Nepalese Capital Market: Issues and Challenges

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Establishment of the Nepal Stock Exchange (NEPSE) market opened an avenue to investors, both large and small, to invest in the enterprise sector and participate in the secondary market. Despite apprehensions of many, the secondary market proved to be successful, with both the entrepreneurs and the investors showing earnest acceptance and participation in the process. However, the performance of stock exchange during the latter years gives only a mixed result. The enthusiasm did not last long as, after 2000/01, both the size and trend began to shrink. The NEPSE index came down to 204 in 2002/03 from a peak of 360 in 1999/00. The transaction volume came down to about Rs 575 million in 2002/03 compared to Rs 2344 million in 2000/01. This scenario, despite increasing number of listed securities and scrips, is not a favourable situation. Generally, the problem is attributed to the prevailing politico- economic situation. No doubt, it is true to a large extent but the problem is not confined to the present situation alone. The management of the companies and the attitude of the board of directors and intermediaries are to blame a lot. The actors of financial markets are loosely tied together from legal provisions, which are not effectively implemented. As the financial institutions predominate the market, it has not been able to diversify. Increasing problems noted with the corporate governance, transparency and disclosure have seriously dented the Nepalese capital market. The Board mainly acts as a superfluous body trying to fulfill formalities rather than seriously attending to corporate governance. The result has been poor security to investors, particularly minority shareholders, who are not fully aware of the risk and return considerations. Hence, to make the stock exchange a vehicle of growth, initiatives must be taken to protect investors, improve corporate governance and make the companies operate in a conducive and transparent manner.

INTRODUCTION

The establishment and operation of the stock exchange market has opened door to small investors otherwise limited by prevailing opportunities and inability to

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assemble diverse sources. The only probable option left for them was bank deposits. Thus, enterprising and venturesome small investors were deprived of opportunities to invest. However, the establishment of the securities market in Nepal in 1985 and Nepal Stock Exchange Market in 1994, has opened an avenue to them. The Securities Exchange Board (SEBO) is operating since 1993. However, to what extent, their interest is being given attention has remained an issue of concern in Nepal.

Security market is a place where buying and selling of securities takes place in an organized way. The parties involved in security market are investors, intermediaries and specialists. Investors who are willing to buy or sell securities quickly may be searching good offers or accepting poor offers with higher risk and of higher return. Securities markets provide options to all categories of investors and make the financial market most competitive in developing countries. The position of liquidity and profitability and the degree of risk embodied on it are indicators taken into consideration while selecting the best options for investment. Intermediaries take temporary positions of securities during a time period in between a flow of buy orders and a flow of sales order and make earning from the variations in supply and demand positions. Commission for security transaction is the another source of income of intermediary.

At present, it has 40 members/ intermediaries comprising of stockbrokers (27), issue and sales managers (10), security dealers (2) and market maker (1). In the security market, investors are termed as customers and customers may be individuals, firms, companies and organized institutions. Members start their work by taking orders from the customers for buying and selling their securities. Customers make agreement with issue manager, security dealer and market maker for underwriting and issue management of shares and against that they take service charge from customers. Stockbroker is a security businessperson who deals on behalf of the investors in buying and selling of securities of a listed company. Issue manager is a security businessperson who carries out functions relating to public issue of securities on behalf of the issuing company in the primary market.

Security dealer is a security businessperson who buys securities in his name at the primary market and sells them from secondary market (stock exchange) either in his own name, or on behalf of customers' name through stockbrokers. Market maker is a security businessperson who deals with bonds issued by the government or bonds issued as per the guarantee made by the government. It carries out functions relating to public issue of mutual fund, unit fund and buying and selling of equity shares in his own name of at least three organized institutions with the objectives of providing liquidity for them.

MARKET PLAYERS

Degree of risk to the stockbroker and issue manager is lower than the security dealer and market maker in dealing securities transaction. It is because the stockbroker buys and sells securities and earns commission on return and in the case of getting down the market price of share during the intermediary period he loses goodwill and a small amount of commission. The issue manager, on the other hand, deals securities in primary market where the degree of risk is comparatively lower and earns its commission. To him buying securities from the primary market in his name and selling them in secondary market through stockbroker is riskier business than mentioned before. Considering issue manager's business as a long-term liability to the company, no transaction was carried out in 2001/02. Organized institutions working as a market makers do not working in Nepal. One, which was registered and renewed before did not get renewed in 2001/02. It is all because of the weaknesses in the market position. The actors of the financial market are loosely tied together from legal provisions and their effective implementation. For effective market operation, legal rules pertaining to it should be made effective.

