

# CHAPTER - I

## INTRODUCTION

### 1.1 Background of the Study

Nepalese financial market is in infancy as compared to other south Asian neighbors. The overall share market index is not being consistent near five hundred in Nepal. Since last three years the market index is bearish trend. Industrial development is so behind that determines the development of the financial market. Investors are not so aware about investments. Nepalese share market is dominated by signaling rather than analysis of firm, industry and overall economy. Investor's preferences and expectations are diversified. According to the nature of financial instrument, investors prefer different securities. Investors have their own expectation according to companies' performance, trend and economic estate. The concerned companies are not fulfilling investor's expectation in proper way.

Financial market helps the organization to raise the required fund by selling their financial assets as security. The buying and selling of securities helps the nation by channeling the money in capital market. Financial market is both market place and a process where long term as well short term securities are sold in order to fulfill their capital investment by companies. Financial instruments are the securities that are used to raise fund. Investment is sacrificing of current money in expectation of future return. Financial instruments use to have their own features. Investor chooses certain securities for their certain objectives. Investor's preferences and expectation makes the security popular and attractive. Usually most of the companies issue popular securities to easily subscribe them in market. Public also demand popular security. This demand and supply of security channels the public money from saving to capital. Company gets the capital need and the investors get the investment need from investment process. Investors always want to be assured that the money should be available back whenever need and the money should grow at desired level.

The investors of Nepal are being in order to maximize the value of their securities. Investment alternatives are not so wide, so most of the investors are concentrated upon few securities. In Nepal real assets, precious metals and collections are other investment alternatives for investment. Bond, debentures, preference shares, convertible securities, treasury bills are the available securities. Right share and repo

agreement also exercises in Nepal. Investors determine their appropriate securities by analyzing the features of securities and their own objectives. Investors give preferences to the securities by matching their objectives and trend to respond investor's expectations.

The increased amount that one gets or expects from the investment, as its return, is termed as profit. The profit is always characterized by the uncertainty and this uncertainty of return is termed as risk. Risks prevail not only in profits but also for the return of principal. Therefore return and risk are two basic components of the investments. It is said, if there is no risk, there is no gain, so return is taken as the compensation of that risk.

There is wide variety of investment alternatives in investment environment. Buying common stocks, debenture of a company, depositing money in the bank, buying a piece of land, jewelries is examples of investment. These show that an investor gets lots of opportunities for investment in the investment environment. Basically those alternatives can be categorized into two groups.

Real Assets or Non Financial Assets

Financial Assets/ Financial Instruments

Real Assets can be tangible or intangible. Plants, machinery, office, factory, furniture and building, precious metals are examples of tangible assets while technical know how, technological collaborations, patents and copyrights are intangible assets. Generally, real asset possess productive capacity and are less liquid in comparison to financial assets. The capital formation is the direct outcomes of this productive investment.

Financial Assets or Instruments are cash, evidence of an ownership interest in an entity, or a contractual right to receive, or deliver, cash or another financial instrument. Financial instruments can be categorized by form depending on whether they are cash instruments or derivative instruments:

Cash instruments are financial instruments whose value is determined directly by markets. They can be divided into securities, which are readily transferable, and other cash instruments such as loans and deposits where both borrower and lender have to agree on a transfer. Derivatives instruments are financial instruments that derive their value from the value and characteristics of one or more underlying assets.

Financial Assets or Instruments are pieces of paper representing an indirect claim to real assets held by someone else. These pieces of paper represent debt or equity commitments in the form of IOUs (written document providing evidence to debt) or stocks certificates (Thapa, 2003:3).

Because of the divisibility, marketability and availability of the information financial asset is getting much more popular now a days. On the other hand, whether it is financial or real assets, it is consider as investment, an investor has the right to select any of the alternatives on his /her own discretion. The investor's decision is always guided by his/her own preference over the investment instruments. The preference of investors guide their decision where to invest and where not.

### **1.1.1 Financial Market and Instruments**

Market is simply defined as an area for potential exchanges. Thus s market is a group of buyers and sellers interested in negotiating the terms of purchase/sales of goods/services. Similarly, financial market is that market is traded- loaned or borrowed-in-terms of different financial assets or instruments stocks and bonds are traded.

Financial assets or simply a security is only a piece of paper that represents the investor's right to certain prospects or property and the conditions under which he or she may exercise those rights. These rights are transferable to another investor and with it will go all its rights and conditions. So, it is just a legal representation of the rights to receive prospective future benefits under stated conditions (Alexander; et al; 1998:1-2). Bonds and common stocks are main examples of Financial Assets or Instrument.

Financial Market or Security can be classified under two categories:

    Money Market and Capital Market

    Primary Market and Secondary Market

**Money Market** is that financial market where funds are borrowed or loaned for short periods – usually for less than one year. Thus main function of money market is to provide short-term loans to business, government and household. Money market activities include primary and secondary market activities in short-term negotiable instruments such as Treasury bill, banker's acceptance, repurchase agreements, and

short-term municipal securities issued by non-financial corporations. The treasury bills, which are government security, serve as a mechanism for non-inflationary financing of government deficits and can also support monetary policy implementation. Other money market instruments are used to facilitate the supply of credit to larger corporations and to ease inter-bank financing.

**Capital Market** is concern with long-term finance. In the capital market, financial instruments with an original maturity of more than one year are traded. Equities or stocks (ownership instruments), bonds, debentures, collateral mortgage obligations, and derivatives are all capital market instruments. It consists of a series of channels through which the savings of the community are made available for industrial and commercial enterprises, and public authorities. It is concerned with private savings, individuals as well as corporate, that are turned into investment through new capital issues and also new public loans floated by government and semi-government bodies.

Money Market is that financial market where funds are borrowed or loaned for short periods-usually less than a year. On the other hand, capital market deals with the longer-term instruments. The financial market, in which corporations raise funds by issuing new securities, is the primary market where as secondary market is that market in which securities are trade among investors after they have been issued by corporations and public agencies (Thapa, 2006:12).

### **Primary Market**

Primary Market is that financial market in which corporations raise funds by issuing new securities. The primary market itself can be subdivided into seasoned and unseasoned new issues. A seasoned new issue refers to the offering of an additional amount of an already existing security, whereas unseasoned new issues are often referred to as initial public offerings (Alexander, 1998:4).

### **Secondary Market**

Secondary market is that market in which corporations and public agencies trade securities among investors after they have been issued. The majority of all capital market transactions occur in the secondary market. Its main function is to provide liquidity for securities purchased in the primary market. Once the investors have purchased securities in the primary market, they need a place to sell those securities. Without the liquidity of the secondary market, firms would have difficulty raising

funds for productive purposes in the primary market. The secondary market comprises the organized securities exchanges and the Over the counter (OTC) market (Cheney & Moses, 10<sup>th</sup> ed.: 72).

The market through which the funds are transferred from savers to investors is called primary market. Hence, the transaction of securities issued for the first time takes place in the primary market. The market where the existing and pre-developed securities are bought and sold is called secondary market. Secondary market provides liquidity to the purchases of the securities. Secondary market can be regarded as the center to convert stocks, bonds, and other securities into cash immediately (Richards et al; 1984: 370).

The Security Exchange Center established in 1975 A.D managed 26 issues between 1978 and 1992 until it was converted into Nepal Stock Exchange in 1993. Since then financial institutions are managing the primary issue, particularly by finance companies. This institution is acting till now as an organized exchange center for the securities. It is the only body, which handles the trading of securities. It is only body, which handles the trading of securities. This regulation made detailed provisions regarding licensing, operating, registrations, listing as well as functions, powers and duties of SEBO. Further on, SEBO was empowered as an apex regular of the capital market, by the second amendment in security exchange Act in 1997. Thus capital market has got a structured shape and institutional arrangements. It is still growing and developing. SEBO is developing several guidelines and directives to regulate the stock exchange, IPOs, issuing bodies and brokers. NEPSE is also empowered to make law to regulate listings and trading of securities.

Preferences in the financial market are the outcome of investors' awareness and maturity of the market. Both primary and secondary market is creeping in their infancy in Nepal. Government up to one decade of its establishment owned only one stock exchange. The primary market is also not so efficient due to lack of investment alternatives. Primary issues of bank and financial institutions are being oversubscribed by many times. Regulating agencies SEBON, NEPSE has given full authority to regulate the market but are not so effective. Rules and regulations are not so appropriate to promote and develop a sound capital market.

The growth of stock market has mainly been due to the liberalization and resulting growth of financial sector (commercial banks and finance companies) rather than that of the industrial sector. There more companies in operation at present but only listed in Nepal Stock Exchange Ltd are presented in the table above. Investors in Nepal are various types. Some are very small investors who hold just 10 or 20 shares of the companies. However, some investors are so cunning and shrewd that they play with different securities to earn more. Very few investors have technical knowledge of investments like; portfolio formation and risk diversification. Besides, institutional investors are also the major segment. Although they are not actively participating in the secondary market, in the primary market, in the primary market they are also considered as the notable segment investors, or the purchases of the securities.

This study is concentrate upon Nepalese financial market, available financial instruments, and investor's expectations from the securities. This study is also concentrate upon availability of securities, investors' preference on securities and companies' response upon investors' expectations.

## **1.2 Statement of the Problem**

Investor has various expectations and preferences that are determined by their objectives. Usually investors choose wealth maximization as their objectives. Furthermore they like to invest to meet contingent cash need. The objectives of investors is determined by need, age, income, occupation, time horizon, liquidity need etc. The available information helps investors to choose and give preferences to the securities. To subscribe the chosen security issuing company should find out the investors expectation and preferences. In Nepal bond, debentures, common stock, treasury bills, saving deposit and their certificates and convertible securities are available as financial instruments. Bank and financial institution, insurance companies, producing processing and trading companies, hotels, hydropower, and telecommunication companies are available as companies to invest. On the other hand government bond and treasury bills are available as government securities. Certificates of deposits and repurchase agreement can be used for financing but cannot be traded in secondary market. Common stock is most popular and dominating securities in Nepalese secondary as well primary market. The banks and financial institutions have become the first choice of investors.

Banks and financial institutions and their common stocks are most preferred in Nepal. The main issue is that why the common share is most popular in trading? Why commercial banks have remained first choice in trading? What are the investor's expectations to run behind the banks and financial institutions? Are concerned companies fulfilling the investor's expectations? Taking all above into considerations this study will focus on the following problems.

- Which instrument is dominating Nepalese capital market?
- Are Nepalese investors aware about all available investment alternatives?
- What is the investor's attitude about risk of their investment?
- What are the investor's expectations from their investment?

### **1.3 Objectives of the Study**

The main objective of the study is to examine the investors to the financial instruments and to find out their expectation that they buy securities. But apart from those specific objectives I have following objectives. To study analyze the state of investment in financial instruments and investors preferences and expectation in Nepalese capital market.

- To study and analyze the state of investment instruments dominating Nepalese Capital Market.
- To examine the investors' awareness of different financial instruments alternatives.
- To examine the investor's attitude about risk management.
- To examine the investors' expectations to choose different financial instruments of different companies

## **1.4 Significance of the Study**

This study is useful to all related parties likewise; market makers, broker, investors, financial analyst who are involved in stock market as it provide guideline to stock market and helps investors to take proper investment decision. Security issuing company and merchant banking company also can take benefit from it because it helps to know them about investor's preferences and expectation about security and security issuing company. Investors are the major part of the security market so their need and expectations should be identified. Fulfillment of investor's expectations always stimulates them to participate actively in investment activities.

Researcher academicians, students, and policy makers may also be benefited from this study as it give some practical insight that can be very useful to turn the theoretical knowledge into practice.

## **1.5 Limitations of the Study**

The study has attempted to present and analyze the fact clearly, truly and within the boundary. However, reliability of tools, lack of research experiences and lack of data are the primary limitations of this study. Every research work has some limitations.

The major limitations of the study are as follows:

- The scope of the study is limited within the framework of financial instruments used in Nepalese financial market. It has not considered other investment alternatives available in investment environment.
- The study is focused on capital market and money market instruments.
- Institutional investors are not taken into consideration.
- The validity of results depends upon accuracy of response because this study is heavily depends upon primary data.
- The study covers the data up to 2011/12 only.

## **1.6 Organization of the Study**

The research has been divided into five chapters. The first chapter deals with background of study, statement of problem, objective of the study, limitations of the study and organization of the study. The second chapter presents the review of various related books, journal, articles, periodicals, reports and other publications. This chapter broadly consists of two parts; theoretical/ conceptual review and review of related studies. The third chapter includes research design, population & sample, sources and types of data, data processing technique and method & tools of data analysis. In fourth chapter available data will be presented in appropriate format and data will be analyzed to show available financial instruments, investors preferences on available instruments, investor's expectation form security and company. Findings from analysis will also be presented in this chapter. The last chapter of the study summarizes the result of analysis and suggestive framework. Besides these, bibliography and questionnaire are presented at the end of the thesis. Similarly acknowledgements, table of contents, list of tables, list of figures, abbreviations are included in the front part of the thesis report.

## **CHAPTER - II**

### **REVIEW OF LITERATURE**

This part of the study includes review of past literature that helps creating theoretical framework for the study. To attain this purpose this chapter incorporates conceptual review, review from national international journals, thesis and existing research papers. It includes also an overview of Nepalese financial market and security market and existing investment environment.

#### **2.1 Conceptual Review**

The conceptual review deals with the various concept regarding financial market, financial instruments or investment alternatives, financial market arrangements in Nepal, investment and investment objectives, Investors preferences and expectations and other related issues.

##### **2.1.1 Financial Market and Financial Instruments**

Market is simply defined as an area for potential exchanges. Thus market is a group of buyers and sellers interested in negotiating the terms of purchase or sales of goods and services. Similarly, financial market is that market is traded- loaned or borrowed-in-terms of different financial assets or instruments stocks and bonds are traded.

The government securities are also important securities, which are issued by Nepal Government through Nepal Rastra Bank (NRB). “Financial assets or simply a security is only a piece of paper that represents the investor’s right to certain prospects or property and the conditions under which he or she may exercise those rights. These rights are transferable to another investor and with it will go all its rights and conditions. So, it is just a legal representation of the rights to receive prospective future benefits under stated conditions”(Alexander, 1998:152).

Financial market is the common floor that helps creating the trade of financial securities. The major purpose of financial market is to transfer funds from lenders to borrower. They are the intermediary link in facilitating the flow of funds from savers to investors. Financial market is defined as a market mechanism that allows people to buy and sell financial securities, currencies, and foreign exchanges or other exchangeable items of value at low transaction cost and prices reflecting an efficient market system. Financial markets can also mean money market that provide for short

term debts and investment as well as derivatives markets providing instruments for the management of financial risk. Financial market is used interchangeably with capital markets that may be primary or secondary depending in nature newly issued or existing securities. Participants in the financial market commonly distinguish between the capital market and money market, former referring to borrowing and lending for long term investment purpose and the latter term generally referring to borrowing and lending for periods of a year or less (Vishwanath, 2003:322).

Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buying and selling orders that flow from investors' demand and supply preferences determine the price of securities in the security market. It plays a significant role in bridging gap between the deficit and surplus units of society. The common stock, preferred stock, debentures and government securities are mainly used in terms of securities in Nepal. The preferred stock and debentures are not commonly used in Nepal. Basically the common stock is traded through NEPSE.

