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## **Assessment of Disclosure Standard in Stock Market**

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Capital market has grown in the country as an important base for the collection, allocation, mobilization and utilization of needed funds for the listed companies. In the global context, the investigation of a host of companies that were playing game with numbers providing unreliable information and improper disclosure has led to massive financial scandals and corporate crimes (Business Week, July, 2002). The cases of Enron, Global Crossing, Kmart, etc. have become hot news, which focused on lack of timely disclosure of information thereby violating the accountability of companies and auditors to shareholders. In the corporate world, disclosure norms are climbing the ladders of misrepresentation, fraud and deception. There had been debunking of myths (Turner, 2001) in global reforms at a time when the global economy is facing poor corporate governance and political interference in business to play hide and seek in the quality and corporate disclosure norms.

Violation of disclosure norms (Donaldson, 2003) is emerging without knowing when there had been enforcement issues, failing to catch illegal trading in securities, corporate stone walling, loss of image of integrity and deepening erosion of investors trust. Even with the existence of new oversight audit Board to improve disclosure standards, the powered pro-investor group voices focused on the financial reporting cases (Byrne, 2003) with lot of accounting scandals, ethical lapses, governance crisis and outrageous CEO payoffs. In fact, companies are in the downside of disclosure (Braham, 2003) for the simple reason that there had been the rising signal of accounting misbehaviour leading to unfair disclosure practices and deteriorating quality of data, poor state-of-the art technology in disclosure standards and shocking revelation of corporate frauds.

In the Tenth plan Document (2002-2007) of HMG/N, it has been clearly stated that the government is committed to create opportunity for number of people to reap benefits from the return obtained by directing investment in income generating portfolio of assets. But this objective can be fulfilled only by the rational and accountable behaviour focused towards the compliance of the

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disclosure standards by the key players in the capital market. The Current Public Statement on Income and Expenditure of the Fiscal Year, 2003-2004, has clearly spelled out the need for developing appropriate disclosure standards and norms to enhance public ownership in the existing new public limited companies while tapping public savings for the growth in national productive sectors.

Moreover, significant efforts are going on at the policy and institutional level through suitable amendments from time to time in Securities Exchange Act, 1983 and other securities by-laws to determine standard of information disclosure and notice for issuing securities and trading in secondary market for reliable and timely public information. Various directives and guidelines have been issued from time to time to improve the quality of disclosure for bringing adequate transparency, and timely disclosure of information to the concerned parties and stakeholders.

The fair disclosure in primary offerings (Five Year's Performance, SEBO, 1998) has been adequately focused to see that registration documents contain sufficient information to help investors make right investment decisions. Due to SEBO's continuous follow-up through correspondence, public notice, education by publication of booklet, improvements have taken place on disclosure with increase in submission of financial statement from more than 70 percent of listed public limited companies (Annual Report, 2001/02, SEBO). To improve the quality and content of disclosure, a new strategy has been initiated through the implementation of Corporate and Financial Governance Project (Study on Corporate Annual Reports and Recommended Formats and Disclosure, ICAN, 2000) to strengthen institutional capacity of Securities Board of Nepal (SEBO) and develop information disclosure standard of securities business persons, listed companies and other relevant professional institutions related to securities market.

An emphasis has been given to the supervision and monitoring activities of SEBO to evaluate the reliability of information disclosed during the public issue process and continuation of secondary market transactions. The issue managers are required to submit the important materials prepared for public announcement that include prospectus, announcement, advertisement, allotment, refunding, securities listing etc. Moreover, on the secondary market, disclosure covers

submission of reports like annual report, minutes of annual general meeting, reports on securities trading, membership, representation, etc.

On this regard, even the Institute of Chartered Accountants of Nepal (ICAN) and Association of Chartered Accountant of Nepal (ACAN) are actively involved in developing appropriate accounting standards disclosure especially information to be disclosed in financial statements that must be simple and informative to the intended beneficiaries, (SAFA, 1994).

The Economic Survey Report, 2002/03 has shown the trends of both primary and secondary markets. In the primary market, issues were approved to additional six companies equivalent to Rs.399.5 million, while in the secondary market; the market capitalization recorded was Rs.34503.3 million, which represented 8.4 percent of GDP. The NEPSE Index stood at 209.6 points. Disclosure standard in stock market however is not winning investors' confidence since approval guidelines in primary issues and monitoring and supervision methods in secondary market are still not transparent, fair, efficient and responsive to the needs of dynamic and competitive capital market.

The disclosure of reports from issue managers, stock brokers, securities dealer, and listed companies does not seem to completely follow the compliance provisions of Securities Exchange Act, 1983. But, improvement in the disclosure practices are taking place since the financial statements of the listed companies and disclosure provisions for securities businesspersons have been put in NEPSE web site for information to general investors.

The needed guidelines and directives have been developed to provide adequate and transparent disclosure to bring efficiency in the function of both primary and secondary markets. The Initial Draft of New Securities Exchange Act, 1999 has been forwarded to HMG/N for consideration and a policy to implement a Study Report on Corporate Annual Reports and Recommended formats and Disclosure is going on. The reliability of information (SEBO and ICAN Study, 1997) furnished by annual reports can be a strong measure for effective disclosure of information to investors in view of developing internationally accepted accounting and auditing standards.

### **Sound Theoretical Rationale: Conceptual Framework on Disclosure**

Disclosure Standard implies to any kind of reliable information disclosed to the users of information especially to shareholders and other interested investors. This helps to understand the performance of companies that affect the capital market as a result of the primary and secondary market activities. Disclosure according the Webster's Dictionary implies to make things known to the public without hiding any material facts. The act of disclosing helps the public to have rational judgment through the process of analysis and evaluation of performance necessary for making decisions. In fact, disclosure standards originate from accounting policies followed because many interested parties want to see whether the management follows the accounting principles, bases, conventions, rules and procedure. Such disclosure tends to be more effective with accounting standards and norms not being violated.

Disclosure should be in line with financial and audit compliance (Audit of Public Enterprises, ITC, 1990) whereby the financial statements properly and truly reflect the financial transactions for the period under investigation and transactions undertaken are in compliance with applicable rules, regulations and laws that follow generally accepted accounting disclosure standards and principles. It is mainly because that the truth in disclosure standards has decisive impact on the performance of the stock market and confidence of the investors.

Whatever the funds raised from the public needs to be expended in accordance with legitimate authority. If not, any illegality and inadequacies in system of management and accounting disclosure standards can undermine the public confidence that ultimately affects the stock market in one way or the other. In our country, despite continuous efforts to improve the quality and contents of disclosure standards, many inconsistencies still exist due to restraint and reluctant attitude (Shrestha, 1996) of management towards adequate disclosure of information to the public. The presentation, quality and contents of disclosure are still not proving satisfactory to win the confidence of investing public.

In advanced countries, the very existence of the phenomena of the efficient market hypothesis is based on the effective disclosure of information to the public. It is because on the basis of disclosure standards, the levels of Market Efficiency are determined (Fama, 1970). In case of weakly efficient market

hypothesis, the traditional type of information usually all the historical information is disclosed to reflect their impact on security prices. The emphasis is disclosure of historical price and volume of transaction data used to reflect the current market price. This is used to predict the future stock price changes in stock market. But many of the empirical studies and evidence reveal that disclosure of past prices changes are unrelated to future price change although there is still strong belief on the random walk hypothesis to operate in a market proving inefficient because of the lack of adequate disclosure of even the historical information for proper stock market analysis.

The second type of efficient market hypothesis related to disclosure is the semi-strong efficient market hypothesis where all publicly available information is reflected in security prices. It is the comprehensive level of market efficiency where disclosure of information of past and publicly known information reflects stock prices. Insiders who have access to valuable information not disclosed to the public could earn a profit larger than the investors having no such access. The problem of inside information is still a continuing phenomena although disclosure rule states that no one can take advantage of inside information and notice has been circulated to make known the price sensitive information to the public.

### **Review of Disclosure Practices:**

Given the conceptual highlight and briefing of the disclosure norms, it is now important to investigate about the disclosure practices in Nepal. There is no denying the fact that disclosure norms are proving weak as well as inadequate as many institutions dealing with public funds are not feeling any responsibility to make full disclosure of information to the public both in the primary and secondary market. Even then the government and regulating authorities are trying to impose disclosure norms necessary to make public known about what is really going on the performance of the institutions.

Under Surveillance and compliance, SEBO is trying to improve disclosure (Strategic Plans, SEBO, 1998-2002) through adequate and timely financial reporting, response to investors; grievance, routine monitoring and supervision and ensuring financial compliance and professional conduct in securities transactions. But, in practice, the management attitudes towards disclosure is not

found to be encouraging since a lot of lame excuse is taken for delaying in information disclosure either because of fear of losing secrecy of management weakness or because of public abuse that management has to face from the public.

Disclosure norms can be looked from different perspectives and for simplification it can be streamlined as follows:

### ***Disclosure in Primary Market***

Any public limited company floating shares to the investing public has to follow disclosure standard norms laid in the law. SEBO monitors and supervises the adequacy of disclosure norms regarding the primary market activities during the initial public offering. In fact, SEBO monitors the primary issues related to status of disclosure provided in prospectus, the proper timing of public issue, the timing allotment of public issues, listing of securities and reporting of issue management activities.

It is not possible to deal in detail with each of these related aspects and mere emphasis is made on disclosure norms required in prospectus. According to Section 20(1) of Companies Act, 1997, every public company has to publish its prospectus before issuing securities and Section 20(2) of the same act requires the directors to submit a copy of prospectus to the concerned authorities and after thorough scrutiny with necessary amendments, the prospectus is approved for initial public offering.

But, in the initial stage of capital market development in the country, rather lax policy was followed and rosy picture shown in prospectus was not subjected to through investigation and supervision (Shrestha, 1997). This had brought booms in capital market for some period of time with rise in investors' confidence.

However, in Companies Act, particulars to be set in prospectus are clearly spelled out to cover objectives of company, minimum number of shares required to be subscribed, remuneration of promoters, provision of bonus shares, reservation of shares to employees, identification of directors with detail particulars, inclusion of premium in issue of shares and shareholders' representation in board of directors. Many other provisions like use of loan

capital, purchase and sale of assets, use of brokerage in floatation of shares, estimate of expenditure and income at least for three years, possible financial risks involved in running the business, financial arrangements made, detail list of the names and particulars of all those involved in companies and other important matters to be clearly stated in prospectus.

The compliance of these specified legal provisions are by themselves disclosure norms and violation of any of these norms can mean direct violation of shareholders' rights. In many companies, the prospectus provides these disclosure norms but in practice, the actual financial statements seem to deviate much from these disclosure to the extent that shareholders are found misguided with fraudulent information due to unhealthy intention (Panthi, 1999). This is because the projected figures in prospectus in most of the public limited companies are not keeping pace to the actual results.

The issue managers like NIDC Capital Market, Nepal Share Market, Nepal Merchant Banking and Finance, National Finance, NEFINSCO, Ace Finance, etc have also significant role to play in the primary market in providing correct disclosure to the investors to save themselves from the false information. But in the initial development of capital market, they are found not serious professionally to go through the contents of the prospectus since they are more concerned how to get business rather than going for thorough investigation and study. Serving as issue managers, that have put the investors in trouble as is case with flotation of shares of Oriental Hotel, Taragau Regency Hotel, Nepal Film Development, Harisidhi Brick and Tile Factory, Himalayan Distillery, Agro Nepal, Nepal Med, Jyoti Spinning Mill, Butwal Dhago, Indreyani Soyabean, Nimrod Pharmaceuticals, Ace Laboratories, Himgiri Textiles, Balaju Kapada Udhyog, etc.

### ***Disclosure in Secondary Market***

In the Secondary market, SEBO has monitored the status of the corporate disclosure focusing on listed companies publishing annual reports, holding annual general meeting timely, dividend declaration and response to the grievances of the shareholders. But greater emphasis is given to annual report and its relationship with compliance of disclosure norms. Every company has to provide annual report to shareholders in annual general meeting to cover

important information specified under section 83(3) of Companies Act, 1997 with subheadings from a to h. The matters to be included are among all-review of the transaction of previous year, impact caused on transactions from national and international situation, achievement of the current year with opinion of board of directors, industrial and professional relations, alteration in board composition, major things affecting the company's transactions, remarks and comments in audit report, percentage of dividend recommended out of profits to the shareholders and any other matters proving important to be disclosed. The contents of the annual report should be true and fair not to deceive the investing public. The compliance of these disclosure norms is still a problem and quality and content of disclosure is not yet found standardized. It is mainly because management attitudes towards disclosure is not still proving professional and encouraging as they think these disclosures are not important.

A concrete empirical study at this juncture is not possible although certain hints and signals do exist in the violation of the disclosure norms laid down in legal provisions and various policy documents. The Company's Act, 1997 under section 83(1) requires Board of Directors of a Public Limited Company to prepare annual account and reports every year at thirty days prior to holding of annual general meeting and they have to disclose balance sheet up to the last date of the fiscal year, profit and loss account of the fiscal year and description of the cash flow of the fiscal year. Again, the concerned authorities like Securities Board of Nepal require the listed companies to submit their annual report including balance sheet, profit and loss statement and cash flow statement within four months after the expiry of the fiscal year and half yearly report within two months after the expiry of the period to NEPSE and SEBO.

The seven years data reveals that the listed companies increased from 89 in 1995/96 to 115 during 2000/01 but due to de-listing it decreased to 96 in 2001/02. But compliance of the disclosure is 71 percent of listed companies and in some years it had dropped to 55 percent. However, taking disclosure status of the listed companies, finance companies top the list since more than 90 percent of finance companies submit the annual report timely to the concerned authorities, then followed by commercial banks providing disclosure varying from 83% to 90%. Insurance companies come under third ranking of the disclosure status from 72% to 82%. Hotels and others provide disclosure from 50% to 80%.

Manufacturing sector have disclosure status from 35% to 50% and among all trading sector has the lowest disclosure status from 18% to 30%.

Year	Listed Companies	Companies Submitting	%
1995/96	89	59	66
1996/97	95	56	59
1997/98	101	58	57
1998/99	107	68	64
1999/00	110	61	55
2000/01	115	67	58
2001/02	96	68	71

*Source: Securities Board, Nepal 1995/96-2001/02, Thapathali, Kathmandu*

A study on the compliance of the legal provisions on listed companies conducted by SEBO during 1997/98 revealed that a fair and transparent disclosure is still a continuing problem. Disclosure norms are complex and confusing (Compliance Status, SEBO, 1997) due to conflicting legal provisions, legal contradictions, existence of multiple regulators, lack of corporate governance practices, non-responsive attitude, less seriousness and no sincere interest in compliance of rules and regulations, weakness in information disclosure, circulars and notice to investors and lastly failure of the management to adhere to the directives and guidelines issued from time to time.

In the study, conflict of legal provision regarding disclosure norms is explained. As for instance, one such conflict is that according to Securities Exchange Act, 1983 listed companies are required to submit financial statements within four months from the expiry of the fiscal year but Section 83 of the Companies Act, 1997 requires the submission of financial statements within six months from the expiry of the fiscal year. Various financial reporting formats have been developed from time to time in addition to change in guidelines for making disclosure beneficial and informative to the public.

But, the core problem remains the same due to conflict in legal provisions as there are multiple regulators imposing their own rules and regulations on the

same institution. It makes financial institutions like commercial banks, finance companies, insurance companies, etc. to fall into legal dilemma-either to follow the legal provisions prescribed in their respective acts or to follow directives and guidelines in the matters of disclosure norms. There is no reason why financial institutions having provided disclosures according to requirements in main law need to again follow guidelines and directives beyond legal provisions of disclosure. This has brought unnecessary disclosure harassment to financial institutions.

Many listed companies are not found to hold the annual General meeting of the shareholders to provide timely financial reporting. During 1998/99, out of 107 listed companies, only 65 companies conducted the annual general meeting of the shareholders. The rest of the listed companies just take lame excuses of irresponsible nature like informing that auditor's report is not yet complete and the company is engaged in other important works. But, there is a provision in Section 63(1) of company's Act that every public limited company shall hold the first annual general meeting within one year from date of approval to commence its business, and thereafter it shall hold annual general meeting every year within six months from the expiry of its fiscal year. In the same act, additional two months time limit is given to hold annual general meeting. The number of companies holding annual general meeting are 59 out of 110 during 1999/00. But, in 2000/01, out of 115 listed companies, only 53 companies held annual general meeting. So, there are many listed companies that have failed to conduct annual general meeting of the shareholders. This means that management is not serious on the matters of timely disclosure.

### ***Disclosure Norms For Others***

SEBO is currently carrying out sweeping reforms to improve the disclosure norms. SEBO has supervised the reporting status of the various market intermediaries like primary market dealers, secondary market dealers, brokers, market makers, etc., to investigate how far their involvement in securities transactions are in conformity to the disclosure standards. Special reporting formats have been developed for adequate supervision of securities businesspersons. It is legally binding for the market intermediaries to submit their annual reports along with their financial statements within 4 months after the expiry of the fiscal year. Taking the period from 1995/96 to 2001/02, there has

been substantial improvement in reporting practices of the securities businesspersons since compliance of the disclosure has increased from the lowest of 28% to the highest of 96% and that of the disclosure of issue managers has increased to 78% from 67%.

