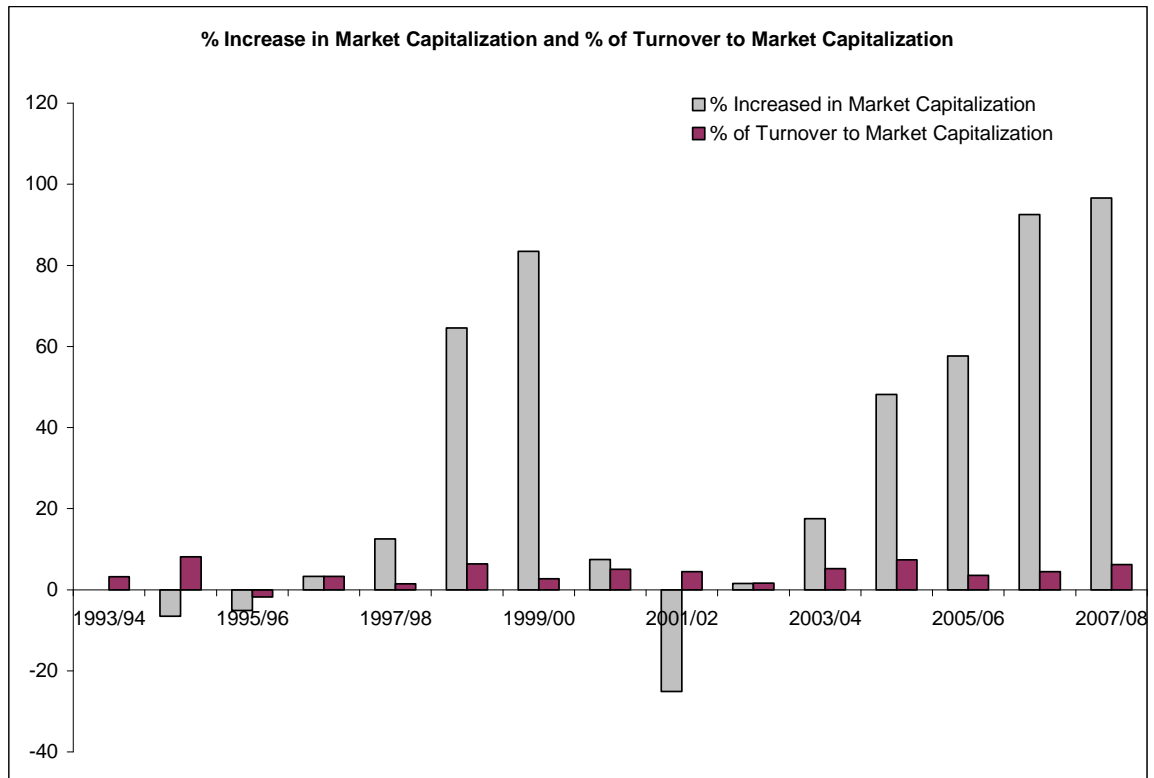


Figure – 2

The highest percentage of turnover to market capitalization was 8.13 % in fiscal year 1994/95 whereas the percentage of turnover to market capitalization is negative in year 1995/96 by -1.75. The percentage of turnover to market capitalization is 6.23 percent in year 2007/08 and it was 4.49 percent in the previous year 2006/07.

4.1.3 Growth Trend of Stock Market Indicator

The position of number of listed companies, number of traded company and number of share traded are some important indicators of the stock market growth. The situations of such variables are presented in Table –4.

Table – 4
Growth Trend of Stock Market Indicator

Fiscal Year	No. of Listed Companies	% of Growth	No. of Traded Company	% of Growth	No. of Share Traded '000'	% of Growth
1993/94	66	-	38	-	993	-
1994/95	79	19.70	53	39.47	3901	292.85
1995/96	89	12.66	59	11.32	2954	-24.28
1996/97	95	6.74	67	13.56	9443	219.67
1997/98	101	6.32	68	1.49	1195	-87.35
1998/99	107	5.94	69	1.47	4857	306.44
1999/00	110	2.80	69	0	7674	58
2000/01	115	4.55	67	-2.90	4989	-34.99
2001/02	96	-16.52	69	3.00	6005	20.36
2002/03	108	12.5	80	15.94	2428	-59.57
2003/04	114	5.56	92	15	6468.18	166.39
2004/05	125	9.65	102	10.87	18433.55	184.99
2005/06	135	8.00	110	7.84	12221.93	33.70
2006/07	135	0.00	116	5.47	18147.25	48.48
2007/08	142	5.18	130	10.77	28599.77	57.60

Source: Various Annual Reports, NEPSE

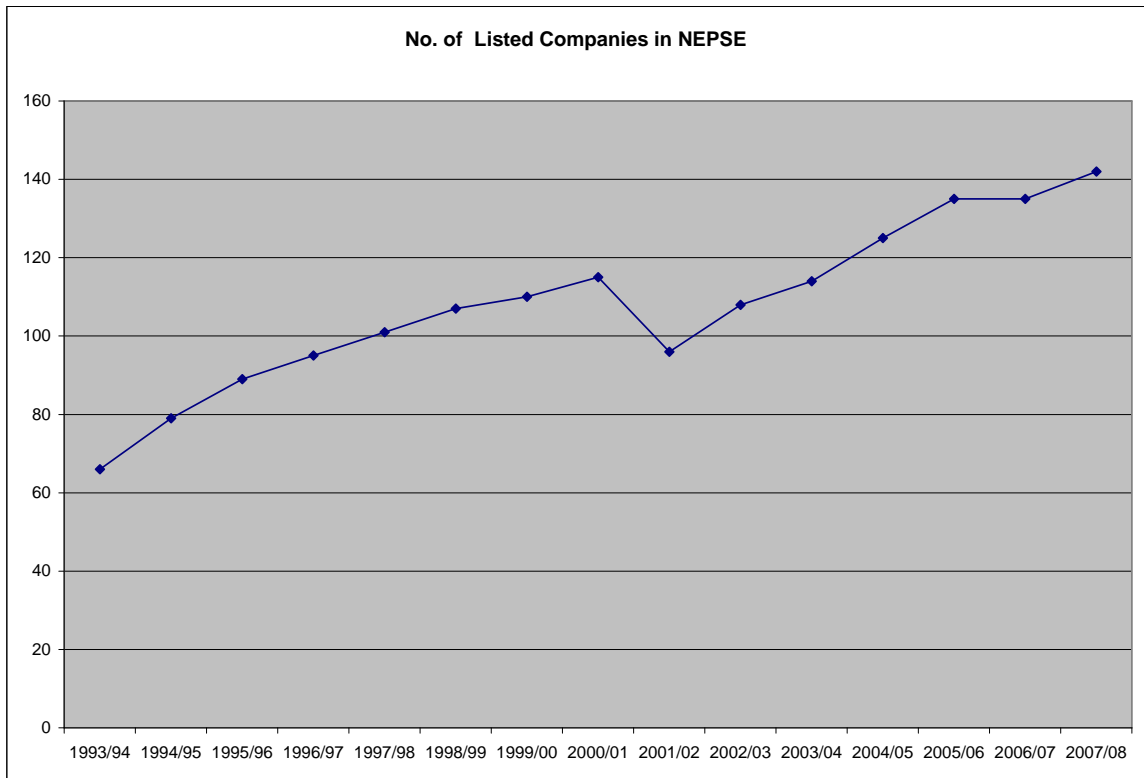


Figure - 3

The number of listed companies was 66 in the base year 1993/94. It was 135 in 2006/07, 142 in 2007/08. The growth rate of listed companies is positive in all these years except in the year 2001/02 with the negative growth rate of 16.52. In that year NEPSE deleted some companies from its list because of non-disclosure of necessary information correctly and timely. The growth rate was highest in 1994/95 with 19.70 percent and lowest in 2001/02 with -16.52 percent.