Generally assets can be real and financial. Real assets can be tangible or intangible. Plants, machinery, office, factory, furniture and building, precious metals are examples of tangible assets while technical knowhow; technological collaborations, patents and copyrights are intangible assets. Financial instruments can be categorized by form depending on whether they are cash instruments or derivative instruments: Cash instruments are financial instruments whose value is determined directly by markets. They can be divided into securities, which are readily transferable, and other cash instruments. Derivatives instruments are financial instruments that derive their value from the value and characteristics of one or more underlying assets. “Financial Assets or Instruments are pieces of paper representing an indirect claim to real assets held by someone else. These pieces of paper represent debt or equity commitments in the form of IOUs (written document providing evidence to debt) or stocks certificates” (Thapa, 2003:12).

“Securities means any shares, stocks, bonds, debentures, debenture stocks or collective investment scheme certificate issued by a body corporate or treasury bonds, saving bonds or bonds issued by the Government of Nepal or by a body corporate against the guarantee of the Government of Nepal, and this term also

includes such other securities as may be specified by the Board to be transacted or transferable through the stock exchange or the instrument to purchase, sell or exchange such securities” (Security Act, 2007:2).

Because of the divisibility, marketability and availability of the information financial asset is getting much more popular now a days. The investor's decision is always guided by his/her own preference over the investment instruments. The preference of investors guides their decision in which to invest and in which to not. Various factors influence on investor's preference to make a choice or investment alternative, this study will focus on them.

### **2.1.2 Money Market and Instruments**

The money market is the financial market for short term borrowing and lending. Money market deals with short instruments having maturity of less than one year. It provides short term liquidity funding for the financial system.

“The money market is where short-term obligations such as treasury bills, commercial paper and bankers’ acceptances are bought and sold. The money market consists of financial institutions and dealers in money or credit who wish to either borrow or lend. Participants borrow and lend for short periods of time, typically up to thirteen months. Money market trades in short-term financial instruments commonly called ‘Papers’. This contrasts with the capital market for longer-term funding, which is supplied by bond and equity. The core of the money market consists of banks borrowing and lending to each other, using commercial paper, repurchase agreements and similar instruments. Money markets are used to facilitate the transfer of short-term funds to those with deficient funds. Money market deals with the short-term financial needs. Here the investors find the instruments with the maturity of short period, usually less than a year. Such instruments that have maturities within one year are referred to as money market securities/ instruments”(Madur, 1998:138).

Instruments that are traded in the money market have the characteristics like: they are all debts obligation; they have maturities ranging from one day to a full year. They exhibit typically a high degree of safety of principal and they have high degree of liquidity. Some main instruments of money market are:

- Treasury Bill
- Commercial Paper

- Certificate of Deposit
- Bankers Acceptance
- Repurchase Agreements
- Short-term Municipal Securities
- Other instruments

#### **a. Treasury Bills or T-bills**

“This is one of the government securities and is very popular money market instruments. T-bills have very short maturities, with a maximum of one year. These securities are bought at a discount from its promised payment in maturity. T-bills have no coupon or stated interest. The interest on the investment is represented by the difference between the promised payment and purchase price”(Haugen, 1997:14-15).

The size of the discount is determined in an auction, which will depend on the terms of the bill and the prevailing market conditions. In the U.S security market, U.S. Treasury issues T-bills. The treasury sells bills at regularly scheduled auctions to refinance maturity issues and to help finance current federal deficits. It also sells bills on an irregular basis to smooth out the uneven flow of revenues from corporate and individual tax receipts. Persistent federal deficits have resulted in repaid growth in T-bills in recent years. Because of the low risk and short maturity of these instruments, T-bills are attractive investments for many financial market participants. In Nepal, Nepal Rastra Bank makes the auctions of T-bills.

#### **b. Commercial Paper**

Commercial paper is a promissory negotiable note issued by a large, well-known corporation and government a foreign commercial paper consists of short term, unsecured promissory notes (IOUs) issued by firms with the greatest financial strength quality to issue commercial paper. It consists of a fixed maturity period and is usually issued on discount. The paper has a life time of one year or less and the maturity is dedicated by regulations. Generally, the terms of the commercial paper are not negotiable but the issuer can prepay the amount if necessary. The commercial paper can be sold directly by the issuing company price through commercial paper dealers.

“The market for developed in the United States in the late 19<sup>th</sup> century. The practice of commercial paper has not yet developed in Nepal. Because of advantages of commercial paper for both investors and issuers, commercial paper has become one of America’s most important debt markets. It is the second largest money market instruments, in terms of outstanding debt, behind T-bills. Money market funds are the largest investors in commercial paper. Insures, banks, thrifts, non financial corporations and state locals government bodies are also important in this instrument”(Santomero and Babbel, 1997:253-255).

### **c. Certificates of Deposits (CD)**

A certificate of deposit or CD is a time deposit with a bank. They are issued at discount to the face value. A CD is a document evidencing a time deposits placed with a depository institution. A CD can be legally negotiable or non-negotiable, depending on certain legal specifications of the CD. Most CDs feature fixed interest rates to maturity; however some CDs have variable interest rates. CDs are issued both in bearer and registered form.

“Four types of CDs are mostly popular with differing rates, risks and liquidity in America. They are: Domestic CDs, Eurodollar CDs, Yankee CDs and Thrift CDs”(Santomero and Babbel, 1997:261).

A bank tries to sell as many CDs as possible directly to investors because banks have limited capability to sell all their CDs directly to investors. However, they often sell some of their CDs to dealers who resell them to investors (Morris and Walter, 1998).

### **d. Banker’s Acceptance**

The investors or lenders would lend a certain amount to the investors in exchange for a document stating that the debt would be paid back on a certain date in the short-term future. The redemption of the loan would have to be guaranteed by a bank, called the acceptance by the bank making arrangement. Thus the name is “banker’s acceptance.

“In exchange for guaranteeing the time draft, the accepting bank is given international trade documents, temporary title to the goods that are related to the transaction, and a commission for its services. Investors in BAs include commercial banks, foreign

central banks, money market funds and non-financial corporation”(Santomero and Babbel, 1997:255-256).

The yields of BAs are slightly lower than on Commercial paper because BAs are less risky due to the borrower’s pledge to pay the collateral of goods and the guarantee of the accepting bank over the past 70 years; BA investors have not suffered any losses of principal. BAs are very popular in export-imports business.

#### **e. Repurchase Agreement (REPO)**

“The major players in the REPO market are banks, savings institutions and non-bank securities dealers. Investors such as banks, money market funds, and other non-financial firms who have funds to invest for short periods of time, take it as an attractive alternative to the zero return received from idle balances in a checking account”(Santomero and Babbel, 1997:256-257).

Repurchase agreements are collateralized loans. Dealers in Treasury securities, dealers in securities issued by federal agencies, and large banks are the primary borrowers that use repurchase agreements. Securities in the dealers’ inventory are used as collateral.

“The term repurchase agreement and reverse repurchase agreement refer to a type of transaction in which a money market participant acquires immediately available funds by selling securities and simultaneously agreeing to repurchase the same or similar securities after a specified time at a given price, which typically includes interest at an agreed upon rate”(Lumpkin, 1998:59-61).

#### **f. Short-Term Municipal Securities**

“Local government often has temporary needs for cash to finance their own expenditures to provide funds to some tax-exempt entities such as non-profit hospitals, colleges and to a limited degree, to provide funds to private firms and individuals. To meet such needs, they often issue short-term municipal securities. These securities are issued in two forms. Interest bearing notes and discounts notes. The interest earnings and the capital gains in the case of municipal securities are generally exempted from the taxes, provided that the investor is a resident of the state or city that issues the debts instrument. Individual, mutual funds, banks and other corporations are the major types of investors in municipal securities”(Santomero and Babbel, 1997:248-250 and Walter, 1998:89-90).

### g. Other Instruments

There are several instruments popular in money market of different countries. When we see the American money market instruments besides above discussed, like: federal funds, federal agency discount notes, Eurodollars etc are very popular.

**Table 2.1**  
**Characteristics of Money Market Instruments**

Money Market Instruments	Principal Borrowers	Principal Investors	Duration (Common Maturities)	Credit Risks	Liquidity	Timing of Payment Risk
Treasury Bills	Government	Individuals, non financial and financial corporations, money market funds etc.	3, 6 and 12 months	Assumed to be none	Very active secondary market	Known
Commercial Paper	Financial and non financial corporations	Non financial corporations, money market funds	20-45 days	Medium to very low, rated by credit agencies	Limited secondary market	Known
Certificates of Deposits	Large banks and thrifts	Non financial corporations, money market funds, individuals	1, 2, 3, and 6 months	Low to high; not guaranteed against default	Active secondary market	Known
Banker's Acceptance	Financial and non financial corporations	Non financial corporations, money market funds, government	1-9 months	Very low; major banks are guarantors	Active secondary market	Known
Repurchase Agreements	Banks, security dealers, other owners of government securities	Non financial corporations and financial institutions	1 day, 1 week, 3-6 months, flexible term	Low risk collateralized by treasury securities, collateral price risk	High liquidity but no secondary market	Flexible
Short-Term Municipal Securities	State and local governments	Insurance companies, Individuals	1-12 months	Rated by credit agencies	Moderately secondary market for larger issues	Known

(Source: Santomero and Babble, 1997:258-259)

### **2.1.3 Capital Market and Capital Market Instruments**

Capital market is an important part of financial market, in which long-term financial instruments such as equities and bonds are raised and traded. Capital market securities include such marketable debt securities with long-term financial instruments, such as equities and bonds. It also includes such marketable debt securities with maturities of a year or more and equity securities. Capital market deals with longer term and relatively riskier securities. Business and industries issue shares and other securities to raise funds from capital market. In the context of our country, capital market is slowly growing as well as improving. Growth of capital market has made it possible for the public limited companies to raise the long-term capital by issuing share and other industries bonds to the investing public. Stock certificates, bonds, debentures, certificates of deposit with maturities over 1 year, collateralized mortgage obligations and beneficial instruments (Rose, 2000).

Most of the capital market financial instruments are transferable from one owner to another. Capital market provides a channel for the borrowing and lending of long term funds. This is designed to finance long-term investments by business, governments and households. The principal suppliers and demanders of funds in the capital market are more varied than in the money market. Capital market is the market for securities, where companies and government can raise long term funds. It is a market in which money is lent for period longer than a year.

The capital market includes the stock and the bond market. Financial regulators; such as the U.S. Securities Exchange Commission (SEC), oversees the capital market in their designated countries to ensure that investors are protected against fraud in USA as of Nepal it is seen by SEBON. The capital markets consist of the primary market and secondary market. The primary markets are where new stock and bonds issues are sold (underwriting) to investors. Capital market provides a channel for the borrowing and lending of long-term funds. This is designed to finance long-term investments by business, governments, and households. Trading of funds in the capital market makes possible the construction of huge establishments like: factories, school and highways. “Financial instruments in the capital market have original maturities of more than one year. The principal suppliers and demanders of funds in the capital market are more varied then in the money market. Families and individuals, government, business of varied sizes, pension funds, mutual funds etc.”(Rose,2000:264). Capital market

provides a channel for the borrowing and lending of long-term funds. This is designed to finance long-term.

**a) Equity Share or Common Stock**

“Equities or stocks are basically the contract that establishes an on- going relationship between “borrower” and “lender” and almost always bundling some combination of “control rights” and rights to be a “residual claimant”. In the establishment of corporations of small and medium sizes, stocks sales to the incorporators are usually the principal source of cash and other assets. “People invest in equities because they want to make more than they do in savings account. For the possibility of making more income, they assume more risk. There are several advantages and disadvantages of investing in stocks. People want to make more income so they invest in equities than they do in a savings account. Dividends and rate of return motivates most investors to consider common stocks. There is the liquidity risk that the price of risk might be quite low when one wants to sell it”(Garman et al, 1985:490-492).

“Equities are often termed as stocks or shares. Stocks represent part-ownership of a corporation. Holding a stocks certificate means that the holder owns the part the corporation. Thus there are only corporate stocks, no government or state and local government stocks”(Ritter and Silber,1993:29).

In market there are two types of equity ownership or stocks.

**I. Common stock:**

Common stock is the first security of a corporation to be issued and, in the event of bankruptcy, the last to be retired. Common stock is an ownership share in a corporation; therefore the common stockholders are the true owners of the corporation. It has the lowest-priority claim on earnings and assets of all securities issued.

An investor in common stock receives certificates of ownership, stating the number of shares and par value of the share. Common stockholders have the voting rights, they can vote for a board of directors. Common stockholders have a right to the earnings of the firm after all expenses and obligation have been paid but they also run the risk receiving nothing if earnings are insufficient to cover all obligations.

“Common stock holders hope to receive a return based on two sources dividends and capital gains. Dividends are received only if the company earns sufficient money and the board of directors deems it proper to declare a dividend. Capital gains arise from an advance in the market price of the common stock, which is generally associated with a growth in per-share earnings. Earnings often do not grow smoothly over time. This fact points the need for careful analysis in the selection of securities for purchase and sale, as well as in the timing of these investment decisions for common stocks has no maturity date at which a fixed value will be realized”(Fisher et al, 2000:11-12).

Investment in common stock is a popular alternative in Nepal. It is traded in Nepal stock exchange (NEPSE). Only the listed companies’ common stocks are traded in NEPSE.

## **II. Preferred Stock**

“Preferred stock is also a form of equity ownership. It is a hybrid form of long term financing with combined features of both common stocks and long-term debentures. Its claim is limited in size to a specified amount. No dividends can be paid on the common stock until the specified dividends have been paid to preferred stocks. It is usually perpetual however some can be callable also”(Haugen,1997:14-15; Fabozzi, 2002:2).

Preferred stock is superior in two areas:

- ) Although they have rights to dividends, if corporation allocates earnings to declared dividends, preferred shareholders must receive before common shareholders.
- ) In the events of forced liquidation, preferred shareholders have a claim on remaining assets up to the par value, as priority over common shareholders.

There are two types of preferred stocks i.e. cumulative and non-cumulative.

### **b) Bond**

“A bond is a type of fixed-income security by a borrowing entity in which the amount to be paid to the investor is specified in the investment contract or indenture. These are also known as contractual obligations since the creation of a debt is implemented by some form of contract fixing the rate of interest and defining the terms and

conditions of repayment”(Whyte, 1951:60). Many individual and financial institutions are interested in buying these papers.

“Mortgage bonds, collateral trust bonds are examples of secured bonds or senior debts. The nature of any bond is indicated by its indenture. It is the legal document that spells out the rights and obligations of the issuer and the investor. Indenture agreement is made between the corporation and the trustee also. When one purchases the corporate bonds, he becomes a creditor of the corporation with the rights fully specified in the indenture, like: to receive regular interest payments, subsequent repayment of the principal and right to initiate legal proceedings if the corporation defaults on any of the terms of the indenture”(Richards et al, 1984:375).

“Bonds have usually the stated interest rate, which is known as coupon rate. For that reason, bonds are often termed as coupon securities”(Ritter and Silber, 1993:28). Beyond interest rate risk that affects nearly all debt, the price and investors is willing to pay for corporate issue will be influenced by its call ability and credit quality. Some bonds are convertible into common stock at a pre-specified price. This is attractive to investors because investors can benefit from appreciating stock price by retaining the bond status.

“Because of this affirmative feature, convertibles have lower promised coupon payments than ordinary bonds. The option of conversion is a sweetener attached to straight debt. Since holders of the convertibles have a choice to convert debt into equity”(Santomero and Babbel, 1997:276-277; Vishwanath, 2000:316-317).

The paper also states when the bond will mature- the date when the loan will be paid off to whoever owns the bond at the time. “Corporate Bonds are often known as debentures. Debenture holders have a prior claim on the assets of the company. The interest on debentures is a tax-deductible expense of the firm”(Vishwanth, 2000:314-315; Grinblatt and Titman, 2003:35-37).

