CHAPTER- I

INTRODUCTION

1. Back ground of the Study

The speedy development of any country in this modern era is depends upon to some extent with the development of economic activities or economic development of that country. For economic development, financial sector play foremost role, where they collect dele funds from customer by paying some percent interest and invest it to large industries and other business sector by taking some percent interest. The participation of private financial institutions play even more important role for the economic development. Beside the economic sector, social culture, industrial and technology sector are also should be strong for the development and progress of a country.

Promotion of investment and utilization of financial resources is necessary for the economic development of any Country. Each and every business organization should make decisions on the basis of financial management. The field of finance is broad and dynamic, which affects the lives of every person and organization directly. Financial management is mainly concerned with the acquisition and investment of cash for the purpose of enhancing value and wealth.

Investors can buy and sell financial instruments such as common stocks in order to get returns on them. The return better known as reward from investment includes both current income and capital gains or losses that arise by increase or decrease of the security price. Therefore, an investor can obtain two kinds of return from an investment in common stock. Now a day people's participation in security investment is increasing. In this situation, potential investors must be able to analyze the risk and return of individual stock to increase the return on investment.

Investment in capital markets collect necessary funds and utilizes those collected fund towards the productive sectors. It provides best opportunities by transferring the funds from surplus sectors to need based sectors through the transaction of financial instrument. Financial instruments are traded in securities market. Stock market is the largest financial market all over the world where stocks of various business organizations are traded. It has the greatest role in the development of financial system. Financial market consists of money market and capital market. Money market is that financial market in which funds are borrowed or loaned for short period generally less than one year. Capital market refers to the market for long term debt, preferred stock and equity shares. Supply of capital fund is possible through the capital market. Stock market is a place where shares of listed companies are traded at a fair price through the organized brokerage system. Security market is also classified in (a) Stock Market and (b) Bond Market. Share issued by industries and business organizations is only traded in Stock Market but bond and government debentures are traded in Bond Market.

"An investment is a commitment of money that is expected to generate additional money. Every investment entails some degree of risk, it requires a present certain sacrifice for a future uncertain benefit."

Investment means sacrifice of current rupees for future. The sacrifice takes place in the present is certain and rewards that comes in future is uncertain. Risk is defined as the variability of returns over the average rate of return over a period of time. Greater the variability of the returns, the riskier the investment.

1.1 Insurance

Insurance may be defined as a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against the risk. During the life of human being it is full of uncertainties and risk. The risk, loss, damage and incidents may be created

incidentally with the cause of natural, divine, and human activities. As a result, human beings might suffer financial crisis. By insurance the risk is transferred from the individual to the insurer who takes into account the total likely loss in certain period, and fixes the premium to be charged from each person insured. Therefore Insurance has been thought of as a financial security against such sufferings.

The insurance is the principle against risk. The risk means the uncertainty about the economic loss and the uncertainty is the major characteristics of man's daily life. Anything can happen is the life of human beings. Insurance can provide safeguard or protect property against the risk and in addition to it; life insurance is a contract in order to be free from financial crises. It performs the task of providing compensation for financial loss under a contract called "Insurance".

Nepal Contract Act, 2056 has clearly defined that, "Insurance is an agreement between two parties to do or not to do work in a contract."

Based on the various definitions, some of the key points regarding insurance are:

- It is a co-operative device to spread the risk.
- It spreads the risks over the group of people who are insured against the risk.
- It eliminates economic loss common to all insured.
- It is a contract between an insured and an insurer.
- Insured pays premium.
- Insurer indemnified the loss caused by the given contingency.

Insurance companies are also established to support economic growth of the country. Insurance companies promote savings and boost up the economic activities of a nation. Main objective of an insurance company is to help an individual by providing security against his aliveness, economic security for him and his family during and after his death. They try to maximize the rate of return by investing the available funds on rational and profitable sectors. Insurance may be defined as a co-

operative device to spread the loss caused by a particular risk over a number of person and their property, which are exposed to it and agree to insure themselves against it. Any things can happen in the life of human being as a result human beings might suffer financial crisis. Insurance gives financial relief from the risk. Insurance is a kind of contract, which is made between two parties. Insurance has been thought of as a financial security against such suffering. Bearing the risk of human being life is called life insurance and other is non life insurance.

Insurance has become the most important risk handling method in the modern age. The party doing insurance business is called insurer. An insurer promises to indemnify the losses in return for a consideration of call premium paid by insured. Insured is a party who insures his/her property against risk. Premium is the expenditures for the insured and income for the insurer. However, premium on life insurance is considered as the saving not as expenditure because it is refundable after certain period. The essence of the contract of insurance, called a policy, is maturity. The major operations of an insurance company are underwritten, the determination of which risks the insurer can take on; and rate making, the decisions regarding necessary prices for such risk. The underwriter is responsible for guarding against adverse situation, wherein there is excessive coverage of high-risk candidates in proportion to the coverage of low risk candidates. In preventing adverse selection, the underwriter must consider physical, psychological, and moral hazards in relation to applicants. Physical hazards include those dangers, which surround the individual or property, jeopardizing the well being of the insured. The amount of the premium is determined by the operation of the law of averages as calculated by actuaries. By investing premium payments in a wide range of revenue producing projects, insurance companies have become major suppliers of capital, and they rank among the nation's largest institutional investors.

There are various types of insurance.

- Life Insurance
- Non-life or General Insurance
- Liability Insurance
- Social Welfare
- Educational Insurance

1.2 Risks and Return

1.2.1 Return

Investment is made with the goal of earning some expected rate of return. Return is an additional amount that of his investment today. It is the result of present investment, which comes in future. The investment return is defined as the after-tax increase in the value of the initial investment. The increase in value can come from two sources: a direct cash payment to the investor or an increase in the market value of the investment relative to the original purchase price over the holding period. The rate of return over the holding period, or holding period return (HPR) is computed as:

$$\text{HPR} = \frac{\text{Ending Price Z Beginning Price } \Gamma \text{ Cash Receipts}}{\text{Beginning Price}}$$

The expect return is based upon the expected cash receipts (e.g. dividends or interest) over the holding period and the expected at ending or selling price. The expected rate of return is an ex-ante or unknown future return. The expected rate of return should equal the weighted average of the various possibilities. The investor has forecast possible outcomes; each possibility is assigned to each outcome. Overall expected rate of return can be calculated as a weighted average of the estimation:

$E(r) = P_i \times R_i$

Where,

E(r) = the expected return of asset

P_i = probabilities of expected returns

R_i = return of individuals assets

1.2.2 Risk

Risk arises in the investment evaluation because the forecasts of cash flows can go wrong. Risk can be defined as the associated with the variability that likely to occur in future returns from the project. Greater the variability of the expected return, the riskier the project. The most common measures of risk are standard deviation and coefficient of variance. The total risk of firm can be divided into systematic and unsystematic risk. Systematic risk is that risk, which cannot be diversified away, but unsystematic risk diversified or minimization with proper management. Different kinds of internal and external activities raise risks. Such events are: economic and political situation, governments' monetary and financial policies, industrial relations in industry, by innovations, change in materials, change of management, strike, natural disaster etc.

2. Focus of the Study

The investors invest their amount of money to get good expected return. Investment is ever followed by risk. So investors must think about the risk before making investment in any securities.

After the government adopted liberalized economic policy, many insurance companies from private and foreign investment came into existence. Till date, altogether 19 insurance companies are registered and operated their functions in Nepal. Now they have introduced new frontier in insurance business. Insurance

companies play vital role in the economic growth of Nepal. Of them, 14 insurance companies have listed their shares in NEPSE in order to make their shares eligible for trading in secondary market. Shareholders want maximum return from their investment in shares. To provide the maximum return to their shareholders, insurance companies should manage their funds in productive sectors.

Every investor seeks proportionate return compared to associated risk. Hence, analysis of risk and return is essential for the investors. Investment in stocks should be followed by fundamental as well as technical analysis. Associated risk in stock should be compensated by reasonable return.

3. Statement of the Problem

The investment process is concerned with how an investor should go about making decision with regard to what marketable securities to invest in how extensive the investment should be and when the investment should be made.

Investment is the most important factor from the shareholder and company's management point of view. Several insurance companies have been established in the country within short span of time. They are collecting funds through issuance of common stocks to the general people. Nevertheless, if the funds are wrongly invested without thinking any financial risk, business risk and other facts, the company cannot obtain profitable return and may lose its existence. Most of the insurance companies have been successful to earn profit from fund mobilization but some are suffering from losses.

It is true that after the establishment of Nepal Stock Exchange, the capital market has grown rapidly within a very short span of time. It is only one secondary market in Nepal. There are no specialized investment analysts rendering professional services to the investors. Most of the investors are least familiar with the financial activities of those companies that have listed their shares in secondary market. They do not have the knowledge of risk and return, diversification, and making portfolio.

Due to the lack of theoretical knowledge of risk and return associated with investment, investors are making investment on non-profitable sectors. However, the attitudes, thoughts and knowledge of the most investors have not changed. Most investors are claiming that they are being cheated by the financial institutions, intermediaries, and brokers. It arises a question – whether Nepalese investors make their investment by studying the market and risk return status of securities or they choose or just they gamble to make the profit. Thus investors must be able to analyze risk and return of individual stocks. Many factors affect the value of stock directly or indirectly. Risk associated with the return should be analyzed before making any investment decision. There arises another question whether the stock price of Nepalese insurance companies are correctly priced or not.

After the establishment of NEPSE, Nepalese investor has more experiences about the investment on securities market but at making the investment they only see the market price of the share. They do not analyze the risk factors associated with the return. They only make decisions on the assumption that the future will resemble the past.

Total market capitalization has increased over the years due to the fact that many private and joint venture companies started floating their shares in primary market and Nepalese public also started trading the stock in the secondary market. It is an indication of bright future of capital market in Nepal.

Increasing the efficiency of the market is the responsibility of the investors to make the rational decision. But in Nepalese context, very few people like financial professionals, management students, university graduates and intellectual groups can analyze the risk and return associated with the stocks.

Therefore, this study seeks to identify the answers of following problems:

- What is the risk and return of listed insurance companies?
- What is the relationship between risk and return?
- How can the risk be minimized?

- What should be compensation for bearing risk?
- How can investors evaluate the stock?
- Whether the stocks of insurance companies are correctly priced or not?

4. Objectives of the Study

The general objective of this study is to analyze the risk and return and other relevant variables that help in making investment decision on the stocks of insurance companies. Nevertheless, the specific objectives of this study are:

- To analyze the return and risk of the common stocks of listed insurance companies,
- To analyze the diversifiable and undiversifiable risk of the return on common stocks of listed insurance companies,
- To determine whether the stocks of listed insurance companies are correctly priced or not,
- To provide the suggestions and make necessary recommendation on the basis of fundamental analysis of the common stocks of select insurance companies.

5. Importance of the Study

First of all, it is the fact that this study is undertaken to apply the theoretical knowledge of Financial Management to the partial fulfillment of the requirement for Master's Degree in Business Studies under Tribhuvan University.

In the present context of Nepal, investment practices under the organized stock exchanges are heading progressively. But very few studies and research have been undertaken. Growing the number of investors – individual as well as corporate, such types of studies have become more helpful for them on making investment decision.