According to available reports, 9 issue management companies and 15 brokering companies submitted the financial statements. Only 70% of issue management companies and 50% of the brokerage firms seem to fulfill the disclosure norms.

In 2001/02, out of 10 market intermediaries, only 7 submitted the financial statements. In case of brokerage firms, 19 out of 27 have fulfilled the disclosure requirements of SEBO by timely submitting their annual report. In 2001/02, 7 out of 10 issue managers are found to submit the financial statements to SEBO. Out of 27 brokerage firms, 26 made the disclosure of reports. However, only 22 securities brokers provided cash flow statement and only 2 securities brokers submitted transaction report to SEBO.

Year	Brokerage Firm			Issue Managers		
	Submitting	%	Total	Submitting	%	Total
1995/96	25	7	28	3	2	67
1996/97	25	9	36	3	2	67
1997/98	29	15	51	3	2	67
1998/99	29	18	62	9	7	78
1999/00	26	19	73	9	7	78
2000/01	27	19	70	10	7	70
2001/02	27	26	96	10	7	70

Source: Securities Board, Nepal 1998/96-2001/02, Thapathali, Kathmandu.

### **Empirical Analysis of Disclosures**

The empirical analysis of disclosures is based on six years data from 1996 July to 2001 July and these data are based on the published Annual Reports of Securities

Board, Nepal. The performance of corporate disclosure on NEPSE Index, Trading Turnover and Market Capitalization is given below:

<b>Year</b>	<b>Corporate Disclosure (%)</b>	<b>NEPSE Index</b>	<b>Trading Turnover (Rs. in Million)</b>	<b>Market Capitalization (Rs. in Million)</b>
1996	73.0	185.6	209.9	12295.0
1997	72.6	176.3	416.2	12698.0
1998	54.7	163.4	202.6	14289.0
1999	58.2	216.9	73.8	23508.0
2000	57.3	360.7	283.7	43123.3
2001	70.8	348.4	128.0	46349.0

### ***NEPSE Index and Corporate Disclosure***

Considering the NEPSE Index as dependent variable, it shows NEPSE Index is positively correlated to the corporate disclosure. The coefficient of correlation is 0.070 but the coefficient of determination R is 0.005. This gives the indicative signal of a positive relation of dependent variable (NEPSE Index) over the independent variable (Corporate Disclosure). However, there is no denying the fact that NEPSE Index is the key determinant variable in the secondary securities market. The positive coefficient of correlation between corporate disclosure and NEPSE Index indicates that investors are gradually getting aware with the importance of fundamentally backed financial information to ignore the risk factors. Similarly, observing the test of confirmation of the results by the use of the F-test ratio, it is found that the tested value is less than the tabulated value at 5% level of significance and this gives a clear cut message that the coefficient of correlation is significant.

The output of regression analysis in the above table exhibits that the regression line is:  $NEPSE\ Index = 289.098 - 0.733 * Corporate\ Disclosure$ .

<b>Dépendent Variable</b>	<b>Constant</b>	<b>Régression Coefficient</b>	<b>R</b>	<b>R<sup>2</sup></b>	<b>t-value</b>	<b>Sig.</b>	<b>F-value</b>	<b>Sig.</b>
NEPSE Index	289.098	-0.733	0.070	0.005	0.856	0.440	0.020	0.895

### ***Trading Turnover and Corporate Disclosure***

In the table presented below, it is clear that the Trading turnover is dependent variable while the corporate disclosure is an independent variable. Trading turnover is positively correlated with the corporate disclosure. The coefficient of correlation is 0.031 but the coefficient of determination R is 0.090. This shows that a positive relation of dependent variable (Trading Turnover) over the independent variable (Corporate Disclosure). Trading turnover is a good surrogate to measure the performance of the stock market in general. The positive coefficient of correlation between corporate disclosure and trading turnover provides a good message of the investors' confidence of buying and selling securities. This also shows the fact that investors are gradually getting conscious to invest in shares of the listed companies. However, observing the test of confirmation of the results by the use of the F-test ratio, it is found that the tested value is less than the tabulated value at 5% level of significance and this shows that the coefficient of correlation is significant.

<b>Dépendent Variable</b>	<b>Constant</b>	<b>Régression Coefficient</b>	<b>R</b>	<b>R2</b>	<b>t-value</b>	<b>Sig.</b>	<b>F-value</b>	<b>Sig.</b>
Trading Turnover	-54.692	4.246	0.301	0.090	-0.125	0.906	0.398	0.563

The output of regression analysis in the above table exhibits that the regression line is: Trading Turnover=-54.692+4.246\*Corporate Disclosure.

### ***Market Capitalization and Corporate Disclosure***

In the table presented below as per annex, it is clear that the Market Capitalization is dependent variable while the corporate disclosure is an independent variable. Market Capitalization is positively correlated with the corporate disclosure. The coefficient of correlation is 0.134 but the coefficient of determination R<sup>2</sup> is 0.018. This clearly exhibits a positive relation of dependent variable (Market Capitalization) over the independent variable (Corporate Disclosure). Market Capitalization is a message of the market to see how the stock is really performing. It is the technical yardstick to measure the performance of the stock market in general. The positive coefficient of correlation between corporate disclosure and Market Capitalization provides an appreciation in shareholders' value in terms of wealth maximization generated

from capital gain from stock transaction. But, the rational behaviour of the investors is still a missing linkage in the slowly growing securities market of Nepal. While observing the test of confirmation of the result using F-test ratio, it is found that the tested value is less than the tabulated value at 5% level of significance and this shows that the coefficient of correlation is significant.

Dépendent Variable	Constant	Régression Coefficient	R	R <sup>2</sup>	t-value	Sig.	F-value	Sig.
Market Capitalization	41103	-244.066	0.134	0.018	0.701	0.522	0.073	0.80

The output of regression analysis in the above table exhibits that the regression line is: Market Capitalization=41103-244.066\*Corporate Disclosure

On the overall observation, it is quite evident from the supporting data that corporate disclosure is significantly related with movement in NEPSE Index, Trading Turnover and Market Capitalization. The favourable the corporate disclosure, the greater is the response in rise of NEPSE Index, Trading Turnover and Market Capitalization.

### Disclosure Issues

The compliance of the disclosure norms is still a problem because the regulatory bodies are not finding so easy to enforce the full disclosure of information. The provisioning of information disclosure norms specified in various acts, byelaws, directives and guidelines pertinent to securities transactions and determination of securities price is not satisfactorily followed due to authority overlapping and conflict of laws and regulations. The listed companies are not fulfilling the disclosure norms since even now many of them do not conduct annual general meeting timely in the absence of the annual and audit report produced within the time framework specified in respective acts, laws and internal rules and regulations.

The prospectus issued to the public at the time of floating shares is not presenting fair and true information disclosure since there is a lot of deviation between projected figures and actual results shown in financial statements. The fraudulent and worthless securities are often issued in the securities market without actually

investigating on the track record of the promoters in terms of their integrity, moral standing and professional background. The regulating authorities often by pass the disclosure affecting the interest of investors without actually making through scrutiny of the prospectus submitted for approval of issues. The unfair stock market practices often go undetected without compliance of the disclosure norms. As for instance, the latest current data on disclosure status reveals that only 68 out of 96 listed companies provided disclosure and there are still 28 listed companies not providing disclosure to the public. Price sensitive information is not provided immediately to investors and there is still play on inside trading on information before coming to the public due to delays in information disclosure.

### **Suggestion for Improvement of Disclosure**

There are many disclosure issues and there is need for improvement of disclosure norms. The regulators should think of undertaking significant measures for upgrading the quality and contents of disclosure standards that help in promoting the capital market in the country. Efforts should be made for encouraging the listed companies to comply with legal provisions such as submitting the financial reports timely, conducting the annual general meeting timely, making access to price sensitive information to investors, discourage inside trading on information, presenting true information in the prospectus, need for having good corporate governance and ensure compliance of the listing guidelines and securities market regulations.

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## **Agency Problem: Implications to Corporate Governance**

- Abin B. Pradhan\*

### **What Type of Problem is this?**

Agency Problem is a management terminology to describe a situation in which incentives of owners (shareholders) and managers are misaligned leading to potential conflict of interests. In other words, agency problem arise when a manager or a management team act to pursue their own interests rather than in the best interest of the shareholders. Such managers make biased decisions favoring short-term pay-offs rather than advocating long-term value of the firm they are working for. As we all know managers are required to fulfill their obligations in a manner that enhances firm and shareholder values and not be driven by elements that help to satisfy their own interests and desires. It has been seen that this issue generally arise when managers get swayed into manipulating financial data to misrepresent his or the firm's performance, in contrary to the company's true economic reality, instead of just exercising their discretionary power based on facts.

Despite continued efforts to curb this problem over the years through numerous creative methods, the problem keeps manifesting itself in many ways, creating a devastating effect in the corporate and financial sectors. Even the root of the problems leading to the Asian financial crisis and the seemingly unending series of scandals that rocked the US corporate sector during 2000-2002, could be traced back to agency problem. Closer to home, the discovery of unacceptably large non-performing loans/assets in the two largest government owned commercial banks (RBB and NBL) is another testimony where managers of those banks and borrowing companies have worked with vested interests rather than thinking about the long-term impact on their respective institutions.

Manipulation of financial data to misrepresent the true condition of the firm, overly optimistic research reports prepared by stock market analysts, and allocations of initial public offerings (IPO) to corporate executives as a quid pro quo for personal favors or the promise to direct future business back to the manager of the IPO are just some of the manifestations of this problem. All of

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this shows a strong link between agency problem and corporate governance. History continues to prove that if this problem is not addressed in the gestation period, which unfortunately goes undetected in the radars of the corporate governance of most economies, it will eventually surface in future as an unstoppable wave that could destroy more than one can imagine. Hence, the modern capital markets could hardly afford to ignore its existence and its potential destructive attributes anymore. The genesis of the agency problem would most probably be the separation of ownership and management in a business.

### **Why Is Ownership and Management Separate?**

Many businesses are owned and managed by the same individual. This simple organization, well suited to small businesses, in fact was the most common form of business organization before the Industrial Revolution. In the US such business entities were popularly known as mom-and-pop shops, as it was usually the heads of families that operated the businesses. Here in Nepal, this is still the pre-dominant form of business. Today, however, in the more developed economies, with global markets and large-scale production, the size and capital requirements of firms have sky rocketed. For example, General Electric lists about \$44 billion of property, plant and equipment on its balance sheet. Corporations of such size simply could not exist as owner-operated firms. General Electric actually has more than half million stockholders, whose ownership stake in the firm is proportional to their holdings of share.

Such a large group of individuals obviously cannot actively participate in the day-to-day management of the firm. This structure means that the owners and managers of the firm are different. This gives the firm a stability that the owner-managed firm cannot achieve. For example, if some stockholders decide they no longer wish to hold shares in the firm, they can sell their shares to other investors, with no impact on the management of the firm. Thus financial assets and the ability to buy and sell those assets in financial markets allow for easy separation of ownership and management. In fact, it is the separation of ownership and management, which has become the most essential ingredient of the modern corporate world and has been the driving force behind the success of the developed economies around the world.

How can all of the disparate owners of the firm, ranging from large pension funds holding thousands of shares to small investors who may hold only a single share, agree on the objectives of the firm? Again, the financial markets provide some guidance. Here, the firm's management pursues strategies that enhance the value of their shares. Such policies will make all shareholders wealthier and allow them all to better pursue their personal goals, whatever those goals might be. One may ask – “Do managers really attempt to maximize firm value?” since it is easy to see how they might be tempted to engage in activities not in the best interest of the shareholders. For example, they might engage in empire building or avoid risky projects to protect their own job or over consume luxuries such as corporate vehicles, reasoning that the cost of such perquisites is largely borne by the shareholders. This effectively leads to the undesirable conflicts of interest between the owners (shareholders) and the managers, who are actually hired as agents of shareholders responsible for safeguarding the shareholders' interests.

### **How is Nepal's Corporate and Financial Sector Faring?**

The development of capital markets in Nepal is still at a nascent stage by any conventional standard. The economic liberalization, which really started to gain momentum after the establishment of several joint-venture commercial banks in the mid-eighties, ushered to establish a full-fledged Nepal Stock Exchange (NEPSE) and a Securities Board of Nepal (SEBO) to trade and regulate securities respectively in the Nepalese capital markets. Despite revisions in the Securities Law and its underlying regulations to make the capital market more vibrant and dynamic, the efforts have not yet yielded the desired results. With current annual stock trading turnover of about US \$64 million, market representation severely tilted towards the banking sector (around 80%), almost non-existent institutional investors, undeveloped bond and derivative markets coupled with serious governance issues, our market is far from appealing to potential investors. In many ways this has restricted the real (manufacturing) sector from actively raising funds from the capital market, slowing down the separation of owners from managers in the majority of businesses in the country. This has given rise to many governance related issues.

The private sector in Nepal, as mentioned earlier, is dominated by businesses, which are owned and managed by the same individual or members of a family. In this regard, it is safe to say that most businesses are family owned and operated

with company's shares limited mostly to family members. It has been seen in many South East Asian countries that there are inherent restrictions in this type of business model, tempting managers or the management to resort to unethical behaviors while raising funds and managing the operations. Cross-holdings, selection of incompetent directors in the Board by virtue of family ties, non-transparent business procedures and strategies, use of various strategies to evade taxes, secret negotiations with banks to relax loan repayment schedule through unfair means, poor monitoring and evaluation of manager's performance in light of agency problem are some of the major compromises made in corporate governance by most of these types of businesses, also prevalent in Nepal. Although some banks in Nepal have started to introduce code of conducts for employees based on good governance, tie performance with remuneration and make directors and managers more responsible for their actions, there is still very little understanding of the potential agency problem and its ramifications. In fact, even the best of banks do not evaluate their manager's performance in light of agency problem, who are, more often than not, likely to massage the financial reports to make it appear much better to the shareholders in the AGM than the true economic reality of the company. Such evaluations have short horizons and are generally responsible for creating unwanted problems in the longer term, while the managers who were initially responsible for creating the problem would have already left scot-free with fat pay-offs.

In most cases, huge problems appear in the business due to the cumulative summation of seemingly benign, yet wrong actions committed by individual managers of a company, which goes unchecked by the Board in the initial stages. By the time it has manifested itself, it would be all too late like other things in life. As we all are aware that the corporate culture in Nepal is still in its primitive stage, though lot of improvements are being made in the recent years. The Company Act and Securities Act have been meticulously revamped with the key objective to improve corporate governance in the financial sector. These laws will require the Board of Directors to function with greater transparency and accountability, greatly facilitate entry and exit of companies and empower SEBO to regulate the capital market with greater effectiveness. In addition, two more laws namely, Secured Transaction and Insolvency (Bankruptcy) Laws, will complement the previously mentioned laws by allowing the use of movable assets as collateral and Chapter 7 restructuring of management post-declaration of bankruptcy. All those legislative reform measures are geared towards

minimizing market distortions and exploitations by managers, who fall victim to agency problem. It is very encouraging to note here that the Securities, Insolvency and Secured Transaction Ordinances were promulgated in September 2005, and the Company Ordinance is expected to be promulgated in October 2005. Compared to the modern corporate world of the USA, which time and again is held hostage by managers whose interest stealthily rise above everything else, no matter how strict and daunting the legislative regime is, one could admit that we are not doing too bad in this part of the world. However, this does not justify the reason to have a lackadaisical attitude towards the current state of affairs, which is paralyzing our economy, to say the least.

One good example that illustrates how ignorance of agency problem led to severe compromise in good governance and is the reason for extremely high levels of NPLs in the two state-owned commercial banks. It is not difficult to see that the root of the problem stems from the fact that the managers of both the borrowing and lending companies resorted to unfair means to pass loan schemes, whose values are less than the market value. This created market distortions leading to arbitrage conditions where the managers were the first to take advantage for their personal gains. Had the banks used an effective system to strictly monitor the performance of the lending officers and their managers, paying attention to the potential conflicts of interest, such high levels of non-performing loan (NPL) would not have arisen. Being a government-owned operation, we must not, however, discount other factors that inevitably come into play to compound this problem. It is yet to be seen if other public and privately held banks and corporate houses of Nepal factor in the agency problem in their equation for evaluating the performance of their managers and directors. It pays to acknowledge good performance with integrity in delivery.

### **What Led to the Crisis in Corporate Governance in the US?**

No monitoring or market discipline is perfect. Most observers agree that boards have not been sufficiently diligent in monitoring management. Despite various mechanisms to align incentives of shareholders and managers, a series of high-level scandals during 2000-2002 collectively point to a crisis in corporate governance. These episodes suggest that the agency and incentive problems are far from resolved. The underlying theme that ties these scandals together is distorted incentives that tilted the decisions toward short-term payoffs rather than

long-term value. Following are two examples of the scandals, which go down in the history as one of the largest accounting and analyst scandals.

