Growth and Performance of Securities Market in Nepal

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ABSTRACT

Securities Board, Nepal, an apex regulator and facilitator of capital market, and Nepal Stock Exchange Ltd., only a single stock market, are the main constituents of securities market in Nepal. This paper attempts to study the growth trend and analyze the performance of Nepalese securities market. Likewise, the variables such as number of listed and traded companies and their securities, number of transactions, trading turnovers, paid up value, market capitalization and NEPSE index are analyzed for the secondary market.

SECURITIES MARKET IS A MECHANISM created to facilitate the exchange of financial securities or assets by bringing together buyers and sellers of securities (Sharpe 1998). Securities markets provide an effective way of procuring long-term funds by issuing shares and debentures or bonds for corporate enterprises and government and at the same time provide an investment opportunity for individuals and institutions (Adhikari 2004). Thus, the market place for these financial securities is called securities market which is further subdivided into the primary and secondary market. The former market denotes the market for newly issued securities to the public whereas the latter market refers to the market for secondhand securities, traded previously in the primary market (Francis, 1991).

The securities market plays an important role in mobilizing savings, and channeling them into productive investment for the development of commerce and industry of the country. It basically assists the capital formation and economic growth of the country. In many developing countries like Nepal, the undeveloped capital market is still prevailing in the economy. The Nepalese securities market still could not take its height. The further improvement of this market is very crucial. It helps in accumulating even small savings for development activities of the economy otherwise, which would have spent in unproductive areas. But it is true that there is no presence even of organized money market in rural areas, which covers almost 90 percent of the total area of the country. Thus, the securities market is only confined to the very limited urban areas of Nepal. Despite these truths, an attempt has been made to analyze the growth trends and performance of Nepalese securities market.

1. Historical Perspective of Nepalese Securities Market

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 (Shrestha 2038). 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

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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 (Gurung 1999).

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 businesspersons.

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. NEPSE opened its trading floor on January 13, 1994 through its newly appointed licensed members and has adopted an "Open Out-Cry" system for the transaction of securities. The trading floor is restricted to listed corporate securities and government bonds with the market intermediaries in buying and selling of such securities.

2. Study Method

2.1 Nature and Sources of Data

This study is based on secondary data only. This study has covered 10 year time span-FYs 1993/94 to 2002/03 and included corporate securities only. SEBO/N and NEPSE Ltd are the major sources of required data. Required information and data are extracted from the annual reports of SEBON/N and downloaded from the official website of NEPSE Ltd. In addition, some of the information and data are culled from the reports of previous studies.

2.2 The Models

Simple analytical tools like percentage, growth rate, and correlation coefficient have been used to analyze the growth trend and performance of securities market. The following model has been used to work out the overall growth rate:

$$A_t = A_o(1+g)^n \qquad \ldots \qquad \ldots \qquad \ldots \quad (1)$$

Where,

        At = values at the end of the FY
        Ao = values at the beginning of the FY
        n = t-1, time period over which growth takes place
        g = growth rate

The following model has been used to work out the slop of regression line:

$$\log(1+g) = \frac{\sum\limits_{t=1}^{n} Yt \; \log At}{\sum\limits_{t=1}^{n} Yt^2} \qquad \ldots \qquad \ldots \qquad \ldots \qquad (2)$$

For the purpose of testing the theoretical relationship between the number of traded and listed companies and their securities, Karl Pearson's Correlation Coefficient (r) has been worked out using the following model:

$$r = \frac{N\sum dxdy - \sum dx \sum dy}{\sqrt{N\sum dx2 - (\sum dx)^2}\sqrt{N\sum dy^2 - (\sum dy)^2}} \qquad \ldots \qquad \ldots \qquad \ldots \ (3)$$

Where,

        X = Number of traded companies and/or their securities
        Y = Number of listed companies and/or their securities
        X_A = Assumed average of X
        dx = X-X_A
        Y_A = Assumed average of Y
        dy = Y- Y_A
        N = Number of pairs of observations of X and Y.

Significance of relationship has been tested by using Probable Error (P.E.) and it is denoted by the following model:

$$P.E = 0.6745 \frac{(1-r^2)}{\sqrt{N}} \qquad \ldots \qquad \ldots \qquad \ldots \qquad (4)$$

3. Result and Analysis

3.1 Public Issue Approval

Public issue of securities is made in the primary market. Funds mobilized through the primary market constitute investment (Machiraju 1998). Issue of securities may be made especially through prospectus and/or offer for sale and private placement. As per the securities legislation, it is mandatory for corporate bodies to get their securities registered with the SEBO/N. The SEBO/N reviews the application and documents and gives issue approval of different class of securities such as equity shares, rights share, debentures, preference

shares, mutual fund and unit schemes, which are in practice. Then companies can issue their securities to the public in the primary market. Public issue is carried out in order to raise long-term capital from the general public. Company keeps the subscription open for a period of minimum 7 days and maximum one month.

