



## Growth of Capital Market in Nepal: Impact on Capitalization, GDP and NEPSE Index

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### Abstract

*The capital market plays an importance role in an economy and provides the opportunity to the investor for the mobilization and channelization of funds. Nepalese capital market is in growing and improving phase. The objective of this study is to analyze the evaluation of the existing status of the capital market in term of its composition of types of the capital market and to examine the impact of capital mobilization in Gross Domestic Product (GDP) and to examine the contribution of capital market in financial resources and GDP. Besides, the study examines the share transaction in Nepal Stock Exchange (NEPSE) and its impact on NEPSE Index. The study period of 2000/01 to 2018/19 has been used for study purposes. Through the use of descriptive research design, the trends of capital market development track after 2000/01 to present status has been presented. Secondary data are analyzed through the use of regression and other descriptive statistics to convert the information into data. The result indicates that the ordinary shares in the primary capital market and market capitalization in the secondary market has significant contribution for the capital market in Nepal. Also, the study reveals that there is a significant and positive impact of capital mobilization on GDP and the number of share transactions on the NEPSE Index in the Nepalese capital market. Hence there is a significant contribution of the capital market for financial resources mobilization and GDP of Nepal. The study reports for modernization and systematization of the capital market need more optimal efforts from concerned stakeholders.*

**Keywords:** Capital market, financial mobilization, Contribution, Growth, Capitalization

## **Introduction**

The capital market is specifically known as the stock or share market which the mobilizer of capital for economic development and the economic mirror of any economy. The capital market plays a significant role in an economy that allows investor's funds to gorge potential opportunities such as saving funds are mobilize and channeled efficiently to users. The capital market is capable of attracting funds even foreign country so foreign capital flows into the country through foreign investments. The capital market is considered as the indicator of the economy which studies the economic conditions of the country for the effective utilization of funds. In addition, capital markets considered as an effective tools of procuring long-term funds through the issuance of shares, debentures and bonds for business enterprises and government and at the same time provide an investment opportunity for individuals and institutions too (Adhikari, 2004). Biratnagar Jute Mill and Nepal Bank Limited which are the first commercial bank, started the primary issue of shares with development of the capital market in Nepal basically the primary markets in the decade of 1930s the development of the secondary market started only after the establishment of the regulator of the securities market, the Securities Board of Nepal (SEBON) and Nepal Stock Exchange Ltd. (NEPSE), the secondary market operator, in 1993 (Karki, 2020).

With establishment of NEPSE, one and only stock exchange of Nepal, opened an avenue for both large and small investors. This also came for enterprises with a chance to find capital which is essential to any business operation. The SEBON is the watchdog of the securities market and is regulating market under the Securities Act 2006. The Act is augmented with a host of laws, regulations, rules, that control the issuance and trade of several types of securities and also the activities of securities broker and traders. Although, modernization of the capital market has started after 2016. As of the three important functions, trading, ownership transfer and payment settlement of the secondary market only share trading was automated in 2007, leaving the other two functions to stay manual (Milne, 2007). Furthermore all three functions were automated with the introduction of the paperless trading system in mid-January 2016, which introduced the Nepali capital market to a new era of modernization, making this market the fifth in South Asia.

Thus, capital markets are a network of specialized financial institutions, series of mechanisms, processes, and infrastructure that in various ways facilitate the bridging together

of suppliers and users of medium to long-term capital. These markets connect the monetary sector with the real sector which is the sector of the economy concerned with the production of goods and services. The capital markets play a significant role in economic development as they facilitate growth in the real sector by supporting producers of goods and services and entities tasked with infrastructure development access to long-term financing. In the context of Nepal, the capital market is a growing phase; however, there are various areas to expand and develop this according to present needs.