Hence this study assesses the risk and return of insurance company that have listed their shares in NEPSE to make them suitable for trading in secondary market.

After the restoration of multi party democracy and introduction of economic liberalization, public involvement in securities investment has increased. But most of the individual investors are not aware about the risk associated with the return from stocks. The investors have sufficient funds for investment but they don't have the knowledge to analyze the stocks of listed companies and create optimum portfolios to minimize the associated risks on them. There is a lack of investment opportunities, which provide higher rate of return to the investors. How much risk is involved in their investment? What is the real financial condition of the company in which they are intending to invest money? The investors must have the knowledge of these questions for making investment decision. Some of the investors are making investment decision on the basis of market rumor and hearsay. This research, therefore, will be beneficial to the existing as well as potential investors for the right investment decision through providing analytical power. Furthermore, it will be helpful for other researchers, professors, university graduates and undergraduates as well as other persons who are directly or indirectly involved in the stock market of Nepal.

6. Limitations of the Study

Any research study may not free from its own limitations. Any research study may not free from its own limitations. Mainly this study is made for the partial fulfillment of Master's Degree in. Business Studies level. So, there are couples of limitations, which weaken the generalization. This study is based on the fundamental analysis of the common stocks of the selected insurance companies that have issued their shares to general public and listed in NEPSE for trading. However, the main limitations of the study are enumerated as:

- Only 5 insurance companies listed in NEPSE have been taken as sample for the study.
- This study will mainly base on the secondary data collected from the respective companies and published sources. So, the consistency of the findings and conclusion will depend upon the reliability of secondary data.
- The study will cover the relevant data and information for the period of 5 years i.e. 2002/03 to 2006/07 only.
- This study will be concentrated only on the analysis of risk and return characteristics of common stock of select insurance companies.
- Financial resource, human resource and time may also be limiting factors.

7. Organization of the Study

This study has been organized into five chapters. The contents of each of these chapters are as follows:

Chapter I : Introduction
Chapter II : Review of Literature
Chapter III : Research Methodology
Chapter IV : Presentation and Analysis of Data
Chapter V : Summary, Findings and Recommendation

Chapter I – Introduction: This chapter includes background of the study, focus of the study, statement of the problems, objectives, importance, and limitation of the study, and research hypothesis.

Chapter II - Review of Literature: This chapter includes review of various literatures such as books, newspapers, journals, magazines, independent researches, university theses and other relevant researches / studies.

Chapter III - Research Methodology: This chapter includes research design, population and sample, sample selection method, data analysis tools.

Chapter IV – Data Presentation and Analysis: Under this chapter, collected data is presented in systematic manner and analyzed accordingly using various analytical tools and models. Major findings of the study are also included.

Chapter V – Summary, Conclusion and Recommendations: This chapter includes summary, conclusion and recommendation based on the major findings of the study.

CHAPTER – II

REVIEW OF LITERATURE

This chapter reviews some basic academic source books\ journals and other related master degree thesis. In addition independent studies carried out by well known experts is also taken into consideration.

2.1 Theoretical/ Conceptual Review

Investment, risk and return are the interrelated financial terms. Theoretical and Conceptual review deals with the theoretical aspects of investment, return, risk and diversification etc. Various books are reviewed under this study.

2.1.1 Investment

"Investment in the broadest sense means the sacrifice of current dollars and resources for the sake of future dollars and resources." *(Sharpe; 1995:1)*

Investment simply means sacrificing current fund for future cash inflow. Here future cash inflows are the 'return'. Investments are made in assets. Assets, generally, are of two types: real assets (land, building, factories etc) and financial assets (stock, bonds, T-bill etc). These two types of investments are not competitive but complementary, highly developed institutions for financial investment greatly facilitating real investment.

But here as researcher of finance, we have focused the term investment as sacrificing current fund on financial assets like shares, debentures, warrants, convertible etc.

"An investment is a commitment of money that is expected to generate additional money. Every investment entails some degree of risk; it requires a present certain sacrifice for a future uncertain benefit." *(Francis; 1986:3)*

Investing or speculating, in the stock market has all the characteristic of the game and the aim is to win. Investment decision involves rational activities for the long run future returns. Investors invest their fund on securities for the long run future returns. Investment is the allocation of capital to future benefits that is not known with certainty and it is always associated with risk and return. A wide range of investment opportunity is available to investors. Investment can be made on common stock, preference stock, bond, convertible, warrant, option etc.

"Investment is any vehicle into which funds can be placed with the expectation that will preserve or increase in value and generated positive return". (*Gitman; 1990:76*)

The investor can invest either in primary market or in secondary market by purchasing the securities of different companies. There are many financial instruments for investor to invest. Nevertheless, the most common securities in our country are common stocks.

2.1.1.1 Investment Process

"The investment process describes how an investor should go about making decisions with regard to what marketable securities to invest in, how extensive the investment should be, and when the investment should be made. Formally five step of investment process are considered at making investment decision**."** *(Sharpe; 1995:11-14)*

- **Set Investment Policy:** It is the initial step of investment process. It involves determining the investor's objectives and the amount of one's investable wealth. Investment objective should be stated in terms of both risk and

return. It is not appropriate for an investor to say that his or her objective is to make a lot of money and there would be also some chances of losing. In this step, the identification of the potential categories of financial assets for consideration in the ultimate portfolio.

- **Perform Securities Analysis**: The second stage of examining a number of individual securities or group of securities with the broad categories of financial assets previously identified. Who utilize technical analysis is called technical analysts where security prices involve the study of market price in an attempt to future price movement and fundamentalists approach is called fundamental analysts where security analysis tries to identify the real or true value of financial assets.
- **Portfolio construction:** The third step in investment process, portfolio construction, it involves identifying those specific assets in which to invest, as well as determining the proportions of the investor's wealth to put into each one. While constructing a portfolio, the selectivity, timing and diversification need to be addressed by the investor.
- **Portfolio Revision:** Portfolio revision concerns the periodic repetition of the previous three steps. That is over the time the investor may change his or her investment objectives. It means that due to the many reason like prices of securities change, attractiveness of securities etc, the currently held portfolio may no longer be optimal. Instead of this the investor should form a new portfolio by a selling certain securities that are currently held or purchasing certain others.
- **Portfolio Performance Evaluation:** The evaluation of portfolio performance involves determining periodically how the portfolio performed, in terms of not only the return earned, but also the risk experienced by the investor. Thus appropriate measures of return and risk, as well as, relevant standard (or benchmarks) are needed.

2.1.2 Common Stock

“The study is focused on the common stock investment that’s why light is thrown on it. Common stock represents ownership position in a corporation. It has a residual claim, in the sense that creditors and preference shareholder can receive payment only after the payment of all other claims. In bankruptcy, common stockholders are, in principle, entitled to assets remaining after all prior claimants have been satisfied. The risk is highest with common stock investment. When investors buy common stock they receive certificate of ownership as a proof of their being part of the company. The certificate states the number of shares purchased and their par value.” *(Bhalla; 2000:196)*

"Of all the form of securities; common stock appears to be the most romantic. While fixed income investment revenue may be more important the most of investors' common stock seems to capture their interest the most. The potential reward and penalties associated with common stock make them an interesting event exciting proposition, no wonder and, common stock investment is a favorable topic for conversation in parties and gets together. "*(Chandra; 1999: 93)*

Common stock is the permanent form of financing; it doesn't mature so repayment of installment is not required. It is legal representation of an equity (or ownership) position in a corporaion.Common Stockholders are the true owner of the firm, who invest their money in the hope of future high return. Whenever a company needs capital for expansion or, for creation of new job, for product development etc, it sells shares of its stock to the public. Equity or common stock is usually known as risk bearing shares. It doesn't receive any dividend during the early stage and during the liquidation they are paid after returning of lender and preferred stockholder. There are various types of common stocks, namely: blue-chip stock, growth stock, income stock, cyclical & defensive stock, small stock, and treasury stock. Risks associated with various stocks also vary significantly.

Common stock holders are entitled certain rights, which are as follows:

- Control through voting rights.
- Preemptive right
- Residual right
- Limited liability
- Right to income and distribution of additional shares.

Common Stock Values

Common Stock Values are either denoted by par value, book value or market value. These three terms are different and their rupee amount differs.

Par Value: The face value of one stock established at the time the stock is initially issued is known as par value. The par value of common stock remains unchanged unless and until the stock split or reverse split exists. Generally common stocks carry Rs. 100 par value.

Book Value: The sum of the cumulative retained earnings and other entries such as common stock and capital contribution in excess of par value under stockholder's equity is the book value of the equity.

Book Value of Equity = Cumulative Retained Earning + Capital Contributed in excess of part + Common Stock

The book value per share is obtained by dividend the book value of the equity by the number of shares outstanding. Higher the profit, higher the book value.

Market Value: The value of shares in secondary market traded between investors and traders is the market value. Market value is the consequence of demand and supply. It is earning and dividends, and market and company risk considerations.

2.1.2.1 Return on Common Stock

Return is commonly defined as rewards for bearing risk. Main purpose of investment on common stock is to get return from dividend and price appreciation of share and to get the control on the company. Return is the main target of investment. The return on common stock can be defined as the dividend yield plus the capital gain or loss. There are following types of returns calculated on common stock-

Single Period Rate of Return

The investment return is defined as the after-tax increase in the value of the initial investment. The increase in value can come from two sources: a direct cash payment to the investor or an increase in the market value of the investment relative to the original purchase price.

"The return is the total gain or loss experience on an investment over a given period time. It is commonly measured as the change in value any cash distribution of period expressed as a percentage of the beginning of period investment value". *(Gitman; 1990:238)*

The rate of return over the holding period, or holding period return (HPR) is computed as:

$$HPR = \frac{\text{Ending Price Z Beginning Price Γ Cash Receipts}}{\text{Beginning Price}}$$

Holding period returns are often calculated for periods other than one year, for this reason, the length of the holding period must always be indicated for a specific HPR. Many HPRs over periods shorter or longer than one year are annualized. In general, if the length of the holding period is not specified, it is assumed to be one year.

Annualized Holding Period Returns

"Holding period returns measure mentioned above is useful with the investment horizon of one year or less. Where as for longer period, it is better to calculate rate of return as an investment yield. The yield calculation is present value based and this considers the time value of money." *(Van Horne and Wachowicz; 1995: 90)*

HPRs are reported as an annual equivalent. One possible measure of annualized HPR might be the average of several HPRs such as:

$$\overline{HPR} = \frac{\sum_{t=1}^{n} (HPR_t)}{n}$$

However, the simple arithmetic averaging ignores the compounding effect that results if the first period's return is reinvested. In addition, the result of an arithmetic average return can be distorted if there are large differences in the rate of returns across time periods. Large differences in the periodic rates of return over longer investment horizons will cause the arithmetic rate of return to be misleading.

The geometric mean rate of return does not suffer from this error. The geometric mean rate of return $\overline{HPR}_g$ is defined as the rate of return that would make the initial investment equal to the ending investment value. Annualized rate of return is calculated as:

Annual Rate of Return (R) = $(1 + HPR)^{1/n} - 1$

Expected Rate of Return

The expected rate of return is based upon the expected cash receipts (e.g. dividends or interest) over the holding period and the expected ending or selling price. The expected rate of return or the expected holding period return should be equal to or greater than the required rate of return for that investment. The expected rate of return should equal the weighted average of the various possibilities.