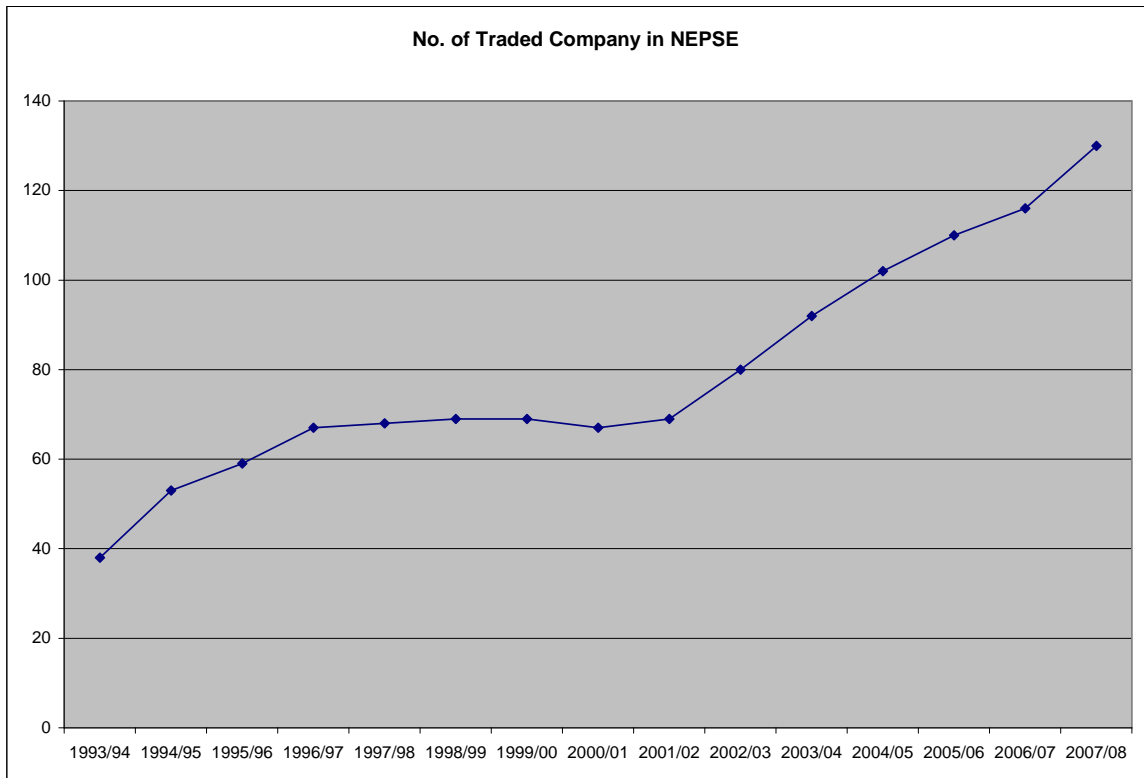


Figure – 4

The number of traded companies was 38 in the base year 1993/94 and, 110 and 116 in the year 2005/06 and 2006/07 respectively. Similarly in year 2007/08 it was 132. Though, only 38 companies were traded in the trading floor in base year, it rose up to 132 in the year 2007/08. The number of traded companies decreased in year 2000/01 with the negative growth rate of -2.90 percent. However, the numbers of trading companies are in increasing position in all other years.

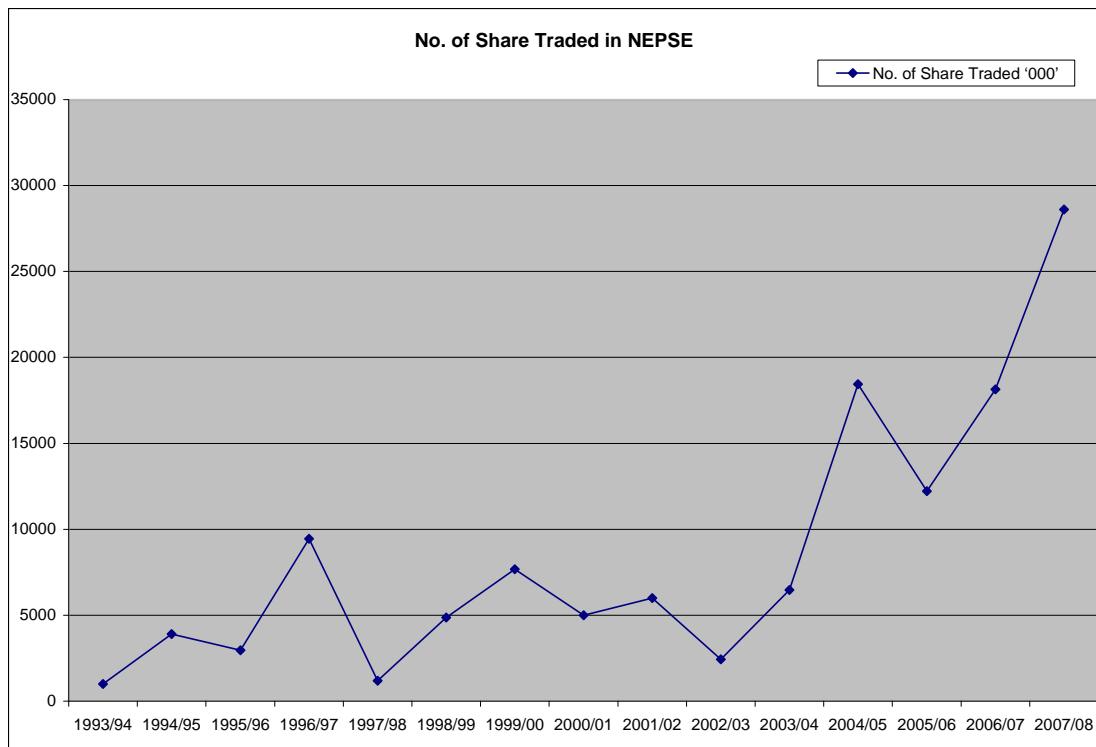


Figure – 5

The analysis of the number of shares traded in different years indicates that it was very much fluctuating in past. The impact on growth rate is also affected. The number of shares traded in the year 1993/94 was only 993000 whereas it was 3901000 in the year 1994/95 with the growth rate of 292.85 percent. Again, in the year 1995/96 it was declined and came to 2954000 with the negative growth rate of 24.28 percent. This negative trend of growth rate was continued in the year 1997/98, 2000/01 and 2002/03 with -87.35, -34.99 and -59.57 respectively. But in the year 1998/99, it touches the new record with 306.44 percent positive growth rate. Like wise in the year 2007/08, 28599770 which is the highest number of share traded in history of NEPSE.