***Accounting Scandals:*** The spate of the accounting scandals is symbolized by Enron and its auditor Arthur Andersen. Enron used so-called special purpose entities to hide massive amounts debt, inflate reported profits, and funnel massive profits to corporate insiders. The Chief Financial Officer of Enron was indicted for fraud and money laundering. Enron declared bankruptcy in late 2001. Enron proved to be only the tip of iceberg. It soon emerged that other firms such as telecom companies Global Crossing, Qwest Communications and WorldCom also had manipulated and misstated their accounts to the tune of billions of dollars. WorldCom's top executives participated in accounting fraud to inflate profits by more than \$11 billion over four years. It paid \$700 million settlement and declared bankruptcy and reemerged from Chapter 11 as MCI. Arthur Andersen was convicted for obstructing justice by shredding documents. Even the incentives of auditors, who are supposed to be the watchdogs for the firms, were skewed. Recent changes were made to split the firms into consulting and auditing firms to improve corporate governance and reduce potential for corroboration.

***Analyst Scandals:*** Wall Street stock analysts regularly publish research reports on a wide range of firms along with buy or sell recommendations. Yet only the smallest fraction of firms (less than 2%) was assigned sell recommendations. Rather than provide unbiased reports, analysts were pressed into the service of the investment bankers. In effect, favorable analysis was traded for the promise of future investment banking business. The most notorious of these episodes involved an investor manager of Salomon Smith Barney (investment arm of Citigroup), who allegedly upgraded his rating of AT&T to win Salomon a role as co-manager of AT&T's massive stock sale. But he was hardly alone. Ten Wall Street firms were working with him, who paid \$1.4 billion to settle claims of improper behavior. Again, conflicts of interest and distorted incentives – in short, agency problems – played a crucial role in the scandals. Analysts were commonly compensated not for the accuracy or insightfulness of their analysis, but for their role in garnering investment-banking business for their firms.

These episodes indicate that many investment bankers were more focused on short-term profits than long-term reputations. In the boom years, there was

considerable temptation to focus on the short-term; investment bankers earned \$10 billion in fees by issuing \$245 billion in new securities in just 1.5 years ending in the first quarter of 2003.

### **What are the Ways to Curb Agency Problem?**

Several mechanisms have evolved to mitigate potential agency problems. First, compensation plans tie the income of managers to the success of the firm. In more developed economies, a major part of the total compensation of top executives is typically in the form of stock options, which means the managers will not do well financially unless the stock price increases, benefiting shareholders. However, it is found that such options can create incentive for managers to manipulate information to prop up a stock price temporarily, giving them a chance to cash out before the price returns to a level reflective of the firm's true prospects. Second, while boards of directors are sometimes portrayed as defenders of top management, they can, and in recent years increasingly do, force out management teams that are under performing. Third, outsiders such as security analysts and large institutional investors such as pension funds monitor firms closely and make the life of poor performers at the least comfortable. Finally, bad performers are subject to the threat of takeover. If one firm observes another under performing, it can acquire the under performing business and replace management with its own team. Other more effective measures that are being used to curb agency problem are by making corporate executives and board members personally liable for the accuracy of financial reports, by mandating a greater role for disinterested outsiders on the board of directors, by creating a new oversight board to oversee the auditing of public companies and last but not least by prohibiting auditors from providing various other services to clients.

In the home grown common sense front, the age-old adage “ A stitch in time saves nine” is certainly well-worth revisiting to ensure effective implementation of sound corporate governance principles in combating imminent crisis and keeping conflicts of interest at bay. That is to say, if agency problems are identified and dealt with expeditiously in the early stages, it could certainly minimize potential loss in firm's value. For that to happen, one must be aware of the various manifestations of agency problem. Common sense says that most of the agency problems have root in human nature. Mankind has always resorted to unfair tactics when its survival is thwarted or at risk. In the competitive corporate

world where the managers have to live by the 'up or out' policy, there would be plenty of temptations to cut corners to rise above the rest.

In effect, the beginning of agency problem very much depends on the natural inclinations of an individual and the ability to ward off temptation for personal gain. Nobody can stop a manager who voluntarily and consciously participates in an activity that is detrimental to the firm. However, strict preventive measures could be put in place to sufficiently discourage managers from indulging in activities that create conflicts of interest with the owners. The company could also try to restrict managers, who are identified or suspected of having such doubtful character, from working in environments that give rise to temptations. Current blacklisting of loan defaulters in Nepal is more of a corrective measure to curb the agency problem - mostly in the banking sector. It appears that the measure has been received with mixed reactions with the outcome less than satisfactory to date. The fact that the concerned authorities waited too long to administer the measure made this issue to escalate to gargantuan proportions, making it extremely difficult to resolve it with a set of unwieldy policy measures. Hopefully, this will be a lesson well learnt, encouraging the corporate and financial sector to take initiative at the right time to put in place an effective monitoring and addressing mechanism for future agency problems.

# Primary Market Development in Nepal: Issues & Challenges

- Deepak Raj Kafle\*

## Introduction

The securities market consists of new issue market and Stock Exchange. New securities are offered to the investing public for the first time through initial public offering. Primary market allows issuance of new securities helping the issuer companies to raise funds for starting new enterprise or for expansion and diversification of the existing ones. Normally, securities once issued get listed in the Stock Exchange enabling securities holders to dispose them at their convenience. Attraction for investing in new securities is interlinked with the liquidity provided by the stock exchange.

Well functioning securities markets are integral part of any financial system. They act as financial intermediaries for debt and equity instruments, ensuring greater competition among financing sources resulting in greater efficiency. Securities markets comprise both money and capital market.

Money markets deal in short-term debt instruments like treasury bills, inter-bank deposits, bankers' acceptances, certificates of deposits and commercial papers issued by non-financial corporations. The treasury bills, which are government securities, serve as a mechanism for non-inflationary financing of government deficits and can also support monetary policy implementation. Other money markets instruments are used to facilitate the supply of credit to larger corporations and to ease inter-bank financing.

Capital markets deal in longer-term debt instruments as well as equities. Long-term debt consists of bonds issued by the government and debentures issued by corporations. Equity instrument represent some form of claim on capital of company and other income generated by that capital. The securities market provides mechanism to mobilize community savings for productive investment. It is believed and also supported by the empirical studies that the stock market

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performance defined by size, liquidity and integration to the global/regional capital market positively influence the economic growth.

The securities market development in Nepal is in early stage of growth. The market, though evolving, shows sufficient potential for growth. The market structure, consisting of regulators, stock exchange, market intermediaries, issuers and investors, has important role in realizing the inherent potential of market growth thereby contributing effectively to the growth of the current economy.

Today policy matters related to securities market development take center stage in most of the emerging and developing economies. Looking at the South Asia, Indian stock market is growing at an outstanding pace and other countries too have carried successful stock market reforms. In Nepal, some initiatives to build the capacity of regulatory regime, modernize stock market and create market infrastructure are taking place. The success of these initiatives is contingent upon how the enabling institutional and legal infrastructures are built. This obviously requires commitment from government and support of the stakeholders. This article focuses on the developments in the Nepalese primary market, identifies relevant issues and reforms required to make it more efficient.

### **Primary Market Scenario**

Primary market is growing in importance as it provides of a good source for corporate financing, an alternative to the private and bank financing. In the past 10 years, capital issue in the tune of Rs. 8.5 billions was offered to the public investors. However, there was uneven growth by sectors. More than two-third of the amount issued was from bank and finance sector, a newly liberalized sector that requires mandatory public offer. Although companies from hotel, trading, manufacturing, mining, aviation and, of late hydroelectric sector have gone public, their operational and market performance continue to be weak. There is list of companies, especially small ones, that disappeared, got de-listed or do not comply to the fiduciary duties, thus impairing investors interest in the offering market.

Another feature of the primary market is the overwhelming presence of retail investors and a very small role of institutional investors. This may be attributed to the limited size of the new issue market and non-availability of risk financing

and merchant banking type of intermediary institutions to support the growth of the market.

Instrumentwise, more than three-fourth of the issue size is made up of equity shares. Other types of instruments offered in the market are debentures, mutual funds and preference shares. The market instruments need to be more innovative in order to meet the funding needs of the company that match the investment preference of the investors.

The intermediaries involved in the issuance of shares are issue and sales managers, underwriters and brokers. However, the role of brokers (selling agents) is not uniformly practiced in the primary issue and the secondary market is yet to be properly integrated with the primary market. Similarly, underwriters are loosely regulated by Securities Board of Nepal (SEBON) and are normally bank and financial institutions regulated by the central bank. The main player in the new issue market are issue managers functioning as professional advisors to the issue and prospectus who take due diligence responsibility on the disclosures and work as registrar to the issue and take a lead role together with the issuer in the allotment of securities. Though the issue managers can manage and commit underwriting, their servicing capacity is limited as they follow prudential banking norms. In many jurisdictions financial institution are the primary buyers of securities who ultimately distribute in favour of the public subscribers. The inadequacy of regulation and the absence of appropriate merchant banking institutions have resulted in cases where some underwriters do not stick to their commitments.

The Securities Ordinance, 2005 and Companies Ordinance, 2005 are the prime legislations enabling and regulating the issuance of securities. Securities Exchange Regulation together with the following policy and procedural framework are applicable in case of securities issues.

1. New Issue Registration and Approval Guidelines (SEBON)- comprehensive disclosure and investors' protection guidelines applicable to the initial offering, issue of rights shares, issue of debentures and preference shares.
2. Share Allotment Guidelines (SEBON) -for the fairness and transparency of allotment of shares.

3. Guidelines for the Issue Managers (SEBON) -for the professional conduct of Issue Management.
4. Stock Exchange Membership Bylaws- for conduct of issue managers as they are now taking membership of Stock Exchange
5. Bonus Share Issue Guidelines (SEBON)-provide mechanism for the issuance of bonus shares, i.e. the issue of shares without considerations affected by the transfer of reserves and issuing stock dividend.

### **Relevant Issues in the primary market**

1. The basic intent of primary market regulation is to require registration of new issue and the disclosure of relevant information by the issuer and prohibit misrepresentation and fraud in securities sales. At present, securities issue and disclosure provisioning are under the Company Ordinance and Securities Ordinance, which normally should be within the exclusive jurisdiction of SEBON. The standards of disclosure are inadequate and accountability of the issuers and other support intermediaries are not properly established.
2. The Bank and Financial Institution Act entrust SEBON to be responsible for the prospectus and new issue. However, the Securities Ordinance, which enables capacity building process of SEBON, has finally been issued and the regulations to facilitate the implementation of the Ordinance are in the development process.
3. Finance companies that are in the deposit/lending business have extended merchant banking services. The primary market is rather broader in terms of public access. The exit to the investors is only through stock exchange intermediaries located mostly in Kathmandu, which has a limited clientele base. The absence of alternative trading mechanism like over the counter (OTC) trading have restricted the trading of shares of those companies not meeting stock exchange listing norms and for the trading of debenture or bonds.
4. The required legal and institutional infrastructure for the issuance of variety of capital market instruments such as debentures, mutual funds and other innovative marketable instrument are not yet ready. The trusteeship function for the debenture and mutual fund issue is restricting the issuance of debentures/bonds and collective investment vehicles. These instruments are critical for the transformation of financial system as they are alternative to the bank financing and facilitate the entry of small savers in the capital

market. There is also a need of private placement market for institutional investment in debentures at the same time having credit rating agency to provide professional rating services.

5. The new issue market inherits a tradition to favour small investors while making allotment of shares. In case of companies requiring mandatory public issue (such as bank and insurance) and in the absence of standardized disclosure (including financial), the policy in favour of small investor is not achieving desired goals. It is said that it has encouraged the multiplication of applications, sometimes labelled to be in fake names too. The basic philosophy of enabling retail investors to share the benefits of corporate growth should be preserved while balancing it with the health of the market and in consideration to the cost to the issuers.
6. The free pricing is a basic guide for a competitive market. However, it is still an issue in Nepalese securities market since the accounting standards and auditing practices are in the process of being implemented. SEBON is yet to establish system of reviewing the financial statements and taking statutory measures to the licensed intermediary and securities issuers.
7. The public trading of securities comes through the initial as well as secondary offering market. The existing regulatory framework provides for regulation of IPO but secondary offering is regulated by the stock exchange without specific disclosure requirements. Furthermore, regulation regarding significant acquisition and takeover of controlling shares is not yet established. There is further need to integrate primary and secondary market by establishing intermediaries working for underwriting/ distribution of securities and developing mechanism for identification of proper client accounts in both the primary and secondary market segments.

### **Envisioned reforms**

Any reforms in the securities market should be responded and supported by the stakeholders and the enabling macroeconomic environments. As a regulator SEBON strives to provide a transparent and efficient market where the issuers are able to raise resources at reasonable cost, conduct in accordance with highest standard of corporate governance and diligently meet its regulatory obligation. SEBON strives to assure that the rights of investors are protected so that they can make informed decisions while accessing capital in the financial market with a degree of fairness. Further, the market intermediaries should be in a position to

compete freely and follow standard conduct in delivering services in an efficient, orderly and fair manner.

In response to the need of reforming primary market, SEBON needs to review its policies and regulations within its domain. It should strive to develop policies to include areas hitherto unregulated or inadequately regulated and implement them in a manner that promotes growth of market with enhanced transparency, fairness, efficiency and integrity. The following list provides the major reforms, in priority, required to be implemented by SEBON with strong support from government and interrelated regulatory institutions.

- Empowerment of regulator enables it to move towards standard practices, restructuring processes and opens up market to outside investments, which has become important in the wake of regional co-operations and WTO accession. The recent issuance of Securities Ordinance is important in terms of empowering the regulator and facilitating capital market reform. Moreover, the planned implementation of the Ordinance will emerge as a challenge.
- In a bank dominated financial market, merchant/investment bank should be promoted to service the medium-and long-term financial needs of corporate sector. Budget program of this year has aptly identified the need of proper regulation of Citizen Investment Trust and Provident Fund Corporation. The long-term contractual savings like provident funds, pension funds, mutual funds mobilized by these institutions should be appropriately channelled to finance industries and infrastructural projects. It would also be advisable to define clear regulatory jurisdiction for commercial banking and investment banking practices.
- The potential growth of securities market can be supported by designing appropriate policy and infrastructural frameworks. Bringing non-corporate i.e. private limited and closely held companies with proven track record and standard disclosure, to debut the capital market will help to expand the securities market. Besides, the implementation of government's privatisation program is not closely integrated with the capital market development. SEBON regulates IPO disclosures and mechanisms but cannot adequately regulate the secondary offering - whether it is government or that of promoters offering. The existing legal and policy gap needs to be addressed quickly.

- Another potential for market growth is to promote debenture/bond market as an alternative financing mechanism. The absence of debenture trustee is expected to be addressed by the newly issued company legislation. A standard rating service could provide the potential debt issuers with the ease in communicating their debt quality to the investors. A crude technique, until the infrastructures are in place, will be to allow companies with convincing track record in cash flows to issue debentures. In promoting demand for the debentures, private placing of bonds/debentures with institutional investors could also be explored. Debt market can be productively used in financing infrastructural and public utility projects.
- The primary equity market growth in the past is propelled by mandatory public participation policy in bank, finance and insurance sectors. The number of shareholders in the listed companies has been more than seven hundred thousands. Share allotment, in case of over-subscription is made by giving greater weightage to small investors.

Probably the reform should aim at avoiding over-regulation and strive to balance the interest of issuers and investors. At the same time, the issue of unfair application and of multiplication of application to take advantage of favourable weightage system also needs to be appropriately addressed.

It is always in the interest of both individual and corporate investor to be identified by the brokers and issue manager. In primary market the SEBON has made investor identification mandatory by requiring citizenship or other government issued identity. Initiative requiring investor identification while investing in stock exchange has been taken. It is further envisaged to create a centralized database to maintain appropriate identification numbers of both the individual and institutional investors.

Probably it is also high time that the government and the regulators reach a consensus to deliver fair justice to the mandated issues. For other issues, proportionate allotment system instead of the weightage system can be introduced.

Free pricing of securities can be adopted for issuers following standard accounting and auditing practices. Further, SEBON is empowered to review

the financial statements of the issuers by the new Securities Ordinance, which will help to address the problems of information asymmetry.