Legal system of securities operating in Nepal falls under following Acts, Regulations, Bye-law and guidelines:

Securities Exchange Act, 1983;
Securities Exchange Regulation, 1993;
Membership of Stock Exchange and Transaction Bye-Law, 1998;
Securities Listing Bye-Law, 1996;
Issue Management Guidelines, 1997;
Securities Allotment Guidelines, 1994;
Securities Registration and Issue Approval Guidelines, 2000;
Guidelines on Business Code of Ethics for Securities Brokers, 2001;
Bonus Share Issue Guidelines, 2001.

Improvements in corporate governance that is the inherent rights of shareholders and the mechanisms of exercising such rights promote development of the capital markets. Corporate governance deals with the market for corporate control. In order to improve the corporate governance in the concerned companies, following regulatory measures are in operation in Nepal.

Company Act 1997;
Insurance Act 1992;
Bank and Financial Institution Ordinance, 2004;
Foreign Exchange (regulation) Act 1962;
Foreign Investment and Technology Transfer Act 1992 .

Domestic firm plays a leading role to develop viable atmosphere for capital market transaction in the domestic market. A firm with good governance can attract the attention of foreign investors towards stock market and the small investors get opportunity to participate in the corporate sector. Heavy investment to only one firm is not an ideal principle of fund management. It bears a higher degree of risk. Diversification of funds in different firms with good governance reduces the risk of capital loss and improves the liquidity position of the firms. To a developing country, capital market is a best means of attracting foreign investment and that begins with the good governance of a firm. Corporate law of international standard and its effective implementation lead to good governance provided that the legal rules (tax laws and other domestic regulations) and institutional constraints like financial structure and ownership structure should not be much typical from other nations. This should be the area of primary focus not only to improve NEPSE but the economy as a whole.

PERFORMANCE OF THE NEPAL STOCK EXCHANGE

Before the establishment of NEPSE, the volume of market activity was very low though it tended to spurt at the latter period. Turnover rose from Rs 2 million in1984/85 to Rs 800 million by 1993 and it became more rapid with the commencement of NEPSE as market promotion and easier access permitted a significantly greater number of players to enter the market. The stock market became highly buoyant and turnover increased manifold as many investors, both small and big, tried to cash on this new opportunity not only with a hope to maximize benefits but also speculated on the possible capital gains in the investments. The initial spurt in NEPSE activity lasted for a little more than six months guided by spectacularly good results in a few companies, particularly in the banking sector, where some companies were paying out dividends well in excess of 50 percent. The stock market performance thus, during the initial phase, far surpassed the modest goals aimed at by the eighth plan (1992-97), which laid the foundation for NEPSE with its first policy outline.

The initial spurt did not last long nay less than a year, once it was apparent that capital gains and returns need not be consistently high across the board and the public became disillusioned and resultantly the market and prices and trading volume all declined. The situation worsened from 1995/96 onwards with the onset of political instability. Both the investment climate as well as the operational climate suffered leading to poorer results in many companies. As a result, the price at NEPSE *nose-dived* and it incurred heavy losses. The worse period was 1997 to 1998, after which the situation improved somewhat with the commencement of operations by many finance companies, which paid out dividends. The improvement, however, was only marginal just to keep enough attentions. The economic and political scenario became more volatile with the rise in insurgency which led to slowing down of economic activities resulting at worsening performance in many sectors like tourism and manufacturing, thus, leading to a more volatile and vulnerable NEPSE. The recent cease-fire does not appear so far to be able to generate enough resurgence of activities and accordingly has not helped to improve neither the index nor the trading volume. As a result, the market has never been particularly vibrant nor particularly liquid.

Some of the important performance indicators of NEPSE in the period 1999/00 to 2002/03 are presented in Appendix. It shows that the turnover volume is fluctuating. It more than doubled in 2000/01 but again recorded a sharp decline in 2001/02 with the turnover reaching Rs 1540.6 million in a total volume of 6095 thousand scrips turnover. The improvement in market operation days has not helped to improve turnover. One of the most notable features of NEPSE is the preponderance of trade in banking and financial institution scrips**.** It accounted for over around 90 percent of total turnover meaning that the scope and volume of turnover of other sectors is nominal at best. It is, however, notable that the share of banks is declining and that of others increasing. In 2002/03, the share of banks came down to only about 62 percent. But including the insurance and finance companies, the proportion is still around 96 percent or the financial sector still overwhelmingly dominates the market. Hotel industry almost accounted for 9.0 percent in 2001/02 but came down to 1.1 percent in 2002/03, other sectors hardly made any presence. The number of companies traded has remained constant more or less at 69 and the growth in number of listings has also been only marginal. The number of listed securities, however, is growing at around 8.5 percent per annum. In terms of listed securities, a little over half (54.2 percent in 2001/02) belonged to banking and financial institutions and just under 30.0 percent belonged to manufacturing sector. These proportions, however, are not reflected in trading making NEPSE one sector ie. financial sector predominating. Just to make a point, the top ten traded companies in 2000/01 all belonged to the financial sector with nine banks and one financial company. Decline in market capitalization does not indicate that the health of NEPSE is sound and it is highly pertinent to enquire into the reasons for this situation. The annual turnover rate of equity shares in Nepal varies from less than 1.5 percent in 1997/98 to 8.13 percent in 1994/95.The present article tries to make an assessment in this respect.