### **Statement of Problem**

The capital market of Nepal is in growing phase but not playing a significant role in capital mobilization. To create a market of international standards as SEBON has got membership of the international organization of securities markets regulators/commissions (IOSCO) by adopting or replacing the current local-based online trading system with a tested international standard online software system. To make the secondary market more competitive and wide-reaching, subsidiary companies of commercial banks having countrywide networks should be immediately licensed to functions as a share trading broker/company. Thought if systematically organized it could be a source of the much-needed capital necessary for economic growth. The supply of capital is urgently required to maintain the momentum of the growth in GDP (Yan & Yudong, 2003). In Nepal, an organized capital market can serve as the medium for transferring part of the business owners of foreign corporations to the citizens (Gurung, 2017). The capital market is a station that promotes the buying and selling of debt or equity securities which aids economic growth by mobilizing the savings of the economic sectors and directing towards channels of productive use (Mmolainyane, 2015). The securities market is a mechanism created to facilitate the exchange the financial securities or assets by bringing together buyers and sellers of securities (Sharpe et al., 1998).

The capital market is influenced by non-economic parameters such as political, social, ethical as well other factors. The capital market helps to mobilize the surplus unit to the deficit unit for productive investments. Capital markets mobilize the scattered resources and channels theming productive sectors. It is an effective instrument of expanding the productive capacities of the country (Saggi, Maskus, & Hoekman, 2004).

In the context of Nepal, despite the history of a decade of planned economic activities to develop the real sector of a country, little attention was paid to the development of the capital market. To make the stock exchange a vehicle of growth, initiatives must be taken to protect investors, improve corporate governance and make the companies operate in a conducive and transparent manner (Koirala, & Bajracharya, 2004). Besides, the study indicates, to improve the capital market, up-gradation in accounting and auditing standards, disclosure and corporate governance are significantly necessary and on the other side monitoring and policy response capacity of SEBON need to be enhanced. Hence this study is with the following research questions.

1. How is the composition of the primary and secondary capital market in Nepal?
2. How the is the growth and development trend of the capital market in Nepal?
3. To what extent has capital mobilization of the capital market has impacted GDP?
4. How the is the relation between share transaction and NEPSE Index in Nepalese capital market?

### **Objectives of the Study**

This study is designed to identify the overall scenario of the Nepalese capital market in terms of its Growth, transitions in NEPSE, and the impact on GDP in Nepal. More specifically the following objectives are set for the study:

1. To identify the composition of primary and secondary capital market of Nepal.
2. To analyze the growth and trends of capital market of Nepal.
3. To explore the impact of capital mobilization on GDP.
4. To examine of share transaction on NEPSE Index.

### **Review**

Capital Market supports the flow of non-productive small savings spread among the people to the productive sector through mobilization. The capital market establishes working relationships between the people engaged in saving, mobilization, and investment capital. Similarly, the capital market plays a significant role in the economy whereas it mobilizes the unproductive financial resource in productive sectors of the economy (NRB, 2012). The capital market is one of the most vital areas of the economy as it provides companies access to capital and investors with a slice of

ownership in the economy and the potential of gains based on the company's future performance (Ujunwa & Modebe, 2012).

The capital market is unique in a country's financial system because of its peculiar function in the economy. Capital markets are a vital part of the financial development and economic development of a country. The development of the capital market has been linked with economic growth (Pagano, 1993). The capital market plays a crucial role in the mobilization of domestic resources and channeling them efficiently to raise economic production and productivity. The level of capital market development is thus an important determinant of a country's level of savings, efficiency, and investment and ultimately its rate of economic growth (Ahmed, & Mmolainyane, (2014). Thus, the economic barometer that reflects the development of the capital market in any country.

Obiakor & Okwu (2011) remarked that relevant indicators of economic growth and performance of the capital market, such as GDP, market capitalization value of shares traded foreign private investment, and gross capital formation. They found that the development of the capital market has a positive relation with economic growth whereas economic growth can be defined as capital market development. Torre, Gozzi & Schmukler (2007) analyzed the impact of reforms of capital markets on economic development in Latin American countries. For measures of capital market development, they applied market capitalization, value traded and capital raised. They used the annual inflation rate and the ratio of government deficit to GDP as alternative indicators.