### **c)Mortgage Loans**

Loans granted for the purchase and construction of real property, that is land and buildings, are called, mortgage loans, because in almost all instances the borrower is required to pledge the property to lender as security for the loan. The document by which the pledge is made is the mortgage.

“The borrowers meet all his obligations the lender gives him a written document called a ‘satisfaction of mortgage’ like bonds, mortgages are debt instruments. In this case loan is generally amortized which means that the principal is gradually repaid along with the interest, during the life of mortgage”(Kent, 1972:271-272).

“In the United States, such families are quite lucky. They mortgage bonus to finance home purchases are readily available, and they are offered at terms that compare quite favorably with other financial claims. Today, most of the homes are purchased with little more than a 20 percent down payment, and the rest is deferred and is converted into long-term debt. Fixed payment mortgages are in use in states, since 1930s. There are adjustable rate mortgages, graduated payment mortgages and graduated equity mortgages, to name just a few. In fact, the largest market for private debt in the United State in the mortgage market. A recent study, commissioned by European mortgage federation from consultant at Mercer Oliver Wyman, put Britain’s market comfortably first for ‘competences’ a measure based on the range of products on offer, the ease of access to the market, the availability of advice and the type of borrowe”(The Economist, October18th 2003:89-91).

### **c) Other Investments**

#### **• Rights**

A corporation issues rights to existing common stockholders in connection with the sale of additional shares of stock at a specified attractive price within a specified time. A rights issue is offered to all existing shareholders individually and may be rejected, accepted in full or (in a typical rights issue) accepted in part by each shareholder. Rights are often transferable, allowing the holder to sell them on the open market. Rights can be sold separately from the share to other investors during the life of the right or shareholders must either take up the rights or let those lapse. Once the rights have lapsed, they no longer exist). Financial manager should consider subscription price for new share, number of new shares, and value of right and effect of the rights before issuing rights.

“Stockholders of most corporations will experience dilution of their ownership position. The issuing corporation often prefers selling shares to current stockholders because it is less expensive. A right is a legal instrument offered to a stockholder to purchase a proportionate number of shares of new company stock at a specific price

during a limited time period. Rights have intrinsic financial value because they are normally offered at a price somewhat lower than the current market value of stock. Consequently, a market exists for the buying and selling of rights and once again we enter the world of the speculation. An especially, attractive speculative investment is using margin to buy rights with the hope that the value will rise”(Garmen et al, 1985:620).

In Nepal here is no any experience of exercise the right in secondary market. Corporations only offers rights to its existing shareholders and they buy the new share at lower than market price but they can't sell their right of buying new share to others.

- **Options**

Option contracts an agreement that gives the owner of stocks the right, but not the obligation, to buy or sell a specific asset at a specified price for a set period of time. The most familiar options are stock options. Options are a very flexible investment tool, and a great deal is known about them. Options come in two flavors - calls and puts options. Call options are securities that allow a person to buy a stock at a specified price, known as the exercise (or strike) price, on or before a certain date, known as the expiration date. Put options are similar to call options except that they give the buyer the right to sell stock at a specific price instead of buying it. Options and futures are often lumped together, because they both represent contractual agreements between two parties concerning some third asset. Thus, both options and futures are often called derivative financial instruments. Options and futures are also similar in that they are both traded in organized securities exchanges. Options and futures are not use by corporations or individuals to raise funds (Ritter and Silber, 1993).

- **Futures**

Investors can profit from increase or decrease in the prices of various commodities by purchasing and selling future contracts. A future contract deals in both rights and obligations regarding the underlying commodity. The buyer of futures, also called the long, has the right and obligation to receive the underlying commodity, at some future date. The seller of the futures, also called the short has the right and obligation to deliver the asset on a specific date in the future. Forward contracts are also very similar with future contracts. These contracts obligate you to buy or sell commodity at

a particular price on a particular day. The price at which the asset is transferred is negotiated when the short to the long on the floor of a future exchange sells the contract. Thus, both parties know exactly how much the asset will cost them in future time (Haugen, 1997).

- **Warrant**

A Warrant is an option to buy a stated number of shares of common stock or bond at a specified exercise price. Warrants are similar to the call options except that they are issued by the firm itself and, typically, have longer maturities. When debt, preferred stock, or common stock is issued, it may be sold in units, which include one or more warrants to purchase common stock or other securities. A warrant, on the other hand is a primary security. A firm issues it, and it is a claim on the assets of the firm. A warrant is in all other respects, identical to call options, although warrants usually have longer lives than call options. A warrant gives its holder the right to purchase shares of stock in the firm at a particular price before a particular date. If the warrant is exercised, the firm must issue new shares of common stock to the holder of the warrant. Thus, the effect of exercise is to dilute the per share value of stock. Warrants are often given to executives as a part of their compensation. They are also frequently attached to other securities, such as bonds and preferred stock offerings. When originally issue to make the more attractive to investors (Haugen, 1997:378).

- **Mutual Fund**

A mutual fund is a professionally managed type of collective investment scheme that pulls money from many investors and invests it in stocks, bonds, short-term money market instruments, and/or other securities. The mutual fund will have a fund manager that trades the pulled money on a regular basis. Most mutual funds in investment portfolios are continually adjusted under the supervision of a professional manager, who forecasts cash flows into and out of the fund by investors, as well as the future performance of investments appropriate for the fund and chooses those which he or she believes will most closely match the fund's stated investment objective. A mutual fund is administered under an advisory contract with a management company, which may hire or fire fund managers (The Economist, 2003).

## 2.2 Securities Innovation

One of the chief characteristics of financial market is their ability to develop innovative financial instruments. The last two decades have witnessed unprecedented innovation in the range of manner in which firms issue securities. Just as engineers apply scientific principles to design new products and services, financial engineers apply principles of financial economics for the purpose of structuring, pricing and managing the risk of financial contracts. “Financial engineers involved in design, development and implementation of financial instruments and process and the formulation of creative solutions problems in corporate finance. Innovative instruments make financial market more complete and efficient. Financial engineering involve three types of activities-design of new financial instruments, developments of new financial processes and providing creative solutions to problems in corporate finance”(Vishwanath, 2000:253-254).

“Firms issue innovative securities for many reasons, but two of the most important are to escape the bite of taxes and regulation. Tax and regulatory frictions are the basic motivators for financial innovations”(Grinblatt and Titman, 2003:309).

Following are the factors responsible for innovations on financial instruments.

- Transaction cost
- Taxation
- Agency cost
- Minimization of risk
- Opportunity to increase an asset’s liquidity
- Regulatory and legislative changes
- Level and volatility of price and interest rates
- New financial theories and similar other technological factors

“Recent innovations include the creation of assets-backed securities, which are securities that are collateralized by cash flows from assets, like mortgages and accounts receivables. In March 1994, for example, northwest airlines brought the first airline industry asset-backed certificates to the market. They were backed b y

northwest's accounts receivable-their ticket payments”(Girblatt and Titman, 2003:311).

Occasionally conditions that influence the macro economy, such as inflation lead to innovative debt securities. For example, during 1989 Kuwait crisis, the crude oil prices sky rocketed, at that time several firms were convinced by their investment banks that it was a good time to issue oil-linked bonds. They were characterized by lower than normal coupon rates and to compensate investors for low. The principal was to be paid either four times the per-barrel price of oil or \$100 at maturity, whichever was larger, the emerging and growing capital markets are more able to welcome the financial innovations, as was seen in Russia in 1994 (Girblatt and Titman, 2003:314).

Likewise, Indian capital market has also witnessed a few innovative debt instruments in the recent past. Some of these innovative instruments are deep discount bonds, capital indexed bonds, and secured premium notes etc. a deep discount bond is issued at 'deep discount' to the face value of the instrument. The bond appreciates to its face value till maturity. The investor does not receive any interest during the life of the instrument. The capital indexed bonds, were designed to eliminate the purchasing power risk.

“The pace of financial innovation has been remarkable, given that new security designs cannot be patented, are easily copied, and once copied, their profitability to the inventor drops dramatically. To encourage such a rapid pace of innovation, successful security designs gave to be phenomenally profitable to the inventor for that brief period of time before competitors introduce imitations”(Girblatt and Titman, 2003:315)”. Financial engineering can be used not only in reducing financing costs and crating customized financial instruments but also in advancing a company's strategic goals”(Vishwanath, 2000:224).

### **2.3 Investment**

“Investment should always ensure two aspects; first the money should be available back when it is needed; second, the invested money should grow because a rupee's real value today is greater than a rupee's value tomorrow in a world of inflation. Investment, thus, is simply concerned with the incremental of the investor's wealth”(Cheney and Moses, 1999:624).

The word investment has become a pervasive word, as a result of which lead to be popular among people from all walks of life. Most of the people earn and spend money. Rarely, their current income exactly balances with their current consumption. These unbalance will lead either to borrow or to save in order to spend in future. Peoples unsatisfied nature in terms of current earning and making more money has lead to the existence of the investment. They always hope of getting enlarged their current sum in the future which is uncertain. An investor seeking higher must be willing to take higher degree of risks as well. In economic point of view investment refers to employing money on any physical or tangible assets, for example, a building, or machinery and equipments. On the other hand, in finance point of view investment refers to money utilized for buying financial assets, for example stocks, bonds, bullion, real properties, and precious items. In capital market point of view, investment refers to the buying of a financial products or any valued item with anticipation that positive returns will be received in the future. The most important feature of investment is that they carry high market liquidity (Francis, 2000).

“An investment is a commitment of money that is expected to generate additional money. Every investment entails (involves) some degree of risk - in the sense that it requires a present certain sacrifice for a future uncertain benefit. Under investment analysis, examination of marketable financial instruments such as common stocks, preferred stocks, bonds, put options, call options, combination options, futures contracts on the traditional commodities, financial futures, and other investments, as well as the risks associated with each are performed”(Francis, 2000: 1-2).“The length of time from the date of investment to the final date is called planning horizon, investment horizon or holding period. In other words, investment implies the employment of the fund with the objective of realizing additional income or growth. And it includes sacrifice of current rupees and waiting for reward”(Francis, 2000: 1) .

“Investment is a process of exchanging income during one period of time for an asset that is expected to produce earnings in future periods. Thus, consumption in the current periods is foregone in order to obtain a greater return in the future”(Britannica Encyclopedia, 2003:823).

Thus, investment is regarded as the function of risk and return. Every investor's main objective in making investment is to maximize ones wealth. "Investing is about money in the same way that school is about education. It is not about chance or

whims and not about fooling around, it is about having enough for the rest of your life. It is not about asset allocation and pie charts and financial planning. Investing about your life and being able to live the way you want to live" (Subedi, 2003:129) .

### **2.3.1 Types of Investors**

Investors are those people who invest their saving in securities to assume risk for expectation of future return. Though there is not much attraction of investors towards the world of financial instruments. Depending on investor's nature, attitude, involvement, risk, capacity, knowledge and information, investor's can be classified in different way. So there are many types of investors in the market. On the basis of information, Investors are classified into individual investors and institutional investors.

#### **a) Individual Investors**

Individual investors are those who buy and sell securities for their personal account, and not for another company or organization. Individual investors buy in much smaller quantities than larger institutional investors. Individual investors are part timer; they are the businessman, government worker, doctors, lawyers and even housewives, students and unemployed adults.

When an individual buys securities, holds them and gets divided of profit through price appreciation, the cash flow becomes income to the people. Individuals have an opportunity cost in obtaining investment information, such as reading publication, tracking stocks prices and building a file on securities(Kumar and Alok, 2009).

#### **b) Institutional Investors**

A non-bank person or organization that trades securities in large enough share quantities or dollar is known as institutional investor. An institutional investor is an investor, such as a bank, insurance company, retirement fund, hedge fund, or mutual fund that is financially sophisticated and makes large investments, often held in very large portfolios of investments.

Because of their sophistication, institutional investors may often participate in private placements of securities, in which certain aspects of the securities laws may be inapplicable. Institutional investors face fewer protective regulations because it is

assumed that they are more knowledgeable and better able to protect themselves (Chancy and Moses, 1999).

### **2.3.2 Investment Process**

The investment process explains how an investor makes decisions about what securities to invest in, how extensive the investments should be, and when they should be made. An orderly, disciplined approach is necessary for successful management of the investment assets. It's a step-by-step process, starting with the assessment of investor's goals and needs.

The investment process includes an analysis of the following five steps:

#### **a) Setting Investment Policy**

The investment process always starts with the setting investment policy. It involves determining the investment objective and the amount of one's ingestible wealth. Investor objectives should be stated in terms of both risk and return. Setting a clear investment policy also involves the identification of potential categories of financial assets for consideration in the ultimate portfolio. The identification of assets depends upon many things, such as investment objectives, ingestible wealth, tax considerations etc. (Bhalla, V.K., 1993 ).

#### **b) Performing Security Analysis**

The second step of the investment process is to complete security analysis which are identified in the previous stage of the process, Security analysis is conducted to assist in making buy and sell decisions for individual securities (or groups of securities) within the broad categories of financial assets. The security analysis gives the basic idea about identification about mispriced securities. These approaches can be categorized into two types; they are Technical analysis and fundamental analysis.

- **Technical Analysis:**

Technical analysis is a process of using past trends in the price and volume patterns to predict accurately the future price movements. In another word, Technical analysis is a technique for predicting market direction of future stock price movements based on historical price and volume behavior and investor sentiment. It is widely used in the commodity markets. It is essentially the search for bullish or bearish signals, meaning positive or negative indicators about stock prices or market direction.

- **Fundamental Analysis:**

Fundamental analysis is another approach to security analysis. It tries to examine the real or true value of financial assets. The fundamental analyst attempts to forecast the timing and size of these cash flows, and then converts them into their equivalent present value by using an appropriate discount rate. Once the real value is calculated, it is, thereby, compared with the current market price per share to identify whether the security is under-priced or over-priced. Information regarding such things as management quality, products and product markets is often examined as well.

**c) Constructing the Portfolio**

The third part of the investment process is construction of the portfolio. At this stage we identify assets in which to invest and what proportion of the investor's wealth to put in each one. While constructing portfolio is divided into three components, the first component is in an investment strategy and portfolio allocation. The second component is the asset selection decision, where individual assets are picked within each asset class to make up the portfolio (J.C., 2000).

**d) Portfolio Revision**

This step means repeating the previous three steps of the process. Over the period of time, the objectives of the investor may change and the current portfolio may no longer be optimal.

**e) Portfolio Performance Evaluation**

The last step of the investment process is to evaluate the investment performance in terms of return and risk experienced. Investing is after all focused on one objective and one objective alone, which is to make the most money we can, given the risk constraints we operate under.

Investors are not forgiving of failure and unwilling to accept even the best of excuses, and loyalty to money managers is not a commonly found trait. By the same token, performance evaluation is just as important to the individual investor who constructs his or her own portfolio, since the feedback from it should largely determine how that investor approaches investing in the future.

## **2.4 Investment Objectives and Preference of Investors**

Investment is all about making multiplying and making money to earn money by investing in available alternatives rationally. Investment is the outcome of your needs and goals. People invest money for different purpose that is; investors invest to increase income, to have funds available during retirement years and specific goals that depend upon age, income, planned activities and attitude about risks. Becoming a successful investor takes times and effort. Getting ahead through investments requires willingness, ability and discipline. Willingness involves understanding your innovations. Investing requires that an individual invest money in assets that will generate the desired wealth when it is needed for retirement, children's education or other financial goals. That is why; an investor seeking higher returns must be willing to face higher levels of risks (Blake, 2000).