The investor has forecast possible outcomes; each possibility is assigned to each outcome. Each economic state will result in a different expected rate of return. Subjective probabilities are assigned to each outcome. Overall expected rate of return can be calculated as a weighted average of the estimation:

$$E(r) = \sum_{jx1}^{n} Pj \times Rj$$

Where,

E(r) = the expected return of asset

P_j = probabilities of expected returns

R_j = return of individuals assets

Required Rate of Return

The required rate of return is the minimum rate of return that an investor expects from his/her investment in risky assets. The required rate of return on an individual securities investment is represent by a risk-free rate of interest plus a risk premium.

"When setting the required rate of return on an investment, an investor must consider the real rate of return, expected inflation, and risk. Because consumption is foregone today, the investor is entitled to a rate of return that compensates for this deferred consumption. Since the investor expects to receive an increase in the real goods purchased later, and assuming for the moment, zero inflation and risk, the required rate could equal the real rate of return, in which case it would represent the pure time value of money. The capital markets determine this rate based upon the supply of money to be invested relative to the demand for borrowed money." *(Cheney and Moses; 1995:33)*

The required rate of return is the return on risk free assets i.e. government securities plus risk premium. Risk premium is the difference in any particular period between

the actual rates of return on a risk assets and the risk-free rate. It is determined by CAPM/SML.

The required rate of return using CAPM / SML is:

Required Rate of Return (K) = $R_f + (R_m - \bar{R}f)$ bi

Where,

Rf =risk free rate of return

E (Rm) = expected market return

bi = Beta or systematic risk

2.1.2.2 Risk on Common stock

"Risk defined most generally is the profitability of the occurrence of unfavorable outcomes. But risk has different meaning in different context. In our context two major development form the probability distribution has been used as initial measure of return and risk. There are the mean and the standard deviation of the probability distribution". *(Weston and Brigham; 1992:93)*

It means that risk can be defined as occurrence of unfavorable outcomes, which is harmful for the business. Risk is the uncertainty associated with the investment. In basic sense, risk is the chance of the financial loss, which arises from the imperfect knowledge or from incomplete date. Risk is the unlooked for and unwanted events that occur in the future. It is the product of all potential outcomes expressed with probability associated with each other and it is measured in terms of degree of variability in the probability distribution of such outcomes. Risk is very much likely to occur in any types of investment but proper analysis will be able to help us to minimize the risk.

"In a world of uncertainty, expected return may not be realized. Risk can be thought of as the possibility that the actual return from holding a security will deviate from

the expected return. The greater the magnitude of deviation and greater the probability of its occurrence, the greater is said to be the risk of the security." *(Van Horne; 1995: 35)*

Financial analysts and statisticians prefer to use a quantitative risk surrogate called the variance of returns, denoted by Var (r). The variance of an asset's rates of return equals the sum of the products of the squared deviations of each possible rate of return from the expected rate of return multiplied by the probability that the rate of return occurs.

$$\text{Var (r)} = \sum_{tX1}^{T} P_t[r_t \; ZE(r_t)]^2$$

$$=P_1[r_1-E(r_1)]^2+P_2[r_2-E(r_2)]^2+\ldots\ldots+P_T[r_T-E(R_T)]^2$$

The square root of the variance of the rates of return is called the standard deviation [∃] of the rate of return.

$$\text{Standard Deviation } (\exists) = \sqrt{\text{var}(r)}$$

Risk of an asset's can be measured in term of standard deviation, co-efficient of variance and beta. Total risk can be divided into two parts systematic risk and unsystematic risk.

Total risk = Systematic risk + Unsystematic risk

2.1.3 The Range

"The range (maximum return-minimum return) is known as one of the traditional way of measuring risk. It simply shoes the difference between the best possible return and the worst possible return but does not provide information about the distribution of the rates of return between the extremes". *(Cheney and Moses; 1992: 8)*

I.e. the Range = Best possible rate of return - worst possible rate of return

2.1.4 Systematic and unsystematic risk

Systematic Risk: "Systematic risk is that portion of total risk caused by factors that simultaneously affect' the prices of practically all securities trades in any given market. Changes in the economic, political and sociological environment that affect all securities in some way are sources of Systematic risk. *(Francis; 1983: 298)*.Systematic risk has its source factors that affect all the marketable assets and thus cannot be diversified away. Systematic risk is due to the risk factor that affects the overall market such as changes in the macro- economic factors like interest rate, inflation, investors' expectations gross domestic product (GDP), tax reform by the government or changes in the world energy situation. It is the causes of external environment. (Political, economic, sociological and technological) of the firm. The sources of systematic risk are market pervasive. The measure of systematic risk permits an investor to evaluate an assets required rate of return relative to the systematic risk of the stock.

Systematic risk is the variability of a security's return with that of the overall stock market. This risk is also called undiversifiable or unavoidable risk. It is that part of the total risk that cannot be eliminated by allocating capital to a diversified portfolio of investments, measured by beta. The beta of a stock is the slope of the characteristic line between returns for the stock and those for the market. Beta depicts the sensitivity of the securities of the market portfolio. If the slope is 1, it means that excess returns for the stock vary proportionately with excess returns for the market portfolio. In other words, the stock has the same unavoidable or systematic risk as the market as a whole.

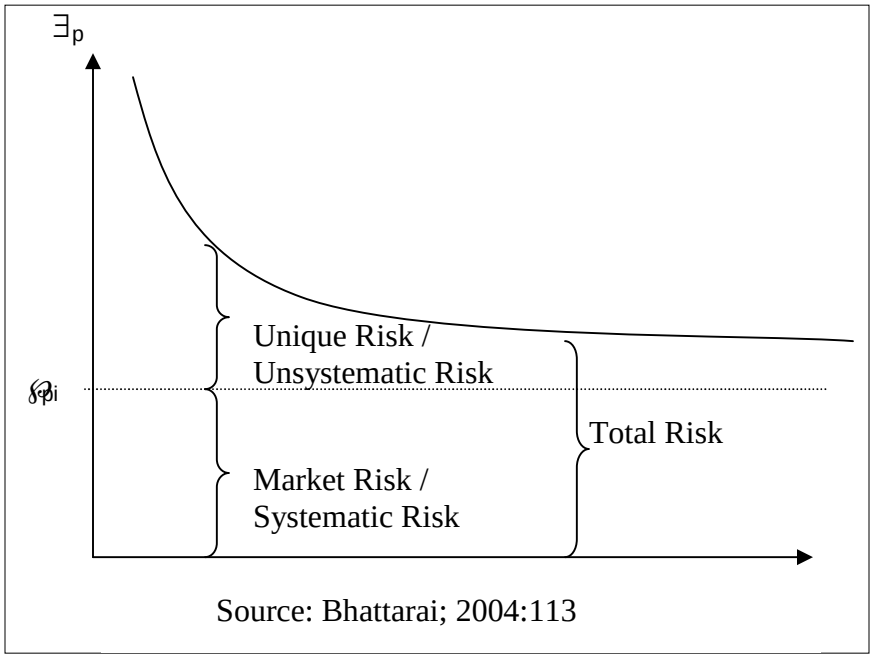
Unsystematic Risk: It is the amount of a stock's variance unexplained by overall market movements. It can be diversified away. It derives from the variability of the

stock's excess return not associated with movements in the excess return of the market as a whole.

This type of risk is unique to an organization and can be largely eliminated by holding a diversified portfolio of investment. Diversifiable risk occurs through the events such as labor strikes, management errors, inventions, advertising campaigns, shifts in consumer taste, and lawsuits cause unsystematic variability in the value of a market asset. Since unsystematic changes affect one firm, or at most a few firms, they must be forecast separately for each firm and for each individual incident. Unsystematic security price movements are statistically independent from each other, and so they may be averaged to zero when different assets are combined to form a diversified portfolio.

Figure: 2.1

Risk and Diversification



Source: Bhattarai; 2004:113

Sources of Investment Risk

Every investment involves uncertainties that make future investment returns risky. The sources of uncertainty that contribute to investment risk are:

i. **Interest Rate Risk:** It is defined as the potential variability of returns caused by changes in the market interest rates. Market interest rate influences the value of an asset and hence its return. If market interest rate rises, the value of an asset will decrease. Present value moves inversely with changes in the market rate of interest. The interest rate risk affects the prices of bonds, stocks, real estate, gold, puts, calls, future contracts, and other investments as well.

ii. **Purchasing Power Risk:** It is the variability of return an investor suffers because of inflation. Economists measure the rate of inflation by using a price index. The percentage change in the consumer price index is a widely followed measure of the rate of inflation.

iii. **Bull-Bear market Risk:** It arises from the variability in market returns resulting from alternating bull and bear market forces. When a security index rises fairly consistently from a low point, called a trough, for a period of time, this upward trend is called a bull market. The bull market ends when the market index reaches a peak and starts a downward trend. The period during which the market declines to the next trough is called a bear market. Bull markets that usually rise more than enough to compensate for the bear market losses follow bear markets. But the alternating bull and bear market forces create a potential source of investment risk.

iv. **Management Risk:** Errors made by business managers can harm those who invested in their firms. Forecasting management errors is difficult work that may not be worth the effort and, as a result, imports a needlessly skeptical outlook. Agency theory provides investor with an opportunity to replace

skepticism with informed insight as they endeavor to analyze subjective management risks.

v. **Default Risk:** Default risk is that portion of an investments' total risk that results from changes in the financial integrity of the investment. The variability of returns that investors experience as a result of changes in the creditworthiness of a firm in which they invested is their default risk.

vi. **Liquidity Risk:** Liquidity risk is that portion of an assets' total variability of return which results from price discounts given or sales commissions paid in order to sell the asset without delay.

vii. **Callability Risk:** Some bonds and preferred stocks are issued with a call provision. Issuers like the call provision because it allows them to buy back outstanding preferred stocks and/or bonds with the funds from a new issue if market interest rates drop below the level being paid on the outstanding securities. But, whatever the issuing company gains by calling in on issue is gained at the expense of the investors who have their securities called.

That portion of a security's total variability of returns that derives from the possibility that the issue may be called is the callability risk. Callability risk commands a risk premium that comes in the form of a slightly higher average rate of return. This additional return should increase as the risk that the issue would be called increases.

viii. **Convertibility Risk:** Conversion is a contractual stipulation that is included in the terms of original security issue. This provision alters the variability of returns from the affected security.

Convertibility risk is that portion of the total variability of return from a convertible bond or preferred stock that reflects the possibility that the investment may be converted into the issuer's common stock at a time or under terms harmful to the investors' best interests.

ix. **Political Risk:** Political Risk arises from the exploitation of a politically weak group for the benefit of a politically strong group, with the effects of various to improve their relative position increasing the variability of return from the affected asset regardless of whether the charges that causes political risk are sought by political or by economic interests, the resulting variability of return is called political risk if it is accomplished through legislative, judicial or administrative branches of the government. Political risk can be international as well as domestic.

x. **Industry Risk:** industry risk is that portion of an investments total variability of return caused by events that affect the products and firms that make up an industry. The stage of the industry's life cycle, international tariffs and/or quotas on the products produced by an industry, product or industry related taxes; industry wise labor union problems, environmental restrictions, raw material availability, and similar factors interact and affect all the firms in an industry simultaneously. As a result of these commonalities, the prices of the securities issued by competing firms tend to rise and fall together.