4.1.4 Number of Transactions and Listed Securities in NEPSE

The number of transactions and number of listed securities in various years are presented in Table – 5.

Table - 5**Number of Transactions and Listed Securities in NEPSE**

Fiscal Year	No. of Transaction	% of Growth	No. of Listed Securities	% of Growth
1993/94	9357	-	43424	-
1994/95	21472	129.48	58247	34.14
1995/96	17943	-16.44	65880	13.10
1996/97	12428	-30.74	85193	29.32
1997/98	15483	24.58	90107	5.77
1998/99	15814	2.14	105632	17.23
1999/00	29136	84.24	114057	7.98
2000/01	46095	58.21	124971	9.57
2001/02	48028	4.19	134150	7.34
2002/03	69163	44	159958	19.24
2003/04	85533	23.67	161141	0.74
2004/05	106246	24.22	194673	20.81
2005/06	97374	-8.35	226540	16.39
2006/07	120510	23.76	243504	7.49
2007/08	150800	25.13	321131	31.88

Source: Various Annual Reports, NEPSE

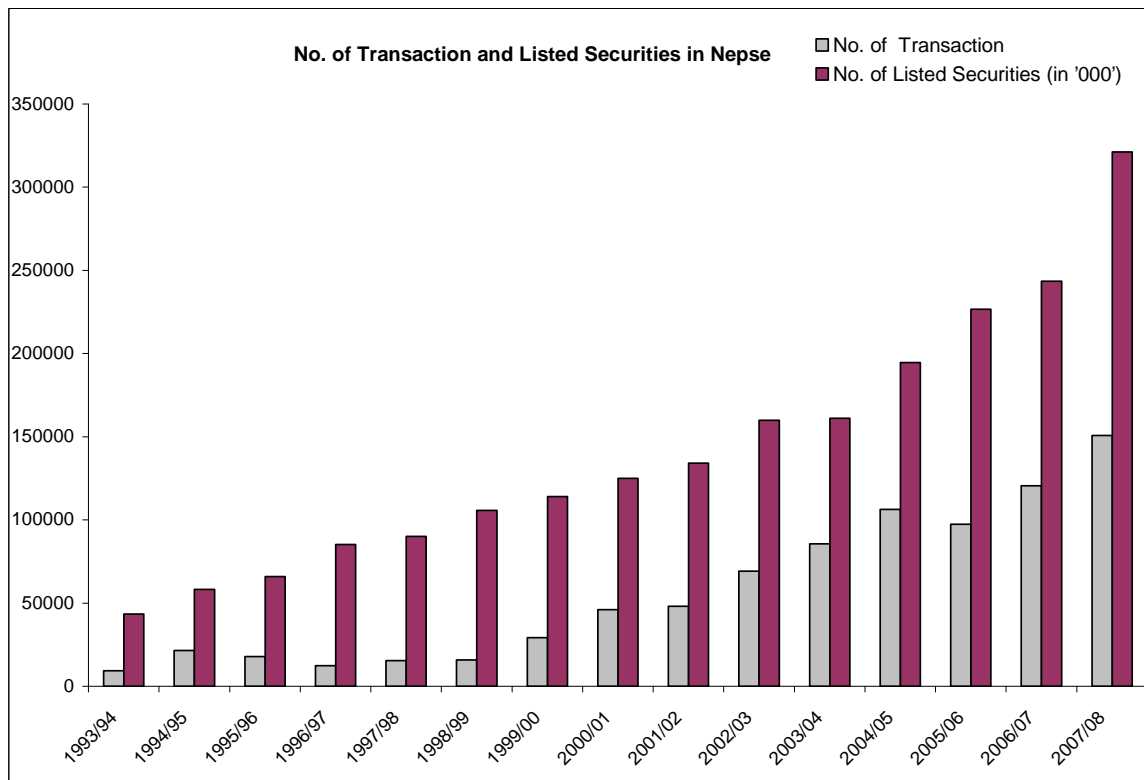


Figure – 6

The above table shows that number of transactions is very much varied comparing with different years. In the year, 1993/94 the number of transaction was 9357 while in 1994/95 it rose up by 129.48 percent with transaction of 21472. There was a negative growth rate in transaction in the year 1995/96 by 16.44 percent and it was continued by -30.74 percent in the year 1996/97 also by 8.35 in year 2005/06. The significant growth rate can be traded in the year 1999/00 by 84.24 percent as compared to the growth rate of 2.14 of 1998/99. The growth rate in number of transactions in 2002/03 was by 44 percent as compared to the growth rate of 4.13 percent of 2001/02. The growth rate in 2006/07 was increased by 23.67 percent and it was increased by 25.13 percent in 2007/08 with 150800 numbers of transactions.

The present system is that the securities issued to the public should be listed in stock exchange within 45 days after the allotment date. The growth rates of number of listed securities are all positive. The numbers of listed securities are highest in year 2007/08 with 321131 numbers and lowest in year 1993/94 with

43424 numbers of securities. The highest growth rate is in year 1994/95 by 34.14 percent and the lowest growth rate is 0.74 percent in year 1997/98.

4.1.5 Market Day per Year and Daily Turnover in NEPSE

Average daily turnover is one of the most important indicators of stock market development. Daily turnover provides liquidity to the stock market and survive without having transaction in stock market whereas market day affects the average daily turnover in stock market. The market day per year and average daily turnover for the period of 1993/94 to 2007/08 are presented in Table- 6.

Table - 6

Market Day per Year and Average Daily Turnover in NEPSE

Fiscal Year	Market Day Per Year	% of Growth	Average Daily Turnover (Rs. in million)*	% of Growth
1993/94	121	-	3.65	-
1994/95	242	100	4.36	19.45
1995/96	240	-0.83	0.90	-79.36
1996/97	239	-0.42	1.74	93.33
1997/98	237	-0.84	0.85	-51.15
1998/99	231	-2.53	6.49	663.53
1999/2000	240	3.9	4.82	-25.73
2000/01	231	-3.75	10.14	110.37
2001/02	246	6.50	6.26	-38.26
2002/03	238	-3.25	2.42	-61.34
2003/04	243	2.10	8.82	264.46
2004/05	236	-0.03	19.10	116.55
2005/06	228	-3.39	15.14	-20.73
2006/07	232	1.75	36.03	137.98
2007/08	235	1.29	97.11	169.53

