Capital Market in Nepal: Integration, Advantages, and challenges

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Abstract

The Nepalese capital market has been groingthese days recently. However, investors and potential investors have been disappointed by the lack of financial tools, low market diversification, and fewer investment opportunities. Low-level market participation in real estate is a consideration in the Nepalese context participants hold. Companies in the real sector account for only around 20% of all listed companies. Because banks dominate the secondary market, the Nepalese capital market does not truly represent the economy. In the secondary market, public sentiment is vital. Internet, trade reporting, and credit rating activities have supported the capital market's expansion. The government and regulator must collaborate to solve current capital market difficulties.

Key Words : Primary market, Secondary market, Financialintegration, Financial instruments securities.

Background of the Study

A stock market is a marketplace for securities exchange between buyers and sellers (Sylvester &Enabulu, 2011), Whichtransfers financial resources from high-income to low-income industries. The stock market's speculative character allows both long-term and short-term investors to profit. A well-functioning stock market may provide liquidity in the financial system, thus boosting the country's economic growth (Levine, R; Zervos, S, 1998; Levine, R 1996). Also, it is said that the stock market's growth helps with the efficient use of resources and has a long-term positive effect on economic growth. The stock market is a better example of the capital market. The stock market is also a way to raise money for economic growth. As a result, the capital market is seen as the economy's mirror. (Chalise, 2020). Several marketplaces are analogous to the stock market—many attempts to profit from the stock market by purchasing and selling equities. People may also purchase and sell bonds, debentures, and mutual fund shares on the stock exchange.(Ritter & Silber, 2012).

Nepalese stock markets began in 1937 A.D. when shares in Nepal Bank Ltd. and Biratnagar Jute Mills fluctuated. For decades, the government did not prioritize capital market development. The structural adjustment plan (SAP) began in 1980. Following that, the private sector was allowed to invest in the economy. In 1984, the Securities and Exchange Commission (SEC) was set up to control and run the primary and secondary markets. In 1993, the Nepal Stock Exchange renamed the Nepal Stock Exchange. The same year, the government formed the Security Board of Nepal to oversee and promote the Nepalese securities market under the Securities Exchange Act of 1993.

People could cry out for help at the Nepal Stock Exchange from January 13, 1994, until August 24, 2007. It switched to a completely automated, screen-based trading system from the technology it had before (Devkota, 2019). In the beginning, NEPSE had 62 businesses. NEPSE now has 50 stockbrokers and 79 depository participants, one central depository system, more than one million investors, and 4828 million shares in 212 companies. As a result of a new online system in the capital market, people who live in rural areas are more interested in the market. Youth, women, and even students and low-wage workers are investing their small savings in the stock market in the hope that they will earn more money than they would in a bank account. Every day, more and more Demat accounts are opened, showing that people are excited about the stock market. There are many ways for public companies in Nepal to get money from people all over the country and from other groups. These are called initial public offerings (IPOs).

Capital markets and financial integration

The financial system helps to grow the economy, possibly through a well-developed " financial infrastructure system," which allows people to provide money to people who can use it more effectively in the economy and the capital market. Money can be spent, invested in, or moved between different types of businesses, and they let people and businesses pool, price, and trade risk (Paudel, 2021). The financial system helps investors and savers stay balanced by addressing knowledge gaps. In a more democratic society, the capital market can help close the wealth gap, and this can lead to a more socialist system, but one that is also democratic.

Figure1:

Capital Market Development

Source: Strategic Plan 2021-2024

Neighboring, regional, and global economies all have a lot in common. Some examples of real financial integration include: firms borrowing and raising money directly from international capital markets, investors directly investing in international capital markets; and new financial products being invented and made in the United States. Financial integration is said to be good for two things. It can make capital allocation more efficient and help spread the risks. The recent global financial crisis, which manythink was worse than anything since the Great Depression, has cast doubt on the benefits and shown that financial integration can come at a high price. When it comes to financial integration, the last two decades have seen a significant change. This growing financial integration leads to much money moving across borders between industrialized and developing countries. Increasing financial integration also brings the world's financial markets closer together and makes foreign financial institutions more visible worldwide. It was impossible not to have currency and financial crises in the late 1980s and the early 1990s because of global capital flows, making it impossible to avoid them.