The above-mentioned uncertainties are the major sources of investment risk. Moreover, there might be numerous minor sources of investment risk. The above said major sources are of additive nature which add up to total risk i.e. variance.

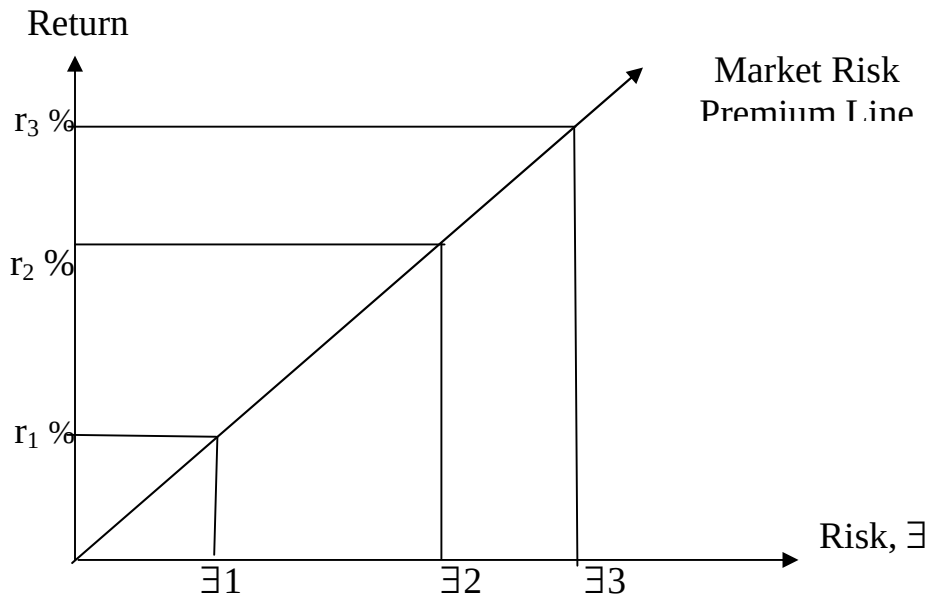
2.1.5 Trade-off between Risk and Return

Risk is complicated subject and needs to be properly analyzed. Risk play central role in the analysis of investment. The relationship between risk and return is described by investor's perception about risk and its compensation. No investor will like to invest in risky assets unless he is assured of adequate compensation for the additional risk. Therefore, it is the investors required risk premiums that establish a link between risk and return. In a market dominated by rational investor, higher risk

will command by rational premiums and the trade-off between the two assumes a linear relationship between risk and risk premium.

Figure: 2.2

Positive Trade-off between Risk and Return



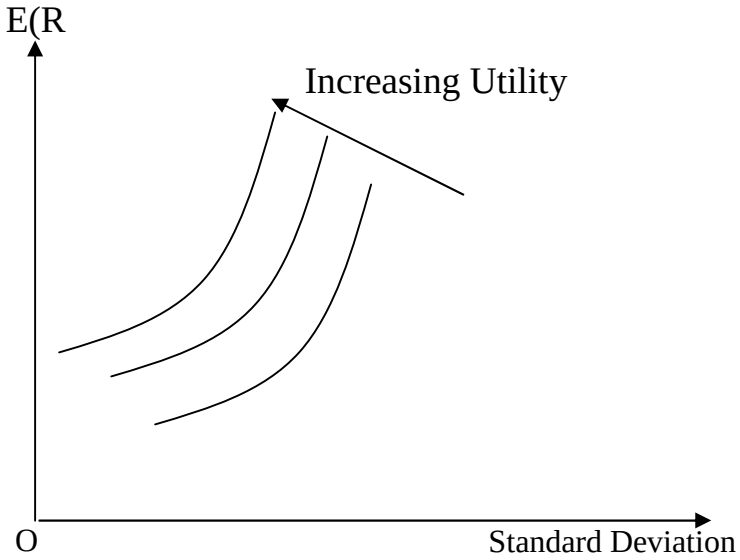
Source: Francis; 1983:7

Figure 2.2 represents a higher risk premium for assuming higher risk. For taking risk ∃1, the expected return is r1. When an investor assumes risk ∃2, the return must be r2 increasing the return (risk premium) by r2 - r1 for assuming more risk: ∃2 - ∃1. The assumption of linear relationship states that the risk premium must increase or decrease in proportion to a change in level of risk. It also indicates – higher the risk, higher the return and lower the risk, lower the return.

2.1.6 Utility Functions and Investors Choice

Figure – 2.3

Hypothetical Indifference Curves



Source: Van Horne; 2000: 59

The best combination of expected return and standard deviation for a security portfolio depends on the investors' utility function. The investor is indifferent between any combination of expected return and standard deviation on a particular curve. The curves are known as indifference curves. We can map out the risk adverse investor who is associate risk with divergence from expected value of return and its utility function might be depicted in the following figure. The expected return is plotted on the vertical axis, while the standard deviation is drawn in the horizontal. Any points of a curve have the same total utility. They lie on an investor's indifference curve. The risk-adverse investor has no risk and low return and the investor. As a result, high-risk assets must offer investors high returns to induce them to make the riskier investments. *(Van Horne; 2000:58-59)*

The greater the slope of indifference curves, the more averse the investor is to risk. As we move to the left in Fig. 2.3, each successive curve represents a higher level of expected utility. It is important to note that the exact shape of the indifference curves will not be the same for different investors. While the curves for all risk-averse investors will be upward sloping, a variety of shapes are possible, depending on the risk preferences of the individual. As an investor, you want to hold that portfolio of securities that places you on the highest indifference curve.

The positive trade-off between risk and return is; high-risk assets must offer investors high returns to induce them to make the riskier investments.

2.1.7 Portfolio and Diversification

Portfolio is simple defined as a combination of two or more securities or combination of investment in more assets. Portfolio is the best way of investment for rational investors. A combination of two or more securities or assets is called portfolio. Portfolio theory gives the concept of investment in very good ways that "never keep all the eggs in a single basket", i.e. the entire amount should not be invested into a single asset Investment on more than one security means diversification or minimize risk. Diversification means reducing the investment risk by dividing the investment among a variety of assets. Diversification helps to reduce risk because different investments will rise and fall independent of each other. The combinations of these assets more often than not will cancel out each others' fluctuation, thereof reducing risk. Standard deviation and co-relation between two securities return plays a vital role in the risk reduction. Because all investments carry with them some level of risk, it is important to diversify and spread your money into many different investments. Portfolio theory deals with the selection of optimal portfolio; that is, portfolio that provide the highest possible return for any specified degree of risk or the lowest possible risk for any specified rate of return. The optimal portfolio is that which is most suitable to the investor. These are the portfolios that fill into the investor's rang of risk parameters and can be placed into a

utility or risk curve. Optimal portfolio shows us that it is possible for different portfolio to have varying level of risk and return.

"Portfolio management is the art of handling a pool of funds so that it not only preserves its original worth but also overtime appreciates in values and yield on adequate return consistent with the level of risk assumed". *(Cohen, Zinbarg and Zeikel; 1978: 591)*

Diversification can help to reduce portfolio risk by eliminating unsystematic risk for which investors are not rewarded. Investors are rewarded for taking market risk. By choosing securities of different companies in different industries, we can minimize the risks associated with a particular company's "bad luck". Diversification among companies, industries and asset classes affords the investor the greatest protection against business risk, financial risk and volatility.

Investments whose price movements are opposite each other are negatively correlated. When negatively correlated assets are combined within a portfolio, the portfolio volatility is reduced.

There are some different diversification techniques for reducing a portfolio risk. *(Francis; 1998:228-235)*

1. Simple Diversification

Simple diversification can be defines as "not putting all the eggs in one basket" or "spreading the risks". But it does not eliminate risk by creating a simple diversified portfolio. The simple diversification would be able to reduce unsystematic or diversifiable risk.

2. Diversification across Industries

Invested in the selecting securities from different industries to achieve better diversification is a diversification across industries. But, empirical research has shown that diversifying across industries is not much better than simply

selecting securities randomly since all industries are highly correlated with one another.

3. **Superfluous Diversification**

If 10 or 15 different assets are selected for a portfolio, the maximum risk reduction benefits from simple diversification have most likely been attained. Further spreading of the portfolio's assets is superfluous diversification and should be avoided.

4. **Simple Diversification across Quality Rating Categories**

Quality ratings measure default risk – essentially the risk of bankruptcy. The highest quality portfolio of randomly diversified stocks was able to achieve lower levels of risk than the simply diversified portfolios of lower-quality stocks. This result reflects the fact that default risk (as measured by the quality ratings) is part of total risk. The higher quality portfolios contain assets with less default risk. This finding suggests that portfolio managers can reduce portfolio risk to levels lower than those attainable with simple diversification by not diversifying across lower-quality assets.

5. Markowitz Diversification

Markowitz diversification may be defined as "combining assets which are less than perfectly positively correlated in order to reduce portfolio risk without sacrificing portfolio returns". *(Markowitz; 1952:11)*

It can sometimes reduce risk below the undiversifiable level. Markowitz diversification is more analytical than simple diversification and considers assets' correlations (or covariance). The lower the correlation between assets, the more that Markowitz diversification will be able to reduce the portfolio's risk.

Applying Markowitz diversification to a collection of potential investment assets with a computer is called Markowitz Portfolio Analysis. It is a scientific way to manage a portfolio, and its results are quite interesting. Since Markowitz portfolio analysis considers both the risk and return of dozens, or hundreds, or thousands of different securities simultaneously, it is a more powerful method of analyzing a portfolio than using intuition.

Expected Portfolio Return

Investing today in an expectation of earning in the future. That is, investment decision that we make today, are based on expectations of returns in the future. The expected portfolio return is the simple weighted average of the expected returns from the investment represented by a portfolio. This expected return is calculated by determining the expected return of each component of the portfolio and using these returns to compute a weighted average. The weights used are the portfolio weights, which describe how the portfolio's investment is weighted among the various assets/securities. Portfolio weights are percentages of the total dollar amount available to be invested in the portfolio and sum to 1. The expected return of a portfolio, E (R_p), is calculated as:

$$\text{Expected Portfolio Return} = E(R_p) \; X \sum_{jx1}^{n} X_j \, E(R_j)$$

Where

$E(R_p)$ = the expected return on the portfolio

E(Rj) = the expected return of asset i

Xi = the portfolio weight for asset i, where

n = number of assets

In a two assets portfolio comprising risk free asset and risky asset, the portfolio return will be as:

Expected Portfolio Return = $E(R_p) = X_f \cdot E(R_f) + X_m \cdot E(R_m)$

Portfolio Risk

Total portfolio risk is measured by the variance of the portfolio's rate of return distribution. The portfolio risk depends on the risk of the individual securities and the covariance between the returns of the individual securities. The risk (variance of returns) from a portfolio made up of n assets is denied as:

$$\text{Portfolio Risk} = \text{Var}(R_p) \sum_{i=1}^{n} \sum_{j=1}^{n} X_i X_j \rho_{ij} \sigma_i \sigma_j$$

Where

X_i = proportion of investment in security i

X_j = proportion of investment in security j

∂_{ij} = correlation coefficient between i and j securities

$\exists_i$ = standard deviation of security i

$\exists_j$ = standard deviation of security j

2.1.8 Capital Asset Pricing Model (CAPM)

Capital assets are the long term financial as well as real assets and CAPM based on the pricing of these assets. Modern portfolio theory of Markowitz suggests that the investment decision should be based on the total risk and the price of asset should also be determined on the basis of the total risk. But the CAPM suggests that, any investor can create a portfolio of assets that will eliminate virtually all diversifiable risk, the only relevant risk in non- diversifiable risk. This is the primary importance of selecting assets with the most desired risk return characteristics. The CAPM further suggests that the price of capital assets should be determined in a way that compensates the systematic risk. CAPM is an equilibrium model of the trade-off

between expected portfolio return and unavoidable risk. The major implication of the model is that the expected return of an asset will be related to a measure of risk for that asset known as beta. The exact manner in which expected return and beta are related is specified by the CAPM.