Preference on investment depends upon the nature of investors. Risk lover (investor) prefers on the stock which have high return and risk adverse investor prefers on the stock, which have low risk even though the stock have low return. So, investors vary in their preferences. Some investors are very concerned about the possibility of losses with stocks and prefer to keep a lower proportion of stocks in their portfolios. Other investors are less concerned about the possibility of losses with stocks and prefer to keep a higher proportion of stocks in their portfolio. Some investors prefer stocks of socially responsible companies and some conventional companies. Some investors prefer foreign stocks while others prefer domestic stocks. Some people believe that they can pick stocks that would earn higher than average returns where as some people believe that they are unable to do so.

“Ability has to do with knowing alternative investments finding investment funds and making intelligent investment decisions. And, discipline describes the courage to act responsible in financial matter”(Garman, 1985:446-447).

While wealth maximization may remain an investor's investment objective over a lifetime, age or family circumstances will necessarily force the investor to change his or her investment objective. Thus an investment objective is not static rather it varies from person to person, from time to time and from one circumstance to another circumstance. It will be most difficult when full achievement is hardly possible or

when it is a question of selecting the investments which, through falling short of complete fulfillment of purpose, yet come nearest to attaining what is required.

“Investors, as buyers of financial products, expect to obtain three characteristics from the financial requirements. They are the expected return, security and liquidity”(Blake, 2000:57).

While making investment the investor should consider about the compensation for the investment that it is going to provide in future will the investment return or not. These issues should be considered while defining the objectives of the investment are described below:

1. Safety
2. Growth
3. Regular return
4. Liquidity

### **1. Safety**

Investor wants the return of the investment or the original principal i.e. the guaranteed return at the end of specified period. Safety doesn't take into consideration the amount of loss due to inflation but rather whether or not the dollars placed into the investment are guaranteed to be return at a later time. Many investors equate the objective of safety of principal with the purchase of high quality investment instruments. Savings accounts, certificates of deposit, and savings bonds all have a virtually guaranteed return of principal. While these types of investments may help to keep the amount of the portfolio reasonably constant inflation may reduce its purchasing power.

“Investor looking for some investment income but cannot risk much loss of principal. For the pension funds, investment of safety instruments is more desirable. Hence, investors often seek to keep the portfolio safe in terms of purchasing power by seeking enough growth to offset changes in the cost of living”(The Economist, 2003:56).

## **2. Growth**

Primarily, most of the investors expect the increment in secured principal. Price appreciation of principal in addition to the secured principal is also one significant objective of investors. An investment is purchased with the hope of earning a capital gain at the time of sale. An important task for the investor is to balance the desire for safety of principal with the desire for growth in a manner consistent with her or his personal preferences (The Economist, 2003).

## **3. Regular Income**

Investors may realize investment income either in the regular income is either necessary or highly desirable. A retired individual often needs a high level of current or regular income to be able to supplement income from social security. The need of regular income varies greatly, depending upon such factors as the age, wealth, and non-investment income of the investor. Bonds, preferred stocks, and other investments with high current yields are traditional income investments.

“Income also may influence risk preferences. High-income investor may be willing to choose higher risk investment since they can more easily contribute additional investment capital. The need of regular varies greatly, depending upon such factors as the age, wealth, and non-investment income of the investor. Bonds, preferred stocks and other investments with high current yields are traditional income investments” (Steverson and Jenning, 1998:324).

## **4. Liquidity**

Liquidity is the ease with which you can convert your assets to cash at fair market value. It is essential that you recognize the need to convert your assets into cash at the appropriate times. As the definition says the ability to turn an investment into cash quickly at a value close to the original amount of the investment is liquidity. Since greater liquidity generally results in lower return, it is necessary to give serious consideration to the inherent tradeoffs (The Economist, 2003).

## **2.5 Review of Studies**

Timilsina has conducted a research entitled “*Capital Market Development and Stock Price Behaviors in Nepal*”. His study has mainly focused in tracing out the historical events controlling to the development process of capital market in Nepal. The specific

objectives of that study were to find out the fair market prices of equities and to observe the variations of the actual market prices from the computed fair prices to see whether the present behaviors of prices will remain the same (stable).

Different types of statistical tools like chi-square, mean, median etc. as well as financial tools were taken for the interpretation of the data taken from the primary and secondary data sources.

The major finding of the study was the market price of share depends on EPS as well as on DPS but DPS is more price sensitive, EPS and DPS will have direct and immediate response in the market. Market values of share computed on the basis of EPS are near to the observed values and the money supply and bank credits however do not have a direct impact on the capital market. When money supply increases, the interest rate may fall causing the share price to move upwards, but inflation may also creep up, as a result the increase of capital gain is neutralized (Timilsina, 2001).

Bhattarai has conducted a research on "*Investors Preferences' in the Choice of Financial Instruments in Nepal*". The major objectives of the study were to identify, the investors preference in choice of financial instruments, Factors effecting investment decisions, to examine the Nepalese investors sector wise preference and to access investors perceptions on their investments.

Researcher has divided research methodology in three sections viz. research design of the study, describes the nature and source of data as well as the selection of the financial instrument and investors, and explains the methods of data analysis employed in interpretation of data. Primary data have been collected through structured questionnaire and personal interview with the investor. For the secondary data source annual reports, publications of NRB, economic survey, studies, websites etc. Common stock, preference stock, debenture and other instruments were taken as sample for representation of financial instruments. In the process of analyzing the data, statistical tools like simple mean, weighted mean, median, quartiles, chi-square test, rank correlation was used. Computerized method was also used.

Corporate common stock's issue were increasing regularly than financial instruments like debenture, preference share etc. So far the preference of financial instrument is concerned; majority of respondents preferred the common stock. Debenture got second, preferred stock third, the factors affecting the investment decision were risk

and return analysis (42%), recommendation of the friend and relatives (41%), investors' income (13%) and tax lasted (Bhattarai, 2004).

Bajracharya had conducted a study on the topic of "*Individual Investors' Preference and Financial Instruments in Nepal*". The study had aimed to explore behavioral aspects of individual investors in financial instruments. However the specific objective of the study was to understand investment procedure and behavior of the individual investors for their investment, to justify how individual investors select specific type of instrument to invest their savings, to identify the element of investment that is considered important by individual investors in a preferential scale and to identify whether personal factors like age, sex, education and occupation of the investor plays significant role in their investment behavior.

Specially, secondary data were used for the analysis of the study. For the analysis and presentation of the data different statistical tools like percentage analysis, median, hypothesis testing, chi-square test etc. were done and questionnaire method of interview was also followed.

Regarding preference to available alternatives investments people gave higher preference to corporate investments alternative while moderate preference to real estate common stock, fixed deposits, bonds, debenture etc. Among security sectors, 76%, 5%, 10%, 4% and 5% saw opportunity in bank, finance, manufacturing, trading, and hotel sector respectively. While non-security sectors, 29%, 7%, 34%, and 30% saw opportunity in fixed deposit, personal money lending, real estate and business ventures respectively (Bajracharya, 2004).

Tamrakar had conducted a study on "*Development of Financial Instruments in the Nepalese Capital Market*". The main objective of the study is to provide details about the development of financial instruments in Nepalese capital market. The major objective of the study was to identify the different investment alternatives available in the Nepalese capital market, to analyze the development of different investment alternative available in Nepalese capital market and to explore the current status of available investment alternatives.

Mainly secondary data was taken as major source of analysis; however primary data sources like questionnaire method were also taken. For the conclusion purpose analysis of systematic examination was done through the use of statistical tools.

Researcher used Parametric as well as non-parametric tools. Non-parametric tools like median, percentage analysis, chi-square, coefficient of contingencies, Cramm's coefficient etc were used. And parametric tools like t-test, f-test etc were followed. Financial tools like subscriptions ratio, growth rate, correlation, coefficient of determination, graphs etc. were used.

According to her study Public Saving Card has appeared as a new concept and is growing in a good phase. Investment in corporate securities, government securities, real estate and bullion are popular. Corporate securities are found to be widely used alternative. However, the government securities also have some scope in the Nepalese capital market. In terms of different categories of investors (less informed, informed, well informed, analyst/professionals) ranking towards different investment alternatives were also found similar. Employed investors like to invest their saving in corporate securities whereas unemployed investors like to invest their saving in real estate than corporate securities.

Investment in sectors likes banking and investors mostly prefer finance in comparison to manufacturing, trading, hotel and others. Commercial banks, finance companies and insurance companies were found to be the most profitable and safe sectors (Tamrakar, 2006).

Darhsandhari had conducted research on "*Investors Preference in Financial Instruments in Nepal*". The specific objectives of the study was to examine the status of investors preferences towards the financial instruments, to analyze the influencing factors that attracts investors to invest in particular security(s) , to assess investors awareness regarding the investment decisions in selecting securities and to explore the shortcomings of securities issuing as perceived by the investors.

Mainly the researcher used secondary data for the analysis of the study through various published and unpublished sources. Needed primary data and information that supported the study were gathered through questionnaire. Direct interview and mail questionnaire method of data collection also followed. Statistical tools like median, chi-square test, testing of hypothesis were used.

Common stock was most popular investments sector, debts and preferred stock are less preferred by investment. The survey made resulted that common stock (1.07 median) were most preferred financial instrument among Nepalese investors.

Similarly, second preference was Government bonds (1.56 median), third preference was Preferred stock (2.80) and Debenture (3.06) was the security that was least preferred by Nepalese investors. The most preferred sector of investment, according to the research, was banking sector, finance was the second attractive sector. Likewise, insurance, hotel, trading, manufacturing, processing simultaneously other sector of investment. Investors objectives of the investment in these sectors were maximize return, enhance social status, and minimize the possible risk (Darhsandhari, 2007).

Rayamajhi had conducted research to examine and analyze the preferences of investors in selecting financial instruments on “*Investors Preference in Financial Instruments in Nepal*”. To analyze the preferences of different investors of Nepal in Financial instruments and to identify the primary issues in Nepalese financial market are the specific objectives of the study.

In order to achieve the objectives of the study, the researcher followed specific research methodology. Different section like research design, nature and sources of data population and sampling, period covered presentation and analysis of the data and method and tools for analyzing data collected data. For the purpose of analyzing the data, primary and secondary markets’ data and information were taken from published and unpublished sources during period 1994-95 to 2007-08. Statistical and financial tools like chi-square, graph, hypothesis and Spearman’s Rank correlation coefficient were used for analysis of numerical data. Total 60 samples were taken as primary source for analysis through questionnaire and statistical tool were used.

According to his study common stock is the most widely used corporate security among Nepalese investors. Moreover, preference shares are in very low limits. Corporate securities are most preferred investment alternative, government securities in second place. And then real estate while bullion is the least preferred investment alternative. Preference as per employment status investors are categorized in two types i.e. employed and unemployed. The employed investors preferred the corporate and unemployed have preferred real estate. Nepalese investors are not well aware of financial market. Most of the investors are investing in the capital market without any proper knowledge or information (Rayamajhi, 2009).

The study “*The Challenge of Behavioral Finance on Credit RiskManagement*” have analyzed developments in the credit risk management theory shows that financial

institutions are thinking more and more about the investor's attitude towards risk. In the meantime, Behavioral finance, completely from the perspective of investor's attitude towards risk, shows that investor's risk preference may transfer and that capital structure has great impact on corporation value, all of which issues a severe challenge to the conventional credit risk management based on efficient market hypothesis. Through the study on the development of credit risk management, they find out that the development of credit risk management is considering increasingly about the attitude of the investors on risk; in the mean time, totally from the inspective point of the attitude of the investors, behavioral finance has demonstrated the theorem that risk bias of the investors transforms and that the capital structure has a great influence on corporate value, which has put on serious challenge on credit risk management and exhibit the direction of the study of credit risk management (Linjie et al; 2010).

A study on “*Behavioral Implications of Investors for Investments in the Stock Market*” In order to understand irrational behaviors of investors in the investment market, they have conceptualized and then developed a risk perception centered model in this study. Different socio economic and attitudinal variables have been incorporated in the model. Impact of these variables on the dependent variables of reinvestment intentions and return expectations can be tested. It has been recommended in the study that there should be stability and consistency in policies relating to various risk sources, transparent and timely spread of information about listed companies for all the investors at the symmetric level and development of mechanism for the training of new investors. Researchers are encouraged to test the hypothesis of the study. The investment professionals should take these factors into account while designing portfolio of their clients. This study is restricted to the development of model only and has limitation of empirical testing which can be done in future. The study can be further expanded in the future by using various socioeconomic, demographic and attitudinal factors not discussed in this study (Iqbal et al; 2011).

A study on “*Individual Investor Perceptions, Behavior, and Performance During the Financial Crisis*” explaining how during the financial crisis individual investor perceptions change, impact trading and risk-taking behavior, and explain performance. They traded less, took less risk, and had lower buy-sell ratios. Investors

who outperformed during the height of the crisis also performed better before. Afterward, however, they became less risk averse, were no longer less likely to trade, and no longer outperformed, suggesting that their success made them overconfident. In this paper, they use a unique panel of individual investors to investigate the dynamic interplay between investors' perceptions, behavior, and performance during the financial crisis of 2007/09. Using matched survey and trading data, they find evidence that information on individual investors' perceptions improves their understanding of their trading and risk-taking behavior and helps explain investors' investment performance during the worst financial crisis in recent history.

In addition, this study finds a sharp increase in the share of investors trading, their turnover, and their buy-sell ratios during the height of the financial crisis (September–October 2008), when Lehman Brothers collapsed and the U.S. government bailed out AIG. Notably, both the levels and dynamics of investor perceptions are linked to their trading and risk-taking behavior and contribute to explaining investment performance. Regarding trading behavior, they find that investors with higher levels and upward revisions of return expectations were more likely to trade and to have higher turnover. Finally, investors with higher levels of risk perception and upward revisions therein were more likely to trade, had a higher turnover, and had a lower buy-sell ratio. Regarding risk-taking behavior, they find that investors who had lower return expectations, that were more risk averse, and that had higher levels of and upward revisions in their risk perceptions chose portfolios with lower standard deviations.

Overall, successful investors during the crisis are characterized by high return expectations and high-risk aversion. In terms of behavior, successful investors had lower turnover, took less risk, traded less derivatives, and had lower buy-sell ratios. Investors who performed well during the height of the market turbulence also performed better in the months before and had higher return expectations during this very volatile period, but became less risk averse in the following months. Subsequently, these investors were no longer able to outperform their peers and were no longer less likely to trade, suggesting that their earlier success may have made them overconfident. That is, performing relatively well during extreme times characterized by overall negative market returns, high uncertainty, high volatility, and very salient events such as bank failures, may have led investors to overestimate their investment skills (Hoffmann et al; 2012).

## **2.6 Research Gap**

There are no proper studies in this specific topic. However, some studies related to the topic have been conducted as a thesis for the partial fulfillment of Master's level. Some relevant research has found to be conducted in favor of individual investors in Nepal, which are useful to this study. Overall previous thesis related to securities and Nepalese investor's assumptions of investments alternatives found to be incomplete.

Some were related only with psychological factors of investors and some were related only with developments of financial instruments. Most of the research works were found not addressing exclusively on the investor's preference in the context of Nepal. Investor's behavior like investments habit, psychological factors and awareness changes with passage of time. So do their preferences and priorities. In this regard, this study covers all these aspects and examines current perceptions and attitude of investors about financial instruments and provides fresh findings and recommendations. That is why, this study, contribute new approach toward preference of financial instrument, which is not sought yet by previous researchers.