The capital market has a significant stake in the GDP of the national economy, which creates employment opportunities through capital formation and growth as a whole as well as created the mechanism for micro-level saving mobilization. The financial literacy and awareness levels such as investor's literacy and knowledge which may be the effective elements for the healthy growth of the capital market (Kadariya et al., 2012). The capital markets of SAARC countries are varied. The most obvious is in size, with India being by far the largest economy in the region. This has had a significant effect on relative capital market development. India's sheer size has always meant that there would be international investor interest once the market overcomes some basic weaknesses. Since the early 1990s, the Indian capital market has been transformed

through a combination of sophisticated information technology, strengthened regulatory structures, the rapid evolution of market structures, and willingness to accept foreign investment. This encouraged foreign investors and intermediaries to enter the market which led to higher standards (Torres, Wells & Khan, 2013).

The capital market has major role in the organization of internal resources and directing them proficiently to raise commercial creation and productivity. Hence the development of capital market is an significant factor of a country's level of savings, efficiency, and investment and ultimately economic growth rate of a country (Buyuksalvarci & Abdiglu, 2011). The development of the stock market reflects the development of the capital market. Linking the equity market with the development of the capital market has shown a positive impact beside there exist an important role in debt and equity markets for the allocation of capital within an economy (Dudley & Hubbard, 2004).

Levine & Zervos (1997) investigated the relationship between economic growths with respect to stock market development and found a strong and significant positive relationship between the development of stock market and economic growth in long run after controlling initial per capita GDP, initial level of investment in human resource, political instability and actions of fiscal and monetary policies taking consideration of exchange rate policy. The study established a strong link between stock market development and economic growth, the results do not identify a causal interaction between the two variables. Asmed Saleem (2013) remarked that capital markets are a key component of national development, improving the mobilization of savings by providing alternative sources of financing for productive investments and supporting the development of long-term savings channels. The capital markets in the SAARC region have made very considerable progress during the last 20 years and most members have functioning capital markets with structures and regulations based on international best practices.

Akenten, Boateng & Kiros (2020) remarked that the development of the capital market has proceeded by the development of the financial sector. The financial sector channels savings and investments to seekers of capital. Furthermore, the study indicated growth may be constrained by credit creation in less developed financial systems and in more sophisticated systems finance is observed as responding to demand

requirements. The line of argument suggests that the more developed a financial system is the higher the likelihood of growth causing the finance market to also boom. To expand and to achieve the sustainable growth of the economy, investor awareness and their commitment to long-term investment play a vital role. It was expected that the awareness and the commitment move in the same direction and their association contributes a lot to the economic development.

### Research Method

This study is based on secondary data and a descriptive research design has been used. Data published by different resources such as Economic Survey, Ministry of Finance, Quarterly Bulletin, NRB, and Reports publish SEBON and Nepal Stock Exchange, etc. were the major sources of statistical information. For analyzing and interpreting the data collected through the different sources in the process of presentation and analysis, both the qualitative and quantitative parameters have been used. Required econometrics, accounting, and statistical tools and techniques have been applied.

### Study Model

The following equations are used to estimate the impact of the capital market on different macroeconomic variables:

The impact of capital mobilization (CM) is estimated by:

$$GDP = \alpha_0 + \beta_1 CM + \epsilon_t \dots \dots \dots (i)$$

Where GDP is generated due to capital mobilization in the primary market, CM is the capital mobilization. The  $\alpha_0$  is constant,  $\beta_1$  is a coefficient parameter. GDP is expected to increase due to capital mobilization in the primary capital market.

The impact of share transaction amount (STA) on NEPSE is estimated by:

$$NEPSE = \alpha_0 + \beta_1 STA + \epsilon_t \dots \dots \dots (ii)$$

For analyzing and interpreting the data collected through the different sources in the process of presentation and analysis, both the qualitative and quantitative parameters have been used. Required econometrics, accounting, and statistical tools and techniques have been applied. Data are also presented in tables, graphs, and diagrams as required.