"The capital assets pricing model states that the expected risk premium on each investment is proportional to its beta. This means that each investment should lie on the sloping security market line connecting Treasury bills and Market Portfolio." *(Myers and Brealey; 2003: 200)*

"In market equilibrium, a security will be expected to provide a return commensurate with its unavoidable risk. This is simply the risk that cannot be avoided by diversification. The greater the unavoidable risk of a security, the greater the return that investors will expect from the security. The relationship between expected return and unavoidable risk, and the valuation of securities that follows, is the essence of the capital asset pricing model (CAPM). This model was developed by William F. Sharpe (1990 Nobel Prize winner in economics) and John Lintner in the 1960s, and it has had important implications for finance ever since." *(Van Horne; 1995: 62)*

There are two types of investment opportunities with which we will be concerned. The first is a risk-free security whose return over the holding period is known with certainty and the second investment opportunity with which we are concerned is the market portfolio of common stocks.

The CAPM used to calculate the required rate of return for stock j is:

$$E(R_j) = R_f + [E(R_m) - R_f] \beta_j$$

Where,

$E(R_i)$ = the expected or ex-ante return on the i^{th} risky asset

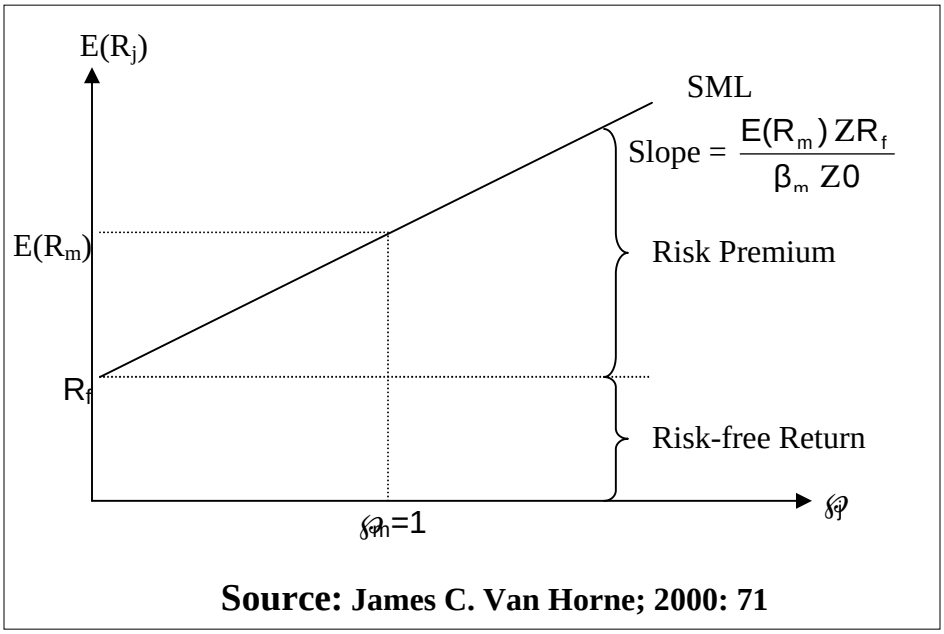
R_f = the rate of return on a risk less asset

$E(R_m)$ = the expected or ex ante return on the market portfolio

β_j = Cov (R_i,R_m)/Var(R_m) = a measure of the undiversifiable risk of the i^{th} security.

Figure: 2.4

The Security Market Line / CAPM



Source: James C. Van Horne; 2000: 71

The greater the beta of a security, the greater the risk and require the greater the expected return. Likewise, the lower the beta, the lower the risk, the more valuable it becomes and the lower the expected return required.

Under the assumptions of the CAPM, all securities lie along this line. When the CAPM is graphed in a figure, it is called the Security Market Line (SML). The expected return on a security is a combination of the risk-free rate plus a premium for risk. Risk premium is necessary to induce risk-averse investors to buy risky securities. The risk adjustment factor is obtained by multiplying the risk premium required for the market return by the risky ness of the individual investment. In equilibrium, all securities must be priced so that they fall on the SML. The fact is that they have different variances, which are irrelevant for determining their

expected return, because total risk contains a diversifiable component, which is not priced in market equilibrium. SML may be used to explain the required rate of return on all securities whether or not they are efficient. The SML provides a unique relationship between undiversifiable risk (measured by beta) and expected rate of return in the capital market. Hence, if we can accurately measure the beta of a security, we can estimate its equilibrium risk-adjusted rate of return.

The CAPM or SML is an equilibrium theory of how to price and measure risk. It has many applications for capital budgeting, asset valuation, determination of cost of equity capital and the explaining risk in the structure of interest rates.

Assumptions of the CAPM

Capital market theory (CMT) uses portfolio theory; thus the assumptions underlying portfolio theory also pertain to the CAPM. The additional assumptions underlying CMT and the CAPM appear less realistic than the portfolio theory assumptions. The assumptions of CMT are as follows: *(Cheney and Moses; 1995:68)*

1. All investors are risk-averse. Thus, all investors seek to be on the efficient frontier.
2. There are no constraints on the amount of money that can be borrowed or lent. Borrowing and lending occur at the identical risk-free rate. Rf.
3. All investors have identical beliefs about the expected returns and risks of assets and portfolios; that are all investors have homogeneous expectations.
4. All investors have a common investment horizon, whether it will be one month, three months, one year, or whatever.
5. All the investments are infinitively divisible and marketable; that is, it is possible to buy or sell any portion of an asset or portfolio.
6. Taxes and transaction costs do not exist. That is, there are no tax effects, costs of acquiring information or transaction costs associated with buying or selling securities. These are often referred to as perfect market assumptions. Markets

are assumed to be competitive; therefore, the same investment opportunities are available to all investors.

7. There are no unanticipated changes in inflation or interest rates.
8. The capital markets are in a state of equilibrium or striving toward equilibrium. There are no under priced or overpriced securities; if under pricing or overpricing exists, the prices will move to correct this disequilibrium situation.

Under- and Over Valuations

In market equilibrium, the CAPM implies an expected return-risk relationship for all individual securities (the security market line). If an individual security has an expected return-risk combination that places it above the security line, it will be undervalued in the market. That is, it provides an expected return in excess of that required by the market for the systematic risk involved: $\overline{R}_j > R_f + [E(R_m)-R_f]$ ℘. As a result, the security will be attractive to investors. According to the theory, the increased demand will cause the price to rise until the expected return declines sufficiently for the security to lie on the security market line and, thereby, for $\overline{R}_j = R_f + [E(R_m)-R_f]$ ℘. An overvalued security is characterized by an expected return-risk combination that places it below the security market line that: $\overline{R}_j < R_f + [E(R_m)-R_f]$ ℘. This security is unattractive, and investors holding it will sell it and those not holding it will avoid it. The price will fall and expected return will rise until there is consistency with the security market line and with equilibrium pricing. *(Van Horne; 1997: 71)*

2.1.9 Beta

Beta is the measure of percentage change in security return as a result of one percentage change in excess market return. It is an index of systematic risk measuring the sensitivity of a stock's returns to changes in returns on the market portfolio.

The Beta of asset j is its systematic risk ($COV_{j,m} / \pm_m$) expressed in units of market risk ($\pm_m$). Thus, beta is not a measure of the systematic risk of a security or a portfolio; it is more like an index of systematic risk. The only difference in Beta measurement and systematic risk measurement is the divisor $\pm_m$. The Beta of a portfolio is simply a weighted average of the individual stock betas in the portfolio.

2.2 Reviews of industry under study

2.2.1 Concept of Insurance

On the one hand, human life is subject to various risks—risk of death or disability due to natural or accidental causes. Humans are also prone to diseases, the treatment of which may involve huge expenditure. On the other hand, property owned by man is exposed to various hazards, natural and man-made.

In respect of insurance relating to property, there are many products available. Property may be covered against fire and perils of nature including flood, earthquake etc. Machinery may be insured for breakdown. Goods in transit can be insured under a marine cargo insurance cover. Insurance covers are also available for ships and other vessels. A motor insurance policy covers third party damage as well as damage to the vehicle.

Insurance of property is based on the principle of indemnity. The idea is to bring the insured to the same financial position as he /she was before the loss occurred. It safeguards the investment in the property. Where there is no insurance, losses can mar a project or an industry. General Insurance offers stability to the economy and to the society.

Insurance offers security and so peace of mind to the individual. The concept of insurance is that the losses of a few are made good by contribution from many. It is

based on the law of large numbers. It stemmed from the need of man to find a solution for mitigation of losses. It also reflects the nature of man to find a solution collectively.

It is important for all to understand the various products that life and general insurance companies offer before they make a choice as to the product they want to buy.

As per regulations, insurers have to give the various features of the products at the point of sale. The insured should also go through the various terms and conditions of the products and understand what they have bought and met their insurance needs. They ought to understand the claim procedures so that they know what to do in the event of a loss.

2.2.2 Business of Insurance in Nepal

Insurance is a newly emerge business in Nepal although there were some social and Co-operative business providing security to costumer from ancient time, modern insurance business started by some Indian companies in the early times.

The were mainly focused in providing insurance facilities specially for import export business increased in India therefore the history of insurance business is definitively very short in Nepal.

As a first insurance company Nepal Mal Chalani Tatha Biam company ltd was established in 2004 BS this insurance company can be taken as the firs step of Nepalese insurance history, with authorized capital of 5 lakhs. It was later converted into Nepal Insurance in transport company Ltd in 2016 BS. This was again renamed as Nepal Insurance Company Ltd 2048 BS. The Company is concentrated in non-life Insurance business.

Considering the role of business in the expansion of economic activities and alarming out flow of money from the country, the government of Nepal felt the need of large and well organized insurance company with in the country. Than immediately the HMG established Rastriya Beema Sanstha under a government

insurance act 2025. This insurance company is totally financed by the government to provide all types insurance peril, which is essential economic development after re-establish of democracy Nepal also implemented the policy of privation and economic liberalization globalization, as the country was following economic liberalization, the previous act were amended and new insurance act 2049 was introduce some of the key features of the acts are minimum paid capital of Rs.5 caror arrangement of service charge from insured, classification of life and non life insurance polices. As a result, number of insurance companies have been establish and can be considered as the golden period in the insurance privilege history of Nepal.