Source: Various Annual Reports, NEPSE

* Average Turnover = Annual Turnover / Market Day Per Year

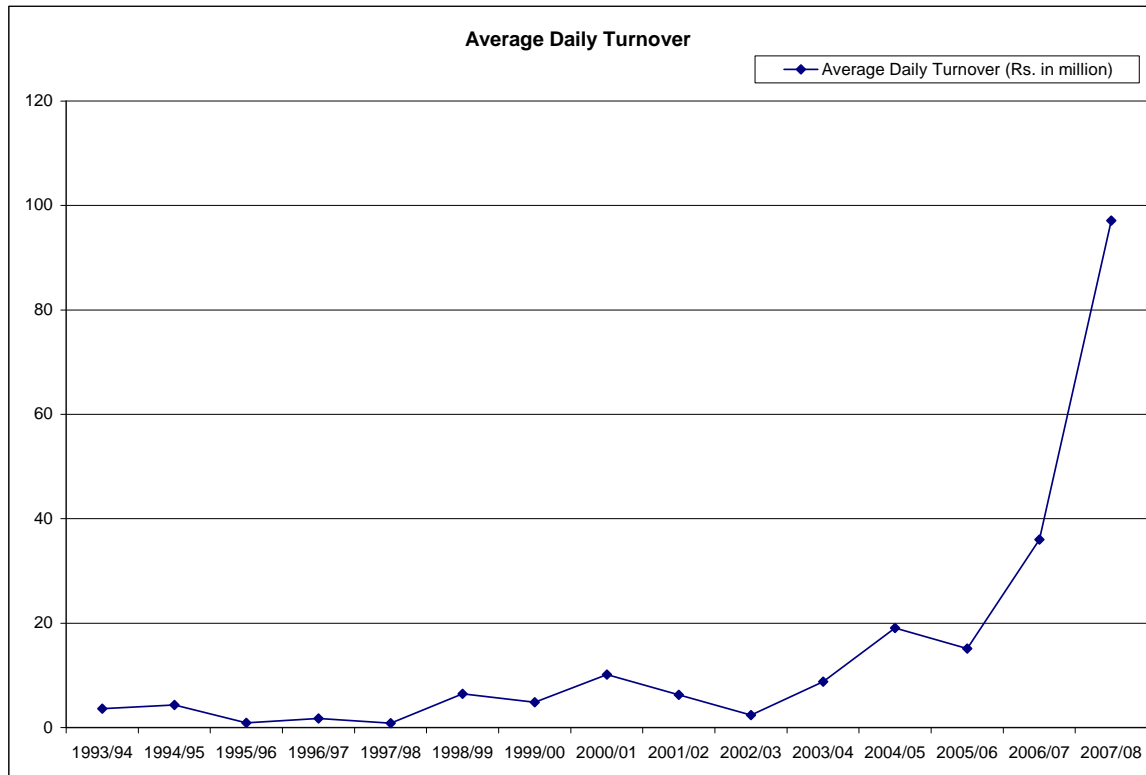


Figure - 7

The above figure shows the inconsistency of average daily turnover in NEPSE during different years. The average daily turnover was Rs. 3.65 million in the year 1993/94 and it has increased up to Rs. 19.10 million in 2004/05, decreased to Rs. 15.14 million in 2005/06 and again increased up to Rs 36.03 million in year 2006/07 and Rs. 97.11 million in years 2007/08. The growth rate is negative during the years 1995/96, 1997/98, 1999/2000, 2001/02 and 2002/03 by 79.36, 51.15, 25.73, 38.26 and 61.34 respectively. The highest growth rate is 264.46 percent in the year 2003/04 with the average daily turnover of Rs. 8.82 million as compared to Rs. 2.42 million of 2002/03 and 169.53 percent growth rate in 2007/08 with highest average daily turnover of Rs. 97.11 million.

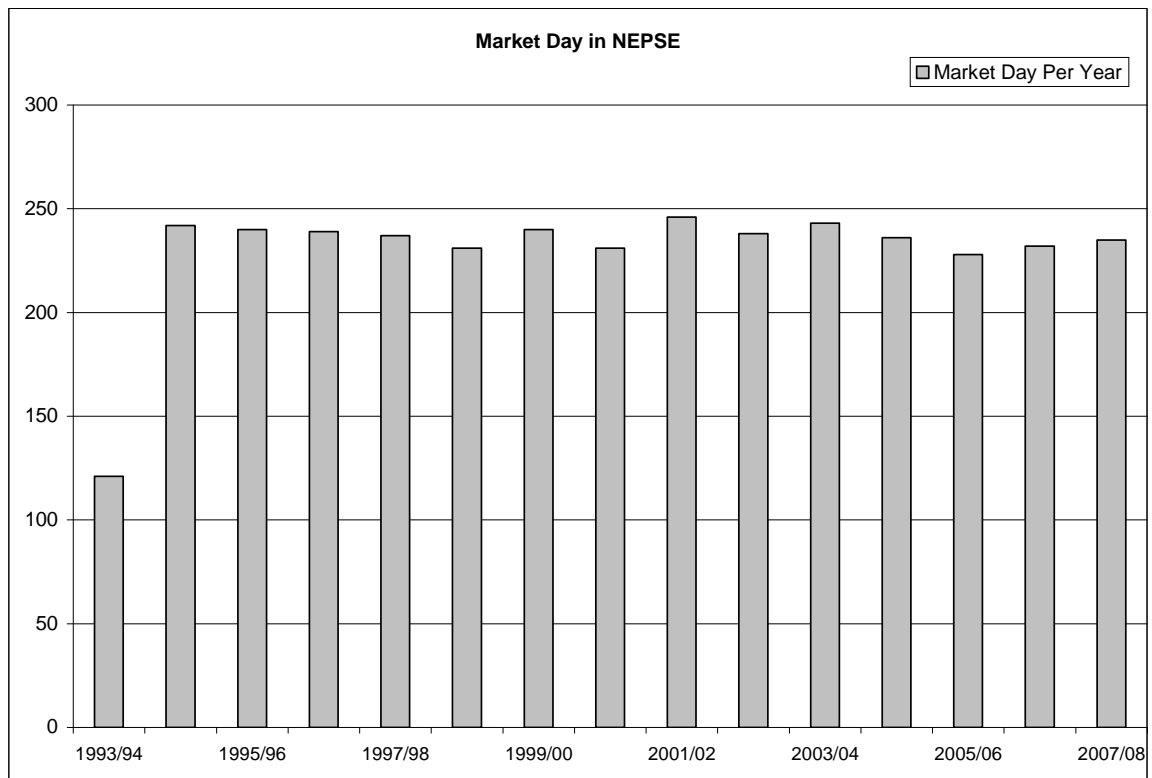


Figure - 8

The above table also shows that the market day is quite consistent except in the year 1993/94 which is of 121 days per year. The highest number of market days is 246 days in the year 2001/02. In this year the growth rate is 6.50 positive following the negative growth rate of 3.75 in 2000/01 with market days of 231 days. The highest growth rate is 100 percent positive in the year 1994/95 with 242 market days per year and in the year 2007/08 with 235 market days. Higher the market day per year, higher will be the chance of stock market growth.

4.1.6 Number of Issue Approved & Total Amount of Issue Approved

The number of issue approved, amount of issued approved and percentage increase in issue approved by SEBON/N for going to public are presented in Table-7.

Table – 7**Number Issue Approved and Total Amount of Issue Approved**

Fiscal Year	Number of Issue Approved	Amount of Issued Approved (Rs. in Million)	% Increased in Amount of Issue Approved
1993/94	17	344.40	-
1994/95	12	254.21	-26.19
1995/96	12	293.74	15.56
1996/97	5	332.20	13.09
1997/98	12	462.36	39.18
1998/99	5	258.00	-44.20
1999/00	10	630.31	144.31
2000/01	10	717.20	13.79
2001/02	17	1555.11	116.83
2002/03	18	854.42	-45.06
2003/04	17	1547.79	81.15
2004/05	12	1270.31	-17.93
2005/06	34	2547.87	100.57
2006/07	31	2757.504	8.23
2007/08	72	11567.86	319.50

Source: Various Annual Reports, SEBO

Table-7 shows that SEBO/N approved the issue of various types of securities in various volumes at various time. The number of issue approved was 17 in initial fiscal year 1993/94. The highest number of issue approved is 72 in fiscal year 2007/08. The second highest issue approved was 34 issues in fiscal year 2005/06. Similarly, the least three issue approved during the period were 5 issues in fiscal year 1996/97 and 1998/99, 10 issues in fiscal year 1999/00 and 2000/01 and 12 issues in fiscal year 1994/95 , 1995/96, 1997/98 and 2004/05

separately. Out of the least three issues approved 5 issues in fiscal year 1996/97 is the least issue approved.