In previous research for the purpose of analyzing the data, primary and secondary markets' data and information were taken from published and unpublished sources up to period 2007/08 and in this study data and information were taken up to period 2011/12. This study, in true sense fills the gap of ignorance with knowledge for seekers. Hence, the research covers what factors affect the investors to invest in securities and which instruments are preferred by investors through the access of investor's awareness regarding the investment decisions in selection of securities through primary and secondary data analysis using different statistical tools which is new to previous research.

## CHAPTER - III

### RESEARCH METHODOLOGY

This part of the study deals with the research methodology adopted in terms of research design, population and sample, sources of data, data collection procedure, and data analysis tools.

#### 3.1 Research Design

This study will adopt descriptive cum analytical research design. For the analysis of primary data to know the preference of investor in various securities the descriptive research design will be used in case of secondary data analysis. To validate the primary data analysis results, the analytical research design will be used. So the study describes and explores the scenario of financial instruments as well as tries to analyze the investor's preferences toward instruments.

#### 3.2 Populations and Sample

The entire number of investors of listed financial instruments is the population of the study. The total population of investors is very large which includes very small investors to analysts and professional investors. Investors were taken as subjects on convenience sampling basis. The investors will be taken based on their features like; small, large, male female, less informed, analyst and so on. Survey was conducted on various points like: NEPSE floor, Broker's office and several other places. Investors are surveyed as per the accessibility i.e. those which are in Butual city of Rupandehi District.

**Table 3.1**  
**Features of Sample**

Population	Sample features	Sample Number
All investor of security market as unit of analysis as individual	Small investor, large investors, male, female, less informed, informed, analyst, professional, various sector investors.	120

(Referred to Table no. 4.8)

### **3.3 Sources of Data**

The secondary data source for the study will be NEPSE reports, SEBON reports, NRB reports, reports of issues like managers etc. on the other hand, to know about preferences of the investors primary data are collected through the questionnaire. Thus, both primary and secondary sources are used for the collection of the data. The study heavily depends upon the primary source, since the main objectives of research is to know about the preferences of investors over financial instruments.

### **3.4 Data Collection Procedure.**

To collect the primary data structured questionnaire has been used. But some open-end questions are also included in the questionnaire to liberalize the response of preference of investors. For the secondary data different publications will be taken into considerations for instance reports, journals, bulletins etc of different relevant sources like: NRB, NEPSE, SEBON etc.

### **3.5 Data Analysis Tools**

For the purpose of analysis, data are presented in various forms. Different relevant statistical and financial tools are used. They are:

#### **3.5.1 Statistical Tools**

##### **1. Median Analysis**

Median gives the middle value in the sets of numbers. In the distribution of scores, median distribution would remain exactly same if the lowest score is simply .Formula to calculate median is given below:

$$\text{Median} = \text{value of } \left[ \frac{n+1}{2} \right]^{\text{th}} \text{ item}$$

Where,

n= Number of items

##### **2. Test of Hypothesis**

###### **2.1 Chi- Square test $\chi^2$**

Chi square is one of the simplest and most widely use non-parametric test in statistical work. It has been used to check whether there is any association between two independent variables as well as to check the uniform distribution of the investor's

response toward various options. Chi-square statistics helps to test the association as well as uniformity. Formulae of chi-square are given below:

$$\chi^2 = \sum \frac{(O-E)^2}{E}$$

Where,

$\chi^2$  = Chi square statistics

O= Observed Value

$$E(\text{Expected Value}) = \frac{RT \times CT}{WT}$$

RT= Row Total

CT=Column Total

WT=Whole Total

Degree of Freedom (d.f.) = (r-1) (c-1)

## 2.2 Kruskal-Wallis Test (Non Parametric ANOVA)

Kruskal-Wallis test helps us to test the hypothesis whether the responses of two categories of subjects are significantly different or not. Kruskal-Wallis Test H has been calculated to test whether there is any difference in the preferences of different investors or not, the formula for H is given below:

$$H = \frac{12}{N(N+1)} \left[ \sum_{j=1}^k \frac{R_j^2}{n_j} \right] - 3(N+1)$$

Where,

K = Number of samples

$n_j$  = Number of cases in  $j^{\text{th}}$  sample

N = Number of cases in all samples combined

$R_j$  = Number of ranks in the  $j^{\text{th}}$  sample

If the calculated value is greater than tabulated value then Null hypothesis is rejected.

### 3.5.2 Financial Tools

#### Growth Rate

Growth rate is used to see how the investment on government securities and common stocks are growing. This helps to reflect the investment made on those financial instruments and performance over them. Growth rate is calculated as given below.

$$\text{Growth rate} = \frac{V_1 - V_0}{V_0} \times 100$$

Where,

$V_1$  = value of current year

$V_0$  = value of previous year

## **CHAPTER - IV**

### **PRESENTATION AND ANALYSIS OF DATA**

This part of study includes the analysis of secondary data regarding the issuance of financial instruments in Nepal and the trading volume. It also includes analysis of primary data collected through questionnaire survey. The study mainly depends on the data collected from published and unpublished secondary sources and collected primary data from own survey.

#### **4.1 Analysis of Secondary Data**

The secondary data collected through published sources are analyzed under this chapter. The data has been taken from the newspaper, journals, bulletin, and annual reports of concerned companies, SEBON, NEPSE, and NRB.

##### **4.1.1 Corporate Securities**

Issue and subscription of the corporate securities are analyzed to find out the investors preferences and expectations upon corporate securities. Corporate sector issue in Nepal is more dominating than others. It can be apparently explained through the table 4.1.

**Table 4.1****Issues of Corporate securities in ('000000)**

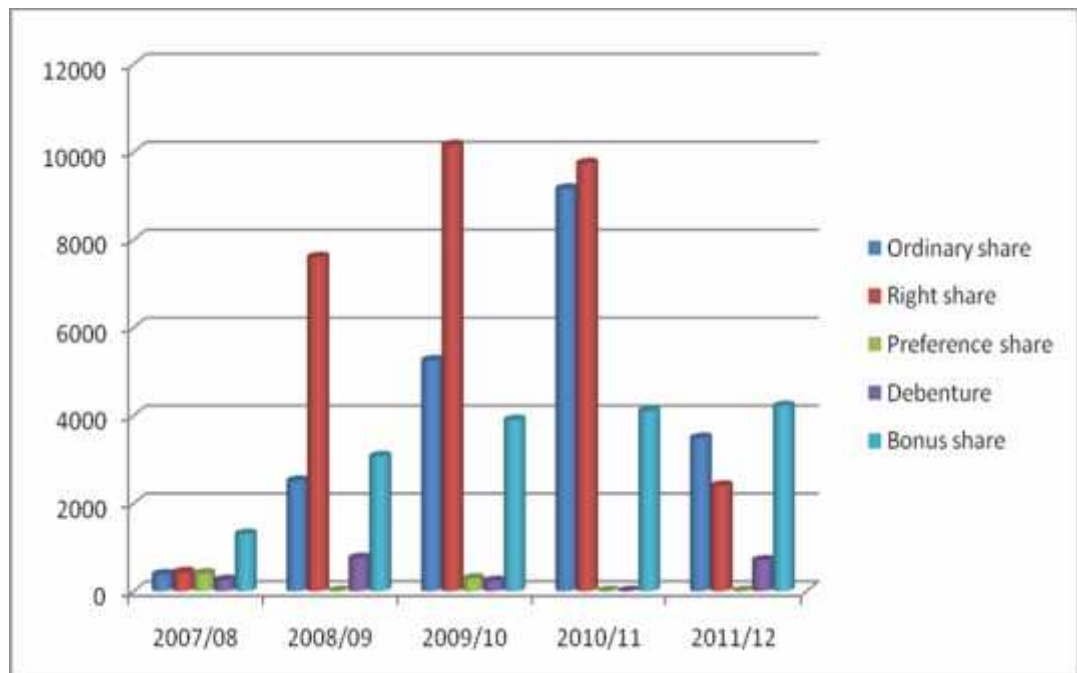
Rs.

Fiscal Year	Common Shares		Preference Share	Debenture	Bonus Share	Total
	Ordinary Share	Right Share				
2007/08	380.25	429.92	400	250	1300	2760.17
2008/09	2509.76	7605.40	0	750.00	3068.77	13933.93
2009/10	5251.68	10153.73	283.67	227.77	3893.83	19810.68
2010/11	9160.60	9741.04	0	0	4102.6	23004.24
2011/12	3484.89	2398.66	0	700	4214.15	10797.70
Total	20787.18	30328.75	683.67	1927.77	16579.35	70306.72
Ranking	2	1	5	4	3	

(Source: NEPSE Annual Reports)

Above table 4.1 shows the amount of different types of securities issued under different time during 2007/08 to 2011/12 in financial market. The total amount of issue is about Rs. 70306.72. million. Table further shows that right share have domination in the total amount i.e. Rs. 30328.75 million and then after there is domination of ordinary share. Bonus share has the third position in ranking according to the amount of issue. The third position of issue of bonus share may be due to capital increment need of corporate sectors. Debentures and Preference share have fourth and fifth position respectively. It is clear from the table that public has the most preference on common share. It can also be said that public offering and right offering of corporate sectors are still being subscribed in intended amount.

**Chart 4.1**  
**Diagram of Corporate Issue**



Above chart 4.1 shows the trend of issuing securities in different years. The common share has been leading the issues from past to present. It has taken a height in recent two years. The amount of common share has increased due to the issue of right share to increase the amount of paid up capital of bank and financial institutions to meet the obligation of Nepal Rastra Bank. Now a day's companies are not willing to issue preferences shares. Debenture issue also has taken place in Nepalese financial market from 2007 and its issue is growing every year. Bonus share has become a means to increase capital for profit earning corporations in last year's. It is very clear that companies are issuing common share to raise needed capital.

Some profit earning companies are issuing bonus share which can benefit the shareholders and that will also meet the capital increment need of the concerned company. Some companies are issuing debentures because that should not pay unlimited benefit as to the common share and whose cost of capital use to be very low than other instruments. Though having more ups and down in issue common share is the most preferred securities and the mutual fund is the least preferred security in the market. Form this it can clearly said that the common share is the security from which investor expect more return and the mutual fund is the security from which investors

expect least return. In fiscal year 2007/08 Everest Bank has issued preference share in convertible form which was the latest innovation in sector of financial instrument.

**Table 4.2**  
**List of Top Ten Compines on 2011/12**

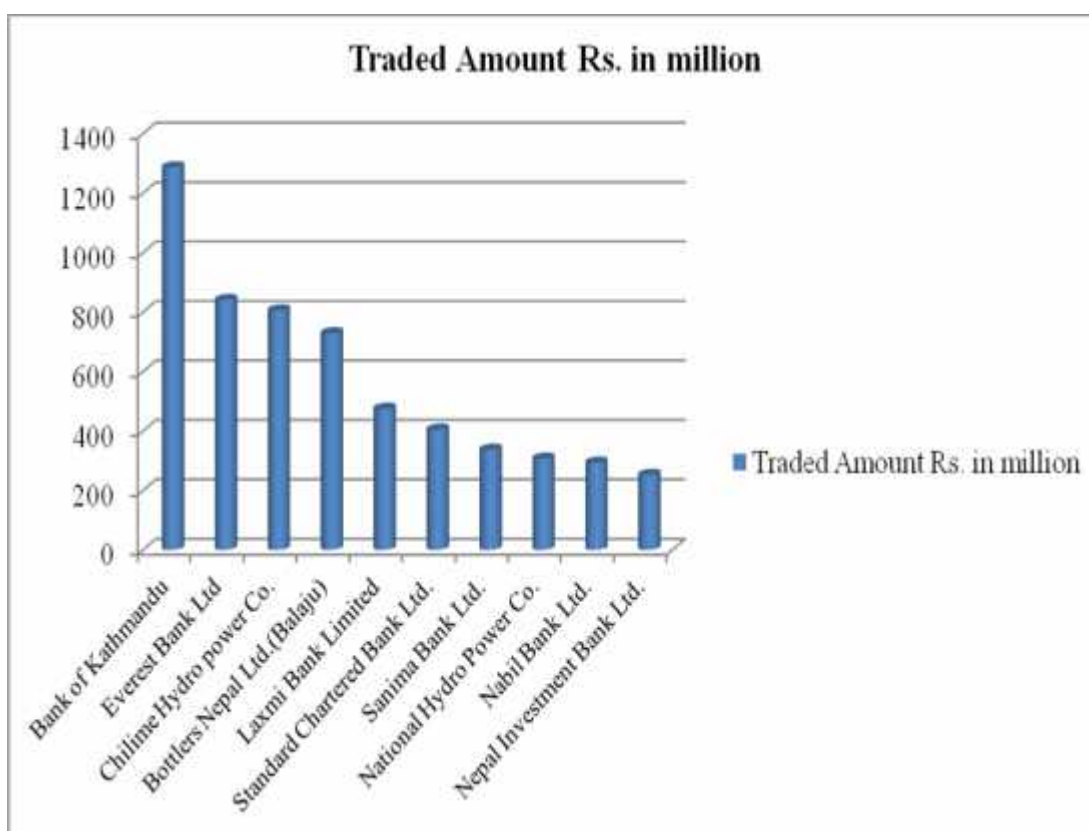
Rs.

SN.	Name of the Compines	Traded Amount in ('000000)
1	Bank of Kathmandu	1286.30
2	Everest Bank Ltd	840.43
3	Chilime Hydro powerCo.	805.22
4	Bottlers Nepal Ltd.(Balaju)	728.71
5	Laxmi Bank Limited	474.50
6	Standard Chartered Bank Ltd.	404.19
7	Sanima Bank Ltd.	336.86
8	National Hydro Power Co.	307.05
9	Nabil Bank Ltd.	293.15
10	Nepal Investment Bank Ltd.	252.26
	Total	5728.67

(Source: NEPSE Annual Report 2011/12)

Table 4.2 shows the list of top ten companies on the basis of traded amount in fiscal year 2011/12. The table shows that the Bank of Kathmandu is in first position with traded amount Rs. 1286.30 million. Everest Bank Ltd, Chilime Hydro power Co., and Bottlears Nepal Ltd. has second Third and fourth position respectively. Nepal Investment Bank takes tenth position with traded Rs 252.26 million.

**Chart 4.2**  
**Graph of Top Ten Compines**



Above chart 4.2 shows the list of top ten companies on the basis of trade amount in fiscal year 2011/12. The figure shows that the Bank of Kathmandu is in first position among the various companies with Rs. 1286.30 million. Everest Bank Ltd has 2<sup>nd</sup> position in traded amount of Rs 840.43 million, Chiline Hydro power Co. Bottlers Nepal Ltd, Laxmi Bank Ltd, Standard Chartered Bank Ltd, Sanima Bank Ltd, National hydro power and Nabil bank Ltd have third, fourth, fifth, sixth, seventh, eighth and ninth position respectively. Nepal Investment Bank Ltd has lowest traded rate among the mentioned companies.

#### **4.1.2 Government Securities**

Investor has choice of corporate or government securities depending on their nature of risk aversions or risk seeking. Government securities are risk free securities but they provide very minimum return as compared to corporate securities. We have details of government securities issued in Nepalese capital market in different years. Government issues Treasury Bills, Development Bond, National Saving Bond, Public

Saving Cards etc. We have following table to show the issue of government securities in Nepal.

**Table 4.3**  
**Issues of Government Securities In ('0000000)**

Rs.