Now insurance business has been converted to modern business both life and non life insurance business facilities are found. We can find out present position of insurance business from period of 5 fiscal years. Total insurance earned of both life and non- life premium of 5 fiscals years are presented below.

Rs in million

Fiscal year	Life insurance premium	Non life insurance premium	Total insurance premium
2002/03	49.43	130.20	179.63
2003/04	56.65	140.36	197.01
2004/05	67.08	155.23	222.31
2005/06	69.56	179.23	248.79
2006/07	130.36	230.21	360.57

(Sources:Yearly Bulletin of Beema Sameeti , 2006/07)

2.2.3 Business of concerned companies

National Life and General Insurance Co. Ltd.

National Life and General Insurance Co. Ltd. was incorporated in 1988 A.D (2044 B.S.) under Nepal company Act 1964 with prime objective to meet nations and national insurance requirements in the field of life and non-life sector. NLGIC is established in technical collaboration with leading syndicate members of 'Lloyds' of London a company, which is owned and managed by risk management and leading re-insurance brokers of U.S.A. The shareholders of the company include industrial promoters, foreign collaborators, institutional investment by Rastriya Banijya Bank and general public with the equity participation of 45%, 10% , 10% and 35% respectively.

NLGIC was listed on Nepal stock exchange in 1989. The company has authorized capital Rs.15,00,00,00,000 and paid up capital Rs.30,00,00,000. Market capitalizations is Rs.138 million and the no. of shareholders are 2445 at the end of fiscal year 2007/08.

Himalayan General Insurance Company

Himalayan General Insurance Company Limited was established in 1988 under the company Act 1964 with an objective of undertaking non-life and re-insurance business in the country and aboard. The company had obtained permission to commence insurance business from insurance board under insurance Act 1992 and stated its business from November 1993. HGIC listed on stock exchange on 1994 A.D. the shareholding pattern of the company is 60% shares owned by promoters and 40% by general public. At the end of fiscal year 2007/08, authorized capital, issued capital and paid up capital were Rs.1600000, Rs.600000 and Rs.300000 respectively, the market capitalization is Rs.57 million and the number of shareholders are 1875.

Premier Insurance Co. (Nepal) Ltd.

Premier Insurance company (Nepal) Limited was established under the company Act 1964 in 1992 (2048 B.S). The major objectives of the company are to carry out life and non-life insurance and re-insurance business in the country and abroad. The shareholding pattern of the company is 60 percent by the promoters and 40 percent by the general public. It was listed on stock exchange in 1995 A.D (2052 B.S)

The company has authorized capital Rs.100000000 issued capital Rs.60000000, paid up capital Rs.030000000, no. of shareholders are 8476 and market capitalization is Rs.57.6 million at the end of fiscal year 2007/08

Everest Insurance Company Limited

Everest Insurance Company Limited was established in 1992 under the company Act 1964. The major objective of the company is to carry out life insurance and non-life insurance business in the country. **Everest Insurance Company Ltd. is a leading Insurance Company of Nepal. Everest Insurance Company has always been ensuring on world-class quality service.** The company is yet to get permission to operate life insurance business from insurance board and has operation only non-life insurance business. It was listed on the Nepal stock exchange in the year 1995A.D. the shareholders of EIC are 60 percent from promoters and 40 percent from general public. The total numbers of shareholders till fiscal year 2002/03 are 8112. The company has authorized capital Rs.100000000, issued capital Rs.30000000 and paid-up capital Rs.30000000, net profit Rs.18522285 and the market capitalization is Rs.183 million at the end of fiscal year 2007/08

United Insurance Company (Nepal) Limited.

United Insurance Company (Nepal) Limited was established in 1992 A.D (2049B.S) with an objective of providing non-life insurance services in the field of fire, marine,

vehicle and miscellaneous insurance in the country and abroad. It was listed in the Nepal stock exchange in the year 1994 A.D (2051/04/17 B.S. The shareholding pattern of the company is 51% form industrial promoters, 40% from general public and 9% from other sector.

The company has authorized capital Rs.100000000, issued capital Rs.60000000, and paid-up capital Rs.60000000, net profit Rs.3384836, market capitalization is Rs.82.8 million and the no. of shareholders are 4933 at the end of financial year 2007/08

2.2 Reviews of Journals and Articles

The Primary focus of the study is to analyze risk and return. The researcher reviews articles publish in journals, which are related to his field of the study. Main purpose of reviewing the thesis is to develop some expertise in ones area, to see what new contributions can be made and to receive some ideas for developing a research design. Thus, the precious studies cannot be ignored because they provide the foundation and ideas to the present study.

Manohar Krishna Shrestha,(1995), in his article *"Shareholder's Democracy and Annual General Meeting "* consider this book as an assemblage of opinions, which he had expressed in different occasions of various annual general meeting where he has critically analyzed the situation of common stock investor and situation that is not improving till date. The content of the book have been divided into two parts. The primary part includes view on the rights of the shareholder regarding how they can exercise them in democratic perspective. Where as the next part consist of feedbacks and the issues raised by shareholders at different annual general meeting of the public limited companies and financial institutions.

In many cases the existing authoritarian mentality of management seems to have not considered the shareholders in deciding the managerial plans and policies. Top level decision often by pass the interest of share holders. As the management lacks

serious concern about the protection of shareholders, right and expectation. The annual General meeting has become a plate form for shareholders to express their opinions and grievance in front of management and Board of Directors. Many General Manager Feedback reveal no serious response to the feelings of shareholders. Thus it reflects on willingness of the management and Board of Director to change their traditionally held activities toward share holders.

Radhe Shyam Pradhan,(1993), in *"Stock Market Behavior in Small Capital Market"* insight in to stock market behavior in Nepalese context by considering listed and traded shares in secondary market. The purpose of this study is to address the stock market equity, market value to book value, price earning and dividends with liquidity, leverage profitability assets turnover and interest coverage. To find out the above objectives the study period is based on cross sectional analysis off 55 observations and the study periods of 1986 to 1990. According to him this paper is based on pooled cross section analysis of 55 observation data could not be obtained on contacting the individual enterprises as they traded them confidential "Due to initial and un-established stage of stock market, there are no system yet to complete and publish stock market data on a regular basis. There is no data base, which market is difficult to carry on any research in Nepalese stock market considering the study period of 1986 to 1990. Usable data could be obtained for 17 enterprises". These enterprises are in different sectors such as manufacturing, banking, trading, hotels insurance etc. In this study, he has constructed 3 different levels of portfolios of sample securities (small, intermediate and large). According to him, market value to book value, P\E and DPS to MPS, DPS to EPS analyzed liquidity, leverage, earnings and coverage of each portfolio in term of larger and smaller and also average ratios are computed. He concludes the result indicate that larger stock have longer price earning ratios. Larger ratio of market value to book value of equity lower liquidity, lower profitability and smaller dividends, p\e ratio and dividend are more variable for smaller stocks; where as market value to book value of equity is

more variable for larger stock. Larger stock also has higher leverage, lower assets turnover and lower interest

Shiva Raj Shrestha,(2055 B.S), in his article" *Portfolio Management in Commercial Banks Theory and Practice"* revealed the portfolio movement becomes very important both for individual as well as instructional investors. Investors would like to select best mix-up investment assets subject to the following aspects.

Higher return which is comparable with alternative opportunities available according to the risk class of investors.

Good liquidity with adequate safety of investment

Certain capital gains

Maximum tax concessions

Flexible investments

Economic, efficient and effective.

Investment mixed.

In view of above expects Mr. Shrestha stated that the investor try to hold a well diversified portfolio that helps to achieve those benefits. Investors want to increase their return by taking investment indifferent sectors with certainty.

However Mr. Shrestha presented approaches to find out the risk of securities depending upon attitudes of investors, towards risk, to develop alternative investment strategies for selecting a better portfolio which will ensure a trade off between risk and return so as to attach the primary objective of wealth maximization at lowest risk and finally to identify securities for investment to refuse volatility of return and risk.

He further stated that the commercial banks needs competent manpower for continuous research and analysis and proper management information system to get success in portfolio management and customers confidences regarding the portfolio management in Nepalese joint venture banks, he concludes that the portfolio management activities of Nepalese commercial banks at present are in nascent stage due to lass develop capital market unavailability of sufficient financial instrument in

financial market, lack of proper technique to run portfolio management activities in the best and successful manners etc. have constrained the portfolio management of a most of the joint venture banks.

2.3 Reviews of Thesis

Pramina Pandey, (2000), has studied on *"Risk and Return Analysis of Common Stock Investment With special reference to Investment portfolio of Insurance Companies"*. The study is based on only six insurance companies listed in NEPSE .The researcher used only historical data for analysis. It covers the six years period from F\Y 2049\50 B.S to 2054\55 B.S. It deals with common stock of insurance companies on the basis of available information.

The main objectives of this study is to analyze the risk, return and other relevant variables that helps in making decisions about stock and investment in insurance companies, to understand and identify the problems faced by individual investor and insurance companies, to analyze the volatility of different stock of insurance companies. She use financial tools as MPS, DPS, HPR, variance, covariance , beta coefficient, CAPM Model, portfolio risk and return, risk minimizing portfolio, Sharpe single index model, statistical tool, as tools for calculating index, tools for hypothesis.

According to market capitalization NIC is biggest insurance company. The expected return on the common stock of NLGC has maximum and that of HGIC & EVIC has lowest return with negative value. About risk, she had concluded that NLGIC is most risky where as EVIC is least risky. As we know higher the risk higher the return, NLGIC's expected return is highest which ultimate the standard deviation to be highest and low standard deviation lower the return.

Here in the study some the diversification of common stock between NB and NGLIC is also not good. As their portion of weight minimizing risk is more than 100%. Selecting of securities of CS of NIC and NBL can reduce risk to some extent. Through positively correlated portfolio can reduce risk in compared to risk and the

null hypothesis is accepted which implies that there is no significance difference between portfolio of insurance companies and overall market portfolio. She further says that proper selection of the portfolio approach is the better way to get success in the stock market. Market investment is important to improve the lives of people and to push the economic state of the country. So we along with government should understand their respective roles and should give proper attention to play their roles with sincerity.

Sudeep Upadhyay,(2001), has studied on, *"Risk and* Return *on Common Stock Investment of Commercial Banks in Nepal"*. The study is based on only eight commercial banks listed in NEPSE and used historical data only. The main objectives of the study were to assess the risk associated with returns on common stock investment of the listed commercial banks on the basis of selective financial tools, to evaluate common stocks of listed commercial banks in terms of risk and return; to assess the risk compensating returns and to analyze the volatility of common stocks and other relevant variables as an affecting factor in portfolio construction of common stocks.

He used financial as well as statistical tools in his analysis. Where he used MPS, DPS, HPR, Standard deviation, coefficient of variance, Beta: systematic risk, market risk and return, portfolio risk and return, CAPM Model. Optimal portfolio or risk minimizing portfolio, testing of hypothesis in his analysis.