Table 1. Nepal Stock Exchange- Basic Information,

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
No. of Listed Companies	79	89	95	101	107	110	115	96	108
Market Capitalization (in Rs)	12963	12295	12698	14289	23508	43123.3	46349.3	34703.9	35240.4
Trading Value(in Rs)	1054.3	215.6	416.2	202.6	1500.0	1157.0	2344.2	1540.6	575.8
Turnover Ratio	6.9	2.2	2.3	2.0	6.9	5.1			
Local Index	206.6	-	170.9	175.5	262.5	488.0	322.1	227.5	204.86
NPSE Index	5.8	-	-	2.7	49.6	85.9	-34.0	-29.4	NA
Change in index(%)	23.2	10.2	8.5	8.0	18.28	27.55	NA	NA	NA
P/E ratio	534.6	34.9	1.2	1.6	2.38	0.123	NA	NA	NA
P/BV ratio	3.6	5.6	6.2	3.9	3.71	3.1	NA	NA	NA
Dividend Yield %									

Source: Emerging Market Fact Book, 2000&2001- International Finance Corporation

Quoted in World Bank (2000), Nepal Financial Sector Study and SEBO Annual Report 2001/02 and SEBO, 2002/03

Table 1 shows some of the critical areas of NEPSE performance. It presents scenario from the commencement of NEPSE in 1993/94 to 2002/03. Market capitalization remained more or less stagnant up to 1997/98 with the capitalization of around Rs. 14.3 billion. This grew rapidly in 1999/00 and 2000/01 reaching a height of Rs. 46.3 billion in 2000/01 with the entry of new banks, and finance companies as well as rise in NEPSE index. The fall in NEPSE index could not sustain this growth recording a fall at market capitalization level reaching Rs 34.7 billion in 20001/02. In terms of trading volume, it reached the peak in 2000/01 with a total volume of Rs 2.3 billion, which declined continuously thereafter reaching only 0.6 billion in 2002/03. Trading volume and value in NEPSE are still low compared to the regional markets.

Market capitalization, in emerging market nations comes to 20-40 percent of GNP and it is 55-110 percent of GNP in developed markets. In case of Nepal, market capitalization varies from 5-11 percent of GNP. Table 1 shows market capitalization growth from less than Rs. 12300 million in 1995/96 to Rs. 46349 million in 2000/01 and fell down to Rs.34704 million due to political instability. No doubt, it shows a small size of equity market. The average market capitalization per firm is far smaller in Nepal (Rs. 483 million) compared to emerging markets ($117 million) and to developed markets ($1.4 billion).

One landmark decision is the decision though belatedly to de-list 26 companies inclusive of 15 trading, 10 manufacturing and one from other category. Rights of shareholders do not appear to be attended whole de-listing companies. It also proves the volatility of the manufacturing and trading sectors in Nepal.

MARKET TRANSACTION

Banks and financial institutions are predominating over others in stock market transaction. Of the total 96 listed companies, about 52 companies appeared in stock exchange transaction and most of them had transaction once or twice a year. Those with higher frequency of stock exchange transactions are about ten commercial banks. In terms of ownership, one is a semi-government bank and others are private banks. Share transaction, in principle, seeks to have a presence of buyers and sellers. In the absence of one party, there is no share transaction. In Nepal stock exchange, buyers are found not willing to purchase shares other than those of banks. Because, they have the knowledge of those buyers who have lost years ago a lot of money from buying shares of the manufacturing companies. Some loss-making manufacturing companies are still alive. Though they have been listed in Nepal stock exchange, they have no confidence in the market. Some other listed companies such as hotels and trading sectors are not eye catching to the buyers and their shares have no market demand. Some manufacturing companies have been liquidated. In liquidating the companies, minority shareholders' rights have not been protected. They have been treated as equal to majority shareholders of the company, because the Company Act 1997 has no provision for minority shareholders. Banking sector, in the eye of buyers, looks safest for the stock exchange followed by finance companies and other financial institutions in Nepal. It is not only the profit that has attracted the buyers, it is the capital gains, that arises within a short period of time, is taken into account while making a buying decision. It is because, some buyers have no access to the audited financial report and records of concerning companies. In the absence of transparent books of accounts, the threat of company liquidation remains in the mind of buyers. There is no report of bank liquidation in Nepal. Following table 2 shows the profit and loss situation of the companies in different sectors