People are generally afraid of taking risks and want to use financial markets to stabilize their income. Thus, the effect of short-term exogenous risk on income growth can be hidden. Financial integration allows money to move from rich countries with much money to developing countries with little money. They can lower the cost of capital and encourage more investment in countries that do not have much capital.

The benefit of financial integration and capital markets

Financial integration is said to have two positive effects on people. It can be more efficient at allocating money and help spread the risks. Even so, the recent global financial crisis, which many people think was worse than anything since the Great Depression, has cast doubt on the benefits and shown that financial integration can come at a high price. Financial integration has grown a lot over the last two decades, and developing, and industrialized countries send much money across borders because of this growing integration of the financial markets. Another benefit of more financial integration is that it brings the world's financial markets closer together and makes foreign financial institutions more visible worldwide. Because of global capital flows, it was impossible not to have currency and financial crises in the late 1980s and early 1990s, making it impossible to avoid them.

General people fear risk and want to use financial markets to protect their income. Thus, the effect of short-term exogenous risk on income growth can be masked by this method. It is easier for money to move from rich countries to poorer countries that do not have much money, and these capital inflows can lower the cost of capital and encourage more investment in developing countries for investment.

The Current Situation of the Nepalese Capital Market

There are two types of capital markets: primary markets and secondary markets. The present situations of these two types of markets are examined to determine the current scenario of the Nepalese capital market.

Primary Market

According to Mishkin and Eakins (2012), a primary market is a market in which a firm or government agency sells newproduct issues, such as a bond or stock, to first buyers. In Nepal, primary market activities are conducted by the Securities Board of Nepal (SEBON) and the Nepal Stock Exchange (NEPSE).

In the primary market, money is raised through initial public issues (IPOs), rights offerings, Further public offerings (FPOs), debentures, and mutual funds (M.F.s). Capital mobilization via primary markets has been on an upward trend over the previous five years, as seen in Table 1 below. The most extensive capital mobilization in the previous five years occurred in F.Y. 2016/17, with a total of NPR 59.39 billion and 101 issues, respectively. Banks and financial institutions have recently issued a record number of rights shares to fulfil the minimum paid-up capital requirement. Table 1 contains Primary market statistics for the previous five years.

Table 1:

Primary Market (Amount NPR in billion)

	Fiscal Year									
Public issue	2015/16		2016/17		2017/218		2018/19		2019/20	
	No	Amount	No	Amount	No	Amount	No	Amount	No	Amount
IPO	14	2.76	17	451.51	21	8.3	28	7.35	9	3.99
Right Share	37	9.4	76	45.64	55	25.7	19	5.88	11	4.41
FPO	3	5.83	4	7.99	6	11.5	0	0	0	0
Debenture	0	0	0	0	1	3	12	29.98	12	23.45
Mutual Fund	1	1	4	4.25	4	4.8	6	6.55	2	1.8
Total	55	19	101	59.39	87	53.3	65	49.76	34	33.66

Source: Strategic Plan 2021-2024

Secondary Market

It has several benefits for the fresh issue market. It enables investors to track the value of their shares and sell them when the time is right. It is a market in which existing securities are continuously exchanged daily. It is a market for previously issued securities. It includes exchanges and over-the-counter marketplaces where securities are purchased and sold following their initial public offering in the primary market (Mishkin and Eakins, 2012, p. 8).

The secondary markets remained satisfactory in F.Y. 2019/20, with positive trends in the majority of market indicators such as the number of listed securities, their paid-up capital, annual transaction volume, total traded securities and transactions, market capitalization, the NEPSE Index, and turnover ratios, among others. As a result of mergers and acquisitions, the number of publicly traded companies has shrunk a little, and this is especially true for BFIs.

The secondary market's overall performance is positive regarding turnover, market capitalization, and paid-up value, even though the NEPSE index has seen a few ups and downs during the previous five years. NEPSE began trading on the secondary market in January 1994 with 100 points and hit a high of 1,881.45 points on July 27, 2016. Table 2 exhibits secondary market statistics over the previous five years.