In order to achieve the set objectives, he used five years (F\Y 1994/95 to 1998/99) historical common stock data of eight commercial banks as sample. The study had the following findings: In general, most people see stock market investment as a black art that they know little about. Many people have unrealistically optimistic or pessimistic expectations about stock market investment or perhaps a fear of the unknown. Due to the lack of information and poor knowledge, Nepalese individual investors cannot analyze the securities as well as market properly. Expected return on the common stock of Nepal Grindlays Bank (now renamed as Standard & Chartered Bank Nepal Limited) is maximum (i.e. 127.84%) which is very high rate

of return. In reality this rate exists only due to the effect of unrealistic annual return because of the issue of bonus share and increase in share price at the same. Similarly expected return of the Common Stock of Nepal SBI Bank Ltd. is found minimum. In the context of industries (or sector), expected return of others sector is highest (i.e. 15.5 %). Manufacturing and production sector is the least performer. Common stock of Nepal Grindlays Bank Limited is most risky and of SBI is least risky. This proves the proverb 'high risk – high return'. Regarding the market volatility, EBL's common stock is more volatile which has beta value of 0.941 and NIBL's common stock is least volatile which has beta value of 0.875. Others are also volatile. All the stocks of commercial banks are over-priced. NGBL stock has maximum difference of expected rate of return and required rate of return.

Most of the Nepalese private investors invest in single security. Some of the investors use their fund in two or more securities. But it is found that they don't make any analysis of portfolio before selecting. They invest their fund in different securities on the basis of expectation and assumption of individual security rather than analysis of the effect of portfolio.

The correlation of returns between most of the banks is nearer to +1. It is not favorable to construct a portfolio. Only the correlation between NIBL's CS return and EBL CS return is found negative. Investor can reduce risks through holding the CS of NIBL and NBBL or EBL.

Portfolio between the CS of NGBL and BBC is very advantageous as far as risk reduction is concerned. Here, portfolio standard deviation is less than individual standard deviation. Hence the portfolio approach of investment is better way to get the maximum return.

Richa Rajkarnikar, (2002), study on the topic "*Risk and Return Analysis of Common Stock (with special to Insurance Company)*" carried out in the year by is also somehow related to this study. The main objective of her study was to describe the important variables while making investment decisions and also to solve problem faced by investors as well as companies. The main problem on which she has

focused is ignorance of the investors about the fact that risk is associated with the investment.

She use financial tools as MPS, DPS, HPR, variance, covariance , beta coefficient, CAPM Model, portfolio risk and return, risk minimizing portfolio, Sharpe single index model, statistical tool, as tools for calculating index, tools for hypothesis, in her analysis.

She concluded that for most stock market is black study would enable investors to accept the return according to the risk associated. She has also emphasized on portfolio investment. She has carried out her study with insurance companies and her study has concluded that NLGIC is most risky and EVIC is least risky. Expected return of NLGIC has highest and that of HGIC has lowest.

Mohan Purna Satyal, (2002), has studied on *"Risk and Return Analysis of Listed Companies (references to Bank, Insurance, Finance and manufacturing company)."* The prime objectives of his study were to analyze the return, risk and other relevant variables that help in making decision about investment of the common stocks of listed companies and to examine the movement of market price of share as so as, to analysis the relation between risk and return of individual stock with that of market and correlation of risk & return. The study was based on five years data from F/Y 1996 to F/Y 2000. He had analyzed the secondary data using financial as well as statistical tools, where he used MPS, DPS, HPR, Standard deviation, coefficient of variance, Beta: systematic risk, market risk and return, portfolio risk and return, CAPM Model. Optimal portfolio or risk minimizing portfolio, testing of hypothesis in his analysis.

He had concluded that the price movement of the shares of selected companies is moving in positive trend. However the price of NIC and BBC is in decreasing trend. The risk and return of NLL is maximum. The expected return on the trading sector has maximum and hotel sector is negative. The risk of banking sector is minimum as comparative to insurance and finance sectors. The beta of HBL has high that is most aggressive investment and BBC is less risky and investment on BBC is defensive or

less risky. In industry wise analysis, the expected return on the trading sector have maximum and the hotel sector have negative.

Ramesh kumar Bhandari, (2003), has studied on *"Risk -Return analysis in Common stock investment of listed companies in Nepal"*. The study is based on 13 sample companies from different industry group to represent the whole population of company.

The specific objectives of this study are, to find the risk return behavior of stock and other relevant variable which are very important in making decision to invest in the stock, to analyze the risk return of the common stocks and their portfolio in a simple way, also analyze the volatility of different stocks and other relevant variables that should be considered while making decision investment in stock.

This study is based on historical and secondary data He had analyzed the secondary data using financial as well as statistical tools. It covers the five years from F\Y 1997/98 to F\Y 2001/02.

He had analyzed the secondary data using financial as well as statistical tools, Where he used MPS, DPS, HPR, Standard deviation, coefficient of variance, Beta: systematic risk, market risk and return, portfolio risk and return, CAPM Model . Optimal portfolio or risk minimizing portfolio, testing of hypothesis in his analysis.

His major finding is these; expected return on the common stock of NFS is highest (i.e 91.56) this is due to the effect of unrealistic annual rate of return. Common stock of NCM HBl, SCB, and NLL's expected return are over 50% and BNL, PLC , SHL and NIC's expected return's are over 10% . The average realized rate of return of all these industries are not same over the sample period. There fore the co-efficient of Variation can be preferred as a measure of risk per rupee. On the basis of CV its minimum (+ve) C.V. among the industries. Hence the Insurance and Finance, Industry can be considered as best investment device as this has low risk and consistent return. Those companies which as (-ve) C.V. Considered to be very risky

assets (here hotel and trading Industry have +ve cv) because Negative expected return not acceptable in the investment point of view.

The correlation coefficient is bounded by the value - 1 to +1. All the sample companies have +ve correlation with market (correlation co-efficient is a statistical measure similar to covariance) in that. It measures the degree of mutual variation between two random variables

Neelam Thapa, (2003), has conducted her Master's thesis as, *"Analysis of Risk and Return on Common Stock Investment of Insurance Companies"*. The study is based on only seven listed companies listed in NEPSE. The relevant objective of the study was to analyze risk and return and other relevant variables that help in making decisions and to identify the constructive portfolio of insurance company with that of Nepal Lever Limited or between two insurance companies.

The study is based on secondary data of five insurance companies covering five years data commencing from F/Y 2053/54 to F\Y 2058\59.

She used MPS, DPS, HPR, Standard deviation, Measure of systematic risk, portfolio risk and return, CAPM model and test of hypothesis as in her analysis.

The major findings of the study were as: Because of the higher expected return associated with the common stock, Nepalese investors are attracted towards it. The standard deviation, which measures the risk of an asset shows that most of the companies are risk. As higher risk must be associated with higher return, it is so only in the case of Everest Insurance Company and Himalayan General Insurance Company where as United Insurance Company and Premier Insurance Company is providing higher return at lower risk. Expected return of the CS of NIC is least. The beta coefficient, which is the measure of systematic risk, reveals that Nepal Insurance Company has highest beta and Premier Insurance Company has least beta. Comparisons between the RRR and ERR the stock price of PRIC, HGIC, EVIC and UNIC were under- priced where as the stock of NIC is over-priced among the selected companies.

Manilata Manadhar, (2003), has conducted her Master's thesis as, "A *Study On risk and Return on Common Stock Investment of Commercial Bank in Nepal"* has taken five commercial banks which are listed on NEPSE for study. Its covers the secondary data and information for five years starting from F\Y 2053\54 to F\Y 2057\58.

Her specific objectives are: to examine risk and return on common stock of listed commercial banks, to calculate risk and return of their portfolio, to identify whether stock of selected companies are overprice, under priced and equilibrium priced, to provide relevant suggestions and practical ideas in the basis of findings of this study.

She used MPS, DPS, HPR, Standard deviation, Measure of systematic risk, portfolio risk and return, CAPM model and test of hypothesis as in her analysis.

Her findings are: The higher risk of common stock may have greater possible return. Banking sector is having good performance than other sector. Banking sector has the highest (0.2262) expected return but Hotel (0.0221) and trading (-0.2023) sector have negative expected return. All the listed five commercial bank's stocks are under priced. So investors need to buy these stocks.

Suresh Bolakhe, (2004), has conducted his Master's thesis as *"Risk and Return on Common Stock investment in listed finance companies"* is based on ten finance companies. In order to achieve the set objectives, he used five years (F\Y 1998/99 to 2002\03) historical common stock data of ten finance companies as sample.

Objectives of this study are as follows: to measure and analyze the risk and return associated with the common stock of selected finance companies, to analyzes the relation between risk and return of selected finance companies, to examine the relation among the returns of the selected finance companied, to determine the effects of portfolio on risk and return.

He used return on common stock investment, expected return on common stock, standard deviation, coefficient of variance, portfolio return, risk, correlation coefficient, beta systematic risk, risk minimizing portfolio weight.

His major findings and conclusions are: All the finance companies have positive expected returns which ranges from 16.6% to 74.4%. All the finance companies have certain value of total risk (SD) which range from 32.71 to 112.59. Systematic risk portion in returns of selected finance companies ranges from 6.59 to 46.54. All the finance companies have positive expected return. The portfolio of finance companies have reduced the risk up to some extent and increased the return. Majority of finance companies have relationship of positive correlation with other finance companies.

Durga Mani Sharma, (2004), has studied on *"Portfolio Management of Listed Commercial Banks and Insurance Companies in Nepal"* included five Banks and three insurance companies. The relevant objectives of his study were to analyze the return and risk of the common stocks of listed commercial banks and insurance companies; to analyze the diversifiable and undiversifiable risk; and to determine whether the shares of commercial banks and insurance companies are correctly priced or not.

The study was based on five years historical data from F/Y 1998 to F/Y 2002. He had analyzed the secondary data using financial as well as statistical tools. Moreover, Mr. Sharma had analyzed the current status of portfolio management adopted by these companies using primary data. He used return on common stock investment, expected return on common stock, standard deviation, coefficient of variance, portfolio return, risk, correlation coefficient, beta systematic risk, risk minimizing portfolio weight.

Major findings of the study were: Considering the return and risk characteristics of the common stock of all the select insurance companies, the common stock of EVIC was more attractive than others. The returns on common stocks of all insurance companies in F/Y 1999/2000 were highest among sampled years. He concluded that

the political and economic scenario was worsening day by day and it could have the adverse impact on the economic activities of the companies. The overall market return could not be regarded as attractive with respect to its risk. The risk per unit of return was very high which proved that the market was more risky than the common stocks of insurance companies. Almost common stocks of insurance companies moved in the same direction meaning they had positive correlation. Hence, no stocks with negative correlation or low positive correlation were available in the stock market. Most of the stocks seemed to be defensive and only few aggressive. The unsystematic risk of the stocks of all the companies was high in comparison to total risk. It seemed that the variability of returns of the common stocks of most of the companies was company specific. The company specific risk could be diversified away with a well-diversified portfolio. The stocks of the insurance companies were under priced since their required rates of return were less than their average rates of returns

Krishana Raj Pokhrel, (2006), has studied on *"Risk & Return Analysis of common Stock Investment with Reference to Six Commercial Banks"*. The study is based on only six commercial banks listed in NEPSE from among 14 listed commercial banks.

The specific objectives of this study are: to study returns associated with common stock investment of selected commercial bank of Nepal which is in group 'A' of NEPSE's evaluation, to study systematic risk and unsystematic risk associated with security, to analysis the variability of the common stock and other relatives variables, to evaluated whether the common stock of sampled companies equilibrium price or not.