Fiscal Year	Treasury Bills	Development Bond	National Saving Bond	Citizens Saving Certificate	Foreign Employment saving bond
2007/08	1250.00	607.00	-	192.64	-
2008/09	900.00	775.00	-	166.71	-
2009/10	1992.98	904.09	-	93.92	0.40
2010/11	1499.66	800.00	1068.00	-	0.33
2011/12	1728.34	1400.00	500.00	12.65	0.86
<b>Total</b>	<b>7370.98</b>	<b>4486.09</b>	<b>1568.00</b>	<b>465.92</b>	<b>1.59</b>
<i>Percent</i>	<i>53.06</i>	<i>32.29</i>	<i>11.29</i>	<i>3.35</i>	<i>0.01</i>
Ranking	1	2	3	4	5

(Source: NRB Annual Report 2007/08 to 2011/12).

Table 4.3 shows the issuance of government securities in different year during the last decade. Government is giving top most priority on Treasury Bills and secondly it is issuing the development bond on market. National Saving Bond and Citizen Saving Card come in third and fourth position. Treasury bill is easy to subscribe in market so government chooses the Treasury Bills to raise the required fund. The Treasury bill hold the 53.06 percent of the total issue Development Bond holds 32.29 percent of issue. National Saving Bond and Citizens saving certificate holds 11.29 percent and 3.35 percent that are ranked as third and fourth according the amount of issue. The above table shows that government does not issued National Saving bond since first three year. The above chart shows that it has found that most of government bond has purchased by bank and financial institution, insurance companies, provident fund, government business enterprises and general public. The major portion of government issues is purchased by banks financial institutions and insurance companies. The companies who are not allowed to invest their fund in risky financial instruments and the company who are directed by NRB to invest certain percent of their fund in

government securities are actively participating in auction of government securities. Negligible amount is being issued to individuals. The least interest of general public in government securities is due to less return as compared to other risky financial instruments. The cause of least public participation is due to huge amount to purchase minimum number of government securities.

**Chart 4.3**  
**Bar-Diagram of Government Issue**

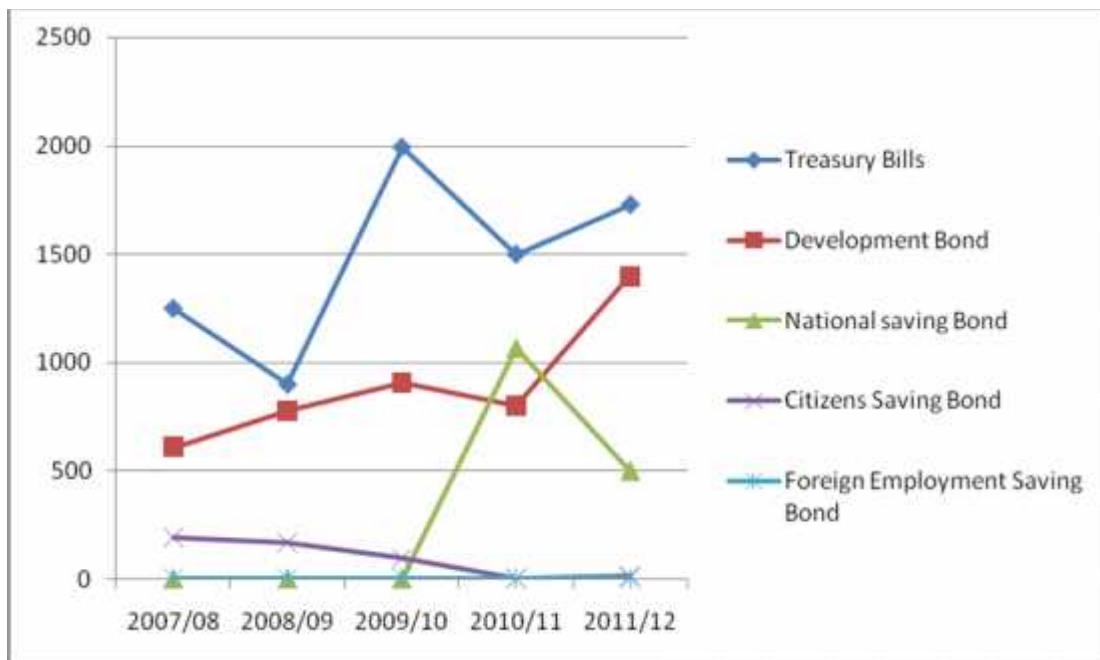


Chart 4.3 shows the Government Issue during last five year. It is clear from the chart that the line of issuing treasury bills is highest amount in fiscal year 2009/10 and in highest amount from the beginning. In former days the development bond was not so intended issue but now days it is the second preferred Government Issue. Citizens saving certificate and the national saving bonds are in decreasing trend in recent years. And also government introduces Foreign Investment Saving Bond last three fiscal year. The above chart proves that Treasury bill and development bond are the most preferred risk free instruments in Nepalese money market.

### 4.1.3. Secondary Market and Investor's Preference in Financial Instruments.

Secondary market also reflects the investor's preferences up on financial instruments. For this purpose the secondary securities transaction in Nepalese secondary market will be analyzed. The data available from Nepal stock exchange and security board are used here to find out the investors preferences upon financial instruments.

#### 4.1.3.1. Listing

Listing is entry of any securities in secondary market to transact through brokerage firm. Listing shows the preferences of concerned company upon certain financial instruments. Table below shows the listing of securities in NEPSE during fiscal year 2011/12.

**Table 4.4**  
**Listing of securities during 2011/12**

Rs.

S.N.	Type of Security	Listed Amount	Ranking
1	Ordinary Share	3,484,890,000.00	3
2	Right Share	2,398,660,000.00	4
3	Bonus Share	4,214,150,000.00	2
4	Government Bond	15,000,000,000.00	1
5	Corporate Debenture	700,000,000.00	5
6	Preference Share	-	
7	Mutual Fund	-	

(Source: NEPSE Annual Report 2011/12)

Table 4.4 shows the listing of securities in fiscal year 2011/12. The listing trend shows that Government Bond is in First and Bonous Share is in Second position. Ordinary Share is in Third position and Right Share is in Fourth position and Corporate debenture is in fifth position but there were no listing of preference share and mutual fund during 2011/12. The above figure also shows that right share has become another means to meet the capital increment for the profit earning organizations.

**Chart 4.4**  
**Pie Chart of Listing of securities**

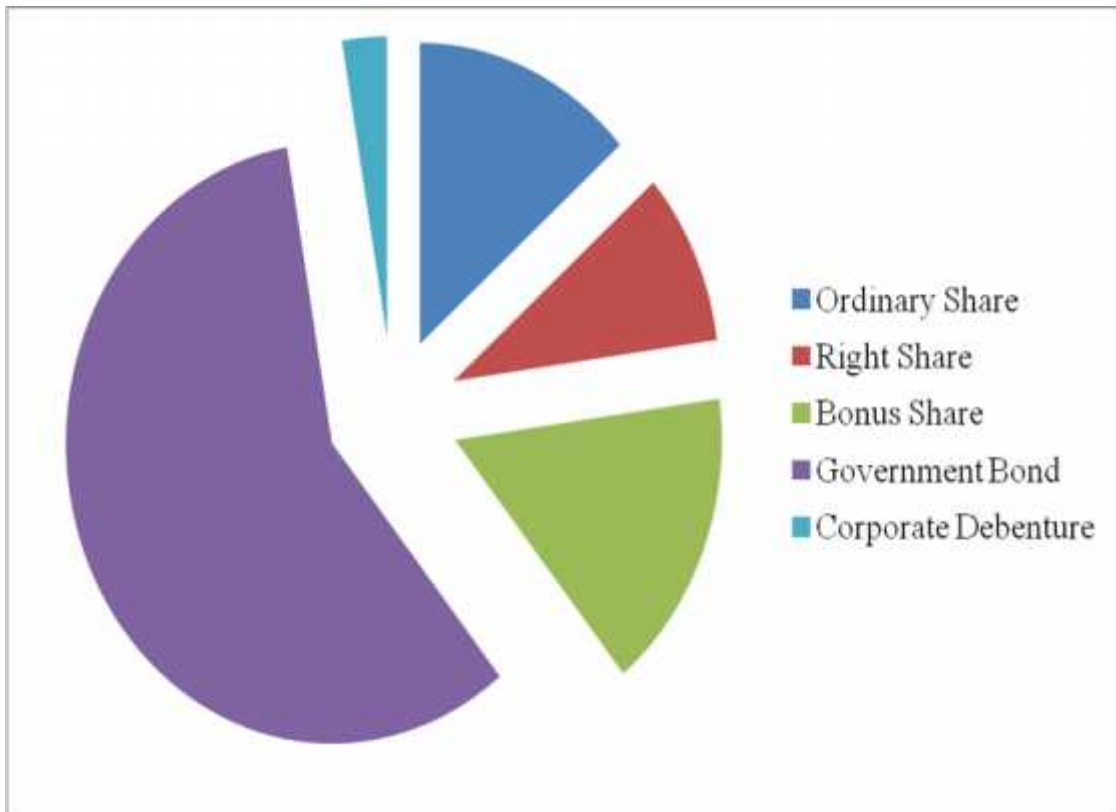


Chart 4.4 shows the portion of listing of the securities. The above figure shows that government bond capture the highest listing position this year. Government bond and ordinary share are in 2<sup>nd</sup> and 3<sup>rd</sup> position respectively. This year the companies also issued huge amount of bonus share. Corporate debenture and preferences share are also listing. But this fiscal year any company does not issued mutual fund and preference share.

#### **4.1.3.2 Trading Volume**

To find out the investors' preferences in instruments and sectors of investment it is necessary to analyze the sector wise trading trend in stock exchange. The only stock exchange of Nepal NEPSE has classified the companies into 9 trading sectors. Companies having similar products and objectives have grouped under same groups. The environmental effect and earning opportunity use to be same for the companies under same group. Almost the companies under same group have similar type of earning pattern. Investors may have belief upon certain sector. Some may like to invest upon Hydropower Company because of having more opportunity of earning. Some may like to invest on banking industry because they are earning very good and

distributing dividend too. The trading volume helps us to find out, which is the sector of investment on which investors prefer to invest much.

#### Tale 4.5

#### Annual Sector wise Trading Volumes in Year 2011/12 In (‘000000)

Rs.

S.N.	Sectors	Traded Amount	Percentage	Ranking
1	Commercial Bank	12406.45	63.83	1
2	Development Bank	2740.36	14.10	2
3	Finance Companies	2615.40	13.46	3
4	Insurance Companies	212.80	1.09	9
5	Hotel	18.69	0.10	8
6	Manufacturing and Processing companies	26.08	0.14	7
7	Trading Companies	33.49	0.17	6
8	Hydropower Companies	890.30	4.59	4
9	Other	493.64	2.54	5
	<b>Total</b>	<b>19437.21</b>	<b>100</b>	

(Source: NEPSE Annual Report 2011/12) .

According to above trading volume it is clear that investors like to invest upon the common share of commercial banks at first and development bank and financial institutions in 2<sup>nd</sup> and 3<sup>rd</sup> respectively. Hydropower Company is the 4<sup>th</sup> most preferred company to invest other group lies in 5<sup>th</sup> position according to traded amount. Trading companies are in 6<sup>th</sup> position manufacturing and processing companies in 7<sup>th</sup> position hotel industry and insurance companies in 8<sup>th</sup> and 9<sup>th</sup> position respectively. This ranking is according to traded amount in the certain group. There are few companies in some group some single companies are representing some sectors of investment. But as a whole it is clear that there is chunk on common shares of bank and financial institutions.

#### 4.1.3.3 Market Capitalization

Market capitalization is the product of number of share traded and price per share. The market capitalization shows that which group or certain security is being traded in high price as well in high quantity. Market capitalization of different sectors can be taken as the indicators of investors' preference in those sectors. Higher market capitalization indicates higher percentage of investors. The higher market capitalization also shows that the share is being actively traded in stock exchange. The security having low price may also have higher market capitalization because of high quantity of share. From the point of view of market capitalization the result may differ than that of trading volume. Traded amount shows that how much amount was traded but capitalization combines the traded amount and no. of shares.

**Table 4.6**  
**Sector wise Market Capitalization in 2011/12** **Rs.**

S.N.	Sectors	Market Capitalization in million	Percentage
1	Commercial Banks	36429456.05	49.77
2	Finance Companies	5780492.86	7.89
3	Development Banks	5785172.12	7.9
4	Insurance Companies	2395070.47	3.27
5	Manufacturing and Processing Companies	2631781.60	3.60
6	Trading Companies	301792.30	0.41
7	Hotel	1292201.70	1.77
8	Hydropower Companies	3406832.84	4.66
9	Others	15174074.18	20.73

(Source: NEPSE Annual Report 2011/12)

According to Table 4.6 it can be said that the most dominating group is commercial Banks, which holds 49.77% of total market capitalization. Other group holds the 20.73% of market capitalization that is second largest group as per market capitalization. Hydropower, Finance Companies, Development Banks, Insurance companies and Manufacturing and Processing Companies holds 4.66%, 7.89%, 7.9%, 3.27% and 3.60% respectively. Overall the banking industry is domination Nepalese capital market. Others and hydropower companies are following the capitalization of banking industry. After the listing of common share of Nepal Telecom the other group has become the second market capitalize in Nepal Stock Exchange. But because of holding near 50% of the total market capitalization commercial banking sector is the

most choice of the investors. The trend shows that the second and third sector of investment is financier and telecommunication industry.

**Table 4.7**

**Top Ten Companies as per Market Capitalization in 2011/12**

**Rs.**

SN	Name of the Companies	Capitalization
		in ('000000)
1	Nepal Doorsanchar Company Limited	75450.00
2	Standard Chartered Bank Ltd.	16766.08
3	Nabil Bank Ltd.	13085.87
4	Nepal Investment Bank Ltd.	12300.12
5	Himalayan Bank Ltd.	7941.88
6	Chilime Hydro power Co.	6639.36
7	Everest Bank Ltd	6599.01
8	Uniliver Nepal Ltd.	5800.41
9	Nepal SBI Bank Limited	5546.59
10	Nepal Industrial And Co.Bank	5337.45

(Source: NEPSE Annual Report 2011/12)

According to Table 4.7 Nepal Doorsanchar company (Nepal Telecom) has the highest market capitalization. This said that the share of Telecom was traded in NEPSE at highest numbers over the year. Standard chartered bank is the second market capitalization. Though standard chartered has highest share price among the share traded in stock exchange it is in second in market capitalization. The second position of standard chartered is because of less number of shares and less trading in the trading days. Nabil and Nepal Investment Bank are in 3<sup>rd</sup> and 4<sup>th</sup> position respectively. Himalayan Bank and Chilime Hydropower Company are in 5<sup>th</sup> and 6<sup>th</sup> position respectively. The table can prove that though Hydropower Company and other companies position in trading volume but they are within top ten markets capitalize over the year. So investor wants to invest upon the shares of hydropower companies and other companies too. This capitalization also said that investor has begun to analyze the earning possibility and dividend distribution of the company on whom they are investing. It can also be concluded that investors on secondary market are wise than that of primary market. In other word the investment in secondary shares are done after proper analysis of the company, industry and economy of the country.

## 4.2 Primary Data Analysis

This section includes analysis and presentation of primary data collected from different respondents. The data was collected from different categories of investors through questionnaire, such as staffs involved in the trading of securities in secondary market, general investors, professional investors etc. The purpose of the analysis is to achieve the objective of the study. The detail about the respondents is as follow.