## Result and Discussion

### Evaluation of capital market of Nepal

Till mid-March of FY 2020/21, Rs.30.41 billion of capital has been mobilized through the primary securities market. This amount is 35.88 percent higher than that of the corresponding period of the previous FY 2019/20. During the period, Rs.2.75 billion of capital has been mobilized through IPO of ordinary shares, Rs.4.41 billion through right shares, and Rs.21.45 billion through bonds and debenture, and Rs.1.80 billion through mutual funds. The NEPSE index had increased to 1377.2 points by the mid-March 2020 which was 1259.0 points by mid-July 2019.

Till mid-March 2019, the number of companies listed in Nepal Stock Exchange Limited was 205 and it has reached 212 in mid-March 2020. The stock market capitalization increased by 24.7 percent to Rs. 1760.93 billion in mid-March 2020 compared to mid-Mach 2019. The market-to-GDP ratio was 46.7 percent. Up to mid-March 2020, the securities turnover stood at Rs. 130.32 billion. It was Rs. 56.99 billion in the corresponding period of the previous year. Up to the mid-March 2020, the number of depository members registered in CDS has reached 75 and the depository members have been providing deposit service from 77 districts. The number of dematerialized securities has reached 5.20 billion in mid-March 2020 which was Rs. 4.12 billion in the corresponding period of the previous year.

With the mandatory issuance of beneficiary account in the primary share, the number of beneficiary account openers has increased and the total number has reached 1.646 million by mid-March 2020. That number was 1.26 million the previous year. Till the mid-March of the FY 2017/18, the paid-up price of shares listed in the Nepal Stock Exchange Limited was Rs.336.85 billion, and a year later in mid-March of FY 2018/19, it has been Rs.391.63 billion.

*Table 1* Status of Primary Capital Market of Nepal (Rs. in Ten Million)

S.N.	Details	Fiscal Years				
		2014/15	2015/16	2016/17	2017/18	2018/19
1.	Capital Mobilization	1443.52	1899.85	5939.00	5330.00	4976.00
(A)	Ordinary Shares	697.73	859.42	950.00	1980.00	735.00
(B)	Right Shares	230.79	940.43	4564.00	2570.00	588.00
(C)	Debentures	290.00	-	-	300.00	2998.00
(D)	Mutual Funds	225.00	100.00	425.00	480.00	650.00
2.	No. of Association of Capital Mobilizers	48	52	101	87	65

Source: *Economic Survey 2019/20*.

Table-1 depicts the primary capital market status from 2014/15 to 2018/19. In the case of capital mobilization; the lowest capital mobilization was Rs.1443.52 ten million in 2014/15 whereas the highest capital mobilization was Rs.5939 ten million in 2016/17. In 2014/15, there were 48 associations of capital mobilizers whereas the highest number of associations of capital mobilizers was 101 in 2016/17. Similarly, there were 65 associations of capital mobilizers in 2018/19. The table presents the ordinary shares, right shares, debentures, and mutual funds status of those periods.

*Table 2 Status of Secondary Capital Market (Rs. in Ten Million)*

Details	Fiscal Years				
	2014/15	2015/16	2016/17	2017/18	2018/19
Share Transaction Amount	6533.15	16395.77	20478.81	12129.96	11006.70
No. of Transaction (000)	159717.47	302021.00	392598.20	293694.60	387465.80
No. of Transaction	477278.00	836902.00	1355585.00	1310090.00	1422791.9
Market Capitalization	98940.39	189013.00	185682.94	143513.80	156749.9
% of Transacted in Market Capitalization	6.60	8.70	11	8.5	7.02
% of Market Capitalization in GDP	46.50	84.10	71.4	47.7	45.3
Paid-up Capital Value of the Listed Share	21058.86	20401.96	28959.04	35209.45	41288.1
No. of Listed Companies	232	229	208	196	215
Types of Share Transaction	271	274	270	259	277
NEPSE Index (at Point)*	961.23	1718.15	1582.67	1212.36	1259.02

**Source:** *Economic Survey 2019/20* \* Base year 1992/93.

Table-2 depicts the status of the secondary capital market from 2014/15 to 2018/19. The share transaction amount was Rs.6533.15 ten million in 2014/15 whereas it was Rs.11006.70 ten million in 2018//19. The market capitalization was Rs.98940.39 ten million whereas it was Rs.156749.9 ten million. The percentage of market capitalization in GDP was 45.50 percent in 2014/15 whereas it was 45.30 percent in 2018/19. It was 84.10 percent in 2015/16. The growth of market capitalization ranges from 6.60 percent to 11 percent. The paid-up capital value of the listed share was Rs.21058.86 ten million in 2014/15 whereas it was Rs.41288.1 ten million in 2018/19. There were 232 listed companies in 2014/15 whereas there were 215 listed companies in 2018/19. The NEPSE index was 961.23 points in 2014/15 whereas it was 1259.02 points in 2018/19.

