Influx of Investors in the Nepalese Stock Market

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The Nepalese equity market capitalization has constantly been on an upward trend ever since NEPSE opened its trading floor in January 1994. Just between 2010 and 2020, the total market cap of NEPSE skyrocketed from almost NRs. 3,76,871 million to NRs. 17,92,762 million. That's even more than a four-fold increment. The prime credit for these sorts of augmentations has to be given to banks and other financial institutions in Nepal. Over the years, these institutions have constantly contributed over sixty percent of the total NEPSE market capitalization amount.

This is when we start questioning the reasons behind the banking and financial sectors of Nepal having such a huge impact on the market. And even if they do have this extensive effect over market capitalization, are other factors such as market value and institutional productivity behaving accordingly?

Well, there are numerous determinants that could lead us to our answers, such as the large number of shares issued by these institutions, changes in government policies, mergers or acquisitions that take place between corporations, and companies being listed on the stock exchange. However, it is the investors who are actually quintessential for the well-ordered functioning of an equity market. After all, a stock market without its investors is like a ship without a rudder. All these determinants, in one way or another, are ultimately influenced either by the actions of active investors or the influx of new ones.

In late July of 2015, Nepal Rastra Bank had directed financial institutions in Nepal to raise their minimum paid-up capital by up to four times to a whopping eight billion rupees just within two years. However, increasing the paid-up capital base by almost six billion rupees within this time frame was certainly not a cinch. According to Mr. Upendra Poudyal, then President of Nepal Bankers' Association, a key strategy that could help banks fulfill this NRB policy was by forking out money from existing or new investors. In fact, just a day after NRB introduced this policy to the public, the stock prices for commercial banks went up by an average of 6.85%.

As banks and other financial institutions started to float bonuses and right shares, experienced investors were lured in to buy company stocks in bulk. The fact that these bonuses and shares could be acquired at their face values rather than their actual trading prices appeared lucrative even for new and so-called "inexperienced" investors. Furthermore, investors who believed that there are greater possibilities for capital gain in stock dividend paying companies were drawn in by the opportunity to convert their cash dividends into stocks. Gradually, these banks were evidently meeting their paid-up capital base target. The volume of outstanding shares had started to skyrocket because of the surging volatility within the stock exchange. Yet, comparing the performance of these companies with their market cap, the former seemed to be comfortably lagging behind the latter. For instance, Everest Bank Limited had a PE Ratio of 42.7 just a couple of months after NRB introduced its policy. However, the PE Ratio for the same bank a month before the announcement was calculated to be at 27.17. Clearly, the stocks of EBL, regardless of its performance enhancement, were drastically overvalued after this policy was made public. Otherwise, why wouldn't the Earning Per Shares respond similarly as well? The difference between EPS for Everest Bank, before and after declaring this policy, was a mere 5.93. And this too apparently had sloped downwards.

Even for other commercial banks, such as Nepal Investment Bank Limited and Standard Chartered Bank Nepal, the PE Ratios had suddenly spiraled while their EPS underwent very nominal changes. Clearly, the influx of investors in the Nepalese equity market between 2015 and 2016 didn't yield much of a change in terms of institutional productivity. With Volume Growth Rates rising up by almost 174% for banks like Nabil, the only aspects that went through the most significant changes due to the influx of investors and investments were paid-up capital base and overall market capitalization. But by no means does it mean that this is always going to be the case.

Another instance we could study to speculate the effect influx of investors can have over the market is the instance of COVID-19. By analyzing multiple facets of financial institutions in 2020 and 2021, we will be able to accredit if there have been any positive changes in the market because of new investors. However, before delving into the facts, it is important we establish that the lockdown and COVID situation as a whole has led new investors to become active within NEPSE.

While it is absolutely true that some inactive investors, whose primary source of income is their salary, have shown hesitation to invest in the market, we shouldn't ignore the fact that workers who otherwise would be actively involved in their workplaces have shown reluctance to stay idle during the lockdown. In these situations, when people's only source of disposable income starts running out, the next viable choice to finance their consumption requirements becomes the equity market. With a single NEPSE online trading account, these new investors can view their orders and carry out trading from within their homes. Buying and selling a tiny volume of stocks has proven to be a good source of income for these investors.

Although minimal occupancy in Nepalese hotels has resulted in lower revenues and intimidated investors, lower interest rates as a part of the country's interest rate corridor seem to have covered this up pretty nicely. These lower short-term interest rates that move around the policy rate set by the central bank easily captivate traders to borrow loans and boost their investments. Supplementing this, the declining remittance not only hit the supply of money in the financial system but also the disposable income of most households. The situation, to some extent, played a role to drive households towards the stock market. Summed up, the influx of new investors within NEPSE during COVID seems to have simply outweighed the efflux of existing ones.

Now that we've come to a conclusion that COVID has resulted in new traders entering the market, it's important to know how this stream of investors has coaxed certain elements within the stock exchange. In terms of growth rates, while most banks and financial institutions encountered hefty increments in their volumes and prices, there were no observable breakthroughs concerning their earnings per share. An important point to note here is the unfamiliarity of new investors with some trading rules such as maintenance margins and margin calls. For instance, an "inexperienced" investor tempted by lower interests and soaring price growth rates often decides to take margin loans from his broker. This ultimately results in growth in the volume of stocks accumulated by the investor and an inflated Volume Growth Rate within NEPSE as a whole. What's more interesting is the lack of progress with regards to the EPS Growth Rate. This is because margin loan availability is at no risk until the market behaves properly. But once the market starts sustaining negative turnovers and the value of the investor's margin account falls below the broker's required amount, the broker performs what is known as a margin call. He requests the investor to either deposit additional money or securities into his account or let go of his holdings. Although the significance of these margin calls is to prevent brokers from falling below their maintenance margins, uncalculated margin loans taken by investors often cause an imbalance between the Volume Growth Rates and EPS Growth Rates in the market.

Post-COVID, leading commercial banks like Nabil Bank and Everest Bank have been able to exhibit massive Volume Growth Rates (453.5% and 612.6% respectively) while their EPS Growth Rates do not look appealing at all (8.3% and 49.2% respectively). In fact, the EPS Growth rates have proven to be dipping downwards during this period. This clearly portrays a simple summary of the Nepalese stock market. Although the market values of companies have been enhanced, the performance is not as satisfactory. Therefore, now the major target for the banking sector of Nepal should be increasing productivity rather than focusing on the augmentation of excessive market cap that will ultimately certify them as "simply overvalued".