**Table 4.8**  
**Analysis of Respondents**

<b><u>Gender</u></b>	Number	Percentage
Male	90	75%
Female	30	25%
<b><u>Age</u></b>		
Below 30	34	28.33%
30 and above	86	71.67%
<b><u>Education</u></b>		
Less than graduate	30	25%
Graduate	66	55%
Post Graduate and above	24	20%
<b><u>Employment status</u></b>		
Unemployed	27	22.5
Job holder	54	45%
Self employed	33	27.5%
Retired	6	5%
<b><u>Category</u></b>		
Less informed	51	42.5%
Informed	48	40%
Well informed	12	10%
Analyst/Professional	9	7.5%
<b><u>Size</u></b>		
Small	75	62.5%
Medium and large	45	37.5%

### **Gender, Age**

Among the Respondents 25% were female investors rest 75% were male investors. According to age 28.33% were under the age of 30 years and 71.67% were 30 year and above that. The age distribution shows that most of the investors are matured and entry of layman into investors is nominal.

### **Education**

On the basis of education of investors they were classified into less than graduate, graduate and postgraduate and above. On them most of investors were found to be graduate. 55% of the investors were graduate 25% were less than graduate and 20% were postgraduate and above. This shows that most of the investors are well educated because graduation is considered as well educated.

### **Employment Status**

Majority of the investors were found to be jobholders. 45% of the total investors were found job holders. 27.5% were self-employed, 22.5% were unemployed only 5% were retired. This shows that most of investors are regular earner who invests their amount of savings on financial instruments. Self-employed investors also use to have money to invest in securities. Retired and unemployed investors should either invest their past savings or operate investment from credit and reinvest the gain from investment.

### **Information about Investment**

As per the information of investment investors were classified into less informed, informed, well informed and analyst/professional investors. Majority of the investors like to say their selves as less informed investors there is another group of investor who likes to be said as informed investors. 42.5% of the investors are less informed and 40% of them are informed investors 10% were well informed and 7.5% of them were analyst/professional investors. This classification result shows that most of investment is done without proper analysis and without gathering proper information about the investment. But some people are informed about investment alternatives and investment environment.

### **Size of Investment**

62.5% of the investors are small sized investor who invests 50 thousand or less as investment and 37.5% were medium or large investors. This result shows that most of

the investment is done from small investors. Small investors dominate Nepalese investment.

#### 4.2.1 Preferences over Major Investment Alternatives.

For the analysis of investment alternatives of Nepalese investors were asked in which they make they make the investment most. The four alternatives were corporate securities, government securities, real estate and bullion. The table below indicates the total rank and the rank assigned as per investment preferences.

**Table 4.9**  
**Ranks of Investment Alternatives**

S.N.	Alternatives	Rank Sum	Rank
1	Corporate Securities	348	1
2	Government Securities	320	2
3	Bullion	296	3
4	Real Estate	236	4

*Source: Questionnaire Survey (Q#4)*

Frequency table for ranking of investment alternatives

Rank	Investment alternatives			
	Corporate Securities	Governments Securities	Real Estate	Bullion
1	10	22	32	56
2	32	24	36	28
3	38	46	16	20
4	40	28	36	16
Rank Sum (Rank×Frequency)	348	320	296	236

Median = Value of  $\left[\frac{(N+1)}{2}\right]^{th}$  item

Where, N= Number of Investment Alternative

= Value of  $\left[\frac{(4+1)}{2}\right]^{th}$  item

= Value of 2.5<sup>th</sup> item

$$= \frac{320+296}{2}$$

$$= 308$$

As per the median analysis the alternatives, which have the rank sum of more than 308, are the preferred alternatives and the alternatives having rank sum less than 308 are less preferred securities. On the basis of rank and median analysis it can be said that corporate securities and government securities are the preferred investment alternatives where as real state and bullion is less preferred alternatives. In this case corporate securities are most preferred securities and bullion is less preferred investment alternative.

Taking response of total cases 120, the investment alternatives are ranked as per their rank sum. It shows that corporate securities are the most preferred alternatives. Government securities are second preferred investment alternatives bullion and real estate falls in 3<sup>rd</sup> and 4<sup>th</sup> position respectively.

#### **4.2.2 Preferences as per Employment Status**

Preferences over the investment alternatives may vary with the types of investors. From the population two groups were separated on the basis of employment status. Jobholders and self-employed were taken as employed investors where as unemployed and retired were taken as unemployed investors. Employment directly affects the earnings of the investors and earnings have impact over investment decision and preferences. Hypothesis is to be tested in this regard is that whether there is significant difference between preferences of employed and unemployed investors or not.

**Table 4.10**

**Ranking of Preferences as per Employment status**

	<b>Investment Alternatives</b>	<b>Rank Sum</b>	<b>Rank</b>
<b>Unemployed investors</b>	Corporate Securities	69	3
	Government Securities	77	2
	Real Estate	84	1
	Bullion	67	4
Total			10
<b>Employed Investors</b>	Corporate Securities	237	5
	Government Securities	211	6
	Real Estate	196	8
	Bullion	202	7
Total			26

**Null Hypothesis**  $H_0 =$  There is no any significant differences between the rank given by unemployed and employed investors.

**Alternative Hypothesis**  $H_1 =$  There is significant differences between the ranks given by unemployed and employed investors.

**Kurskal Walis one way non-parametric ANOVA** by ranks has been used to test the differences in two groups.

**Frequency table for ranking made as per employment status**

**Unemployed Investors**

		Investment Alternatives			
		Corporate Securities	Government Securities	Real Estate	Bullion
Rank	1	12	10	6	13
	2	10	8	9	9
	3	7	9	12	8
	4	4	6	6	3
Rank Sum		69	77	84	67

**Employed Investors**

		Investment Alternatives			
		Corporate Securities	Government Securities	Real Estate	Bullion
Rank	1	16	23	27	22
	2	19	21	23	28
	3	25	26	25	24
	4	27	17	12	13
Rank Sum		237	211	196	202

$$H = \frac{12}{N(N+1)} \left[ \sum_{j=1}^K \frac{R_j^2}{n_j} \right] - 3(N+1)$$

Where,

K = no. of samples

N<sub>j</sub> = number of cases in j<sup>th</sup> sample

N = n<sub>j</sub>, the number of cases in all sample combine.

R<sub>j</sub> = Sum of ranks in the i<sup>th</sup> sample.

$$= \frac{12}{8 \times 9} \left[ \frac{10^2}{4} + \frac{26^2}{4} \right] - 3 \times 9$$

$$= 5.33$$

Tabulated value of chi-square at 5% level of significance with 1 degree of freedom is 3.841. Since the calculated value (5.33) is greater than the tabulated value. Hence null hypothesis is rejected. It can be concluded that person holding a job and a person without a job has different preferences toward investment alternatives. It can be concluded that jobholder investors and jobless or retired investors use to have different investment preferences toward investment alternative. Employed or investors having regular earning has preferred the corporate securities and government securities respectively but Unemployed or people do not having regular income has preferred Real estate and government securities most. Employed investor has bullion and real estate in 4<sup>th</sup> and 5<sup>th</sup> alternative where as unemployed investors has corporate securities and bullion as 4<sup>th</sup> and 5<sup>th</sup> investment alternatives respectively. It can be conclude that employed investors are willing to take additional risk in order to take more return so they have preferred corporate securities most. The retired people want to invest the lump sum amount into land and buildings and they enjoy playing with real-estate business. Some unemployed investors do not want to take risk anymore so they prefer risk free government securities.

#### **4.2.3 Preferences over Financial Instruments**

This part of study considers only the financial investment alternatives and their preferences by the investors. Study has considered common stock, Preference share, Government bond, Debentures, Mutual fund and treasury bills as the major financial instruments, since these are the major instruments that are traded in Nepalese financial market.

**Table 4.11**  
**Ranking of Financial Instruments**

S.N.	Financial Securities	Rank Sum	Rank
1	Common Stock	288	1
2	Government Bond	270	2
3	Debentures	263	3
4	Preferences Shares	258	4
5	T-Bills	247	5
6	Mutual Fund	240	6

### Rank of Financial Instruments

		Financial Instruments					
Rank		Common Share	Government Bond	Preference Share	Debenture	Mutual Fund	T-bills
	1	31	28	36	31	37	34
	2	25	47	40	43	49	51
	3	49	32	34	38	31	29
	4	15	13	10	8	3	6
Rank Sum		288	270	258	263	240	247

$$\begin{aligned}
 \text{Median} &= \text{Value of } \left[ \frac{(N+1)}{2} \right]^{\text{th}} \text{ item} \\
 &= \left[ \frac{(6+1)}{2} \right]^{\text{th}} \text{ item} \\
 &= 3.5^{\text{th}} \text{ item} \\
 &= \frac{258+263}{2} \\
 &= 260.5
 \end{aligned}$$

Table 4.11 shows the rank sum and ranks of the financial instruments. As per the calculation the common stock has highest ranking and mutual fund has the lowest ranking. Since we have median of 260.5, the instruments having rank sum of more than 260 are preferred instruments and those having less than 260 are less preferred instruments. So common stock is the most preferred instrument in financial market that has 288 rank sum and the government bonds are the second preferred instruments that has 270 rank sum. Corporate debentures, preferences shares, Treasury bills lies in third, fourth and fifth position respectively. Mutual fund is the least preferred instruments in the financial market it has least rank sum of 240. In recent years the convertible feature on preference share has drawn the attention of the investors toward it. Banks and financial institutions to manage liquidity heavily exercise treasury bills. Individual involvement in treasury bills is nominal. Due to least return and close-end system mutual fund is not being able to retain the investor's faith on it.

#### 4.2.4 Preference over Investment Sector

According to classification made by NEPSE there are nine investment sectors in Nepalese secondary market. As per the respondents' view the sector of investment has ranked as described in table 4.12.

**Table 4.12**  
**Ranking of Sectors of Investment**

Investment Sectors	Rank as Best	Ranking
Commercial Banks	39	1
Development Banks	19	2
Finance Companies	15	3
Insurance Companies	13	4
Hydropower	10	5
Other	8	6
Manufacturing & Processing Companies	7	7
Trading Companies	6	8
Hotels	3	9

*Source: Questionnaire Survey (Q.N. # 9)*

#### Ranking of Investment Sectors

Investment Sectors	Rank as Best	Ranking	Percentage
Commercial Banks	39	1	32
Development Banks	19	2	16
Finance Companies	15	3	12
Insurance Companies	13	4	11
Hydropower	10	5	8
Others	8	6	7
Manufacturing & Processing Companies	7	7	6
Trading Companies	6	8	5
Hotels	3	9	3
Total	120		100

From the table 4.12 it is clear that investors have most preferences on securities of commercial banking sectors. Among 120 investors' 39 investors ranked the commercial banking as best investment sector available in Nepal. 19 on 120 ranked development banks as second preferred investment sector. Finance companies, insurance companies, hydropower companies and other sectors are ranked as 3<sup>rd</sup>, 4<sup>th</sup>, 5<sup>th</sup> and 6<sup>th</sup> position in ranking by sample of investors. Manufacturing companies, trading companies and hotels are the least preferred sectors of investment. It is clear that transparency, high profit and dividends has made the financial instruments of banks and financial instruments more attractive though they may give less return. There are other, hydropower and manufacturing and processing companies that have been distributing same level of dividend as compared to banks and financial instruments. Up to some extent it can be said that Nepalese financial market is not so developed so most of the investors buy whatever available in the market. Most of the investors are passive they take suggestions of well-known investors and make their investment. And a large number of investors run after the rumor of the market.

#### 4.2.5 Preferences over Investment Objectives

The major investment objectives (as reviewed in former chapter) of the investors in this study are considered as the price increment or growth, regular return, liquidity and safety. Different investors might have different objectives. Table 4.15 shows the frequency of ranks provided by respondents to those objectives, rank sum and ranks.

**Table: 4.13**

#### **Investment Objectives and Investors Preferences**

Research Variables	Types of Investors				Total
	Less Informed	Informed	Well Informed	Analyst	
Price Increase	8	16	6	5	35
Regular Return	14	14	3	2	33
Safety	13	8	2	1	24
Liquidity	16	10	1	1	28
Total	51	48	12	9	120

To test whether the different types of investors has same type of preferences over investment objectives **chi square test** for independence of attributes were used.

**Null hypothesis**  $H_0$  = The investors has similar types of preferences over investment objectives.

**Alternative hypothesis**  $H_1$  = The investors do not have similar types of preferences over investment objectives.

Preferences of investors as per types and objectives

Research Variables	Types of Investors				Total
	Less Informed	Informed	Well Informed	Analyst	
Price Increase	8	16	6	5	35
Regular Return	14	14	3	2	33
Safety	13	8	2	1	24
Liquidity	16	10	1	1	28
Total	51	48	12	9	120

Calculation of observed and expected values

Observed Value (O)	Expected Values (E) $\frac{(RT \times CT)}{WT}$	$(O - E)^2$	$\frac{(O - E)^2}{E}$
8	14.875	47.26563	3.177521008
14	14.025	0.000625	0.0000446
13	10.2	7.84	0.768627451
16	11.9	16.81	1.412605042
16	14	4	0.285714286
14	13.2	0.64	0.048484848
8	9.6	2.56	0.266666667
10	11.2	1.44	0.128571429
6	3.5	6.25	1.785714286
6	9.2	10.24	1.113043478
9	9	0	0
Total $\sum \frac{(O - E)^2}{E}$			8.986993058

Here calculated Value of Chi Square  $\chi^2 = 8.99$

Degree of freedom  $= (R-1) \times (C-1) - 5$

$= (4-1) \times (4-1) - 5$

$= 4$

Tabulated Value of Chi square at 10% level of significance at 4 degree of freedom is 7.78

Calculated value of  $\chi^2$  is 8.99. Tabulated value of  $\chi^2$  at 10% level of significance with 4 degree of freedom is 7.78. Since  $\chi^2 > \chi^2_{Tab}$  null hypothesis is rejected. Hence we can conclude that the investors do not prefer all the investment objectives equally. As per this study out of 120 samples 35 has preferred price increment as best objective.

#### 4.2.6 Opinion Regarding Propositions

To know the awareness of investors in different regards, different propositions were provided. The propositions and their responses are presented as followed.