### **Growth and Trends of Capital Market of Nepal**

The capital market is growing phase of Nepal since the 1990s. There has been significant progress of primary and secondary markets of the capital market in Nepal. The capital mobilization in the primary market has been significantly increasing trends. Several associations of capital mobilizers have also been growing phase. Similarly, the share transaction amount has been increasing trends the most of years. The NEPSE point value has been fluctuating trends after the 2000s.

Table-3 depicts the status of the primary market and secondary market of the capital market of Nepal from 2000/01 to 2018/19. Capital mobilization and share transaction amount take a significant position of Nepal for financial mobility and economic growth and development of Nepal. The lowest point of NEPSE was 204.86 in 2002/03 whereas the highest point was 1718.15 in 2015/16. There has been a significant contribution of market capitalization in GDP. The range of market capitalization in GDP falls between 7.72 to 84.1 percent during the study periods. In 2000/01, there were just 7 number associations of capital mobilizers whereas the number had reached 101 in 2016/17. Similarly, the number of associations for capital mobilizers has decreased to 65 in 2018/19.

Table 3 Growth and Trends of Capital Market of Nepal

(Rs. in Ten Million)

Year	Primary Market		Secondary Market		% of Market Capitalization in GDP
	Capital Mobilization	No. of Association of Capital Mobilizers	Share Transaction Amount	NEPSE Index	
2000/01	63.43	9	234.42	348.40	11.80
2001/02	141.66	12	154.06	227.50	8.40
2002/03	81.37	18	57.58	204.86	8.22
2003/04	109.04	14	214.43	222.04	7.72
2004/05	167.23	14	450.77	286.67	10.41
2005/06	244.33	29	345.14	386.86	14.80
2006/07	229.55	34	836.01	683.95	25.60
2007/08	996.82	64	2282.08	963.36	44.90
2008/09	1682.85	64	2168.11	749.10	51.91
2009/10	1082.24	61	1185.11	477.73	32.15
2010/11	707.77	47	666.53	362.85	19.48
2011/12	295.01	25	1027.28	389.74	23.41
2012/13	1185.05	36	2204.88	518.33	30.24
2013/14	826.68	45	7729.85	1036.11	40.00
2014/15	1443.52	48	6533.15	961.23	46.5
2015/16	1899.85	52	16395.77	1718.15	84.1
2016/17	5939.00	101	20478.81	1582.67	69.4
2017/18	5330.00	87	12129.96	1212.36	47.1
2018/19	4976.00	65	11006.7	1259.02	45.3

Source: Economic Surveys 2010/11 & 2019/20.

Figure 1 Percentage of Market Capitalization in GDP from 2000/01-2018/19.