Table. 2

Sector	2000/01			2001/02		
	Total Number	Profit Making	Loss Making	Total	Profit	Loss
Bank	12	10	-	12	11	1
Finance Company	30	28	-	29	26	3
Insurance Company	11	9	-	6	6	-
Hotel	4	2	-	4	-	4
Manufact. Company	28	7	7	13	9	4
Trading Company	8	3	-	3	3	-
Other	3	2	1	-	-	-

Source: SEBO, Nepal, Annual Report, Fiscal Year, 2002/03.

Table 2 shows that the manufacturing companies were the most loss making institutions in Nepal in 2000/01. In 2002/03, all hotels listed with NEPSE incurred losses due to unfavourable impact of the prevailing situation of the country on tourism. Economic reforms initiated since early nineties and political instability since the mid-nineties have seriously affected the manufacturing sector leading to poor performance. However, it needs to be mentioned that only a very small proportion of manufacturing, trading and hospitality sectors are listed with NEPSE. More importantly, services sector, which has shown tremendous growth after economic reforms, have hardly been listed except a few hotel and airline companies (both in the hospitality sector). The most affected are the manufacturing companies followed by trading and hospitality companies. Banks and finance companies, as compared to others are in better position. They look less affected then the performance of manufacturing and hotel companies. All banks made money except Nepal Bank Ltd. and in 2001/02, 3 finance companies also reported losses indicating that the golden era may be over in the finance sector except for strongly managed and robust companies. Investors not willing to buy shares of the profit making manufacturing and hospitality companies in the secondary market is the indication of confidence crisis with them and on their disclosed financial performance. Data relating to financial performance of the listed companies disseminated by the Securities Board are not sufficient to make a marketing decision. It should come in terms of financial statement analysis of each company such as detailed financial analysis. The management 'guru' Peter Drucker has different opinion on the correlation between the profitability and the respective value of the sock market. According to him the stock market increasingly values companies according to their liquidity rather than by their earnings. The quotations on every major stock exchange- New York and London, Zurich, Tokyo, and Frankfurt- correlate quite closely with cash flow and liquidity, and very poorly, if at all, with the inflation-distorted earning figures (Drunker, 2003: 13). Liquidity refers to the ability of investors to convert securities into cash at a price that is similar to the price of the previous trade. It can be measured in terms of the size of spread between the bid and asked price, smaller spreads correspond to greater liquidity of securities. Liquid securities possess the risk of holding by the investors and reduce the frequency in transaction.

It is further said that securities' holding percentage increases as the investors have little knowledge on risk and return of securities available in the secondary market. Most of the minority shareholders in Nepal hold the securities and have faced heavy losses by the declining position of the concerned companies. There is no provision made so far about to protect the interest of the minority shareholders in Nepal. Securities transaction in Nepal is made for ownership shares/common stock not for bonds and debentures. Those investors holding bonds and debentures keep concern with liquidity position of the concerned companies whereas the investors of ownership securities have to take interest on profitability position of the concerning companies. Both liquidity and profitability positions of the companies do not make any difference to the investors since the profit of the company is calculated on cash basis not on accrual basis. The corporate sector in Nepal is not transparent that is necessary for smooth operation of a stock exchange.

EQUITY MARKET CAPITALIZATION

Equity market capitalization, in the emerging market nations comes to 20-40 percent of GNP and it is 55-110 percent of GNP in developed markets (Maturing markets, IFC, 2002). In case of Nepal, equity market capitalization varies from 5-11 percent of GNP (see figure 1). Table 1 shows equity market capitalization grew from less than Rs 12300 million in 1995/96 to Rs 46349 million in 2000/01 and fell down to Rs 34704 million in 2001/02 due to acute disturbance caused by insurgency in the country though it marginally recovered in 2002/03. No doubt, it is a small size of equity market. The average market capitalization per firm is far smaller in Nepal (Rs 483 million) as compared to emerging markets ($117 million) and to developed markets ($ 1.4 billion).