**Table 4.14**  
**Opinion Regarding Propositions**

S.N.	Propositions	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Mode
1	One should not invest whole amount in the same investment instruments, s/he should form a portfolio of different alternatives.	<b>62</b> (51.67%)	36 (30%)	14 (11.67%)	8 (6.66%)	0 (0%)	<b>62</b>
2	Banking is the biggest investment sector	<b>52</b> (43.33%)	40 (33.33%)	16 (13.33%)	8 (6.67%)	4 (3.34%)	<b>52</b>
3	Nepalese investors don't have defined preferences they just follow the whim or rumor	<b>54</b> (45%)	23 (19.1%)	18 (15%)	14 (11.67%)	11 (9.16%)	<b>54</b>
4	Nepalese investors do detailed analysis before investing in corporate securities.	18 (15%)	24 (20%)	26 (21.67%)	<b>30</b> (25%)	22 (18.33%)	<b>30</b>
5	We don't have wide choice of investments, so we buy whatever floats in market.	<b>39</b> (32.5%)	26 (21.6%)	34 (28.33%)	12 (10%)	9 (7.5%)	<b>39</b>
6	Government securities yield less than corporate securities, so they are not attractive.	33 (27.5%)	32 (26.67%)	<b>36</b> (30%)	13 (10.83%)	6 (5%)	<b>36</b>
7	The main attraction of securities of bank and financial institution is due to right share and bonus share rather than cash dividend and capital appreciation	<b>50</b> (41.67%)	38 (31.67%)	13 (10.83%)	11 (9.17%)	8 (6.66%)	<b>50</b>
8	First one should save a certain level of amount very safely like: deposits in bank, than only he has to invest the surplus amount in securities.	<b>32</b> (26.67%)	24 (20%)	45 (37.5%)	12 (10%)	7 (5.83%)	<b>32</b>

Tale 4.14 summarizes the ranking made by investors among propositions. The first proposition was to find out the awareness about investment risk minimization. Most of the investors are strongly agree constructing portfolio while investing in securities, 62 was calculated mode on 120 investors. More than 50% investors are strongly agreed to construct portfolio for investment in financial instruments. Most of the investors were agree that they should not invest whole amount in same investment. Second proposition was to find out investors preferences on investment sector. 44% of the investors were strongly agreed that banking is the biggest investment sectors. As a whole 76% of investors were agreed that banking is the biggest investment sector. There were few who disagree that banking is the biggest investment sector 12 on 120 were disagree that banking is the biggest investment sector. 3<sup>rd</sup> proposition was to find out whether investor has defined preferences or they purchase whatever float in the market. 54 investors are strongly agreed that Nepalese investors don't have defined preferences they just follow the whim and rumor. 23 investors are agreed that Nepalese investors follow whim and rumor. 1% investors are strongly disagreeing that Nepalese investors follow whim and rumor on preferences of the instruments. Most of the investors disagree that Nepalese investors do detailed analysis before investing in corporate securities. At about 44% investors disagree that investors do detail analysis before investing in corporate securities. Only 18 are strongly agreed and 24 are agreeing that investors do detail analysis before investing in corporate securities. 5<sup>th</sup> proposition was to find investors response about availability of financial instruments in Nepal. Most of the investors are agree that they do not have wide choice of instruments so they buy whatever float in the market. 26 on 120 are agreed and 39 are strongly agreed that they don't have wide availability of financial instruments. Less than 2% were agreed on wide availability of the financial instruments. 6<sup>th</sup> proposition was set to find out the awareness about the return of government securities and its comparison with corporate securities. Most of the investors are unaware about the return of government securities. 30% of the investors were neither agree nor disagree that government securities yields less than corporate securities so they are not attractive. More than 60% are agreeing that government securities yield less than corporate securities so they are not attractive. More than 70% investors are agree on the proposition that the main attraction of securities of banks and financial institution is right share and bonus share rather than cash dividend. It means that most of the investors want to have huge number of share rather than take

cash benefit. The company which is going to distribute right share their price use to be in bullish trend in Nepalese secondary market. The 8<sup>th</sup> proposition was asked that one should save a certain level of amount very safely like: deposits in bank, than only he has to invest the surplus amount in securities. It was set to find out the awareness of investment risk. But most of the investors found to be unaware about it. If we invest all our money in securities and in bullish days of securities market we would be in heavy loss. So to have chance to resume we should have some amount very safety in deposit in banks. 45 on 120 neither agree nor disagree they should have some amount very safety before making investment. Some of them know this principle of investment, 24 are agreed and 32 are strongly agree on this proposition to save some amount in banks and financial institution before making investment.

#### 4.2.7 Consideration for Investment Decision

In the course of taking decision of investment in the security market different reasons were analyzed as presented in following table. In this regard different reasons were provided and asked the most important factor for investment decision.

**Table 4.15**  
**Consideration for Investment Decision**

S.N.	Alternatives	Frequency	Rank
1	Company's track-record/ goodwill	31	1
2	Management team and promoters	27	2
3	Forecasted profit	18	3
4	Possibility of distributing bonus share and right share in future	14	4
5	Environmental factors of the concerned company and the economic situation of the country	11	5
6	Expected risk level	8	6
7	Taxation	6	7
8	Liquidity and maturity	4	8
9	Inflation	1	9

*Source: Questionnaire Survey (Q.14)*

Awareness of the investors regarding the investment in financial market and investment helps to the development of the security market. The above table shows that most of the investors consider company's track record/goodwill most importantly before making investment decision. 26% percent of the sample investors opine that they consider the concerned company's track record/goodwill before making investment decision. Management team and promoters of the concerned company is the second major factor which investors analyses before making investment decision. 23% of sample was agreed that they do analysis about the Management team and promoters of the concerned company. Forecasted profit is the third major factor for consideration for investment decision. Nine major factors, which are crucial for investment decision, were asked with investors that are presented in above table. Those factors are ranked as per opinion of investors.

#### 4.2.8 Attitude toward Re-investment

Re investment process which makes the circulation of investment in investment. Investors were provided with following four variables and asked about the preferences of following options.

**Table 4.16**  
**Attitude toward Re-investment**

	Re-investment Options	Frequency	Percentage
Re-invest	Purchase more securities of same kind	57	47.5
	Purchase some other type of securities	42	35
Total		99	82.5
Do not Re-invest	Spend in durable products	12	10
	Save it in bank deposit	9	7.5
Total		21	17.5

Source questionnaire survey (Q #13)

Above table shows investors attitude toward re investing the amount gained form investment in securities. The majority of investors want to re invest the return. 82.5% want to re invest return in securities and rests of 17.5% spend the return in other than in securities. 47.5% want to purchase same kind of securities but 35% want to purchase some other kind of securities. 10% want to spend return in durable products but only 7.5% want to save the return in bank. The investors said that the decision to select which instrument to invest fully depends upon the market scenario.

#### 4.2.9 Investors Expectations

The investors were asked what about their expectation toward the company of which they are holding some securities. Summary of their response is presented in the table below.

**Table 4.17**  
**Ranking of Investors' Expectations**

S.N.	Expectation	Frequency	Rank
1	Distribution of Right share in order to get huge number of share	52	1
2	Distribution of bonus share and get benefit from capital appreciation	36	2
3	Distribution of cash dividend to get regular cash inflow	24	3
4	Regular cash dividend or interest and huge amount at the end of intended period.	8	4

Source: Questionnaire Survey (Q.17)

As per table 4.17 it is clear that most of the investors are expectation that the company will distribute right share in future and they would be having huge number of shares as cheaper price and selling those right share they would enjoy the capital gain. 43% of sample investors were agreed that they buy the share that will distribute right share. Right share has become the main attraction on the company's share. Bonus share is the share on which investors should not pay any money but they can sell the share in market at present market value.30% of sample investors were agreed that they buy share for bonus share. To get the capital gain a large number of well-informed investors is attempting the companies having possibilities of distributing bonus share. Another most preferred expectation is that the company will distribute regular cash

dividend and the investors will meet regular cash need. 20% of sample investors are expecting regular cash dividend from the companies. Only near about 7% of the sample investors want regular cash dividend or interest as return and at the end of intended period they want huge amount liquidating the securities.

### **4.3 Major Findings of the Study**

The major objectives of this study is to assess the investors preferences in making investment however on the basis of the overall study made here, following are the major findings of this study:-

- ) Corporate securities, government securities, real estate and bullion are considered as the major investment alternatives. During fiscal year 2007 to 2012, issue amount of corporate securities is Rs.70306.72 million.
- ) Those who are less educated, less informed and are unemployed are found to be unaware of securities market, so they were found quite reluctant toward heavy investment on financial instruments. Among 120 samples 33 unemployment investors preferred real state and government securities in first and second alternative.
- ) Those investor who are more aware, educated and employed are positive attitude towards corporate and government securities. Among 120 sample 87 employed investor has preferred corporate securities and government securities in first and second alternative.
- ) On observation common stock is the must preferred instrument in financial market that has 288 rank sum in which out of 120 samples 31 has preferred common stock as first preference. 25, 49, and 15 preferred common stock in second, third and fourth place respectively.
- ) Government bonds are the second preferred instruments that have 270 rank sums. Corporate debenture, Preference shares, Treasure bills lays in third, fourth and fifth position respectively. Mutual fund is the least preferred instruments in the financial market it has least rank sum of 240.
- ) Result showed that, among 120 investors 39 investors ranked the Commercial banking as best investment sector available in Nepal. 19 on 120 ranked

development bank as second preferred investment sector. Finance companies , insurance companies, hydropower companies and other sector ranked as third , fourth, fifth and sixth position in ranking by sample of investors. During fiscal year 2011/12 commercial bank holds 49.77% of total market capitalization.

- ) Capital gain was found to be must preferred investment objectives for all type of investors. Either they are less informed, informed, small or large investors. As per this study out of 120 samples 35 has preferred price increment as best objective.
- ) Results showed that, 82.5% of sample investors, want to re invest return in securities and rests of 17.5% spend the return in other than in securities. 47.5% want to purchase some kind of securities but 35% want to purchase some other kind of securities. 10% want to spend return in durable products but only 7.5% want to save the return in bank for risk management.
- ) The investors of Nepal found as the moderately risk taker for the average rate of return only few seems taking higher risk for the return maximization. And more than 50% investors are strongly agreed to construct portfolio for investment in financial instruments for risk management.
- ) Bonus share, cash dividend and right share are the return or benefit that investors are expecting from the companies. 43% of sample investor was agreed that they buy the share that will distribute right share. 30% of sample investors were agreed that they buy share for bonus share. 20% of sample investors are expecting regular cash dividend from the companies.

## **CHAPTER - V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

Development of the country depends on the development of the financial institutions. But development of the financial institutions only will not play effective role until the deposit raised by the financial institutions will be used on productive sectors. Industrial development will accelerate economic development of the nation. It has been seen that industrial revolution has been base for the economy of developed countries. Biratnagar jute mills have passed 75 year of the first flotation of share in market. During this long period we have few well known investors about financial instruments and investment environment. Political instability, government negligence are the main cause for it. Failure of public enterprises is another cause that people does not want to investment on the companies where government has majority of ownership. Financial institutions and market maker are subscribing most of the issue of the government bonds and treasury bills. Very minimum interest rates and lack of awareness is the root cause of least public participation in government securities. Until the return from the securities would not be excessive than the inflation rates of existing economic situation, the return will be in negative. But even the government securities are paying less than half of the current inflation rate.

The study was conducted to explore out the preferences and expectations of Nepalese investors toward financial instruments and the overall investment environment. During this study investor were classified into less informed, informed, well-informed, analyst/professionals, according to the information about investment and financial instruments. Large and small investors were classified as per investment amount. Jobholder, self-employed, retired and unemployed were classified as per employment status. 120 investors were taken as sample in order to represent each investor group. During this study majority of investors had found unaware about financial instruments. Most of the investors who have their own investment they have invested as per the suggestions of friends and relatives. Most of the primary investment is done on whim and rumor. Most of the investors are holding securities

they do not know what to do of it. Some of the investors are unaware about the distributed dividend.

Passive nature of investors has been reflected on the unclaimed dividends of the companies. Theoretically right dilutes the market price of the share of concerned company so it is wisest to average their securities purchasing right shares. Some portion of investors does not know about the right distribution of the concerned company of whose they are holding some securities. Some informed and well-informed investors are running behind the company that is going to offer right share so most of the share of right distributing companies are going up in the secondary market. Considering the theory we can say that the common share is the most preferred security.

The secondary data shows that investor's expectation is slightly changing into return distributing company rather than the companies distribute very minimum return or distributes right shares. Domination of Nepal Doorsanchar Company is proof that investors are willing to do some analysis before making investment decision. Chilime Hydropower Company and Uniliver Nepal Ltd. are also in top ten companies as per market capitalization.

While collecting the information from investors that whether the companies are being able to fulfill their expectation majority were found dissatisfied. Majority of the investors had the buy and hold strategy on investment in financial instruments so most of the respondents were willing to have huge number of securities from the company by right or bonus share. Those who were expecting cash as regular dividend are still not satisfied because few companies are distributing cash as dividends. The companies who are highly reputed and earning much profit are distributing cash dividend. Those promoters who cannot sell the securities in their market are willing to distribute cash dividends rather than bonus share.

Expectations other than return or the concerned companies are also not responding benefits. Delaying to transfer the ownership of the purchased securities is the most burning issue. Though the company is in profit they are not distributing to shareholders, they are concentrated on increasing the benefits to the employees in many means. Timely completion of AGM and timely disclosure of public information is delaying. The profits of some companies have differed in audited and un audited

balance sheet by more than 100%. Some positive signal have found during the study. Awareness of investment and financial instruments is in growing stage. Security innovation is taking place. Regulating entities are being more investors friendly. In past years some progress has achieved in future and derivative market on commodities. Some expert investors are taking interests on bullion trading in future market. Some companies are emerging for derivatives trading.

## **5.2 Conclusion**

From the research it has been found that currently the large portion of investors prefers common stock most to invest. Common Stocks appeared as the most preferred financial instrument. However, government bonds appeared as the second most preferred financial instrument. Those investors who are more aware and educated have positive attitude toward government bonds. Preferences of different categories of investors, as well as different size of investors were also found similar.

Results showed that investors prefer banking and financial sector in comparison to other sectors like; manufacturing and processing, trading and hotels. Commercial banks, finance companies, hydropower companies, other group were found to be most preferred sectors.

Capital gain was found to be most preferred investment objective for all type of investors either they are less informed, informed, small or large investor.

Most of the respondents were unaware about government securities. Majority of investors who have invested in government securities have invested because they do not have risk.

Nepalese financial market is lacking well-informed and professional investors. Most of the investors are educated but lacking the knowledge of market and investment opportunities.

Most of the investors in Nepal found as the moderately risk taker for the average rate of return only few seems taking higher risk for the return maximization.

Commercial banks and finance companies are the major institutional investors in Nepal. They make higher investment on government securities in comparison to common stock.

Most of the investors are expecting to have huge number of securities in future from present investment. The investment environment has slightly sifted toward return distributing companies' rather than right distributing company.

share, Cash dividend and right share are the return or benefit that investors are expecting from the companies. Investors want timely disclosure of information about the company. Some of investors are investing on shares of the companies so that they can participate in the AGM. The existing feature of common stock and that of preferences share or debenture both are not in the context of Nepalese economy. Common stocks rarely use to pay dividends to the investors and the interest rates offered to the preferences share and debentures are very low. At present interest rates offered on corporate debentures or government bonds both are less than existing inflation rate so most of the returns on fixed income securities are negative. It has been found that the hybrid nature of instrument should be invented to response the investors' expectations.

### **3 Recommendations**

Recommendations of the study are as follows:

There is huge attraction on common share but people are unaware of preferences share, debentures and other derivative securities. People who know about debenture and preference share do not want to invest on them because of least interest and dividend. Hence security innovation is necessary to avail wide range to invest. The security having quality of common share and fixed income yielding security should be the answer to the expectation of investors.

Every organization should oblige to disseminate public/investors' related information within specified time. Violation of the rule should be punished. Now a days the banks and finance companies are providing little bit public related information except that other companies are not fulfilling investor's expectations.

Due to unclear policies and passiveness of regulating entities primary as well secondary issues are not so fair. SEBON and NEPSE should act as full-fledged authority rather than watchdog to promote and protect investors' interest.

Public awareness is still lacking whether about financial instruments or investment or return and benefit. People do not trust upon other securities expect common stock though they pay more return.

Nepalese investors always have neglected risk analysis. They say the shares of banks and finance will never go down below face value.

Decentralization of brokerage firm has been done but most of corporate offices and stock exchange are centralized in Kathmandu that is making the security transaction difficult.

Commodities market has been started which is bringing little bit investment alternatives but few people know about it so awareness about derivatives and commodity market should be raised.

Least return on government securities is making less attractive. The return should be at least more than saving offered by financial institutions.

Central depository system and increment in number of broker should be done initially to increase secondary transaction.

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