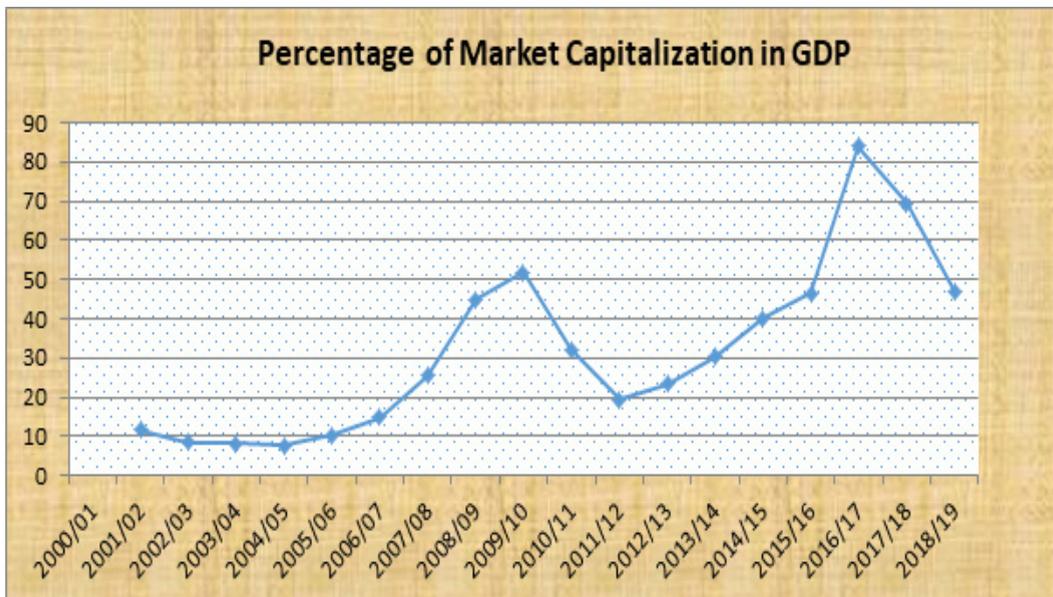


Figure 1 depicts the percentage trends of market capitalization in GDP from 2000/01 to 2018/19. The contribution of share capitalization percentage in GDP seems to be increasing and dressing trends in different time intervals in the study periods.  
 Figure 2 Histogram of Capital Mobilization in Primary Capital Market

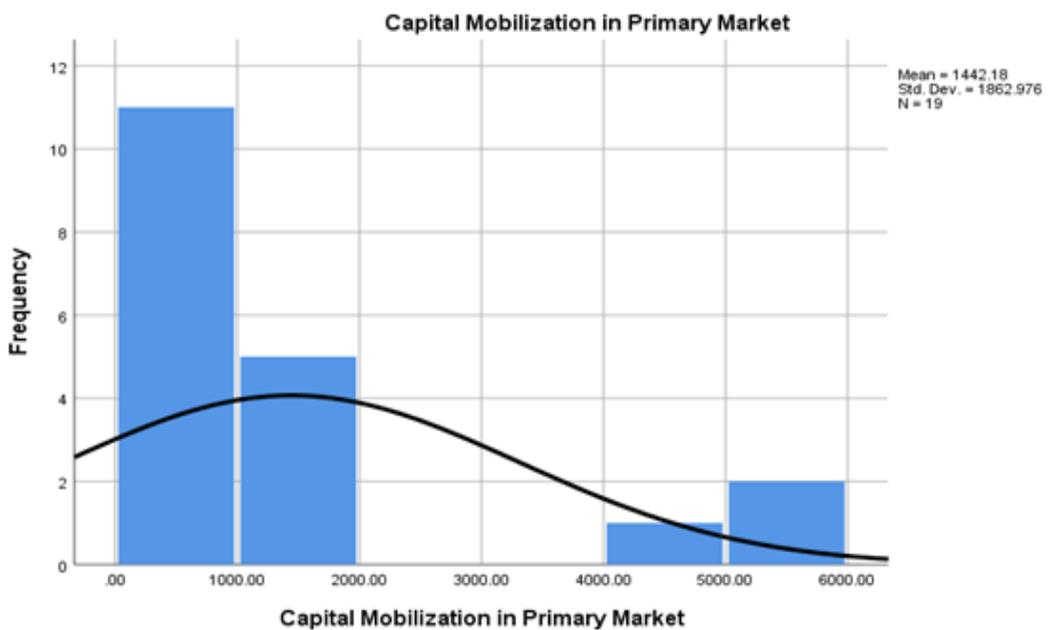


Figure-2 depicts the capital mobilization in primary market. The mean value of capital mobilization found 1442.18 and standard deviation value was 1862.976 during the study period.