- As said earlier the streamlining of Securities and company laws through the new Ordinances could address the duplication and inadequacy present in the regulations. The banking regulation has already handed over the responsibility of regulating disclosure (through prospectus) to the SEBON. Now, the primary market will rely on the implementation of new Companies Ordinance to see SEBON as an effective primary market regulator to endorse the truth and adequacy of disclosure.
- The central bank, which has pioneered the growth of financial system including its involvement in stock exchange (which still retains significant ownership and management), has its role in supporting capital market growth. It has now entrusted the stock exchange to run the secondary market for government securities. Financial market efficiency indeed supports successful transmission of monetary policy. There are some undefined or grey area of regulation and some areas common to both banking and securities regulation. The government, the central bank, company registrar's office and SEBON should cooperate to resolve the following issues.
  - Developing appropriate regulatory framework for collective investment funds and merchant banking. It is in this context the current budget envisages developing regulatory framework for Citizen Investment Trust and Employee Provident Funds.
  - Most of the issue managers at present are financial institutions (under Banking and Financial Institution Ordinance). Enabled by the new Securities Ordinance, SEBON envisages to allow market intermediaries to provide full range of capital market services including brokering, dealing, underwriting and advisory services under one roof. It is probably high time that the role of bank and financial institutions in the capital market is defined and well coordinated through an understanding by the respective regulators.
  - The capital market intermediaries have to maintain brokerage account with advances from the investors. Besides, the mechanism for margin financing and advances against the securities should be developed. As the market grows these financing mechanism should be properly

designed to assure the health of capital and money market and to contain possible systematic risk.

## **Conclusion**

Nepalese financial system is at a critical stage of transformation. While banking sector is being consolidated under the umbrella Bank and Financial Institutions Act, the responsibility of financing long-term projects including infrastructure and potential hydroelectric projects fall on securities market. In this context, there is an urgency of consolidated development of Securities Market. This consolidation not only accommodate the present need but also contributes to the growth process through the development of equity and debt markets.

With the implementation of newly issued Securities Ordinance 2005, the SEBON will be better placed to regulate the integrity of disclosures in the securities issue. Some efforts mentioned here could broaden the primary market, resulting in the entry of new companies, issuance of new instruments, entry of new investors (especially institutional), and competitive services of intermediaries. The attraction of the primary market depends on an efficient stock exchange coupled with efficient clearing and settlement system. This is why the stock exchange modernization with governance reform and automation should be a priority. With the modernized stock exchange, the primary market is bound to increase manifold, providing a reliable and sustained alternative for raising capital.

# Capital Market Indicator

- Pramod Bhattarai\*

## Introduction

Capital market is the most important part of any financial market. It is the market place for the collection of long-term funds. Entrepreneurs who have ideas but do not have funds to establish, manage and operate the business can collect the required funds by mobilizing the scattered public savings. They issue tradable securities like shares, debentures and others. The market through which they make new issue or additional issue is called IPO market (Initial Public Offering) or primary market. The success of the issue depends upon the public response. If the public response is high with over-subscriptions, it is called successful issue. The purchase of securities is called investment. The investors sacrifice their present consumptions for future.

Here, one of the major factors to be considered is the public response to the public issue. They will response only if they think they can dispose their investment at the time of their need. The entrepreneurs have invested their funds and have earned profit. The entrepreneurs also set aside certain percent of earned profit for the development and diversification of the business and distribute portion of the profit. Sometimes, if the entrepreneurs are in need of fund they will not distribute any amount and plough back all the profit into the business. Due to this increased capital and reserve, the investors expect higher percentage in the return. Such investors can liquidate their investment in secondary market. In this situation, they will demand higher prices for their investment. There are other investors who are also looking for better investment opportunities. Therefore, the price of the securities determines the performance of the company and information dissemination process.

Different techniques are used to calculate the average value as an indicator of the market price. Such a value is called an index. For example, Nepal Stock Exchange calculates NEPSE Index to represent the market price.

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\* Acting Manager, Nepal Stock Exchange Ltd.

## Methods for Calculating Indices

There are several methods used by different organizations. They calculate their own index as a market indicator and supply information to the public. On this basis, they make investment decisions. The indices differ with respect to the number of securities used and also with respect to method used to calculate it. Let us discuss and elaborate some of the popular methods of calculating indices briefly before explaining the NEPSE Index.

### *Dow Jones Industrial Average (DJIA)*

Dow Jones Industrial Average is popularly known as DJIA includes 30 stocks. This is a price weighting mechanism popularly used by Dow Jones in the US to calculate the average price as an indicator. Under this method the price of all 30 stocks are added and divided by the number of stocks included in the portfolio. E.g. Let us say there are two companies A and B whose outstanding number of shares are 1500 and 2000 respectively. At the end of the day the closing price is Rs10 and Rs.20 respectively. Therefore, the average price on that day will be  $Rs.15 = (Rs.10 + Rs.20)/2$ . This will indicate the level of index. The divisor will be constant until the stock split takes place.

When the company makes the decision for stock split the calculation requires certain adjustments to reflect the true and fair picture of the market performance. If this is not done the indicator will be misleading. E.g. In the above example, B Company splits its share 2-for-1. This will increase the number of outstanding shares. Provided all other things remain constant, the price will decrease. Let us assume Rs.11 for B shares and Rs.13 for A. If we consider the above example in this case, the index will be  $(Rs.13 + Rs. 11)/2 = 12$ . It shows the index has decreased by  $(12-15)/15=20\%$ . This is a misleading scenario. In fact, the price is increased and index went up by  $17.5\% = [13+(11*2)]/2$ . It indicates the gain of  $(17.5-15)/15=16.67\%$ . Therefore the divisor should be adjusted to get the true and fair picture of the market.

The following formula should be used for this purpose.

$$\frac{\text{Closing Price of Company A} + \text{Closing Price of Company B}}{\text{Divisor}} = \text{Increased Index}$$

$$\frac{\text{Rs. } 13 + \text{Rs. } 11}{D} = 17.5$$

$$D = \frac{\text{Rs. } 24}{17.5} = 1.37$$

In this case, the new divisor will be 1.37 instead of 2 till another split takes place.

### Standard and Poor's index

This is the second method popularly used in US and other parts of the world. This is known as value weighting method. In order to calculate the index, the outstanding shares of all selected companies will be considered and will also be multiplied by the respective price. The total value will be sum up and divided by the base price to arrive the ratio of change and it will be multiplied by 10. One of the popular indexes is Standard and Poor's 500 composite index. In order to calculate the index, 500 companies are taken into account. These companies are selected from New York Stock Exchange (NYSE), American Exchanges (AMEX), OTC (over- the – counter) market, and others. All the profitable and sick companies are taken into sample. This mechanism is getting more popularity nowadays due to value-weighted system. The index will change even the price of the shares or the number of outstanding shares changed. This can be illustrated with the following example.

SN	Company	Outstanding <u>Shares</u>	Price at <u>Day 0</u>	Market Value
1	A	1000	10	10000
2	B	2000	15	30000
3	C	3000	20	60000
Total Market Value:				100000 (Assume base market Value)

SN	Company	Outstanding <u>Shares</u>	Price at <u>Day 1</u>	Market Value
1	A	1000	15	15000
2	B	2000	20	40000
3	C	3000	25	75000
Total Market Value:				120000 (Assume base market Value)

Now, using formula

Index = (new market value / base market value) \*10

In this case, it is  $120000/100000*10 = 12$  is today's index.

In India the multiplier is 100 and in Korea, Pakistan and Sri Lanka it is 1000. Let us find out the differences.

$(120000/100000)*100=120$

$(120000/100000)*1000= 1200$

The above calculations indicate that higher the multiplier the smaller change in price can be notified to the investors.

### *Value Line Composite Index (VLCI)*

The VLCI is based on geometric average of the individual stock price changes. It is an opposed to the arithmetic average calculated by DJIA and Standard and Poor. In order to calculate this, a geometric average of stock price is calculated dividing the current price of each stock by its price in the preceding time period, computing the product of these ratios, taking the nth root of this product. In this case n is the number of securities and subtracting 1. This can be made clearer with an example.

<u>SN</u>	<u>Stock</u>	<u>Price at Day 0</u>	<u>Price at Day 1</u>	<u>Ratio of Prices</u>
1	A	20	35	1.75
2	B	25	25	1.00
3	C	30	32	1.07
	Total	75	92	

This indicates the increase of price by 75%, 0%, and 7% of A, B and C shares respectively. Let us calculate the VLCI.

Geometric Average =  $(1.75) (1.00) (1.07) - 1 = 1.8725 - 1 = 1.2326 - 1 = 23.26\%$

## NEPSE Index

Nepal Stock Exchange as an organized secondary market of Nepal for listed securities is calculating NEPSE Index to reveal the performance of the market. The investors before making investment decisions are eager to know how the market is performing. The brokers will answer in short that the index is increasing or decreasing on that day. And the investors are also able to understand the market performance and the trend of the performance from these indexes. Just like in NYSE, NEPSE is calculating all equity index, based on the formula of Standard and Poor's Index.

$$(P1 * Q1 / P0 * Q0) * 100$$

It can be illustrated with the following example.

Company	Outstanding Shares	Price at Period		Market Value at Period	
		<u>0</u>	<u>1</u>	<u>0</u>	<u>1</u>
A	1000	20	30	20000	30000
B	2000	30	35	60000	70000
C	3000	40	45	120000	135000
				<u>200000</u>	<u>235000</u>

$$\text{Index for day 1} = (235000/200000) * 100 = 117.5$$

In practice, the listed company may increase its capital either by issuing rights shares or bonus shares or making additional issues. In these cases, the base price needs to be adjusted to reflect the true performance of the market. Let us assume B company issues 50 percent bonus shares to its shareholders. In this case, the adjustment will be made as follows:

Company	Outstanding Shares at Period		Price at Period 1	Market Value at Period	
	<u>0</u>	<u>1</u>		<u>0</u>	<u>1</u>
A	1000	1000	32	32000	30000
B	2000	3000	30	60000	90000
C	3000	3000	50	150000	150000
				<u>242000</u>	<u>272000</u>
			Total	242000	272000

The adjustment will be made as follows to calculate the adjusted base price.

(New market value including new listing/ New market value excluding new listing)\* Previous base price

In this case it will be  $(272000/242000) * 200000 = 224793.39$

Index for today =  $(272000/224793.39) * 100 = 120.999$

### **Conclusion and Recommendation**

As said above, indices must be the indicator of the national economy. That is why the academicians have rightly said that it is the economic barometer of the country. NEPSE has been taking into consideration all the listed equity to calculate index. If we consider DJIA, they have taken only thirty scripts to calling S & P 500, S & P 400 and S & P 200 composite index. Among these, S & P 500 composite index is popular. Therefore, besides all equity indices, NEPSE must calculate other indices including different scripts though it is calculating sector wise index, which is not sufficient.

The provision as mentioned in securities listing byelaws, NEPSE can group the listed companies into “A” group if they meet all the given criteria in the byelaws. In fact, this grouping is not sufficient because all the sick companies and well performing companies that do not meet own criteria, also lies in the same group. So, further classification of the listed companies is essential and the index must be calculated on the basis of grouping of securities.

If this is done, all equity indices gives the general view of the market and “A” group, “B” group and general group indices give the trend of the indices reflecting the performance of companies in the economy. This can also be considered as the barometer of the country reflecting the performance on the given economic policy. This facilitates the contribution of particular group in total indices and assists the academicians, researchers and investors.

# Securities Markets Development in Nepal

-Nabaraj Adhikari\*

## Abstract

*This paper assesses the securities markets development in Nepal. Nepalese securities market is in an underdeveloped stage. Weak regulation, insufficient market infrastructures, poor corporate governance, inefficient trading system, low instrument diversification, low involvement of institutional investors are the major issues of Nepalese securities markets. These issues should duly be addressed to develop the markets as an important venue for funds mobilisation in Nepal.*

## I. Introduction

Capital plays a vital role in the economic development of a country. Nepal being one of the least developed countries in the world has to make every possible endeavour to efficiently mobilise the available capital. The need for securities market development in Nepal has been an accepted reality, however, it has not been developed at desired rate. If we see the size of the market during the past 11 years (i.e., FY 1994/95-FY2004/05), the annual average amount of public issue was Rs. 620.04 million, annual average amount of turnover was Rs. 1423.48 million, annual average paid up value of listed securities was Rs. 8197.96 million, annual average market capitalisation was Rs. 30723.70 million, annual average percent of turnover on paid up value was 13.35, annual average percent of turnover on market capitalisation was 4.30, and annual average percent of market capitalisation on nominal GDP at market price was 8.11. The above indicators show that securities market has low level of resource mobilisation, low level of turnover, and low level of impact on national economy.

## II. Role and Significance of Securities Markets in the Economy

Securities market is recognised as an effective way of raising capital for commercial enterprises, and at the same time providing an investment opportunity for individuals and institutions. The activities of buying and selling securities in the securities markets are extremely important for the efficient

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allocation of capital within economies. The securities market is a requisite for the sound development of an economy because it not only provides stable long-term capital for companies and an effective savings vehicle for the public, but also functions as an efficient tool for resource allocation. Mass participation in country's industrialisation process is possible only through the efficient mechanism of securities markets as it promotes efficient collection of small and scattered savings from the investors and provides returns to them in the form of dividend. A developed securities market is the medium through which only productive firms that have better performance can easily raise capital. In other words, well-developed capital markets enable high-quality firms to increasingly finance themselves from securities (bond and equity) rather than from bank loans (Shirai (2004)). This type of behaviour of developed market enhances economic growth process by productivity growth.

Securities markets play a crucial role in the economy by channelling investment where it is needed and by putting it to best use (Lieberman and Fergusson (1998)). The securities markets help to channel public savings to industrial and business enterprises. Mobilisation of such resources for investment is certainly a necessary condition for economy to take off, but the quality of their allocation to various investment projects is as important as a factor for growth. Securities markets help agents manage liquidity and productivity risk by eliminating premature capital liquidation, which increases corporate sector productivity. Securities markets also accelerate growth indirectly by reducing liquidity risk, which encourages firm investment (Levine (1991)).

There is a strong correlation between various measures of securities market development and long-run economic growth. Securities market liquidity is said to have positive impact on long-run economic growth, capital accumulation and productivity growth (Levine and Zervos (1998)). More liquid markets reduce the disincentives to investing in long-duration projects because investors can easily sell their stake in the project if they need their savings before the project matures. Enhanced liquidity, therefore, facilitates investment in long-run higher return projects that boost productivity growth.

Securities markets contribute to mobilisation of domestic savings by enhancing the set of financial investments available to savers to diversify their portfolios and doing so, they provide an important source of investment capital at relatively

low cost (Dailami and Aktin (1990)). Securities markets help investors to cope with liquidity risk by allowing those who receive a liquidity shock to sell their stake to other investors. The result is that capital is not prematurely removed from firms to satisfy short-term liquidity needs. Moreover, securities markets play a key role in allocating capital to the corporate sector, which has a real effect on the economy in aggregate.

The development of the securities market is a necessary factor for modern day economy. There should be no doubt regarding the significance of securities market as it is clear that countries having developed securities market mechanism are developed and countries with poor securities market mechanism are underdeveloped (Dhungel (2001)). Securities markets must function well for the sustainable economic development. Firms need capital to grow and finance their investment needs. It requires efficient ways of raising funds. If the investment is required for new technology for the projects with long-gestation period, premature liquidation of the capital is always inevitable without the existence of liquid and well functioning securities markets. Securities market forms a significant part of the infrastructure essential for dynamic functioning of the economy and in promoting industrial and economic development of a country.

Securities market plays a crucial role in mobilising a constant flow of saving and channelling these financial resources for expanding productive capacity in the countries. Thus, securities markets assume a greater role and significance in the present day economies.

### **III. Historical Development of Securities Markets in Nepal**

The history of securities markets began with the flotation of shares to the general public by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. However, the development of securities markets could not be a national policy for a long time. The then industrial policy of Nepal led to the development of securities markets with the establishment of Securities Marketing Centre (SMC) in 1976. Before the establishment of SMC, there were no institutional arrangements to undertake and to manage the new issues of securities. Initial Public Offerings (IPOs) had to be made as per the provision of Companies Act, 1936, which were not adequate and relevant. The Act had not even included preference share as corporate security. It was recognised as corporate security only by Companies Act, 1964.

SMC started secondary trading of securities in 1981, which was restricted to government bonds. Till 1983, the concept of well-structured secondary market had not evolved in Nepal. No separate Act existed to regulate the trading of securities. The Securities Exchange Act, 1983 was enacted in 1983. The Act restricted the exchange of unlisted securities. The SMC was renamed Securities Exchange Centre (SEC) in 1984. The SEC was the only institution at that time managing and operating primary and secondary markets of long-term government and corporate securities.

A need to develop different institutional mechanisms relating to securities market was strongly felt to avoid potential conflict of interest between the services provided. The first amendment in the Securities Exchange Act, 1983 in 1993 paved the way for the restructuring of securities market in Nepal, which led to the establishment of Securities Board of Nepal (SEBO) in 1993 with a mandate to regulate and develop the securities markets. SEBO started to register securities and grant approval for issuing securities to the public in 1993. The first amendment in the Act also led to conversion of SEC into Nepal Stock Exchange Ltd. (NEPSE) in 1993 with the objective of operating and managing secondary transactions of securities. The initial efforts led to the opening of a full-fledged stock exchange in January 13, 1994.

The second amendment in Securities Exchange Act, 1983 was made in 1997. This amendment made provision for registering securities businesspersons in SEBO. As per the provision of the second amendment, SEBO provided licences to the securities businesspersons in 1997. The amendment made mandatory provisions for the listed companies to submit annual and semi-annual reports to SEBO. This amendment also required securities businesspersons to submit annual reports incorporating the securities transactions carried out by them to SEBO.