Table 3 provides comparative stock exchange information for the six main stock exchanges of the South Asian Region. The comparative data is for 2000. India was by far the largest as to be expected with almost 5937 listed companies and a market capitalization in that year of $148 billion. Trading value in India was $49.4 billion. By contrast in Nepal, there were only 110 companies listed with a market capitalization of $800 million in 2001, and a total trading value of only $31.7 million. Pakistan, Sri Lanka, and Bangladesh range in between the Indian and Nepali stock exchanges in terms of relative size. Pakistan, the region's second largest stock exchange has 762 companies listed (13 percent of what India does); a market capitalization of $ 6.6 billion (4.4 percent of India); and a trading value of $1.2 billion (2.4 percent of India). Meanwhile, Bangladesh, which has the third largest stock exchange, has 211 companies listed (twice as many as Nepal); a market capitalization of $1186 million (fifty percent higher than that of Nepal); and a turnover of $768 million (more than 24 times that of Nepal). With only 13 listed companies (12 percent of what Nepal has and less than a quarter of a percent of what India has), a market capitalization of $38.0million (around 5 percent of

Nepal's) and a trading value of $3.5 million in 1999, Bhutan has the smallest exchange in the South Asian region (World Bank, 2002). Compared to Bangladesh, market capitalization is not low in Nepal in proportionate terms but in turnover terms it is miniscule, meaning that the scrips coming into the secondary market is very low probably belonging to minority shareholders only. It indicates that only through wider ownership turnover can be improved.

Table 3. Comparative Table- South Asian Stock Exchanges- Basic information, 2000 (currency in million)

	India (BSE)	Pakistan	Sri Lanka	Bangladesh	Bhutan	Nepal
No. of Listed Companies	5937	762	239	221	13	110
Market Capitalization (in US$)	148064	6581	1074	1186	38.3	799.8
Trading Value (in US$)	49,403	1184	5.2	768	3.5	31.7
Turnover ratio	33.2	19.0	0.5	74.4	9.2	5.1
Local Index	912.8	1507.6	698.5	642.7	-	488.0
Change in index (%)	-0.9	18.1	5.3	31.8	-	85.9
P/E ratio	16.8	-117.4	5.2	12.4	-	27.55
P/BV Ratio	2.6	1.4	0.7	1.8	-	0.123
Dividend Yield (%)	1.5	6.2	8.0	5.2	-	3.1
Economic Data						
Gross Domestic Product (us $)	479404	61673	16402	47864	440	5450
Change in CPI (%)	3.8	3.6	6.2	3.6	9.2	3.4
Exchange Rate (period average)	44.9344	53.9257	70.7055	52.1656	42.9850	71.0940

Data pertaining to 1998.

Source: International Finance Corporation, Emerging Stock Markets Fact book, 2000 & 2001 quoted in the World Bank 2002, Nepal Finance Sector Study.

The annual turnover rate of equity shares in Nepal varies from less than 1.5 percent in 1997/98 to 8.13 percent in 1994/95 during nine years period since 1993/94. These data suggest more liquidity risks in equity share market of Nepal, because higher volume of trading tends to reduce liquidity risks and trading costs.

LISTING OF SECURITIES

In Nepal, the company willing to sell its securities to the general public shall have to get listed with Nepal Stock Exchange. Documents needed and points to be explained to apply for listing are company objectives, ownership structure, memorandum of association, articles of association and audited balance sheets and profit and loss accounts and annual reports for the last three consecutive years to the Nepal Stock Exchange. Some documents like audited financial statements and annual reports are mandatory to furnish to Nepal Stock Exchange at the end of each year in order to renew the listed company. There are altogether 96 listed companies, in which 7 companies have renewed their licenses by submitting their respective annual reports only and one out of them has submitted financial statement within a scheduled time. To those submitting a year later are 88 in number in which five companies have submitted financial statements and the rest of other have submitted annual reports only. It is an example of a very weak regulatory discipline in the stock market of Nepal. Because, annual report is not taken as a statutory statement and it is not audited document too. Thus, the degree of manipulation can not be underestimated due to the non-audited reports. Since the audited financial statements are not accessible to Nepal Stock Exchange, there is no possibility for small investors to reach them. It is because those statements are not submitted to Nepal Stock Exchange and are to be accessible to minority shareholders. In the absence of transparency in financial and non-financial information, stock market cannot be expected to perform and grow. Regulatory discipline decides the demarcation for market players and in a weak regulatory measure, there is a least possibility of adopting market discipline by market players. Weak listing requirements mean that almost any company can be listed on the exchange merely by providing some accounting information. The NEPSE should enforce much more vigorous listing standards so that only good name institutions with financial information audited to international standards, are listed on the Stock Exchange. Any company found to be in contravention of new, more stringent, listing requirements, should be warned and ultimately de-listed from the exchange if they do not comply (World Bank, 2002.). The recent de-listing of 26 companies is expected to some extent to rectify the process. Institutions like Provident Fund Corporation can be an important player in the market. At the present time, Provident funds are restricted to investing only in the capital of banks and financial companies. This explains, in part, the relative better performance in the share market of these types of institutions. In most, well-developed markets, the funding held by these institutions forms a major part of an economy's investible long –term resources, and they are thus important players in the stock exchange. Permitting these institutions to invest in an improved stock exchange- where listing requirements were significantly tightened, account standards were at international levels, and adequate corporate governance was ensured- would have a potentially powerful positive impact upon the development of capital market activities. However, these pension funds should not be permitted to invest in an extended range of securities prior to the above changes being made. As these funds represent the future pension benefits of many, often poorer, workers- they should not be put at risk in the current lax environment (World Bank, 2000). In improved environment, however, these agencies should be allowed to play a major role thus creating a foundation for institutional growth and in return national economy as a whole.