Figure 3 Histogram of Share Transactions in Capital Market

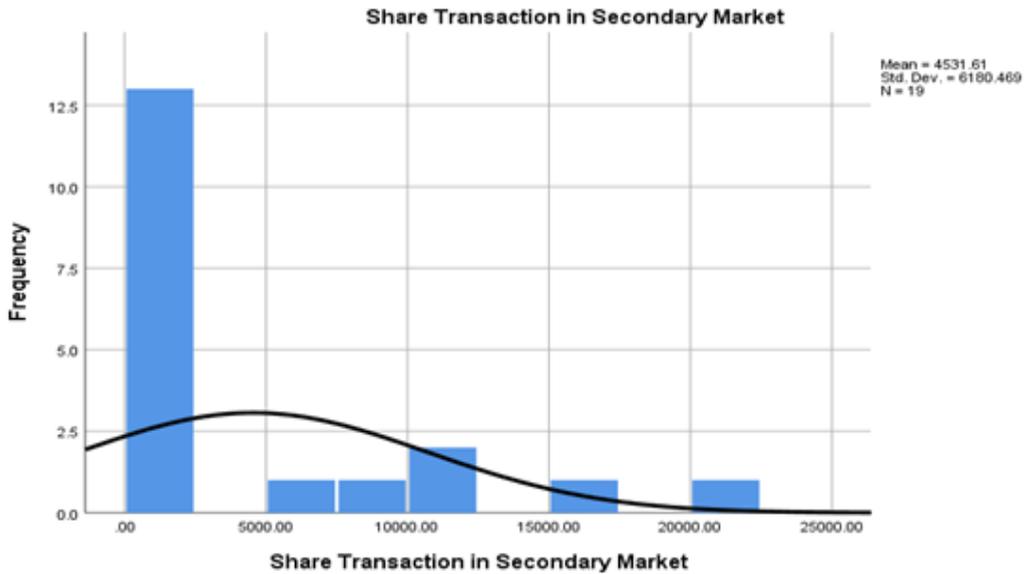


Figure-3 indicates the share transaction in secondary market in capital market. The mean values have been found 4531.61 and standard deviation value of 6180.469. It indicates that data are more scatters.

Figure 4 Histogram of NEPSE in Capital Market

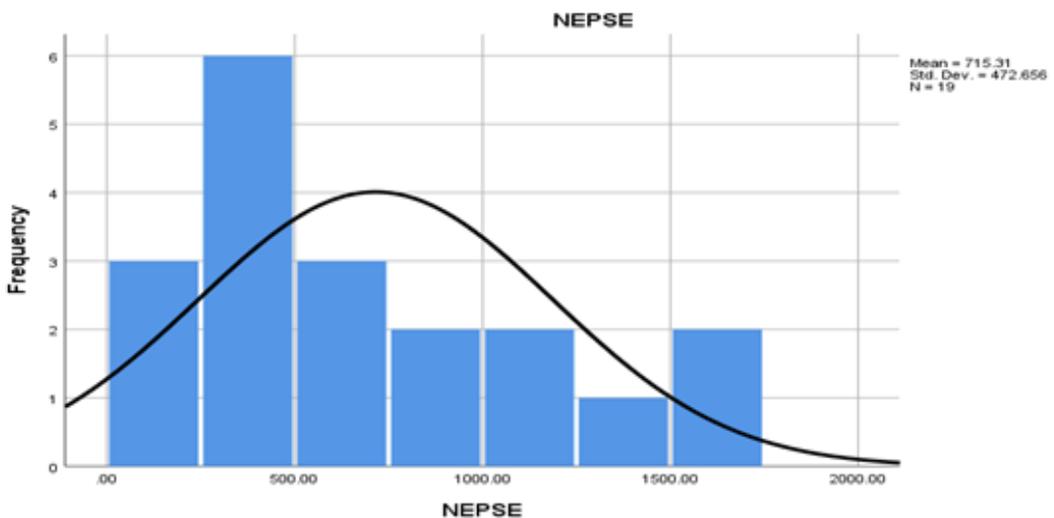


Figure-4 represents the NEPSE index in capital market where the mean value was 715.31 and standard deviation (Std.Dev.) was 472.656 in the study periods. The value of Std.Dev. is less than the value of mean value which indicates that data are closure to each other's.