Presently, there are 24 stock brokers, two securities dealers, nine issue managers and one stock exchange and 125 listed companies in the Nepalese securities market.

#### **IV. Issues and Suggestive Measures**

Securities market in Nepal is yet to be a significant part of economic development. Major issues regarding development of securities market and possible measures are dealt below.

##### **Legal Inadequacy**

The securities laws are unclear and inadequate from several aspects. Process and procedure for enforcement and investigation in securities legislations are not clear. This restricts the regulator from correcting the unethical and unfair market practices. The regulator also does not have the power to suspend market intermediaries indulging in such practices. This increases chances of fraudulent activities and investors' are cheated easily. No doubt, this will erode the investors' confidence. Due to inadequate legal provisions, the regulator can not review and make further inquiry into the financial reports submitted by issuer and listed companies. Besides, it does not specify the liability of directors who sign in the prospectus and the experts who prepare the financial statements. There are such large gaps in securities laws. Laws such as insolvency laws, arbitration laws, trust laws etc., which are supplementary to the securities laws, are still absent. In addition, several inconsistencies and duplications in between the companies' laws and securities laws exist.

A new Securities Ordinance is in the process of being promulgated. Provisions required for addressing the inadequacies and ambiguities in the present securities legislations are incorporated in the new Ordinance. The Ordinance, among others, provides adequate enforcement and investigation power and procedures for the regulator along with special power to review financial statements of the issuer, to order the issuer to convene the annual general meeting, to reform management, financial and other concerned matter, and to issue directives to the securities businesspersons for minimum capital requirements. There is significant improvement in the new provisions regarding penalties. The fine has been raised up to Rs. 3,00,000. Procedural aspects for registering securities have been made clearer and simpler and the directors who sign in the prospectus and the experts who prepare the financial statements are made responsible for their jobs. The Ordinance also incorporates provisions for regulating merger and takeover of issuer companies. Similarly, the new Companies Ordinance is also in the

legislative process, which has incorporated various provisions to make it consistent with the Securities Ordinance.

The proposed Securities Ordinance and Companies Ordinance should duly be enacted and strictly implemented to rectify the present legal inadequacy. Similarly, Insolvency Laws, Arbitration Laws, Trust Laws etc., should also be enacted to address the legislative gaps in securities market.

### **Low Resource to Regulator**

For the effective and efficient regulation of the market, the regulator should have adequate capability. The capability of the regulator highly depends on the availability of resources. It should have sufficient resource to develop and maintain that expertise. However, in case of Nepalese regulator, it is weak in terms of both financing as well as expertise.

The source of financing for SEBO is very limited. It receives nominal amount i.e., around 4.5 percent of the total revenue generated in the securities market (SEBO (2004)). It is basically relying on government grant to finance its operations. However, in the context of giving autonomy to SEBO, both in terms of financing and operation, to effectively and efficiently regulate the market, relying only on government funding could not be considered a viable and sustainable option. In the international practice, most of the financing for the regulator is obtained from the market as regulatory charges.

To address the problem of limited financial resources, licensing and license renewal charges of securities businesspersons and stock exchange should be reviewed and increased from the present level by revising the prevailing provisions of the securities law. In addition, the securities market activities such as underwriting and registrar to an issue, which is currently not under the SEBO's regulatory regime, should be brought under the SEBO's regulatory regime to provide for some more source of financing to SEBO.

SEBO is unable to make effective and efficient efforts in regulating securities market due to lack of expertise in some critical areas such as legal and accounting. SEBO's HR policies should be directed towards recruiting and retaining such professionals with adequate incentives.

## Poor Liquidity

The securities market provides liquidity to the issued securities. The market will have better liquidity if the securities are available to the price takers and the price reflects all relevant information. Nepalese securities market is performing poorly in both these aspects. The consequence is very low market participation. There is close nature of ownership pattern of listed companies. Holdings in the equity market are heavily concentrated within family groups (Dhungel (2002)). This is also supported by the statistics on the ownership pattern of listed companies, where promoters on an average hold 35.83 percent to 73.83 percent ownership, foreign joint venture 21.0 percent to 59.33 percent, HMG 33.0 percent to 76.0 percent, and public hold 18.33 percent to 46.17 percent ownership (SEBO (2004)). The Bank and Financial Institutions Ordinance, 2004 requires every financial institution to offer at least 30.0 percent share of issued capital to the general public. Similarly, Insurance Board also requires every insurance company with its registered office in Nepal to offer at least 20.0 percent of its issued capital to the general public. However, in case of the companies from other sectors, there is no mandatory provision for the issuance of securities.

The liquidity in the market can be promoted by increasing public floatation of shares. This could be done by amending the legal provisions governing financial institutions and insurance companies that require the increased percentage of public floatation. In addition, mandatory provision should be made for the companies from other sectors to float certain percent of their shares to the public. The government should also be committed to achieve its goal set in the Tenth Plan to increase the public ownership in the corporate bodies, which could be through providing fiscal and other incentives to the companies floating share to the public. The pace of privatisation of public corporations should also be increased by making use of the securities markets mechanism in the process.

Trading of securities is limited to listed securities as per the provision of securities laws restricting trading facility for the securities that are not listed. Due to the lack of alternative trading facility i.e., over-the-counter (OTC) market, the securities of companies not fulfilling listing criteria and those de-listed from the exchanges have turned illiquid. An initiative to develop an OTC market and provide greater liquidity to these securities is the need of the hour.

### **Lack of Instrument Diversification**

Investors tend to avoid securities market because they do not have options to invest in securities according to their risk-return preference (K.C. (2004)). The diversity in more developed securities market instruments attracts the investors of various risk-return preferences thereby promoting the size of the market and liquidity. Ordinary share is risky instrument whereas preference share, mutual fund and debenture are low risk instruments. If we see the securities market instruments available in the market, as of the end of fiscal year 2004/05, there were 128 issue of ordinary share including rights share, 4 issue of preference share, 2 issue of mutual fund, 4 issue of debenture. It is clear that there is less opportunity for risk averter and risk neutral investor in the market as there is dominance of ordinary share, i.e. most risky instrument. Market is not conducive to the knowledgeable investors as there are no derivative instruments i.e., warrants, options, futures, swaps etc. to match with their preferences and expectations. Government securities (bonds) market is unsystematic as the buying and selling of government securities is not based on demand and supply. Corporate bond market is also in the initial stage of development. Thus, the market is not encouraging to attract the large number of potential investors.

Systematising the government securities market and attracting institutional investors in the market could partly solve the problem of low diversity in securities market instruments. The systematic market for government securities also provides benchmark in setting interest rate for corporate debentures. To systematise government securities market, government securities should be transacted through the Stock Exchange. Privatisation bonds, development bonds, municipal bonds, and securitisation activities should be promoted to increase the market for fixed income instruments. Institutional investors should be encouraged to enter in the market with suitable fiscal and other incentives as they could stimulate demand for debentures.

Presently, the efforts are being made in this direction with the enactment of Primary and Secondary Market Management Regulation of Government Securities, 2005 and other supplementary bylaws. Though lately, the efforts are certainly towards the systematic development of government as well as corporate bond markets in the country. However, considerations should also be given towards establishing securities rating agency with proper legal framework, as it is

vital for the overall development of bond market. Incentives should also be provided to the companies raising funds by issuing derivatives.

### **Double Taxation on Dividend and Capital Gain Tax**

In an uncertain world in which verbal statements can be ignored or misinterpreted, dividend action does provide a clear cut means of making a statement that speaks louder than a thousand words (Solomon (1963)). Dividend is the most inspiring aspect for the investment on ordinary shares of the companies (Pradhan and Adhikari (2002)). Stocks with larger ratio of dividend per share to book value per share have higher liquidity, lower leverage, higher earnings, higher assets turnover, and higher interest coverage (Pradhan and Adhikari (2004)). Nepalese shareholders are not indifferent towards payment or not-payment of dividends as dividend payout affects the price of a common stock (Pradhan and Adhikari (2003)). Despite the important aspect of dividend to encourage investment in the securities market, it is taxed twice. First it is taxed at corporate level and when it comes to the hands of investors then also it is taxed. This discourages the investment in ordinary share. In view of present level of securities market development, there should not be double taxation on dividend.

Capital gain tax can divert securities market investment to the commodity and bullion markets. In the provision of present capital gain tax, tax is imposed on capital gains from the trading of securities but there is no clarity regarding the write off of capital losses incurred and there is also a problem of establishing net gains in the trading of securities. So the provision of capital gain tax should be rationalised in view of present initial stage of securities market development.

### **Poor Corporate Governance Practices**

Generally companies with poor governance practices hesitate to issue securities. Companies with poor governance practices lack credibility. In many emerging markets, the issue of corporate credibility is one of the most significant challenges faced by public firms in raising capital (Travlos, Trigeorgis and Vafeas (2001)). Issuing companies with poor corporate governance practices from manufacturing and processing, trading and hotel sectors, which issued securities in the past, had very poor performance and could not provide any returns to the investors. Presently investors hesitate to subscribe public issues

from manufacturing and processing, trading and hotel sectors and due to this the companies from these sectors face difficulties in raising funds from the market. Hence, concerned authorities must be aware to improve corporate governance practices in the country and rehabilitate the companies from manufacturing and processing, and trading sectors. For the purpose, adequate tax and other incentives should be provided to the companies running with good corporate governance practices. Similarly, regulators should prescribe codes on corporate governance and should make mandatory provisions to follow.

### **Poor Disclosure Practices**

A good disclosure practice is essential to bring transparency in the securities market. Inadequate disclosure practices and poor transparency discourage potential investors from investing in the securities market. In order to secure investors' confidence and commitments, a flow of information is a must as investors can make informed decisions in securities market only with adequate information. Informed decisions of investors not only help to stabilise price of securities but also help to attract additional investors in the market. If we review the disclosure practice that on the market, we see in an average (during the period of past five years), 62.80 percent of the total listed companies presented their annual reports and other financial statements to SEBO. Out of the listed companies disclosing their reports, only 6.07 percent, on an average (during the past four years), disclosed their reports in the prescribed time. This indicates that there is poor disclosure practice in the market. Poor disclosure practice increases uncertainty in the securities market investment and diverts investment to other unproductive areas such as gold, saving deposit, land and building and discretionary items. To curb the problem of poor disclosure practice, regulatory provisions related to securities market should be strengthened, as present Securities Laws do not provide sufficient power to the regulators to enforce better disclosure practice of the listed companies. The proposed Securities Ordinance vests investigation and enforcement power to SEBO. It is thus imperative to promulgate the proposed Securities Ordinance. SEBO could then develop financial and legal investigation capability based on power vested by the proposed Ordinance.

Investors gain little benefit from historic accounting data because they contain no new information. What investors would like to know is how the management

estimates future performance to be. In particular, investors would benefit from unbiased estimates of the rate of return on future investment, the amount of new investment, the length of time supernormal growth is expected to persist, and the percentage of new capital that will be provided from equity sources (Copeland and Weston (1992)). This kind of information can be supplied in the company chairman's letter in the annual report without legal liability in the event that things do not turn as well as anticipated. Although the annual report may serve as a useful device for monitoring the performance of management, it has little value to the investment community. So, in addition to insisting the companies to present annual report, they should also encourage the companies to present chairman's letter in the annual report by incorporating the management estimates of future performance. This would promote informed decisions in the securities markets.

### **Low Involvement of Institutional Investors**

Institutional investors are large in size, they have economies of scale in collecting information on companies and their decisions to sell or buy can affect share prices. They are more informed than individual investors and have more incentive to monitor performance and keep management up to the mark and management has more incentive to listen. Institutional investors help stabilise price of securities and maintain confidence of retail investors in the market. Institutional investor such as Citizen Investment Trust has very low participation in Nepalese securities market and Employee Provident Fund has no participation in the securities market. The participation of mutual fund in the securities market as institutional investors is limited to only two, namely- NCM Mutual Fund and Citizen Investment Scheme. Similarly, listed companies as institutional investors have stake in an average below one percent in the primary market. To address this problem, Government (HMG/N) should take initiative in establishing a clear regulatory provision that requires the Employee Provident Fund and Citizen Investment Trust investing certain portion of funds in the securities market along with some provisions of fiscal and other incentives.

### **High Cost of Public Issue**

Cost of public issue (i.e., underwriting cost, advertising, printing and other expenses, collection and refund charges, and issue management commission) is

relatively high in Nepal as compared to neighbouring countries. The aggregate cost of public issue is 0.34 percent at minimum and 24.25 percent at maximum of the issued amount in Nepal and this cost is 7.1 percent at minimum and 10.3 percent at maximum in India (SEBO (2002)). Among the cost components, collection and refund charges is highest due to over-subscription of the issue. Presently, Office of the Company Registrar and Securities Board of Nepal are regulating the public issue activities resulting in a cumbersome process. Hence, the public issue process should be made simple by adopting one window policy that ultimately reduces cost of public issue. The proposed Securities Ordinance and proposed Companies Ordinance have incorporated this provision

### **High Transaction Cost**

Cost relating to secondary trading of securities is taken here as transaction cost. Lower the transaction cost higher the return to the investors on securities trading and vice versa. Competitive transaction cost is an incentive to increase volume of share trading. Low transaction cost helps to stabilise securities market by reducing volatility in pricing thereby provide investors a safer place to invest.

As per the present legal provision relating to brokerage, the range of brokerage to be taken based on trading value is 1.0 percent to 1.50 percent. Such a brokerage is 0.5 percent of purchasing or selling price in Thailand and 0.0002 percent on traded value in India. This presents the fact that brokerage is comparatively high in the securities market of Nepal than in Thai and Indian securities market. Thus, one of the ways for making competitive transaction cost is to reduce the prevailing range of brokerage by amending the relevant legal provision. It is by setting a maximum limit of brokerage at 1.0 percent and leaving the rest to be decided by the market.

The securities market in Nepal is underdeveloped where procedural or opportunity cost is significantly higher than explicit cost. To reduce the cost, the present open-out-cry trading system should be replaced with automated trading system. This will reduce transaction time and increase the ease of trade execution. Further development of on-line trading system of securities will provide trading facility to greater number of investors who have access to web. The reduction in transaction time and increasing ease of trade execution should lead to higher volume of securities trading and lower transaction cost. Similarly,

the present clearing and settlement system should also be improved. Dematerialization of securities should be established to provide speedy delivery of securities to buying investors and enable brokers to ensure that sellers are the real owners of securities before they accept an order to sell. Speedy delivery and low risk of settlement would reduce the transaction cost.

### **Lack of Accounting and Auditing Standards**

There is lack of accounting and auditing system that meets the demand of whole corporate sector of the country (Adhikari (2004)). This makes the accounting and auditing practice poor that do not portraint the real picture of the corporate sector. This does not allow informed investment decision in the securities markets. Presently, Accounting Standards Board and Auditing Standards Board have developed more than 40 accounting and auditing standards at par with international satandards and some other standards are being drafted. These standards are yet to be effectively implemented by empowering the regulators and creating required awareness in the corporate sector.

### **V. Conclusions**

There is no alternative to securities market to allocate scarce resources efficiently within economies and increase mass participation in country's development (industrialisation) process. Though the institutional development of securities market in Nepal started in 1976, it is still at an underdeveloped stage, characterised by legal inadequacy, low resource availability to the regulator, low liquidity, double taxation on dividend and capital gain tax, poor corporate governance practices, low involvement of institutional investors, poor disclosure practices, high cost of public issue, high transaction cost, and lack of enforcement of accounting and auditing standards.

The present status of securities market could be improved and developed as an important source of long-term financing by finalising the legislative process of the proposed Securities Ordinance and proposed Companies Ordinance and implementing them effectively, taking regulatory measures that mandates investment of a certain percentage of funds in securities market by institutional investors i.e., Employee Provident Fund and Citizen Investment Trust, enhancing the pace of privatisation by sale of shares, promoting privatisation bonds,

development bonds, municipal bonds and securitisation activities in the market, following one window policy in public issue process, establishing automated trading system, OTC market and Central Depository of Securities (CDS) , provisioning increased resources to the regulator, improving the taxation policy to avoid double taxation of dividend, rationalising the present capital gain tax provision, and by the implementation of accounting and auditing standards developed by Institution of Chartered Accountants of Nepal.

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# **Revenue Structure in Nepalese Securities Markets\***

## **1. Introduction**

Different market participants share the revenue generated in the securities markets. In the Nepalese securities markets, Securities Board of Nepal (SEBO), Nepal Stock Exchange Ltd. (NEPSE), Issue Managers, Stock Brokers and the Government (HMG) share the revenue generated thereon. SEBO is the apex regulator and NEPSE is the front line regulator and trading floor provider in the securities markets. Different provisions of Securities Exchange Regulation, 1993, Listing By-Laws, 1996 and Membership of Stock Exchange and Transaction By-Laws, 1998 have enabled the market participants to share the revenues. This study tries to find out the extent of revenue shared by the regulator and other market participants by reviewing legal provisions and status of sharing.