OWNERSHIP STRUCTURE AND CORPORATE GOVERNANCE

Nepalese business ownership is concentrated in a few hands. In the tradition of many South Asian Companies, many firms in Nepal are family-owned and operated. Often inexperienced family members operate as managers, accountants, and hold other senior management positions. It is said that ten largest companies and business houses control the industry and trade sector in Nepal. Their involvement is found in trading, agriculture production, real estate business, and in stock exchange activities too. Their participation in financial sector is slowly increasing. Same businesspersons possess ownership in commercial banks as well as in different types of business and industrial activities. It is, therefore, made mandatory for newly incorporated organized institutions to issue ownership shares of 15 per cent at the minimum to 25 per cent of the paid up capital and sell them through primary market on public notice to the general public. To the bank and financial institutions, the amount of issue should be 25 per cent to 30 per cent. Through these legal provisions, it aims to represent at least one board member from minority shareholders. As per the Company Act 1997, number of members representing shareholders to the Board of Directors may range from 3 to 11 persons depending upon the size and nature of the company, but in practice, 5, 7, and 9 are the odd number selected for a composition of the board. Board directors, in great number, are non-executives among which one is made Executive Director who works as a member- secretary in the board meeting. By regulation, one can be an executive chairperson in place of executive director. Changing a hierarchy of authority for executive power is made by ad-hoc decision mainly in the interest of major shareholders in most of the organizations. So board members have to support major shareholders than to be accountable to shareholders and to the company. According to the Organization for Economic Co-operation and Development (OECD), accountability to shareholders means that an equal treatment of majority and minority shareholders and accountability to the company means that directors must ensure that the company complies with existing laws and regulations, such as tax, labor, health and safety laws, environmental legislation, and company laws (Fremond and Capaul, 2002). Business sector in Nepal is slowly realizing the importance of professional managers but their work style is still not getting free from traditional business culture that is the domination from the ownership rather than to listen to the professionals. This has also forced them to hold on to scrips thus limiting the volume to be operated at the secondary market.

Board of Directors is a composition of directors selected from different sources such as from the majority shareholders, from among the promoters by election under the support of majority shareholders, and from among the minority shareholders by election in the annual general meeting. Without the backing and support of majority shareholders, none of the contestants have chance of being represented on the board. The minority shareholder representing on boards, at present, is very close to the major shareholders and thus cannot go against the interest of them. A proxy voting is acceptable in election and a majority shareholder can transfer his votes which are over and above a limit requiring to win the election to a contestant representing the minority shareholders. The companies, as such, tend to follow a "parliamentarian model" of board representation, but majority shareholders exercise significant influence over boards directly as board members or indirectly through the appointment of board members who report to them. Disclosure of business relation and other personal interest with the company in which one becomes board member is mandatory since a new member joins the board meeting. Nepalese Company Act 1997 is not specific on the right and responsibility of the Board of Directors. It is left to the annual general meeting (AGM) which has to make decision on it. Without making the board of directors responsible to their duties, it is very difficult to make them effective. The apex body for good governance looks very privileged class in the company organization without commensurate repository of responsibilities.