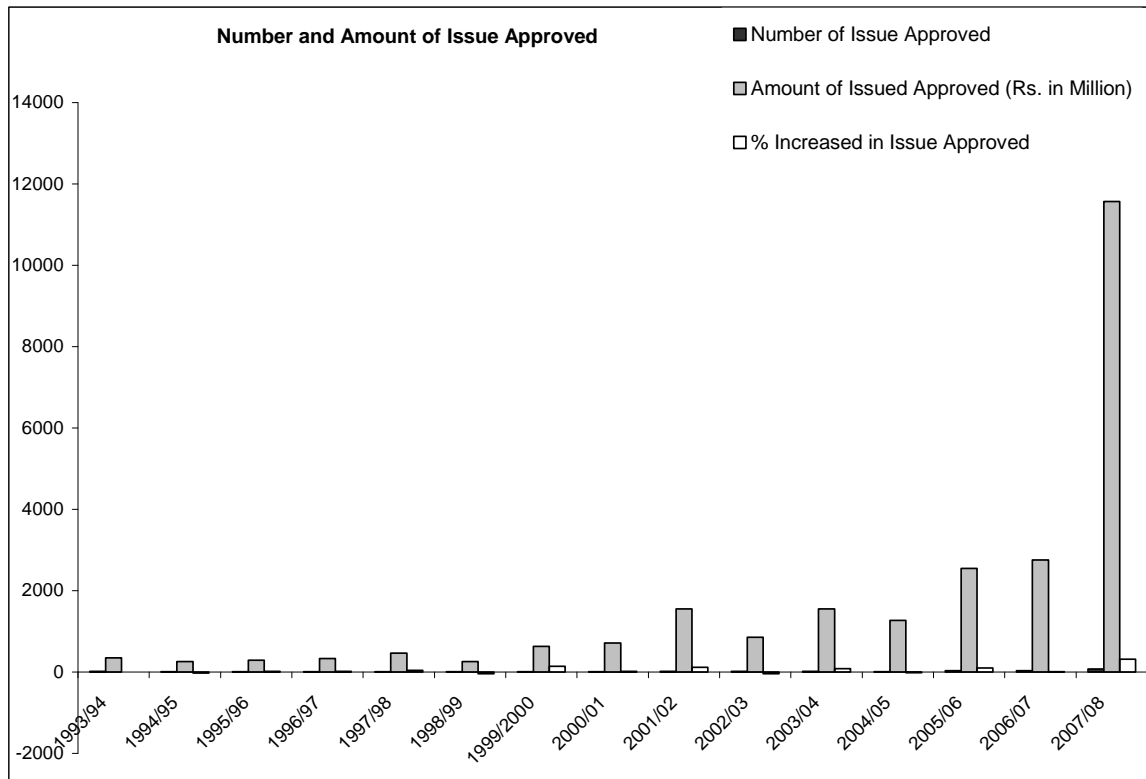


Figure - 9

Similarly, form the table-1 it can be conclude that the amounts of issues approved by SEBO/N vary during the period. The highest amount of issue approved is 11567.86 million in the fiscal year 2007/08 and it was followed by Rs. 2757.505 million in fiscal year 2006/07, Rs. 2547.87 million in years 2005/06. Similarly, the least issue approved for the period was Rs. 254.21 million in fiscal year 1994/95 and it was followed by Rs. 258.00 million in fiscal year 1998/99 and Rs 293.74 in fiscal year 1995/96. The percentage increased in issue approved of fiscal year 2003/04 is 81.15 percent which is very significant than that of the negative rate of -45.06 percent of pervious year 2002/03. The highest growth rate in issue approved can be traced in the fiscal year 2007/08 which is 319.50 percent positive. There was a negative increased

in issue approved in the fiscal years 1994/95, 1998/99 and 2002/03 by -26.19, -44.20 and -45.06 respectively.

4.1.7 NEPSE Index

Market indexes are used to determine the relationship between historical price movements and economic variables and to determine the systematic risk for individual securities and portfolios.

The index is taken as a measuring tool whether the performance of stock market is good or not. This clearly focuses on the price of stocks that is increasing or decreasing in the market. Because the prices of stocks go up and down in a particular period compared to the previous period as disclosed by index. The highest index suggests the increase in market price of the stocks and implies the better performance of companies and vice-versa. Thus the NEPSE index shows the behavior of stock prices in the capital market.

The computation formula for price index is as follows:

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

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

Where,

P_{01} = NEPSE Price Index

P_1 = Today's Stock Price

P_0 = Base year price

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

Q_0 = Base Listed Shares.

Base: 16/07/2006, (Adjusted on 1/04/2007) = 100

Table – 8
NEPSE Index

Year	NEPSE Index *	% Change in Index
1993/94	226.03	-
1994/95	195.48	-13.52
1995/96	185.61	-5.05
1996/97	176.31	-5.01
1997/98	163.35	-7.35
1998/99	216.92	32.79
1999/00	360.70	66.28
2000/01	348.43	-3.40
2001/02	227.54	-34.70
2002/03	204.86	-9.97
2003/04	222.04	8.39
2004/05	286.67	29.11
2005/06	386.83	34.94
2006/07	683.95	76.81
2007/08	963.36	40.85