The number of companies public issue approval granted by SEBO/N showed a sharp downward-trend in the first four FYs whereas the issue approval amount has changed in erratic trend during the same period. Then, from the FY 1997/98 to 1999/00 the number of public issue approval of the companies remains fluctuating. But it showed an increasing trend in the successive FYs and reached 17-issue approvals in the FY 2002/03. The empirical result reveals that the overall growth rate of number of companies issue approval is very negligible i.e. 0.89 percent during the study period. This sort of growth trend indicates the expansion of public issue approval in the primary market is very poor.

The amount of issue approval shows ups and downs during the study period. In the FYs 1994/94, 1998/99 and 2002/03, the growth rate on yearly basis is negative. The amount of issue approval indicates an absolutely attractive growth trend from FY 1999/00 to 2001/02 but the equity shares of Nepal Merchant Banking and Finance Ltd. valued Rs.50 million in 1999/00 and Nepal Bank of Ceylon Ltd. valued Rs.150 million in 2000/01 and 2001/02 were not issued. The study found that the overall growth rate of public issue approval amount is 17.72 %, which showed even a very small growth.

The results indicating a poor growth trend imply the weak performance of the primary market in case of public issue. Moreover, the results prove that the response on the liberalization and public participation policies of the government has become ineffective except in a few sectors.

3.2   Number of Listed and Traded Companies and their Securities

Securities Exchange Act, 1983, Section 8, prohibits securities trading without listing to Nepal Stock Exchange Ltd. The number of listed companies was 66 in 1993/94 and went up to 115 in 2000/01. It sharply decreased to 96 in 2001/02 due to de-listing of securities of 25 companies for non-compliance of annual reports and listing fees. Likewise, during the same period, securities listed with the stock exchange increased from 43 million to 160 million. The number of traded companies is almost in increasing trend. But the securities traded in NEPSE are fluctuating during the study period. The percentage of traded companies over listed companies is more than 57% in each FY. Similarly, the percentage of traded securities over listed securities ranged between 1.52% to 11.08% during the study period.

The growth rate of listed companies during the study period is 4.69 and it is 5.86% in the case of traded companies. Similarly, the growth rates of listed and traded securities are 13.7% and 9.16%. Karl Pearson's Correlation Coefficient (r) between traded and listed companies (r=0.88) and their securities (r=0.933) are positive and significant. Since, in both cases r is greater than 6 times of its P.E. In spite of the significant relationship between traded and listed companies, and the traded companies and securities, the number of companies traded is not satisfactory and the volume of securities traded in NEPSE is almost negligible during the study period. These evidences indicate the trading of securities is unattractive and illiquid in the capital market and this also implies that there is lack of confidence among investors or fear and uncertainty in the investment environment in the economy.

3.3   Number of Transactions and Annual Turnover

Securities, especially shares, are traded in a specific lot of certain face value on NEPSE trading floor. It has fixed the board lot of 10 shares if the face value is Rs.100 and 100 shares if the face value is Rs.10. The transaction of less than 10 shares is permitted only on odd lot trading hours-Monday and Friday from 2.00 P.M. to 3.00 P.M. (NEPSE 2000).

The number of annual transactions shows a slightly increasing trend during the study period. It has increased from around 9 thousands to 69 thousands. The highest growth rate (129.48%) took place in 1994/95. However, the overall growth rate during the study period is 19.94 %.

Annual turnover in stock exchange has fluctuated between Rs.202.61 million to Rs.2344.16 million in the past ten FYs. The initial euphoria of liberalization of stock exchange began in 1993/94 and continued to be reflected in trading value and also in volume in the following year. The subsequent few years up to 1997/98 could not witness increase in the market activities as in the beginning FY. But, then after, it started to take its speed continuously except in 2002/03. The growth rate of annual turnover is 14.29 % over the observed period.

The percentage of turnover on paid up value has fluctuated between 35.5% and 4.58 %. It was 35.5 % in 1994/95. As such, the increasing trend in number of transactions and annual turnover implies the higher liquidity and attractiveness in securities.

3.4 Paid up Capital and Market Capitalization

Total paid up capital is the function of the number of listed securities of traded companies and paid up value per share. Market capitalization simply refers to the market price of listed securities. It is derived by multiplying the number of listed securities of all companies by the closing market price of corresponding securities and summing up them. Thus, the paid up capital indicates the actual investment in the financial assets whereas market capitalization indicates the present value of the investments.

The amount of paid up capital has increased in every subsequent FYs. However, the annual growth rate has not increased in the same ratio. Paid up capital of overall listed securities has increased from Rs.2182.2 million in 1993/94 to Rs.12560.07 million at the end of 2002/03. The overall growth rate is 19.91 % over the observed period. This indicates the pace of investment in corporate sector through securities is still in snails pace.

The market capitalization based on closing market price of listed securities was worth of Rs.13872 million in 1993/94. It decreased during the subsequent two years which significantly recovered in the later years of the study period. Share prices in the market went up during the first FY of opening up of NEPSE. However, it could not sustain in subsequent few years then it started to pick its height, as a result, market capitalization reached up to Rs.46349.4 million in the FY 2000/01. Annual growth rate is positive in all observed FYs except in 1994/95, 1995/96 and 2001/02. The initiation of reform program in the economy after restoration of democracy, the problem of peace and insecurity, frequent closure of market, occasional programmes of peace talk with Maoist etc. have made frequent changes in the value of market capitalization during the study period as the value of market capitalization changes due to the changing sentiments of the investors. The overall growth rate of the market capitalization during the study period is 17.13 %. The erratic trend in the value of market capitalization and its low contribution to GDP imply the poor and immature capital market, de-motivation in investment in the companies, and downward trend of economy during the study period.