These big businesspersons posses enough power to influence politics and bureaucracy, by supplying election funds to the national parties with a chance of coming in power and to major opposition benches to be able to influence the governments. Most of the minority shareholders, on the other hand, do not want or can be owners. They want to be passive investors or short-term investors. They do not buy a company. They buy shares that are sold as soon as they no longer offer good prospects for capital gains over a fairly short time. Hence, the prospective differs sharply and overwhelming domination of the majority shareholders persist. To overcome these problems companies, which are listed on the stock exchange, should have professional management and adequate checks and balances in place to protect the interests of minority shareholders to the maximum extent possible. There has been some discussion in Nepal about establishing a Corporate Governance Code. This may be one way of helping to ensure stronger corporate governance for the future thus paving way for the healthy growth of stock exchange by ensuring responsibility and accountability (World Bank, 2002:111).

RIGHTS OF SHAREHOLDERS

Voting is a fundamental right of equity shareholders in Nepal. The shareholders have the right to receive share ownership certificate within three months from the date of transferring share. It is mandatory to sell the derivatives through secondary market but the share ownership is not transferred unless it is registered to the new buyer at the office of the registrar. Shareholders are being made well informed about the financial position of the company through supplying audited profit and loss account and balance sheet in each year before the date of annual general meeting. In case of necessity, each type of information and documents such as memorandum of association, articles of association, prospectus, annual books of accounts and auditor’s report are accessible to them. Advanced notice that is 21 days before the date of annual general meeting with detailed agenda for discussion is published on a national daily newspaper inviting the shareholders to attend AGM. Those subjects not mentioned in agenda are not discussed. To a subject of shareholders’ interest to be discussed in AGM is to be written in the agenda before its circulation since the shareholders have noted down it.

All equity shareholders attending the AGM have equal opportunity of participating in policy decisions and in the election of board of directors. Each of them can raise questions pertaining to company performance and other matters. The objectives of possessing shares are found different in between minority shareholders and majority shareholders. To get a capital gain from holding shares is the main objective of minority shareholders while the objective of majority shareholders is to get ownership position in the decision making process of the company. However, a proportion of profit or bonus shares against taking profit are some of the options sometimes opened to the equity shareholders when the company makes profit.

Shareholders' meetings are generally organized once in a year, and is called annual general meeting (AGM) and a special general meeting is called in special conditions, AGM can make a decision to change the status of the company such as from public limited to private limited company since it fulfils the conditions mentioned in the company Act, 1997. In case of necessity, AGM can amend the memorandum of association and articles of association. With the permission taking from the company's registrar office, the AGM possesses the authority to increase and decrease the authorized capital. In case of increasing the capital, the increased additional amount is collected by selling additional shares in which a top priority is given to the previous shareholders.

The company Act 1997 makes an equal treatment of majority and minority shareholders and there is no special consideration for minority shareholders.

DISCLOSURE AND TRANSPARENCY

The family owned business in Nepal dominates the business sector as specified earlier. It has originated from personal relationship and mutual trust between the customers and businesspersons where the stakeholders had no use of corporate information. Such books of accounts and accounting information are important variables for decision-making but that were treated as secret documents. Since the government had started to impose tax on corporate income, accounting records and books of accounts started to be prepared scientifically in different forms and purposes. It generally reported in Nepal that three types of books of accounts are used e.g. one for taxation, one for taking loan from banks, one for confidential use. It is a serious issue, if correct, requiring detailed and thorough enquiry to adhere to acceptable accounting standards and ensure proper disclosure. VAT is expected to minimize these anomalies but in real practice, a lot more needs to be done. With the establishment of World Trade Organization (WTO) in 1995, a drastic change has taken place in the philosophy and practice of corporate culture. It emphasizes on stricter disclosure and transparency. A changed culture is a new culture, which encourages to maintain good relationships between a company's management, its board, its shareholders and other stakeholders and to disclose the financial and non-financial information to stakeholders. Financial information is a statement of books of account and non-financial information includes (i) company objectives (ii) off-balance sheet commitments and litigation risks (iii) the ownership structure of the company (iv) the remuneration of board members and key executives (v) material foreseeable risk factors (vi) material issues regarding employees and other stakeholders and (vii) information on governance structures and policies. It takes time to adapt a new corporate culture in Nepal.