## **2. Review of Legal Provisions**

### **2.1 Provisions of Revenue to SEBO**

As provisioned in the Securities Laws, SEBO receives securities registration fees from the issuer and licensing and renewal fees from the securities businesspersons and stock exchange.

#### **a) Licensing and Renewal Fee for Stock Exchange:**

As per the provision of Rule 12, sub-rule 1 and annex 2 of Securities Exchange Regulation, 1993, a company applying to operate stock exchange should pay to SEBO Rs.0.2 million as licensing fee. The annual renewal fee for the stock exchange is Rs.0.05 million.

#### **b) Licensing and Renewal Fee for Securities Businesspersons:**

Rule 28, sub-rule 1 and annex 12 of Securities Exchange Regulation has made provision regarding the licensing and renewal fees for the securities businesspersons as presented in Table 1.

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\* Study Conducted by Securities Board of Nepal

**Table 1: Licensing and Renewal Fees for Securities Businesspersons**

<b>S.N.</b>	<b>Particulars</b>	<b>Licensing Fees (Rs.)</b>	<b>Annual Renewal Fees (Rs.)</b>
1	Stock Broker	2,500	1,500
2	Market Maker/Securities Dealer	5,000	3,000
3	Issue Manager	10,000	5,000
4	Other functions relating to securities transaction	10,000	5,000

The securities businesspersons should renew their licenses for the coming fiscal year before the expiry of the current fiscal year. In this regard, rule 34, sub-rule 2 of the Regulation states that the securities businesspersons not being able to renew their licenses within the stipulated period should pay additional 25% of renewable fees as penalty.

### **c) Securities Registration and Issue Approval Fee:**

Rule 17, sub-rule 1 and annex 5 of the Securities Exchange Regulation, 1993, has made provisions for securities registration and issue approval fees as presented in Table 2.

**Table 2: Securities Registration And Issue Approval Fees**

<b>S.N.</b>	<b>Amount of Issue Approval</b>	<b>Fees</b>
1	Up to Rs. 50,00,000	0.25%
2	Rs. 50,00,001 to 1,00,00,000	0.20%
3	Rs. 1,00,00,001 and above	0.15%

## **2.2 Provision of Revenue to NEPSE**

### **a) Securities Listing Fees**

Rule 23, sub-rule 2, and annex 9 of Securities Exchange Regulation, 1993 has made provisions for the listing fees and annual listing renewal fees for a

corporate body as presented in Table 3. As per the provision, the annual fees should be paid to NEPSE within three months of the expiry of fiscal year.

**Table 3: Securities Listing and Annual Listing Renewal Fees**

S.N.	Amount of Securities (Share, Debenture, Unit Saving or Mutual Fund)	Listing fees	Annual Listing Renewal Fees
1	Up to Rs. 10 Million	0.20%, or Minimum Rs. 15,000	Rs. 15,000
2	Rs. 10 to 50 Million	0.15%, or Minimum Rs. 45,000	Rs. 25,000
3	Rs. 50 to 100 Million	0.10%, or Minimum Rs. 75,000	Rs. 35,000
4	Above Rs. 100 Million	0.075%, or Minimum Rs. 1,00,000	Rs. 50,000

### b) Membership Fees

By-Law 3, sub-by law 1 and annex 2 of Membership of Stock Exchange and Transaction By-Laws, 1998 has made provision for the membership and annual renewal fees, as presented in Table 4.

**Table 4: Membership Fees for Securities Businesspersons**

S.N.	Type of Membership	Membership Fees	Annual Fees
1	Stock Broker	Rs. 30,000	Rs. 10,000
2	Market Maker/Securities Dealer	Rs. 1,25,000	Rs. 40,000
3	Issue Manager	Rs. 1,25,000	Rs. 40,000

### c) Trading Commission

As per the by-law 11, sub-by-law 2, part 3 of Membership of Stock Exchange and Transaction By-laws, 1998, Stock Exchange receives 25% of total commission received by stock brokers on trading of securities. Similarly, as per the provision of by-law 11, sub-byelaw 4, part 24; Stock Exchange receives 10% of the total commission received by the members who provides portfolio management services. Stock Exchange also receives 5% of the total commission from the issue managers providing issue management and underwriting services

as per the provision of sub-by-law 5, part 17 of Membership of Stock Exchange and Transaction By-laws, 1998.

#### **d) Fees for Changing Representative**

By-law 16, sub-by-law 5 of Membership of Stock Exchange and Transaction By-laws, 1998, states that stock brokers and the market makers while appointing new representatives in place of earlier, should pay Rs.500 and Rs.700 respectively to the Stock Exchange.

### **2.3 Provision of Fees to Securities Businesspersons**

#### **a) Brokerage Fees**

Rule 36, sub-rule 1 and annex 16 of Securities Exchange Regulation, 1993 states that the securities businesspersons can take the following commissions for providing securities business services.

*Table 5: Stock Broker's Commission on Securities Trading*

<b>S.N</b>	<b>Amount of Securities Trading</b>	<b>Commission</b>
1	Up to Rs. 25,000	1.50%
2	Rs. 25,000 to Rs. 50,000	1.40%
3	Rs. 50,000 to Rs. 1,00,000	1.30%
4	Rs. 1,00,000 to 5,00,000	1.20%
5	Rs. 5,00,000 to Rs. 10,00,000	1.10%
6	Above Rs. 10,00,000	1.00%

#### **b) Issue Management and Underwriting Commission**

Issue managers could take commission as presented in Table 6 for providing issue management services to the public issue of securities or issuing securities through circular method.

**Table 6: Issue Management Commission**

S.N	Amount of Issue Managed	Commission
1	Up to Rs. 25,00,000	2.25%
2	Rs. 25,00,000 to Rs. 50,00,000	2.00%
3	Rs. 50,00,000 to Rs. 1,00,00,000	1.75%
4	Above Rs. 1,00,00,000	1.50%

Securities businesspersons providing underwriting services to public issue or circular issue of securities can charge up to 3% of the underwritten amount as underwriting commission. Similarly, securities businesspersons involved in public issue or circular issue of securities can charge a commission up to 0.50% of amount of securities sold by the businessperson.

#### **2.4 Revenue to HMG**

HMG receives taxes at the rate of 15% levied on brokerage commission as TDS and capital gain tax at the rate of 10% on capital gain at the time of trading.

### **3. Status of Securities Market Revenue**

The status of revenue shared by different market participants as presented in Table 7 shows that in the fiscal year 2001/02, out of total revenue generated in the securities market, issue managers received 41.29 percent, stock brokers 25.05 percent, NEPSE 20.91 percent, HMG 8.10 percent and SEBO 4.65 percent. Similarly, in the fiscal year 2002/03, out of total revenue, issue manager received 38.60 percent, NEPSE 28.51 percent, stock brokers 15.14 percent, HMG 13.18 percent and SEBO 4.57 percent. It is clear from the above figures that the issue managers obtain the highest portion of the total revenue and NEPSE obtains the second highest portion. At the same time, SEBO obtains the lowest portion of the total revenue.

**Table 7: Tentative Revenue Structure of the Securities Markets for the Fiscal Years 2001/02 and 2002/03****(Rs. in Million)**

S.N.	Particulars	Fiscal Year 2001/02						Fiscal Year 2002/03					
		SEBO	NEPSE	Issue Manager	Stock Broker	HMG	Total	SEBO	NEPSE	Issue Manager	Stock Broker	HMG	Total
1	Issue Approval (Issuer Companies)	2.1	1.1*	20.2	-	-	23.4	1.2	0.6*	11.7	-	-	13.6
2	Securities Listing (New & old securities)	-	3.9	-	-	-	3.9	-	5.5	-	-	-	5.5
3	Trading (Investors)	-	4.8**	-	12.3*	4.0***	21.1	-	1.8**	-	4.6#	4.0***	10.4
4	License Renewal & Membership Fees (NEPSE and Securities Businesspersons)	0.1	0.8	-	-	-	0.9	0.1	0.7	-	-	-	0.9
Total		2.3	10.2	20.2	12.3	4.0	49.0	1.4	8.6	11.7	4.6	4.0	30.3
Percent		4.7	20.9	41.3	25.1	8.1	100.0	4.6	28.5	38.6	15.1	13.2	100.0

\* 5% of issue management commission

\*\* 25% of commission received by broker from transaction

\*\*\* Only TDS @ 15% [commission received by broker from transaction- commission paid by broker to NEPSE (25%)]×15% and @10% Tax on capital gain

# Income to Broker = (Total Traded Amount × Average Commission Rate)-25% of Commission to NEPSE -15% Tax from remaining amount after Commission to NEPSE

#### **4. Conclusions and Recommendations**

SEBO has a dual role of regulating and developing the securities market in the country. Nepal's accession to the World Trade Organisation has added greater challenges in the securities markets, as it should be opened to foreign investors and foreign securities businesspersons. Fulfilling more roles and responsibilities with limited resources can seriously compromise the potential of a thriving capital market.

Due to low level of income from the securities market, SEBO has no alternative than to depend on government funding to carry out its regulating and market development roles. However, in the long term, SEBO can not rely only on government grant and would have to look for other alternatives to provide SEBO with greater operational and financial autonomy. Additional roles and responsibilities of SEBO would justify such increment in resources.

If we see the practice of Indian securities markets, the stock exchanges contribute, on average, 5 percent of the total listing fees to Securities Exchange Board of India (SEBI) every year. Additionally, stock brokers provide service fee at the rate of 0.01 percent of the turnover if the turnover is more than Rs. 10 million in case of corporate securities and 0.001 percent of the turnover in case of government securities. Similarly, mutual fund managers pay service fee to SEBI based on net assets value of the fund managed. We find similar practices in the other securities markets too. In this context, SEBO's share on market revenue should be increased, which can be done by increasing licensing and renewal fees of market intermediaries, allocating some portion of listing fees and trading commissions to SEBO and bringing securities services like underwriting and registrar to the securities within the ambit of SEBO's regulation and making provisions for charging some fees for such services.

# **Performance Analysis of Issue Managers\***

## **I. Introduction**

Public offering market in Nepal is at the evolving stage. Before the establishment of Securities Board, Nepal (SEBO), the then Securities Exchange Centre used to provide services regarding public offerings of securities. In 1993, as per the provision of first amendment in Securities Exchange Act, 1983 SEBO was established to regulate the securities market. Securities Exchange Centre was converted into Nepal Stock Exchange Ltd. (NEPSE) authorizing it to manage secondary trading of securities. Initially, as per the provision of the Act, market intermediaries including issue managers were introduced in the market, through the membership of NEPSE. At that time, SEBO designated the interested members of NEPSE to function as issue managers. The second amendment of the Act in 1997 made a provision to allow only those registered in SEBO to perform as issue managers. Accordingly, issue managers were registered with SEBO to qualify for trading license since then.

SEBO has been monitoring and supervising the activities of issue managers for the past 12 years. In view of initial development of securities markets in Nepal, this period is quite sufficient to assess the performance of the issue managers, and seek measures to further improve their performance. With this objective, SEBO conducted this study. In this study, SEBO reviewed the role of issue managers, public offerings market and related legal provisions. The number and amount of issues handled by individual issue manager and the performance and compliance practices in each issue have been compiled and analysed for greater insight into this critical aspect of capital market operation.

The study starts with an explanation on the role and significance of issue managers. It then presents the objectives of the study, reviews the public offerings market and legal provisions, explains the sample selection and methodology, presents the empirical analysis, presents the conclusions of the study, and finally provides the recommendations.

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\* Study conducted by Securities Board of Nepal

## **II. Role and Significance of Issue Managers**

Issue manager has a greater role in developing and promoting the primary market of securities. They not only help issuer companies to raise funds but also help investors to make informed investment decision in initial public offerings. Their services are more pronounced in bringing transparency in the public offerings. In addition, they support regulators in regulating primary markets.

Services such as preparing prospectus and fulfilling other procedural aspects required for public issue provided by issue managers to the issuer companies make fund raising process more easy and certain. Generally, the situation of market, perception of investors and procedure relating to issuing securities are the major areas of support provided by the issue managers to the issuer companies. Issue managers could also suggest the types of instruments to be issued through joint discussion with the issuer companies. As issue managers are more tuned to the general perception of investors, market trend, and advantages and disadvantages of a particular instrument, their suggestions greatly help the issuer companies to select the right type of instruments.

The principal functions of an issue manager are issue advising, helping to prepare prospectus with required disclosure and helping allotment and refunding, listing of securities, and assisting in compliance with the issue related legal provisions. In practice, issue managers also provide services relating to registrar to the issue and underwriting.

Companies issuing securities to general public must register their securities with SEBO. For this, the company and issue manager must file detailed registration statements. SEBO vets the registration statements and the prospectus for legal compliance, information integrity and clarity.

The issuer company is mainly accountable for the authenticity, reliability and adequacy of the information disclosed in their prospectus, along with, its board of directors, valuers and auditors and this is attested by the issue managers. The issue managers are required to present the due diligence certificate regarding the proposed issue. As provisioned in the prevailing securities legislation, SEBO uses this due diligence certificate from the issue manager as a key basis for approving the issuance of securities.

### **III. Objectives of the Study**

The major objective of the study is to assess the performance of issue managers. The study also has the following specific objectives:

- To find the total number and size of issues handled by individual issue manager.
- To assess the performance of different public issues.
- To assess the post issue compliance practices of the issues.
- To provide recommendation for improved performance of issue managers.

### **IV. Review of Public Offering Market and Legal Provisions**

#### **Public Offering Market**

A review of public offering market during the period 1993/94 to 2003/04<sup>1</sup> reveals that public issue approval from SEBO reached Rs. 7,249.1 million. Annual size of average issue approval is Rs.659.0 million. The average issues approved by SEBO in the last four years exceeded the average annual size of the last ten years indicating an increasing trend.

Of the total public issue approved during the period 1993/94 to 2003/04, 51.09 percent was from banking sector, 23.83 percent from finance sector, 12.45 percent from manufacturing and processing sector, 4.38 percent from hotel sector, 3.87 percent from insurance sector, 0.04 percent from trading sector and 3.89 percent from other sectors. This shows that the major portion of the total public issue approval was from bank and finance sectors. It is to be noted that there is mandatory provision to issue securities for the banks, finance and insurance companies.

Similarly, instrument wise public issue approval during the period of the fiscal year 1993/94 to fiscal year 2003/04 reveals that on average 77.14 percent of the total public issue approval was equity share i.e. common stock including rights issue, 10.39 percent debenture, 9.21 percent mutual funds and 3.26 percent preference share. This shows the market dominated by risky instrument i.e.

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<sup>1</sup> Assuming Nepalese Fiscal Year (Mid July to Mid July)

equity shares, which means the market is not preferable to risk averse or risk neutral investors.

In addition to their normal functions, these days issue managers are also providing services for selling government owned shares in course of privatisation through securities market. They are also involved in selling promoters' shares to the public through secondary offerings and assisting the issuers in the process of private placement. In the absence of a clear mechanism, these activities are not within the purview of SEBO's regulation. However, viewing the necessity of providing adequate information relating to these types of public offerings, SEBO has recently started to seek concurrence from the issuer and the issue managers to publish public announcement incorporating information on such offerings.

There is a provision of issuing securities at premium under the securities related laws. However, all the equity shares issued to date were at par value. To bring this provision in practice, among others requires credible financial reporting practices. In the securities related laws, there is also a provision that restricts the issuance of securities at discount. This provision has been an impediment to free pricing of securities in public offerings.

### **Legal Provisions**

Companies Act, 1997, Securities Exchange Act 1983, Securities Exchange Regulation, 1993, Securities Registration and Issue Approval Guidelines, 2000, Issue Management Guidelines, 1998, and Share Allotment Guidelines, 1994 provide the legal framework within which the issuer companies and the issue managers perform their public issue and issue management activities.

Following are some of the key provisions related to public offering to give a feel of the regulatory regime prevalent in our capital market.

Section 20(1) of the Companies Act, 1997, states that a public company should publish prospectus approved by the Company Registrar's Office (CRO) before issuing the securities. Section 21 of the Act mentions the contents of the prospectus, while section 23 states that the directors who sign the prospectus are accountable to its contents. Regarding the allotment, section 26 states that the issued securities should be allotted within three months of the public

announcement. Further, it states that for the allotment of securities, it requires at least 50 percent subscription to the issue. Section 28(1) requires the issuer company to take the services of issue manager for the sale and allotment of securities, and refunding. Similarly, the Companies Act also includes provisions regarding the issuance of securities at premium and restriction of issuing securities at discount, prerequisite to issue different securities instruments, holding of Annual General Meetings (AGM) and reporting requirements.

Section 7f and 7h of the Securities Exchange Act, 1983 require the companies to register their securities in SEBO and seek issue approval before issuing to the public. In this regard, rule 17(2) of Securities Exchange Regulation, 1993 provisions the necessary information and documents to be submitted to SEBO. Section 7k of the Securities Exchange Act, 1983 has made the company and its directors, individually or collectively, accountable to the authenticity of the statements and information submitted to SEBO for the purpose of registration of securities. Section 8 of the Act states that the issued securities should be listed in the stock exchange for the purpose of transaction. Section 15a of the Act requires the listed companies to submit annual financial statements to SEBO and Stock Exchange within four months of the closing of its annual accounts.