Table 2:

Secondary Market

S.N	Indicators	2015/16	2016/17	2017/18	2018/19	1019/20
1	Number of listed companies	229	208	196	215	212
2	Number of listed securities(in billion)	2.1	2.97	3.6	4.21	4.82
3	Paid-up capital of listed securities(in billion)	204.02	289.6	352.1	412.28	473.39
4	Amount turnover (NPR in ten million)	164.65	205.02	121.39	110.07	150.03
5	Total Traded Securities (NPR in ten million)	30.36	39.29	29.38	38.75	42.85
6	Number of Transactions (Number in Million)	0.84	1.36	1.31	1.42	1.85
7	Market Capitalization of Listed Securitas (NPR in billion)	1890.13	1856.82	1435.14	1567.5	1792.8
8	Float Market Capitalization of Listed Securities (NPR in billion)	632.66	641.89	483.9	585.25	638.09

S.N	Indicators	2015/16	2016/17	2017/18	2018/19	1019/20
9	Market Capitalization to GDP (percentage)	84.1	71.44	47.7	45.25	40.9
10	NEPSE index (Point)	1718.15	1582.67	1212.36	1259.02	1362.7
11	NEPSE Float index (Point)	125.41	116.14	87.15	92.43	95.37
12	Turnover to Market Capitalization (Percent)	8.71	11.04	8.46	7.02	8.37

Source: Strategic Plan 2021-2024

Importance of Capital Market

As long as there is no secondary market where investors can turn their investments in new issues into cash whenever they want, many investors might not buy new issues in the first place. A secondary market for common stock alone is not enough for investors who want to put their money into a company for a long time. Second, money flow into the new issue market is very important for the economy. In this way, the economy can invest in real capital for a long time. It is best shown by thinking about what would happen if people and businesses could not trade their financial claims in the secondary market.

The secondary market allows people who want to invest for the long term to buy the money of people who do not want to invest for the long term.As a result, they let the economy think about new ways to build capital (Josiah et al., 2012, p. 10).

Securities and market instruments

The equity share is the primary instrument utilized to raise funds in Nepal's securities markets. Debentures, bonds, mutual funds, and preference shares are used in practice. The preference share is relatively tiny. Specialized investment funds (mainly private equity and venture capital), as well as local currency-denominated bonds, stocks, and index derivatives, are now operational. Table 4 shows the paid-up value of securities market instruments.

Table 3: :

Status of Security Market Instruments paid-up value (As of November 10, 2020)

Instruments	Issue Approved and Paid-up Value I Listed securities (NPR in Million)	Percentage
Equity	472048	65
Preference Share	640	0
Corporate Bond	33269	5
Government Bond	202140	28
Mutual fund	15953	2
Total	724050	100

Source: Nepal Stock exchange Ltd.

Table 4:

Overall Scenario of Nepalese Securities Markets

S.N.	Institution	Mid-July 2019	Mid-July 2020
1	No. of Stick Exchange	1	1
2	No of Central Securities Depository	1	1
3	Clearing Banks	4	4
4	No of Stockholders	50	50
5	No of Listed Companies	215	212
6	Credit Rating Agencies	2	2
7	No of ASBA/ C-ASBA	59	52
8	Merchant Bankers	32	30
9	Mutual Funds	15	16
10	Depository Participants	66	79
11	No of D-Mat A/cs	1571000	1753000

S.N.	Institution	Mid-July 2019	Mid-July 2020
12	No Active Traders	159212	245474
13	No Qualified Instrumental Buyers (QIBs)	0	88
14	investors Using Online Services	11703	35159
15	IPO Issued Amount (Rs.in Billion)	49.76	33.65
16	Paid-up Value of Listed Securities (Rs in Billion)	412.3	473.39
17	Market Capitalization (Rs.in Billion)	1567.5	1792.8
18	Securities Transaction (Yearly in Millions)	1.42	1.85
19	Annually Securities Turnovers (Rs, In Billions)	110.07	150.03
20	Average Daly Turnover (Rs, in Billions)	447.5	824.4
21	Market Index (NEPSE in Points)	1259.02	1362.35
22	No of listed Securities (in Millions)	4207	4828
23	Traded Securities (In Millions)	387.5	428.5
24	No of Meroshare A/s (for IPO subscription)	564.4	742.58
25	Capital Gain Tax (Rs in Millions)	641.4	984.8
26	Outstanding Mutual Funds (Rs in Billion)	18.2	16.81
27	Market Capitalization to GDP (%)	42.1	48

Source: Strategic Plan 2021-2024

The Challenges of the Nepalese Stock Market

Despite four decades of development, Nepal's capital market is relatively young. Many investors and potential investors are disappointed with the stock market. Most capital-raising alternatives in Nepal are stock, indicating low financial instrument diversity and investment possibilities for investors. The bond market is relatively young and limited to corporate bonds, and the state has not issued municipal bonds. Many BFIs now issue debentures to raise funds (Sigdel, 2021).