Table 4. Status of Disclosure

Category	2001/02			2002/03		
	Total No	Disclosed Companies	Percentage	Total	Disclosed	Percentage
Banks	12	11	91.7	15	12	80.0
Finance Companies	30	28	93.3	35	29	80.3
Insurance companies	7	5	71.4	13	6	46.2
Hotels	4	2	50.0	4	4	100.0
Manufacturing and Processing Companies	28	14	50.0	29	13	44.9
Trading Companies	8	5	62.5	8	3	37.5
Others	3	3	100	4	0	0.0
Total	92	68	73.9	108	67	64.8

Source: SEBO, 2002

The disclosure status shows 2001/02 that overall only 73.9 percent companies were furnishing information to NEPSE in 2001/02, which further deteriorated to 64.8 percent in 2002/03. Out of it the finance companies with 93.3 percent disclosure (non-disclosing includes only public sector NIDC) and banks except Nepal Bank Ltd., (not disclosing after 1994/95) and one recently listed have all met requirements in 2001/02. But in 2002/03, Nepal Bank Ltd furnished the data but 20 percent banks and finance companies did not furnish it showing that the problem is becoming all pervasive across the sectors. The manufacturing, hotels and trading sectors lag substantially behind in meeting disclosure requirements. De-listing in 2001/02 is a right step but it still reflects poor disclosure status. It should also be noted that out of 68 disclosing companies, six have furnished only financial information and one has submitted only partial information. Adjustment to these would further reduce the real disclosure status, which is a very weak showing on the part of SEBO and NEPSE.

Beside poor disclosure, those who disclose also do not adhere to internationally standard practices due to poor accounting and auditing standards. The general level of accounting as well as auditing are poor meaning that investing on published financial statements are not without risk- actually could be highly risky at times. Perhaps the most important factor impeding the development of the NEPSE is poor accounting standard in corporate sector in general in Nepal. It is still poorer in other enterprises. This is a fundamental problem, which will require rectification before the market can grow beyond its current incipient state. Weak accounting and auditing standards mean that many companies' financial statements are not credible (World Bank 2002:111). In fact, some companies which are currently listed on the NEPSE have not produced accounts for several years-Nepal Bank Limited being one case in point, which has not furnished information since 1997/98.

CONCLUSION

Capital market remains important for all types of investors to participate in economic development. Nepal lags behind to develop a healthy capital market with a sound financial infrastructure though the Nepal Stock Exchange was formalized eighteen years ago in 1985 and NEPSE established only in 1994. Regulatory measures are slowly updating incorporating the contemporary issues but that has not been found effective because of governance problem in the corporate sector. Corporate sector is generally not transparent. The culture of keeping books of account secret is still alive. Minority shareholders have no access to the books of accounts kept as secret documents. Capital market in Nepal is confined to equity market only. Debt transaction is negligible in Nepal Stock Exchange. Turnover as well as market capitalization are very small relative to its GNP. Besides, NEPSE is not integrated into the world markets. Capital market, at the present position, is beneficial to the investors who can overlook the rules of game. It is yet to be rational to a discerning investor. Unless, it is changed, capital market will not contribute in a desirable way to contribute to growth. In order to improve it, accounting and auditing standards, disclosure and corporate governance need to be upgraded significantly and on the other the monitoring and policy response capacity of SEBO should be enhanced.

APPENDIX

Nepal Stock Exchange Limited
Summary Sheet of Transactions, 1999/00 to 2002/03

	1999/00	2000/01	2001/02	2002/03
Turnover(Rs in million)	1157.0	2344.1	1540.6	575.8
Banks %	75.9	82.3	76.3	62.2
Insurance and Finance %	12.4	12.6	12.9	34.0
Manufacturing and processing %	6.4	2.9	1.4	0.6
Hotels %	2.3	1.0	9.0	1.1
Trading %	1.1	0.2	0.2	2.3
Others %	2.0	1.1	0.2	0.1
Market Days	240	231	246	238
Average Daily Turnover (Rs. in Million)	32.0	10.1	6.3	2.42
Number of Transactions	29136	46095	42028	69163
Number of Companies Traded	69	67	69	81
Number of Shares Traded(Share Units 000)	7673.7	4989.2	6005	2428
Number of Companies Listed	110	115	96	108
Number of Scrips Listed	112	115	NA	NA
No. of Listed unit of Mutual Fund	5250	5250	NA	NA
Total amount of Listed Shares (000)	7347.4	7919.1	NA	NA
Market Capitalization of Listed Companies (Rs in Million)	43123.3	46349.0	34703.8	35240.4
% of Turnover to paid up value	15.7	28.7	15.9	4.5
% of Turnover to Market Capitalization	2.7	5.1	4.4	1.6
No of Listed Securities	114057	124971	134150	159958
Banks %	9.1	8.7	12.5	NA
Insurance and Finance %	30.9	33.9	41.7	NA
Manufacturing and Processing %	33.6	32.2	29.2	NA
Trading %	2.7	2.6	4.2	NA
Other %	20.0	19.1	8.3	NA
NCM Mutual Funds	1	1		
NEPSE Index	360.7	348.4	227.5	204.8

Source: Nepal Stock Exchange, Annual Report 2002 and 2003

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