Securities Registration and Issue Approval Guidelines, 2000, as per the provision of section 2(10), requires the disclosure of economic, physical, managerial and trading aspects of the issuer company to be factual. It also states that the financial forecasting of the company should be realistic. Section 6.2(f) states that the prospectus should contain the forecast figures of net worth, profit and loss account, and balance sheet for the following three years. Section 18 provides the allotment and refunding scheme for the issue, which is presented in Table 1.

**Table 1: Allotment and Refunding**

<b>Number of Application</b>	<b>Allotment and Refunding Period</b> (Within the days after the closure of the issue)
Up to 15,000	45 days
15,001 - 60,000	60 days
60,001- 1,00,000	75 days
1,00,001 and above	90 days

Section 9(1) of the Securities Registration and Issue Approval Guidelines, 2000, state that the issue should be opened within 2 months of issue approval. If the issue is not opened within the said period, section 9(3) requires issue manager to incorporate the changes, if any, relating to technical, financial, economic and managerial aspects in the prospectus and take issue permission for the same from SEBO. Section 19.1 states that the provision for trading of securities should be made within 45 days of securities allotment for those securities issued publicly or by circular method. Section 19.2 states that if the issuer company apply with justification for delay in listing SEBO could provide additional time not exceeding one month.

Regarding the issuance of securities at premium, section 2(7), requires the company to have run in profit for the last two years, to have its net worth higher than the paid-up value, not to have restriction by any laws for issuing securities at premium and to present justification for issuing securities at premium.

Issue Management Guidelines, 1998 defines the role and responsibility of issue managers regarding the issue. Section 6.6 states that while submitting application in SEBO for issue approval, issue manager should take into account whether the issuer company's managerial, technical, economic aspect and future prospects as well as other information presented justify the public issue. Section 14.5 states that in case of over subscription of public issue, issue manager should submit the criteria and report of allotment to SEBO within 7 days of allotment. Section 17.2 states that issue manager should submit the report relating to issue within 90 days of closure of issue. Section 18 states that while providing issue approval, SEBO can prescribe additional conditions to the issue manager and the issuer company.

## **V. Sample Selection and Methodology**

During the period of the fiscal year 1993/94 to fiscal year 2003/04, SEBO approved a total of 130 public issues. Out of the total issues, 93 were ordinary shares, 27 rights shares, four preferences shares, three mutual funds and three were debentures. There were a total of 10 issue managers in the markets. This study analyses only the issues relating to ordinary shares. As the present study analyses the performance of individual issue managers, this study does not consider the issues, which were handled by more than one issue manager (a total of 7 issues relating to ordinary shares were handled by more than one issue

manager). It also does not consider the issues of the fiscal year 2003/04 (a total of 11 issues of ordinary shares) as the data relating to these issues do not provide scope for the comparison of the actual and forecast performance. With these considerations the number of issues relating to ordinary shares would be 75, 80.65 percent of total population (total number of issues of ordinary shares).

The performance of different issues handled by issue manager is analysed based on the following indicators.

1. Issue Activities: allotment and refunding, and listing
2. Subscription (response to the issue)
3. Forecast and Actual net profits
4. Closing Price of day one (closing price of securities in the first transaction day)
5. Post issue compliance to regulation

The rationale behind the selection of the indicators like allotment and refunding, and listing is to assess whether the issue managers had performed these activities as per the prevailing legal provisions. Similarly, the subscription to the issue shows the efficiency of issue manager as well as the performance of the issuer, while the closing price of day one shows the performance particularly of the issuer vis-à-vis the quality of issuing company selected by the issue manager. Likewise, difference in forecast and actual net profit of issuer is selected in order to assess the professionalism of issue managers and issuers in disclosing the realistic picture of the company.

The rationale behind assessing post issue compliance practices of the issues is to find out how well-governed are the companies, selected by the issue managers - a concern for the regulators and investors. For this purpose, two important post issue compliance indicators relating to the disclosure of the immediate fiscal year following the issue are considered.

1. Financial Statement/Annual Report Submission
2. Holding Annual General Meeting

## VI. Empirical Analysis

### Total Number and Size of Issues handled by Individual Issue Manager

A comparative analysis on the total number and size of issues as shown in Table 2 reveals that NIDC Capital Markets Ltd. (NCML) has managed the highest number and amount of issues. NCML has managed 30 issues (40 percent of total number of issues) amounting to Rs.971.84 million (46.92 percent of total issued amount). Similarly, Citizen Investment Trust (CIT) has managed a total of 17 issues (23 percent of total number of issues) amounting to Rs.508.60 million (24.56 percent of total issued amount). The number of issues managed by Nepal Merchant Banking & Finance Ltd. (NMB) is eight (11 percent of total number of issue) and the total amount of the issues is Rs.369.00 million (17.82 percent of total issued amount). The other four issue managers namely Nepal Share Markets Ltd. (NSML), National Finance Co. Ltd. (NFCL), Rastriya Banijya Bank (RBB) and Nepal Finance & Saving Co. Ltd. (NEFINSCO) have managed 20 issues (26.67 percent of total number of issues) amounting to Rs. 221.63 million (10.70 percent of total issued amount). The remaining three issue managers namely Nepal Sri Lanka Merchant Bank Ltd. (NSMB), Ace Finance Co. Ltd. (AFCL) and United Finance Ltd. (UFL) have not managed any issue of ordinary share.

*Table 2: Number and Size of the Issue Handled by Individual Issue Managers*

SN	Issue Manager	No. of Years in Service	No. of Issues	Amount of Issue (Rs. in Million)
1	NIDC Capital Markets	11	30	971.84
2	Citizen Investment Trust	11	17	508.60
3	Nepal Merchant Banking & Finance Ltd.	7	8	369.00
4	Nepal Share Markets Ltd.	10	9	90.00
5	National Finance Company Ltd.	10	5	72.51
6	Rastriya Banijya Bank	9	2	30.12
7	Nepal Finance & Saving Co. Ltd.	8	4	29.00
8	Nepal Sri Lanka Merchant Bank Ltd.	10	0	0.0
9	Ace Finance Co. Ltd.	7	0	0.0
10	United Finance Ltd.	8	0	0.0

Detail on number and amount of issues managed by individual issue managers is presented in Exhibit 1.

### **Performance of Different Public Issues**

The performance of issue managers in terms of timely allotment and refunding, timely listing, over subscription, actual profit higher than forecast profit and closing price of day one higher than the issue price in the issues handled by them is presented in Table 3.

In regard to the allotment and refunding, all the issues managed by NMB have been performed timely while 75 percent of the total issues handled by NFCL and NEFINSCO are allotted and refunded timely. Similarly, NSML, CIT and NCML have respectively 66.67 percent, 50 percent and 41.38 percent of the issues allotted and refunded timely. However, none of the issues handled by RBB allotted and refunded timely.

Analysis of performance of issue managers in terms of timely listing shows very poor result as the highest percentage of timely listing of the issues handled by issue managers is only 37.5. Timely listing of issues handled by NMB, NCML, NSML and CIT were 37.5 percent, 24.14 percent, 11.11 percent and 6.25 percent respectively. However, none of the issues handled by NFCL, RBB and NEFINSCO were listed timely.

*Table 3: Performance of Issues Handled by the Issue Managers*

<b>Issue Managers</b>	<b>Timely Allotment and Refunding</b>	<b>Timely Listing</b>	<b>Over Subscription</b>	<b>Actual Profits higher than Forecast Profits</b>	<b>Closing Price of Day One higher than Issue Price</b>
NIDC Capital Markets Ltd.	41.38%	24.14%	75.86%	31.03%	75.86%
Citizen Investment Trust	50.0%	6.25 %	43.75%	37.5%	62.5%
Nepal Merchant Banking & Finance Ltd.	100.0%	37.5%	100.0%	50.0%	100.0%
Nepal Share Markets Ltd.	66.67%	11.11%	44.44%	44.44%	66.67%

<b>Issue Managers</b>	<b>Timely Allotment and Refunding</b>	<b>Timely Listing</b>	<b>Over Subscription</b>	<b>Actual Profits higher than Forecast Profits</b>	<b>Closing Price of Day One higher than Issue Price</b>
National Finance Co. Ltd.	75.0%	0%	75.0%	50.0%	50.0%
Rastriya Banijya Bank	0%	0%	0%	50.0%	0%
Nepal Finance & Saving Co. Ltd.	75.0%	0%	100.0%	25.0%	0%

Most of the issues were oversubscribed thus showing good public response. Hundred percent of the issues handled by NMB and NEFINSCO were oversubscribed. Similarly, 75.86 percent, 75.0 percent, 44.44 percent and 43.75 percent of the total issues handled by NCML, NFCL, NSML and CIT, respectively were oversubscribed.

In case of 50 percent of the total issues handled by NMB, NFCL and RBB, actual profit was found to be higher than the forecast profit. Similarly, actual profit was found to be higher than forecast profit at 44.44 percent, 37.5 percent, 31.03 percent and 25 percent of the issues handled by NSML, CIT, NCML and NEFINSCO respectively. This shows the overstated financial forecasting in most of the issues.

With respect to the closing price of day one higher than the issue price, the closing price of 100 percent of the issues managed by NMB was higher than the issue price. Similarly, the closing price of day one in 75.86 percent of the issues handled by NCML was higher than the issue price. This figure was found to be 66.67 percent, 62.5 percent and 50 percent in case of the issues handled by NSML, CIT and NFCL respectively. However, in case of RBB and NEFINSCO, none of the issues had closing price of day one higher than the issue price.

The detail on performance of individual issues handled by different issue managers is presented in Exhibit 2.

## Post Issue Compliance Practices of the Issues

The status of timely submission of annual reports and timely holding of AGM of the issues handled by the issue managers for the immediate following year is presented in Table 4.

*Table 4: Post Issue Compliance of the Issues handled by Issue Managers*

Issue Managers	Timely Submission of Annual Reports	Timely Holding of AGM
NIDC Capital Markets Ltd.	13.79%	27.59%
Citizen Investment Trust	12.5%	18.75%
Nepal Merchant Banking & Finance Ltd.	37.5%	25.0%
Nepal Share Markets Ltd.	11.11%	44.44%
National Finance Co. Ltd.	25.0%	50.0%
Nepal Finance & Saving Co. Ltd.	0%	50.0%
Rastriya Banijya Bank	0%	0%

Note: 1 As per the provision of Securities Exchange Regulation, 1993, listed companies should submit its annual report to SEBO and NEPSE within 4 months of the end of the fiscal year.

2 As per the provision of Companies Act, 1997, companies should conduct their AGM within 6 months of the end of the fiscal year

As revealed by Table 4, 37.5 percent of the issues handled by NMB has submitted annual reports on time. Similarly, 25 percent of the issues handled by NFCL has submitted the reports timely. In case of the issues handled by NCML, CIT and NSML, the reports submission rates are 13.79 percent, 12.5 percent and 11.11 percent respectively. With respect to the holding of AGM, 50 percent of the issues handled by NFCL and NEFINSCO have conducted AGM on time. Similarly, 44.44 percent of the issues handled by NSML has conducted AGM timely. In case of the issues handled by NCML, NMB and CIT, the AGM holding rates are 27.59 percent, 25 percent and 18.75 percent respectively.

## VII. Conclusions

The aforementioned empirical analysis leads to the following conclusions.

- NIDC Capital Markets Ltd., Citizen Investment Trust and Nepal Merchant Banking & Finance Ltd. are the three most active issue managers in terms of number and size of issues handled. These three issue managers have

occupied 89.3 percent of the total amount of issue managed. The other four issue managers namely, Nepal Share Markets Ltd., National Finance Co. Ltd., Rastriya Banijya Bank and Nepal Finance and Saving Co. Ltd. have managed only 10.7 percent of the total amount of issue managed. The remaining three issue managers namely Nepal Sri Lanka Merchant Bank Ltd., Ace Finance Co. Ltd. and United Finance Ltd. have not yet managed any new issue.

- In terms of timely allotment and refunding, timely listing, over subscription, actual profits being higher than the forecast profits, and closing price of day one of the stock being higher than the issue price, Nepal Merchant Banking & Finance Ltd., NIDC Capital Markets Ltd., and National Finance Co. Ltd. are the three best performers
- National Finance Co. Ltd., Nepal Merchant Banking & Finance Ltd., and NIDC Capital Markets Ltd. are best issue managers in selecting comparatively well-governed companies as the higher percent of issues managed by these issue managers complied with post issue legal provisions. However, the post issue compliance practices of the issuers can not be considered satisfactory as the maximum percent of timely submission of annual reports is only 37.5 and maximum percent of timely holding of AGM is only 50.0.
- The study reveals that banking and finance sectors have occupied 74.92 percent of the total issue approval (including all the instruments). There is dominance of equity share in the market as it has occupied 77.14 percent of the total instruments available.

### **VIII. Recommendations**

- Besides managing the issues, issue managers should also encourage public companies to raise funds from securities market; since, their role is crucial in promoting and developing the market. However, there are only three issue managers actively involved in the market, which may not be sufficient. So, it is high time to find out why not all the issue managers are being involved in issuance and encourage them to be involved more actively.
- Timely listing promotes dynamism in the securities market. However, over the study period, the timely listing practice was found poor. Hence, issuer and issue managers should try to list issued securities on time.

- Post issue compliance practice is poor. So issuer companies should be made aware in complying with the post issue legal provisions at the time of public issues. In this regard, issue managers should also take the responsibility to make the issuer companies aware of compliance issue.
- Most of the public issues were from banking and finance sectors. So, issue managers should take initiative to promote their business from other sectors too. They should be equally effortful in developing the public offering market as an avenue for cost effective financing.
- Market is dominated by a risky instrument i.e., equity share. This type of market is not preferable to risk averse or risk neutral investors. So, the efforts should be made towards diversifying the instruments in the market to encourage other types of investors.
- All the activities relating to issue management should be within the ambit of securities regulation. Hence, there is a necessity of developing clear regulatory mechanism regarding the selling of government owned shares in course of privatisation and prescribing standard formats for the offer documents to systematise the secondary offerings and private placement.

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**Exhibit 1: Number and Amount of Issues Managed by Issue Managers**  
(FY 1993/94 to FY 2002/03)

S.N.	Issuing Companies	Amount (Rs. in Million)
<b>Issues Managed by NIDC Capital Markets Ltd. (NCML)</b>		
1	Nepal Share Markets Co Ltd	4.00
2	Himalayan General Insurance Co Ltd	12.00
3	Harisiddhi Brick & Tiles Factory Ltd	53.20
4	Nepal Lever Ltd	13.80
5	United Insurance Co. (Nepal) Ltd	24.00
6	Nepal Film Development Co Ltd	21.90
7	Birat Shoe Ltd	5.00
8	Premier Insurance Co Ltd	12.00
9	Nepal Bangladesh Bank Ltd	36.00
10	Everest Insurance Co Ltd	12.00
11	Kathmandu Finance Co Ltd	8.00
12	Leatherage Bansbari Tannery & Shoe Factory Ltd	15.00
13	Everest Bank Ltd	36.00
14	Yeti Finance Co Ltd	8.00
15	HISEF Finance Ltd	24.00
16	Fleur Himalayan Co Ltd	12.28
17	Bank of Kathmandu Ltd	45.00
18	Shreeram Sugar Mills Ltd	46.50
19	Lalitpur Finance Co Ltd	9.50
20	Goodwill Finance & Investment Co(Nepal) Ltd	10.00
21	Nepal Merchant Banking & Finance Ltd	50.00
22	Sagarmatha Insurance Co Ltd	10.20
23	Oriental Hotels Ltd	150.00
24	Nepal Merchant Banking & Finance Ltd	50.00
25	Himalayan Distillery Ltd	173.46
26	Union Finance Co Ltd	24.00
27	Life Insurance Corporation (Nepal) Ltd	50.00
28	Nepal Srilanka Merchant Bank Ltd	40.00
29	Central Finance Co Ltd	8.00
30	Premier Finance Co Ltd	8.00
<b>Total</b>		<b>971.84</b>
<b>Issues Managed by Citizen Investment Trust (CIT)</b>		
1	Nepal Med Ltd	2.70
2	Nimrod Pharmaceuticals Ltd	18.00
3	Necon Air Ltd	16.50
4	Nepal SBI Bank Ltd	36.00