Source: Various Annual Reports, NEPSE

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

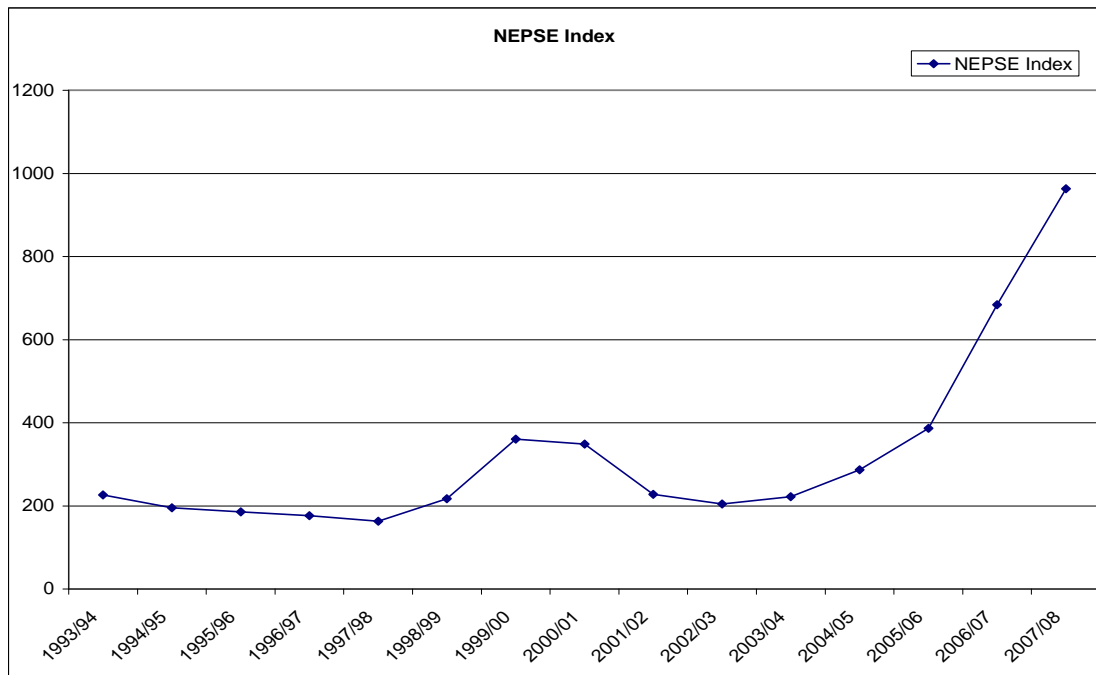


Figure -10

The NEPSE index is highest in the fiscal year 2007/08 with 963.36 and it was lowest in the year 1994/95 by 195.48 points. The NEPSE index in the year 2006/07 is 683.95 which is 76.81 percent higher than the NEPSE index of previous year 2005/06.

4.2 Presentation and Analysis of Primary Data

The researcher conducted the survey taking 40 respondents from different areas as sample to analyze the view about the growth, problems and prospects of stock market in Nepal.

4.2.1 Growth trend of Nepalese stock market

Table No. 9
Growth trend of Nepalese stock market

S. N.	Variables	No. of respondent	% of respondent
A	Good	36	90
B	Bad	2	5
C	Do not know	2	5
Total		40	100

Source: Field Survey

Regarding this question, 90 percent of the respondents agree that the growth trend of Nepalese stock market is good. About 5 percent of the respondents feel that the growth trend of stock market is bad. And rest of the 5 percent respondent do not know about it.

4.2.2 Problem faced by stock market

Table No. 10
Problem faced by stock market

S. N.	Problems	No of respondent	% of respondent
A	Shortcomings of rules and regulations	10	25
B	Lack of sufficient knowledge among investors	10	25
C	Lack of sufficient knowledge among stock market intermediaries	6	15
D	Lack of proper coordination between authoritative body	4	10
E	Restriction to foreign investors	-	-
F	All of the above	10	25
Total		40	100

Source: Field survey

Regarding this question, majority of the respondents agree about the lack of sufficient knowledge among investors, shortcoming of rules and regulations and lack of knowledge among stock market intermediaries. The proper coordination between authoritative bodies is also major drawback of Nepalese stock market. About 25 percent of the respondents express their opinion regarding all the mentioned problems.

4.2.3 Problems of primary market

Table No. 11
Problems of primary market

S. N.	Problems	No. of respondent	% of respondent
1	Lack of awareness among the investors	16	40
2	Weak regulatory body	8	20
3	Ineffective method of allotment	12	30
4	All of above	4	10
	Total	40	100

Source: Field Survey

Regarding this question, 40% of the respondents agree that there is lack of awareness among investors about the primary market. Besides analyzing the financial condition of particular company, investors are influenced by rumor. In the view of 20% respondent, Ineffective method of allotment of primary share is another major problem of Nepalese primary market. Likewise 20% respondent pointed out the major problem that primary market suffering from is due weak regulatory body.

4.2.4 Performance of NEPSE

Table No. 12
Performance of NEPSE

S. N.	Variables	No. of respondent	% of respondent
A	Good	14	35
B	Bad	26	65
C	Do not know	-	-
	Total	40	100

Source: Field Survey

Regarding this question, 35 % are satisfied about the performance of NEPSE. About 65 percent of the respondents are not satisfied with the performance of NEPSE.

4.2.5 Motivating factors for investment in Nepalese stock market

Table No. 13
Motivating factors for investment in Nepalese stock market

S. N.	Variables	No. of respondent	% of respondent
1	Marketability & Profitability	28	70
2	Limited opportunity to invest in other sector	10	25
3	Friends and Family	2	5
4	Share brokers consultation	-	-
5	If other, please specify	-	-
	Total	40	100

Source: Field Survey

Regarding motivating factors for investment, 70 percent of the respondents invest in stock for its marketability & profitability. It is clear that Nepalese investors are more profit concerned. Likewise 25 % of respondents

viewed that, due to limited opportunity to invest in other sector they invest in stock market. Rest of the respondent is motivated by their family and friends.

4.2.6 More Investment in Financial Sectors than in Real Sectors

Table No. 14

More Investment in Financial Sectors than in Real Sectors

S. N.	Variables	No. of respondent	% of respondent
1	More Profitable	14	35
2	Timely Financial Report	6	15
3	Marketability and Liquidity	6	15
4	Strong Regulatory Body (NRB)	6	15
5	All of Above	8	20
Total		40	100

Source: Field Survey

Nepalese investors give more emphasis to investment in financial sectors-commercial bank, development bank and finance company- than in real sectors-trading, manufacturing and tourism sectors. Regarding the reason for attraction of financial sectors for Nepalese investors, 35% of the respondent viewed that, investment in financial sector is more profitable than others. Likewise 15% prefer this sectors because publication of timely financial report, 15% prefer it because of its marketability and liquidity, another 15% of the respondent chose it because of strong regulatory body. And rest of the 20% respondent argues all of the above pointed reasons.

4.2.7 Interrelationship between stock market and economy

Table No. 15

Interrelationship between stock market and economy

S. N.	Variables	No. of respondent	% of respondent
1	High	8	20
2	Moderate	26	65
3	Low	6	15
Total		40	100

Source: Field Survey

Regarding this question, 20 percent agree towards high relationship between stock market and economy, 65 percent rank it moderate and other 15 percent rank it low correlated. Undoubtedly, it can be said that stock market and economy is positively correlated to some extent.

4.2.8 Performance of stock market for the development of the economy

Table No. 16

Performance of stock market for the development of the economy

S.N.	Variables	No. of respondent	% of respondent
1	Yes	8	20
2	No	22	55
3	Do not know	10	25
Total		40	100

Source: Field survey

Regarding this question, 55 percent are not satisfied with the performance of stock market, 20 percent are satisfied with the development of stock market and rest of the respondent do not know about it.

4.2.9 Prospects to Nepalese stock market growth

Table No. 17

Prospects to Nepalese stock market growth

S. N.	Variables	No. of respondent	% of respondent
A	Stock market provides max returns	10	25
B	Limited opportunities for investment	6	15
C	Liquidity & Marketability of securities	6	15
D	Increasing concerns of generals and academicians in stock market	6	15
E	All of the above	12	30
Total		40	100

Source: Field Survey

Regarding to the question, 25 % put their view that stock market provide maximum return, 15 % agree limited opportunities for investment in other sectors is the main prospects of Nepalese stock market. Likewise, liquidity & marketability, increasing concerns of generals and academicians in stock market are also good prospects for stock market growth and development.