3.5 NEPSE Index

Stock market indices are used to study the trend of growth pattern in the economy, to analyze as well as to forecast business cycles and to correlate it with economic activities (Bhalla 1997). The higher the index implies the increase in market price of securities and the better performance of companies and vice versa. NEPSE follows the Standard and Poor's Index method for its calculation by taking the market capitalization of all listed securities based on February 12, 1994 prices as 100 (SEBO 1998).

NEPSE index at the end of 1993/94 was 226.03 then it started to move down and reached a level of 163.35 in 1997/98. Then, in the two subsequent FYs it was increased and reached to a peak level of 360.70 points in the FY 1999/00. From FY 2000/01 onwards there has been downward trend in NEPSE index. These facts prove that the NEPSE index has highly fluctuated during the observed period. On the whole, the market was bullish in 1997/98 to 1999/00 and then it took its bearish trend till the last FY.

The overall growth in NEPSE index during the study period is 3.55% . The very low and highly fluctuating NEPSE index growth rate indicates poor performance of public limited companies listed in stock exchange. This further implies unsatisfactory performance and deteriorating economy of the country.

3.6   Securities Businesspersons

Securities businesspersons-brokers, issue managers, market makers, and securities dealers,-must get license from SEBO/N and membership from NEPSE Ltd. for securities business. It is mandatory for the securities businesspersons to submit their annual report along with their financial statements and trading report to SEBO within 4 months after expiry of each FY (SEBO 2001).

In the FY 1993/94, there were altogether 30 securities businesspersons-25 stockbrokers and 5 market makers. Then the number of securities businesspersons increased slightly during successive two years. In the FY 1996/97, this increased to 49 as 11 new issue managers and 4 securities dealers entered into securities dealings. From the FY 1997/98, the number of securities businesspersons has slowly decreased and no market makers have renewed their licenses in the last two FYs under study. On the whole, the number of securities businesspersons increased in the first four FYs and then gradually decreased and dipped to 38 at the end of study period. In the total number of securities businesspersons, more than 60% is dominated by stockbrokers over the study period. However, the growth rate of number of securities businesspersons is very low, i.e. 1.42 % during the study period.

3.7   Measuring Size and Liquidity

Size of the securities market can be measured in term of the number of companies and scrips listed to the stock exchange. As stated earlier, the number of listed companies in 1993/94 was 66. This increased to 108 in 2002/03. Similarly, the number of listed scrips increased from 43,424 thousands to 159,958 thousands during the study period. The paid up capital of listed securities was about Rs.2.18 billion in 1993/94 and Rs.12.6 billion in 2002/03. The number of securities businesspersons increased in first few years and then decreased in the later FYs. Despite these truths, only about 12 % of the companies registered to the office of the company registrar as public limited were listed to NEPSE during the ten FYs (K.C. 2004).

Another measure of stock market size is the market capitalization ratio. This is the ratio of aggregate market value of the listed shares to GDP. It is, on an average, is around 0.07 during the observed period. It has fluctuated in the range of 0.047 to 0.12 %. In developing countries it is in between 0.2 and 0.4. All these facts imply that the stock market in Nepal is very small in size and it is yet to show its impact on the economic activities of the

country.

There are two major indicators- annual turnovers of the stock market and percentage of GDP-of market liquidity. Except in the FY 2000/01, the ratio of the value of shares traded to GDP is always below 0.005 during the study period. During the study period, the value of shares traded accounted, on an average, only for about 0.003 of GDP. In developed stock market this figure is as high as 0.4 and in developing countries, it varies in the range of 0.001 to 0.01 of GDP (K.C. 2004).

The turnover ratio is another measure of liquidity of stock market. A high turnover ratio indicates low transaction cost and relative ease in buying and selling of securities. It is believed that the high turnover ratio indicates the faster development of the economy and vice versa. In Nepal, the turnover ratio has remained very low during the study period. This ratio was the highest in 1994/95. The declining trends of the ratios in the later FYs indicate growing illiquidity in the country's stock market.

4. Conclusions

Securities market plays a pivotal role in mobilizing savings and channeling them in productive purposes and many more like providing liquidity on securities so that one can minimize the risk and maximize the returns. The study on the securities market performance reveals that there is no synchronization among different securities market performance indicators, but it is true that they almost have depicted an erratic trend during the observed period. This indicates the unstable and poor performance of securities market. Relative to the overall economy, the size of securities market is very small and the liquidity of securities also is poor. These facts suggest that the Nepalese capital market now is passing through a bearish situation. The growth and performance of Nepalese securities market, even after the introduction of new mechanism in 1993/94, are not satisfactory though it is improving gradually.

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