<b>S.N.</b>	<b>Issuing Companies</b>	<b>Amount</b> (Rs. in Million)
5	Peoples Finance Ltd	9.80
6	Agro Nepal Ltd	9.00
7	Himgiri Textile Industries Ltd	19.20
8	Shree Brikuti Pulp & Paper Nepal Ltd	105.00
9	Color Scan Nepal Ltd	14.34
10	Universal Finance and Capital Markets Ltd	15.00
11	Alliance Insurance Co Ltd	20.00
12	Pokhara Finance Co Ltd	8.00
13	Universal Finance & Capital Market Ltd	3.26
14	Nirdhan Utthan Bank Ltd	3.30
15	Shree Investment & Finance Co Ltd	16.00
16	NB Insurance Co Ltd	20.00
17	Laxmi Bank Ltd	192.50
<b>Total</b>		<b>508.60</b>
<b>Issues Managed by Nepal Merchant Banking and Finance Ltd. (NMB)</b>		
1	Siddhartha Finance Ltd	8.00
2	Development Credit Bank Ltd	48.00
3	United Finance Ltd	24.00
4	Nepal Life Insurance Co Ltd	50.00
5	International Leasing & Finance Co Ltd	30.00
6	Machhapuchhre Bank Ltd	165.00
7	Butwal Finance Ltd	20.00
8	Standard Finance Ltd	24.00
<b>Total</b>		<b>369.00</b>
<b>Issues Managed by Nepal Share Markets Ltd. (NSML)</b>		
1	Annapurna Finance Ltd	2.00
2	Balaju Textile Industries Ltd	7.50
3	Ace Finance Co Ltd	12.00
4	Nepal Housing & Merchant Finance Ltd	12.00
5	General Finance Co Ltd	8.00
6	Nepal Bitumen & Barrel Udhyog Ltd	74.00
7	Paschimanchal Finance Co Ltd	8.00
8	Lumbini Finance & Leasing Co Ltd	24.00
9	Gorkha Finance Ltd	10.00
<b>Total</b>		<b>90.90</b>
<b>Issues Managed by National Finance Company Ltd. (NFCL)</b>		
1	Ace Laboratories (Nepal) Ltd	12.26
2	Citizen Investment Trust	16.00
3	Kosh Byabasthapan Co Ltd	30.25

<b>S.N.</b>	<b>Issuing Companies</b>	<b>Amount</b> (Rs. in Million)
4	Narayani Finance Co Ltd	4.00
5	Mahalaxmi Finance Co. Ltd.	10.00
<b>Total</b>		<b>72.51</b>
<b>Issues Managed by Rastriya Banijya Bank (RBB)</b>		
1	Nepal Awas Bikas Bitta Co Ltd	20.00
2	Samjhana Finance Ltd	10.12
<b>Total</b>		<b>30.12</b>
<b>Issues Managed by Nepal Finance &amp; Saving Co. Ltd. (NEFINSCO)</b>		
1	Alpic Everest Finance Ltd	5.00
2	Janaki Finance Co Ltd	8.00
3	Nawadurga Finance Co Ltd	8.00
4	Om Finance Ltd	8.00
<b>Total</b>		<b>29.00</b>

## Exhibit 2: Performance of Individual issues handled by Issue Managers

(FY 1993/94 to FY 2002/03)

S.N.	Issuer Companies	Timely			Subscription		Profits (Rs. in Million)			Closing Price of Day One (Rs.)
		Issue	Allotment & Refunding	Listing	Over	Under	Forecast	Actual	Diff. (%)	
<b>Performance of Issues handled by NIDC Capital Markets Ltd. (NCML)</b>										
1	Nepal Share Markets Co Ltd	√	√	√	√	-	0.69	3.29	376.81	112
2	Himalayan General Insurance Co Ltd	√	-	-	√	-	(0.72)	0.04	105.56	635
3	Harisiddhi Brick & Tiles Factory Ltd	√	-	√		√	4.37	(7.95)	(281.92)	5
4	Nepal Lever Ltd	√	-	-	√	-	52.60	(21.84)	(141.53)	417
5	United Insurance Co (Nepal) Ltd	√	-	-	√	-	0.00	0.008	8.00	117
6	Nepal Film Development Co Ltd	√	-	-	√	-	4.35	(1.46)	(133.56)	-
7	Birat Shoe Ltd	√	-	-	√	-	0.60	0.32	(46.67)	-
8	Premier Insurance Co Ltd	√	-	-	√	-	0.20	1.96	880.0	140
9	Nepal Bangladesh Bank Ltd	√	√	-	√	-	2.0	6.56	228.0	139
10	Everest Insurance Co Ltd	√	-	√	√	-	3.70	0.26	(92.97)	152
11	Kathmandu Finance Co Ltd	√	√	-	√	-	0.87	0.14	(83.90)	100
12	Leatherage Bansbari Tannery & Shoe Factory Ltd	√	-	-		√	18.67	-	-	100
13	Everest Bank Ltd	√	√	-	√	-	3.60	(3.95)	(209.72)	122
14	Yeti Finance Co Ltd	√	-	-		√	0.04	0.55	1275.0	65
15	HISEF Finance Ltd	√	√	√		√	0.81	(1.85)	(323.46)	53
16	Fleur Himalayan Co Ltd	√	-	-		√	20.29	(1.22)	(106.01)	-
17	Bank of Kathmandu Ltd	√	√	-	√		29.00	(5.14)	(117.72)	153
18	Shreeram Sugar Mills Ltd	√	-	-		√	74.32	(19.73)	(126.55)	45
19	Lalitpur Finance Co Ltd	√	-	-	√	-	5.41	5.59	3.33	128
20	Goodwill Finance & Investment Co(Nepal) Ltd	√	-	-	√	-	2.66	4.52	69.92	66
21	Nepal Merchant Banking & Finance Ltd		-	√		-	-	-	-	-
22	Sagarmatha Insurance Co Ltd	√	-	-	√	-	3.1	2.80	(9.68)	236
23	Oriental Hotels Ltd	√	-	-	√	-	2.98	(78.28)	(2726.85)	49
24	Nepal Merchant Banking & Finance Ltd	√	√	√	√	-	5.90	31.19	428.64	233
25	Himalayan Distillery Ltd	√	-	-		√	3.09	-	-	100

S.N.	Issuer Companies	Timely			Subscription		Profits (Rs. in Million)			Closing Price of Day One (Rs.)
		Issue	Allotment & Refunding	Listing	Over	Under	Forecast	Actual	Diff. (%)	
26	Union Finance Co Ltd	√	√	-	√	-	8.30	7.44	(10.36)	100
27	Life Insurance Corporation (Nepal) Ltd	√	√	-	√	-	29.95	0.79	(97.36)	125
28	Nepal Srilanka Merchant Bank Ltd	√	√	-	√	-	8.03	1.12	(86.05)	91
29	Central Finance Co Ltd	√	√	√	√	-	4.54	2.09	(53.96)	138
30	Premier Finance Co Ltd	√	√	√	√	-	3.57	0.42	(88.24)	110
<b>Performance of Issues handled by Nepal Share Markets Ltd. (NSML)</b>										
1	Annapurna Finance Ltd	√	√	√	√	-	0.89	0.59	(33.71)	275
2	Balaju Textile Industries Ltd	√	√	-	√	-	3.97	-	-	-
3	Ace Finance Co Ltd	√	√	-	-	√	0.09	(0.11)	(222.23)	110
4	Nepal Housing & Merchant Finance Ltd	√	-	-	-	√	0.28	2.42	764.29	63
5	General Finance Co Ltd	√	√	-	-	√	0.15	0.09	(40.0)	40
6	Nepal Bitumen & Barrel Udhyog Ltd	√	-	-	-	√	1.0	0.80	(20.0)	-
7	Paschimanchal Finance Co Ltd	√	√	-	-	√	2.76	4.22	52.90	121
8	Lumbini Finance & Leasing Co. Ltd.	√	-	-	√	-	14.30	14.68	2.66	205
9	Gorkha Finance Ltd.	√	√	-	√	-	2.27	4.27	88.11	100
<b>Performance of Issues handled by National Finance Company Ltd. (NFCL)</b>										
1	Ace Laboratories (Nepal) Ltd	√	-	-	√	-	14.85	1.31	(91.81)	-
2	Citizen Investment Trust	√	√	-	√	-	3.52	0.36	(89.77)	49
3	Kosh Byabasthapan Co Ltd	-	-	-	-	-	-	-	-	-
4	Narayani Finance Co Ltd	√	√	-	√	-	0.16	0.42	162.5	101
5	Mahalaxmi Finance Co Ltd	√	√	-	-	√	4.1	4.63	12.93	165
<b>Performance of Issues handled by Rastriya Banijya Bank (RBB)</b>										
1	Nepal Aawas Bikas Bitta Co Ltd	√	-	-	-	√	1.11	1.22	9.91	48
2	Samjhana Finance Ltd	√	-	-	-	√	0.28	(1.36)	(585.71)	42
<b>Performance of Issues handled by Nepal Finance &amp; Saving Co Ltd. (NEFINSCO)</b>										
1	Alpic Everest Finance Ltd	√	-	-	√	-	4.59	5.0	8.84	48
2	Janaki Finance Co Ltd	√	√	-	√	-	5.72	-	-	42
3	Nawadurga Finance Co Ltd	√	√	-	√	-	4.28	2.12	(50.47)	42
4	Om Finance Ltd	√	√	-	√	-	2.41	-	-	42

S.N.	Issuer Companies	Timely			Subscription		Profits (Rs. in Million)			Closing Price of Day One (Rs.)
		Issue	Allotment & Refunding	Listing	Over	Under	Forecast	Actual	Diff. (%)	
<b>Performance of Issues handled Citizen Investment Trust (CIT)</b>										
1	Nepal Med. Ltd.	√	√	-	-	√	-	-	-	-
2	Nimrod Pharmaceuticals Ltd.	√	-	-	-	√	-	-	-	-
3	Necon Air Ltd.	√	√	√	-	√	10.44	5.21	(50.99)	115
4	Nepal SBI Bank Ltd.	√	-	-	-	√	1.05	7.37	601.90	512
5	Peoples Finance Ltd.	√	-	-	-	√	0.35	1.0	185.71	106
6	Agro Nepal Ltd.	√	-	-	-	√	0.002	-	-	-
7	Himgiri Textile Industries Ltd.	√	√	-	-	√	9.73	(9.71)	(199.79)	-
8	Shree Brikuti Pulp & Paper Nepal Ltd.	√	-	-	-	√	7.40	10.58	42.97	100
9	Color Scan Nepal Ltd.	√	-	-	-	√	-	-	-	-
10	Universal Finance and Capital Markets Ltd.	√	-	-	√	-	1.04	0.43	(58.65)	40
11	Alliance Insurance Co. Ltd.	√	-	-	√	-	17.34	5.28	(69.55)	175
12	Pokhara Finance Co. Ltd.	√	√	-	√	-	3.02	7.53	149.34	180
13	Nirdhan Uthhan Bank Ltd.	√	√	-	√	-	0.25	1.15	360.0	100
14	Shree Investment & Finance Co. Ltd.	√	√	-	√	-	10.81	8.60	(20.44)	145
15	NB Insurance Co. Ltd.	√	√	-	√	-	21.77	10.88	(50.02)	124
16	Laxmi Bank Ltd.	√	√	-	√	-	(3.21)	1.03	132.09	103
<b>Performance of Issues handled by Nepal Merchant Banking and Finance Ltd. (NMB)</b>										
1	Siddhartha Finance Ltd.	√	√	-	√	-	3.15	2.94	(6.67)	151
2	Development Credit Bank Ltd.	√	√	√	√	-	1.86	9.36	403.23	152
3	United Finance Ltd.	√	√	-	√	-	8.83	0.26	(97.06)	103
4	Nepal Life Insurance Co. Ltd.	√	√	-	√	-	65.07	147.92	127.32	115
5	International Leasing & Finance Co. Ltd.	√	√	√	√	-	9.30	12.22	31.40	112
6	Machhapuchhre Bank Ltd.	√	√	-	√	-	33.50	15.31	(54.30)	100
7	Butwal Finance Ltd.	√	√	-	√	-	5.79	4.35	(24.87)	121
8	Standard Finance Ltd.	√	√	-	√	-	5.90	5.92	0.34	122

**Exhibit 3: Post issue compliance practices of the issues managed by individual issue managers for the Immediate Following Year after Listing  
(FY 1993/94 to FY 2002/03)**

S.N.	Issuer Companies	Timely	
		Holding of AGM	Submission of Annual Reports
<b>Compliance Record of Issues Managed by NIDC Capital Markets Ltd. (NCML)</b>			
1	Nepal Share Markets Co. Ltd.	√	√
2	Himalayan General Insurance	×	×
3	Harisiddhi Bricks & Tiles Factory Ltd.	×	√
4	Nepal Lever Ltd.	×	×
5	United Insurance Co. (Nepal) Ltd.	×	×
6	Nepal Film Dev. Co. Ltd.	×	×
7	Birat Shoes Ltd.	×	×
8	Premier Insurance Co. Ltd.	×	×
9	Nepal Bangladesh Bank Ltd.	×	×
10	Everest Insurance Co. Ltd.	×	×
11	Kathmandu Finance Co. Ltd.	√	√
12	Leatherage Bansbari Ta. & Shoes Factory	×	×
13	Everest Bank Ltd.	×	×
14	Yeti Finance Co. Ltd.	×	×
15	HISEF Finance Ltd.	√	√
16	Fleur Himalayan Co. Ltd.	×	×
17	Bank of Kathmandu Ltd.	√	×
18	Shree Ram Sugar Mills Ltd.	×	×
19	Lalitpur Finance Co. Ltd.	√	×
20	Goodwill Finance Co. Ltd.	×	×
21	Nepal Merchant Banking & Finance Ltd.	×	×
22	Sagarmatha Insurance Co. Ltd.	×	×
23	Oriental Hotels Ltd.	×	×
24	Nepal Merchant Banking & Finance Ltd.	×	×
25	Himalayan Distillery Ltd.	×	×
26	Union Finance Co. Ltd.	×	×
27	Life Insurance Corp.(Nepal) Ltd.	√	×
28	Nepal Srilanka Merchant Bank Ltd.	√	×
29	Central Finance Co. Ltd.	√	×
30	Premier Finance Co. Ltd.	×	×
<b>Compliance Record of Issues Managed by Citizen Investment Trust (CIT)</b>			
1	Nepal Med Ltd.	×	×
2	Nimrod Pharmaceuticals Ltd.	×	×
3	Necon Air Ltd.	×	×
4	Nepal SBI Bank Ltd.	×	×
5	Peoples Finance Ltd.	×	×
6	Agro Nepal Ltd.	×	×
7	Himgiri Textile Industries Ltd.	×	×
8	Shree Bhrikuti Pulp & Paper Nepal Ltd.	×	×
9	Color Scan (Nepal) Ltd.	×	×

S.N.	Issuer Companies	Timely	
		Holding of AGM	Submission of Annual Reports
10	Universal Finance and Capital Markets Ltd.	×	×
11	Alliance Insurance Co. Ltd.	×	√
12	Pokhara Finance Co. Ltd.	√	×
13	Nirdhan Utthan Bank Ltd.	√	×
14	Shree Investment & Fin. Co. Ltd.	√	√
15	N.B. Insurance Co. Ltd.	×	×
16	Laxmi Bank Ltd.	×	×
<b>Compliance Record of Issues Managed by Nepal Merchant Banking and Finance Ltd. (NMB)</b>			
1	Siddhartha Finance Ltd.	√	×
2	Development Credit Bank Ltd.	×	√
3	United Finance Ltd.	×	×
4	Nepal Life Insurance Co. Ltd.	×	×
5	International Leasing & Fin. Co. Ltd.	×	√
6	Macchapuchhere Bank Ltd.	√	×
7	Butwal Finance Ltd.	×	√
8	Standard Finance Ltd.	×	×
<b>Compliance Record of Issues Managed by Nepal Share Markets Ltd. (NSML)</b>			
1	Annapurna Finance Ltd.	×	×
2	Balaju Textile Ind. Ltd.	×	×
3	Ace Finance Co. Ltd.	√	×
4	Nepal Housing & Mer. Fin. Ltd.	√	×
5	General Finance Co. Ltd.	×	×
6	Nepal Bitumin & Barrel Ltd.	×	×
7	Paschimanchal Finance Co. Ltd.	√	×
8	Lumbini Fin. & Leasing Co. Ltd.	×	×
9	Gorkha Finance Ltd.	√	√
<b>Compliance Record of Issues Managed by National Finance Co. Ltd. (NFCL)</b>			
1	Ace Laboratories (Nepal) Ltd.	×	×
2	Citizen Investment Trust Ltd.	×	×
3	Kosh Byabasthan Co. Ltd.	×	×
4	Narayani Finance Co. Ltd.	√	×
5	Mahalaxmi Finance Co. Ltd.	√	√
<b>Compliance Record of Issues Managed by Rastriya Banijya Bank (RBB)</b>			
1	Nepal Housing Development Finance Co. Ltd.	×	×
2	Samjhana Finance Ltd.	×	×
<b>Compliance Record of Issues Managed by Nepal Finance &amp; Savings Co. Ltd. (NEFINSCO)</b>			
1	Alpic Everest Finance Ltd.	√	×
2	Janaki Finance Co. Ltd.	×	×
3	Nawadurga Finance Co. Ltd.	√	×
4	Om Finance Ltd.	×	×