4.2.10 Respondent opinion regarding Nepalese stock market

One question was asked to respondents to share the view regarding the problems of stock market in Nepal. 20 respondents have given many suggestions answering their views out of the 40 respondents. They are presented below:

1. The primary market of the Nepalese Stock Market is not properly regulated by the regulatory body. Method of allotment is ineffective.
2. The operation of NEPSE is not transparent.
3. NEPSE index is not representing the actual index of NEPSE after listing huge number share of Nepal Telecom.

4. Big investors and some stock brokers influence stock market for their own sake.
5. There is not efficient information system and much delay in providing company's financial status.
6. The number transaction is in increasing trends but the number of stock brokers is not increasing.
7. Brokers do not provide proper advice and suggestions to the clients.
8. Brokers are commission oriented and have very little knowledge about stock market mechanism.
9. The process of transferring of ownership of shares is lousy and time consuming.
10. Stock market should be decentralized.

Suggestions from respondents to solve these problems.

1. The securities board should monitor and regulate primary and secondary by following strict controlling mechanism and appropriate penalty system. It should be upgraded according the trend of the market mechanisms.
2. The stock exchange should carry out periodic research and analysis and findings should be made public.
3. The number of market intermediaries should be increase immediately.
4. Laws governing the stock market should be more liberal but strict to maintain stock market discipline.
5. Investors should be provided with investment guidelines.
6. The role of market player of the stock market should be made more effective.

4.3 Major Findings of the Study :

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

1. The market capitalization value of listed securities at the end of the Fiscal Year 2007/08 is Rs. 366247.56 million. It was Rs. 186301.28 million in the previous year. The highest increase in market capitalization rate is 96.59 percent in the fiscal year 2007/08. It was decrease by 25.12 percent in year 2001/02, which is the highest negative growth rate in market capitalization.
2. SEBON approved the issue of various types of securities in various volumes. The number of the issue approved in its beginning year was 17. In the fiscal year 2007/08 the number is 72. It includes ordinary share, right share, preference share and debenture.
3. The number of traded companies was 38 in the base year 1993/94 and it has 130 in the year 2007/08. The average growth rate of the traded companies over the 15 year period is 8.88 percent.
4. The total share traded in the fiscal year 2007/08 has 28599770 and this is a 57.60 percent decrease over the previous year 2006/07. The average growth rate of the transaction over the fifteen year period is 78.82 percent.
5. The figure shows an inconsistency in the average daily turnover in NEPSE during the study period. The average turnover in the year 2007/08 is has reached 97.11 million from the turnover Rs. 3.65 million in the year 1993/94.
6. The market day is quite consistent as compared to average daily turnover. In the initial year 1993/94 the total transaction day was 121. The highest number of market days is 246 days in the year 2001/02. The growth rate remained negative in the year 2005/06 over 2004/05 due to the political disturbances.
7. The NEPSE index was highest in the year 2007/08 with 963.36 and it is lowest in the year 1994/95. NEPSE index at the end of the fiscal year 2007/08 has reached 963.36 and it is a 40.85 percent growth over the previous year index.

8. It is found that the stock market in Nepal is in developing stage, however, majorities of the respondents are not satisfied with the growth trend of the market.
9. The majority of the Nepalese investors do not have sufficient knowledge about investment.
10. Majority of respondents are not satisfied with the performance of stock market for the development of the economy.
11. NEPSE and SEBO do not provide information accurately and timely. They further added that information provided is not sufficient.
12. Marketability and profitability are the major motivating factors of investment for investors. Majority of responded that they make investment decision without analysing the financial performance of the company and without consulting the experts.
13. Primary market is more attractive for majority of the respondent because of low risk.
14. Majority of the respondent prefer to invest in banking and financial sectors because of its marketability and profitability.

CHAPTER - V

SUMMARY, CONCLUSION AND ECOMMENDATION

5.1 Summary

The development of stock market in Nepal started in 1976 when the government established Securities Exchange Centre to provide and develop market for securities of government and corporate. In 1993, Securities Board Nepal was established with the objectives to regulate, supervise and monitor the securities market. Similarly, the Securities Exchange Centre was converted into Nepal Stock Exchange Limited (NEPSE) with the objectives to provide secondary market for securities transaction. NEPSE, now, is adopting NEPSE Automated Trading System (NATS), fully automated screen based trading system from broker office by using wide area networking (WAN).

Stock market growth is one of the important issues in Nepalese capital market. Capital market facilitates the exchange of financial assets by bringing together buyers and sellers of securities. Capital market provides an effective way of raising money for commercial enterprises and at the same time provides an investment opportunity for individuals and institutions. Thus, stock markets have both theoretical and practical perspectives. This study mainly aims to examine the situation of stock market in Nepal. The specific objectives of this study are: (a) to examine the pace of primary market growth in Nepal (b) to trace out the growth of listed companies in Nepal (c) to trace out the growth of NEPSE index (d) to analyze the trend of market capitalization, number of transactions, number of securities traded and number of securities listed etc.

The equity market activities grow with the development and reform in the financial sector. Over the past 15 years the stock market of Nepal has made significant progress. For example, between the fiscal year 1993/94 to 2007/08, the number of issue approved increase 17 to 72. Due to increase in the number of banking and financial institution and other real sectors institution, the primary market increases both in volume and value significantly. The number of listed companies in NEPSE increased by more than two times that is 62 to 142 during the periods. The market capitalization value rose almost twenty six times from Rs. 13872 million to Rs. 366274.56 million. During this period NEPSE index jumped from its base value of 100 to 963.36. Likewise, during the same period the number of securities listed with the exchange increased by more than seven times from 43 million to 321 million and the number of annual transactions increased more than sixteen times from around 9 thousands to 150 thousands.

By the end of 2007/08 the stock market indicators like; total no of listed companies had reached to 142 which were 66 in its initial fiscal 1993/94, the amount of paid up value reached to Rs. 29465.80 million from Rs. 2182.2 million, the amount of annual turnover reached to Rs. 22820.76 million from Rs. 441.6 million, number of issue approved increase significant in every year and number of listed securities reached to 321131 from 43424 securities. In addition, the amount of market capitalization increased to Rs. 366247.56 million from 13872 million. These all indicate that there was a significant development in various stock market indicators during the period of 1993/94 to 2007/08.

Majorities of the respondents are not satisfied with the growth trend of the market. They do not have sufficient knowledge about investment as well. Similarly majority of respondents are not satisfied with the performance of stock market for the development of the economy. Because of the profitability, majority of the respondent prefer to invest in financial sectors than in real

sectors. Marketability and profitability are the major motivating factors of investment for investors. Majority of the respondent are not satisfied with the performance of NEPSE. Most of the respondent feels that they are not fully aware about the primary market. According to majorities of the respondent, the main prospects of stock market is, it provide maximum return.

5.2 Conclusions

On the basis of the findings of the present study it can be conclude that the concept of stock market in Nepal was begun with the flotation of shares of Biratnagar Jute Mills (BJM) and Nepal Bank Limited (NBL) in 1937 and after this to develop the stock market government established the Securities Exchange Center (SEC) in 1976 which was the first and most important attempt made by the government to develop the stock market in Nepal. SEC acts as an issue manager for corporate securities and started to list and provides market for the corporate stocks from fiscal year 1984/85 under the Securities Exchange Act, 1983 to promote the primary as well as secondary market for government and corporate securities from fiscal year 1984/85. Although, the share of this sector the growth of the economy in the national economy is still very low due to the negligible size of the corporate Sector. Similarly, the incorporation of the Securities Board and conversion of the SEC into the Nepal Stock Exchange (NEPSE) has greatly contributed to the development of primary as well as secondary market for the corporate securities in Nepal.