### Impact of Capital Mobilization in GDP

There is a close relationship between capital mobilization in the primary capital market and the percentage of market capitalization in GDP. There has been a significant contribution of capital mobilization on GDP. The value of GDP has determined by capital mobilization. Empirical evidence shows that capital mobilization has a positive impact on GDP. By using data of 2000/01-2018/19, this study finds that the relationship between capital mobilization and GDP is positive.

### Model Summary of the GDP and Capital Mobilization

Table 4 Regression between Capital Mobilization and GDP

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.673 <sup>a</sup>	.453	.421	16.54110
a. Predictors: (Constant), Capital Mobilization				

In the regression analysis, the relationship has been analyzed between the capital mobilization and GDP. Table 4 shows the model is enough to explain the impact of capital mobilization on GDP in the Nepalese context.

Table 5 Regression between Capital Mobilization and GDP

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	21.385	4.849		4.410	.000
	Capital Mobilization	.008	.002	.673	3.752	.002
a. Dependent Variable: GDP						
b. Predictors: (Constant), Capital Mobilization						

Source: Calculated by Author based on Table-3.

The result seems to be valid as all diagnostic parameters justified the relationship, for instance such as the regression coefficient is significant at 5 percent p-value with coefficient 0.453 ( $R^2 = 0.453$ ). It indicates that there is impact of capital mobilization on GDP of Nepal (Table-4 &5).

### Impact of Share Transaction on NEPSE Index

There is close relationship between capital mobilization in primary capital market and percentage of market capitalization in GDP. There has been significant contribution of share transaction on NEPSE index. The value of NEPSE point has determined by the share transaction amount. Empirical evidence shows that share transaction amount has positive impact on NEPSE index. By using data of 2000/01-2018/19, this study finds that the relationship share transaction amount and NEPSE index is positive.

*Table 6* Regression between Share Transaction in Secondary Market and NEPSE Index

Model Summary						
Model	R	R Square	Adjusted R Square		Std. Error of the Estimate	
1	.932 <sup>a</sup>	.869	.862		175.73652	
Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	392.168	50.476		7.769	.000
	Share Transaction in Secondary Market	.071	.007	.932	10.640	.000
a. Dependent Variable: NEPSE						
b. Predictors: (Constant), Share Transaction in Secondary Market						

**Source:** Calculated by Author based on Table 3.

In the regression analysis, the relationship has been analyzed between the share transaction amount and NEPSE index. The result seems to be valid as all diagnostic parameters justified the relationship such as the regression coefficient is significant at a 5 percent p-value with a coefficient of 0.869 ( $R^2 = 0.869$ ). It indicates that there is a significant impact of share transaction amount on the NEPSE index of Nepal (Table-5).

## Conclusions and Implications

The capital market of Nepal has not been well developed. There has been strict disclosure enforcement, potentially non-viable national market, patchy regulatory structure, and weak disclosure by limited companies. There is a state-owned stock exchange system, has neither been modernized nor has the market been fully modernized. The capital market demands one more stock exchange in the corporate private sector is strongly needed as mentioned in SEBON's approved policy and program to minimize the monopolistic situation. The modern stock exchange could see a breakthrough in daily share-trading.

The NEPSE index could not become a true economic mirror and indicator because the role of the real sector seems to be insignificant. By analyzing the data of indices and Nepal's economic growth in the last 20 years, real sector contribution is near about one percent. To encourage the real sector companies in the capital market, different measures must be taken such as high tax rebate, putting the sector on the priority list of the central bank, and adopting the international system of free pricing based on book building.

The bitter fact of the study is concluded and recommends that there exists the traditional fixed pricing system in initial public offering as it was in the beginning phase of its operation and need to well systematize and modernize. SEBON should introduce the latest system without delay in a phase-wise manner. Modernization of the capital market is dependent on the development and reform of the economy, the government needs to revive the depressed economy through a stimulus package (Kari 2020). The paces of reviving the economy and structurally reforming will lead to stability and complete modernization of the Nepalese capital market.

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