Any country's stock market performance is regarded as an economic indicator.. Since stock prices represent profitability expectations, and profitability is directly tied to economic activity, stock price variations are considered to predict economic direction. If the economy is expected to shrink, the stock market will lower the prices of stocks in order to make money. However, in Nepal, the stock market is not seen as an accurate measure of the economy. In part, it's because real-world businesses do not have much involvement in the secondary market. Real sector sectors comprise roughly 20% of all listed firms, mostly hydropower, hotels, and manufacturing. Their market cap share is negligible, and their stock market trading is similarly restricted.

Banks dominate the secondary market. As a result, the stock market cannot be considered an accurate economic mirror because it does not reflect all industries.In the private sector, there are many reasons why they do not want to get into the real-estate business. These include extra compliance work like setting up a separate share department, holding an AGM where the promoters are likely to be grilled by public shareholders, and publishing quarterly, half-yearly, and annual reports.

Moreover, many real estate companies are family-owned and do not want to relinquish control by going public. However, new premium pricing rules and existing tax refunds have provided some incentives for actual sectors to come forward. They should be encouraged by highlighting the advantages of becoming a public limited company, such as cheaper capital costs, excellent corporate governance and openness in commercial transactions, professionalism, more vital risk-taking ability, and public trust. They should also be told how they might help the economy by distributing money to more significant shareholders.

Investor illiteracy is another hindrance to Nepal's capital market growth. While most investors now have access to information, just a few can analyze it thoroughly. Besides the introductory study of the security's performance, most investors rely on their investment decisions and actions on market rumours, trading patterns, and sometimes insider information. The market's top participants might easily mislead these investors by collectively manipulating the prices of select stocks to climb or decline. Tiny investors always get into fights because they do not all know the same things about the market. They have to leave sooner or later.

Thus, regulators should play a vital role in the overall growth of the capital market. SEBON must aggressively promote a friendly environment for capital generation and mobilization in the country. Since it advises the government on capital market issues, it should provide creative and investor-friendly policy recommendations based on thorough research. To restore public trust in the capital market, the government should lead efforts to stop insider trading and poor corporate governance among intermediaries, brokers, and other people who work in the market. All of these things should be a top priority for SEBON. They should also work on diversifying financial products, making the capital market more modern with technology, and encouraging all businesses to list.

Conclusion

The capital market is very safe for businesses, whether they are new or old. There is a lack of money, so it fills that gap. It also encourages entrepreneurship and local industry, ensures that investors can make transactions at any time, and relieves the government of extra costs through PPPs. As a result, the capital market is not useless because it gives money to businesses in the real world, like agriculture, tourism, manufacturing, and services. Improve public trust and sentiment toward the capital market in order to grow the market. This is because public trust and sentiment are essential factors in this market. Dematerialization, online trading, reporting requirements, and credit ratings are recent changes in the capital market that deserve praise. Nonetheless, the government and regulators must devise ways to deal with many problems.

Opening up local marketplaces to foreigners will assist Nepal. Liberalization raises P/E ratios and the breadth and liquidity of domestic capital markets. Domestic capital expenses are reduced as a result. Workers in developing economies may benefit from improved accounting and transparency policies. This entails decreasing transaction costs while enhancing market appeal. Integration of financial systems may increase volatility. Foreign investors' agency costs are further increased by volatility and information asymmetry. Economic policy improvements and diversification lessen sensitivity to fundamental shocks. Capital market reforms and enhancements must address excessive volatility caused by information gaps and faults.Reliant on foreign assistance, emerging countries were more vulnerable than developed nations. We all know these rising economies were hammered hard. Financial integration has been debated recently due to recent financial crises. As Nepal's leading capital market regulator, SEBON must encourage financial integration through cross-border commerce and FDI.

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