Likewise, Nepal Government adopting liberalized economic policy has been initiating different programmed for the organized development of securities market. However, other program like amendment of Securities Exchange Act, standardizing stock exchange by initiating Automated Trading System (ATS) etc., which were perceived to be more important for the securities market development,. Furthermore, Three Year interim Plan of Nepal Government also developed various objectives and programmed for securities market

development and to meet these objectives, it has taken the policy of modernizing stock exchange, strengthening the regulatory system of the securities market, widening the participation of the stock exchange and making it dynamic, transparent, credible and investor friendly capital market for developing the securities market as an important sources of long-term financing. More than 90% of primary market is from banking and financial sectors. It is because the obligatory rule of regulatory body (NRB) to go to the public issue. Real sector like manufacturing, trading and hotel are in few numbers in primary market, it is because less attractive than financial sectors in terms of liquidity and profitability.

Despite the large volumes traded on stock exchanges many listed stocks trade infrequently; or their balance of trading is not sound. For example, in NEPSE mostly the commercial banks shares are transacted. The reasons behind this high expectation of investors from the banks are the dividend and capital gains. Some of the banks in the past days are distributing dividends regularly and in increasing rate. Therefore, the serious problem facing by Nepali Stock market is among various sectors only the banking sector is doing well in terms of liquidity, but other sectors rarely do so. From this analysis, it shows that the breath of the market is not so strong.

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

Various measures of stock market development indicate that the stock market in Nepal is underdeveloped and has failed to show impact on the overall

national economy. Small market size has made it vulnerable to manipulation and price rigging. Low turnover rates and value-traded-rate to volatility, and high concentration ratio indicate that the stock market in Nepal is highly illiquid and risky. Investors tend to avoid stock market because they do not have options to invest in securities according to the risk-return preference. Similarly firms shun it because stock market is less reliable source of raising funds for them. Due to this financial system in Nepal has remained basically bank-dominated.

5.3 Recommendations

On the basis of findings of the study, the following recommendations are made to the concerned stakeholders:

-) The procedures for offering public issue should be simplified and rationalized. Securities Board Nepal and other concerned authorities should conduct public awareness and investors education programs to increase the level of investors' awareness.
-) The government should strictly implement the defined policy and should encourage the number of listed companies in all sector including manufacturing, trading, insurance, hydropower sectors.
-) Securities Board Nepal (SEBO/N) should regulate NEPSE and other financial institutions adequately, appropriately and effectively.
-) The NEPSE index should be calculated with different method in order to present real situation of the market.
-) The number of transaction is increasing significantly but the number of brokers remains same. So it should be increase immediately.
-) The listed firms whose shares are not traded should provide the financial status publicly in order to make the investors aware about their exact financial condition.
-) Investors should be aware about the rational investment decision.

-) Large and ineffective government corporations should be privatized in order to develop the Nepalese stock market through the wide spread distribution of shares to public investors.
-) To increase the width of the Nepalese capital market, government should allow foreign investors to invest in Nepalese Capital Market.
-) The information and financial statements of the companies should be disseminated properly and timely.
-) Different market intermediaries should be educated, trained and professionalized.
-) Besides it the most needed changes which are fundamental for stock market development are listed below:
 - The mutual saving schemes should be enhanced.
 - Stock Exchange should be privatized.
 - Stock market should be decentralized.
 - The automation in the clearance system.
 - Tax system should be reformed which should encourage and stimulate capital formation.
 - The rules and regulations should be up to date.

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ANNEXES

Annex – 1

Paid up Value of Listed Securities for Different Years

Fiscal Year	Paid-up Value (Rs. in million)
1993/94	2182.2
1994/95	2961.8
1995/96	3358.5
1996/97	4476.5
1997/98	4959.8
1998/99	6487.4
1999/00	7347.4
2000/01	8165.2
2001/02	9685.04
2002/03	12560.07
2003/04	13404.90
2004/05	16771.8
2005/06	19958.0
2006/07	21746.44
2007/08	29465.80

Source: Various Annual Reports, NEPSE

Annex – 2

Annual Market Turnover in Volume and Value

Fiscal Year	Annual Turnover in Volume (0000)	Annual Turnover in Value (Rs. in million)
1993/94	99.30	441.60
1994/95	390.00	1054.30
1995/96	294.70	215.60
1996/97	914.30	416.20
1997/98	119.50	202.60
1998/99	478.80	1500.00
1999/2000	767.40	1157.00
2000/01	498.70	2344.20
2001/02	579.10	1540.60
2002/03	242.80	575.99
2003/04	646.80	2144.27
2004/05	1843.40	4507.68
2005/06	1222.10	3451.43
2006/07	1814.70	8360.07
2007/08	2860.00	22820.76

Source: Various Annual Reports, NEPSE

Annex – 3

Research Questionnaire:

Dear Respondent,

I am doing a research on the topic of “**Stock Market Growth in Nepal**” in Partial Fulfillment of the Requirements of the degree of Master of Business Studies (M.B.S.) Your sincere and unbiased response will be highly beneficial and as such will be appreciated. The information you provide hereby will be kept confidential and be solely used for this research purpose.

Respondent’s Profile

Name:

Occupation:

Address:

1. What do you think about the growth trend of Nepalese Stock Market?
 - (a) Good []
 - (b) Bad []
 - (c) Do not Know []

2. Which of the following problem that the Nepalese stock market has been suffering from?
 - (a) Shortcomings of rules and regulations. []
 - (b) Lack of sufficient knowledge among investors. []
 - (c) Lack of sufficient knowledge among stock market intermediaries. []
 - (d) Lack of proper coordination between authoritative bodies. []
 - (e) Restriction to foreign investors. []
 - (f) All of the above. []

3. Which of the following problem that the Nepalese primary market has been suffering from?
 - (a) Lack of awareness among the investors []
 - (b) Weak regulatory body []

- (c) Ineffective method of allotment []
 - (d) Low chances to allotted []
 - (e) All of above []
4. Are you satisfied with the performance of Nepal Stock Exchange?
- (a) Yes []
 - (b) No []
 - (c) Do not Know []
5. What factor motivates you to make investment in stock?
- (a) Marketability and profitability. []
 - (b) Limited Opportunity to invest in other sector. []
 - (c) Friends and Family. []
 - (d) Share Brokers. []
 - (e) If other, please specify. []
6. Why the investment in bank and financial sectors are more attractive than in real sectors?
- (a) Timely financial report []
 - (b) More profitable []
 - (c) Marketability and liquidity
 - (d) Strong regulatory body []
 - (e) All of above. []
7. To what extent Nepalese Stock Market and Nepalese economy are interrelated?
- (a) High []
 - (b) Moderate []
 - (c) Low []
8. Are you satisfied with the performance of stock market for the development of the economy?
- (a) Yes []
 - (b) No []
 - (c) Do not Know []

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

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

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

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**** The End ****