Randomly selected 6 commercial banks listed companies in NEPSE index. It covers the 5 years from the F/Y 2000/01 to 2004/2005. The study is based on historical and secondary date. These data collected from NEPSE periodicals articles and previous research reports etc. and from different website of internet. Data are analyzed by using financial as well as statically tools. The financial tools included 'market price'

dividend amount expected returns of individual and portfolio statistical tools represent the hypothesis testing i.e. t-test.

His finding and conclusions are: Economically, Nepal is backwards its economic performance is not satisfactory. Generally public are least understood about the stock market and have fake conceptual thoughts about its risk. Expected return in the common stock of NABIL is maximum (i.e. 14.03%) which in normal rate of returns and expected returns of Nepal Investment Bank Ltd is negative (i.e.0.0396%) which is minimum among selected commercial banks. Common Stock of Bank of Katmandu Ltd is most risky. Since it has the highest standard deviation and common stock of Himalayan Bank Ltd on less risky because of it's lowest standard deviation. When risk and return compared to different industries hotels, finance and insurance is the best as per highest expected return with higher degree of risk where as trading industry has minimum return. The study shows that common stock of Nepal Investment bank Ltd. is overpriced and rest of all are under priced all the sock are in demand and investor cab buy the stock of NABIL, Standard Chartered Bank, Himalayan Bank, Everest Bank Ltd. and Bank of Katmandu.

Paras Kumar Kafle, (2006), conducted a research on *"Risk and Return analysis of Equity investment"* includes seven listed commercial banks in NEPSE and is a very closely related to this study. It includes five years data from 2000\01 to 2004\05 and used secondary data only.

The main objective to the study is to study and analyze various aspect of return and risk of common stock investment, to find the overpriced under priced and correctly price of Common stocks of commercial banks and to examine the relationship between dividend and market price of stock with reference to their risk and return.

In his study Mr. Paras found that "Banking industry is the biggest one terms of market capitalization and turn over. Expected return of on the common of Everest Bank Ltd. is the maximum and Nepal Arab Bank Ltd. is found to be Minimum. In this regard common stock of Everest Bank Ltd is mostly risky and common stock of

NABIL is least risky. The common stock of SBI is more risky on the basis of CV standard deviation but on the basis of common stock of NABIL are more risky because it has highest CV. He concluded that "common stock in the most risky security and life blood of stock market because of the higher expected return, common stock attracts more investors. But investment should be made after analyzing the risk and return properly.

Pradip Raj Panta, (2006), has studied on *"Risk and Return Analysis of Listed Commercial Banks in Nepal"*. The study is based on four commercial banks listed in NEPSE.

The major objectives of this study are as follows: to analyze the diversifiable and undiversifiable risk of the return on common stocks of the sample commercial banks, to examine whether the sample commercial banks are correctly priced or not, to analyze the portfolio return and risk of the sample commercial banks. To assess the present status of portfolio management of sample commercial banks.

For data analysis purpose exploratory and comparative research design has been used to this study. The study is based on secondary data. However primary data have also been used to analyze the current scenario of risk & return analyze of commercial banks. Data of the stocks of the respective banks traded in NEPSE with in the last seven years (F\Y1998\99 to F\Y 2004\05) are only considered. When analyzing portfolio risk and return, investment of the listed companies are categorized into two assets only i.e. risk free and risky assets.

Finding and Conclusions

Considering the overall market return and risk, the shares of all commercial banks are attractive for investment common stock of Himalayan Bank Ltd. seems attractive among all considering risk per unit of return. The returns on common stock of all the commercial banks in F/Y 1999/2000 were highest among sampled years. Most of the stocks seem to be defensive and only few are aggressive. The return from the portfolio managed by commercial banks cannot be taken satisfactory. The risk and return analysis of listed commercial banks does not seem

effective. In selecting the securities to make investment, most of the commercial bank adopts simple diversification and very few adopt diversification across quality rating categories.

Commercial banks are not satisfied from their portfolio return. The unsystematic risk of all the companies is high in comparison to total risk.

CHAPTER - III

RESEARCH METHODOLOGY

"Methodology refers the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind it. Thus, research methodology is a systematic and organized effort to investigate a specific problem that needs a solution." *(Wolff and Pant; 1999:203).*

This chapter mainly deals with the research methodology used to ascertain the study objectives. Under this, research design, population and sample, sample selection method, data collection and analysis techniques have been described.

3.1 Research Design

This study is based on recent five years historical data from F/Y 2002/03 to F/Y 2006/07. It deals with common stocks of companies, which have listed their shares in NEPSE to make them eligible for trading. Hence, it's a historical research. The common stocks under study have been analyzed in a descriptive and analytical way. It is more analytical and empirical and less descriptive.

3.2 Population and Sample

Population of this study includes all the insurance companies, which have listed their shares in NEPSE for trading in secondary market. At present, there are 19 companies that have listed their shares to make them eligible for trading in the secondary market of Nepal. They have only been considered as population. For this study purpose, only 5 insurance companies have been considered as sample based on simple purposive judgment. Samples are selected based on volume traded, data availability, price movement and so on. The sampled companies are listed in Table 3.1.

Table – 3.1: Population and sample of the study

Category	Population size	Sample size	Sampled Companies
Insurance Companies	19 (only listed companies)	5	1. Himalayan General Insurance Company 2. United Insurance Company Limited 3. Everest Insurance Company Limited 4. Premier Insurance Company Limited 5. National life & General Insurance Company Limited

Source: http://www.nepalstock.com

3.3 Sources of Data

The study is based on secondary data. Secondary data have been collected through various books, published annual/trading reports of NEPSE, SEBO-N and concerned companies. Especially the data have been derived from the official website of NEPSE – http://www.nepalstock.com and Annual Reports of Securities Board of Nepal.

3.4 Data Collection Technique

The researcher has visited the different libraries, concerned companies, NEPSE, SEBO-N and other useful bookstores; and collected related publications and periodicals. Official websites were searched in order to collect required information. Furthermore, secondary data related to common stocks of concerned companies have been downloaded from the official website of NEPSE, http://www.nepalstock.com.

3.5 Data Analysis Tools

Under this study, financial as well as statistical tools have been used to analyze the data and information.

3.5.1 Financial Tools

(a) Return and Risk Analysis of Individual Stocks

- **Dividend Per Share (DPS)**

Dividend per share (DPS) is calculated using the following model:

DPS = Cash Dividend + Stock Dividend

Cash equivalent of stock dividend is calculated as:

Cash Equivalent of Stock Dividend = SDR x Next Year MPS

Where, SDR = Stock Dividend Ratio

- **Market Price of Share (MPS)**

One of the principle measures of the value of the stock is market price of stock. It is denoted by P. Three price records are available in Nepal Stock Exchange Limited namely – High, Low and Closing Price. For our study purpose, closing price of the stocks is taken since our study focuses on annual data.

Return on Common Stock (R)

Holding Period Return

Generally, single period return or holding period return is represented by R and expressed in terms of percentage basis. It is calculated as:

$$\text{HPR} = \frac{\text{Ending Price} - \text{Beginning Price} + \text{Cash Dividend}}{\text{Beginning Price}}$$

Symbolically,

$$\textbf{HPR} = \frac{P_t - P_{t-1} + D_t}{P_{t-1}} = \text{Capital Gain} + \text{Dividend Yield}$$

Where,

P_t = Price of a stock at time t

P_{t-1} = Price of a stock at time t-1

D_t = Dividend per share at time t

Average Return of Common Stock ($\bar{R}$)

When probabilities of the return are given, the weighted average rate is known as the expected rate of return, represented by E(R). But when the historical data are used, then the arithmetic mean of the returns is known as average return on common stock, represented by $\bar{R}$. It is used as proxy for expected rate of return. It is computed as:

$$\textbf{Average Rate of Return on j stock} = \frac{\text{Sum of returns of past years}}{\text{Number of years}}$$

Symbolically,

$$\bar{\mathbf{R}} = \frac{Rj}{n}$$

where

Rj = Summation of annual returns on stock j

n = Number of observations

- **Risk of Common Stock**

Stock returns may be riskier or more volatile, but this concept is a difficult one to express simply. In Finance, a concept from Statistics called Standard Deviation is borrowed to measure the risk on returns of investment. Standard deviation is a summary measure about the average spread of observations around the mean. It is the square root of the variance. The standard deviation and the variance are equally acceptable and conceptually equivalent quantitative measures of an asset's total risk. It is computed as:

$$\textbf{Standard Deviation } (\pm_j) = \sqrt{\frac{(R_j \; Z \bar{R}_j)^{\;2}}{n}}$$

(b) Risk and Return Analysis of Market

- **Return on Market**

Annual return on market is the average return of market based on the index of market. Rm denotes it. Under this study, NEPSE index will be used. It is a value weighted index and comprises of all the stocks listed in NEPSE. The NEPSE index is used for the study.

$$\textbf{Annual Market Return } (R_m) = \frac{\text{Ending NEPSE Index} - \text{Beginning NEPSE Index}}{\text{Beginning NEPSE Index}}$$

Average Market Return ($\bar{R}_m$)

$$\bar{R}_m = \frac{R_m}{n}$$

Where

R_m = Summation of annual market return

n = Number of observations

- **Risk of Market Return**

Risk of market return is also measured by the standard deviation of the returns of market. The standard deviation of market returns is computed as:

$$\textbf{Standard Deviation } (\pm_m) = \sqrt{\frac{(R_m - \bar{R}_m)^2}{n}}$$

(c) Market Sensitivity Analysis

- **Covariance**

The covariance measures how two variables co-vary. It is a measure of the absolute association between two variables. Here, how the returns of individual stocks and

the market return co-vary will be measured by covariance between the return of individual stocks and market return. It is computed as:

$$\textbf{Cov (Rj, Rm)} = \frac{(Rj - \bar{R}j)(Rm - \bar{R}m)}{n} = \rho_{j,m}\,\sigma_j\,\sigma_m$$

If two variables are independent, their covariance is zero.

- **Correlation coefficients**

Correlation coefficient is a measure of the relative association between two variables. It describes how much linear co-movement exists between two variables. Correlation between stock j and the market is computed as:

$$\rho_{j,m} = \frac{Cov(R_j\ R_m)}{\sigma_j \sigma_m}$$

(i) If $Corr_{jm}$ is positive, the returns on security j and market tend to be large at the same time and small at the same time.

(ii) If $Corr_{jm}$ is negative, relatively large return of security j is associated with relatively small return of market.

(iii) If $Corr_{jm}$ is zero, the return of security j is uncorrelated to the return on market. Movement on the return of security j appear unrelated to movements in the return of market.

- **Beta**

Beta coefficients may be used for ranking the systematic risk of different assets. Beta coefficient of stock j is denoted by β_j. It is functionally related to the correlation and the covariance between the security and the market portfolio. It is computed **as:**

$$\beta_{j,m} = \frac{Cov(R_j R_m)}{Var(R_m)}$$

Where, Cov (R_j, R_m) = covariance of returns of the j_{th} asset with the market

Var (R_m) = variance of returns for the market portfolio

Individual stocks can be classified as aggressive or defensive or average on the basis of beta coefficients.

Beta coefficients	**Stock classification**	**Degree of risk**
Less than 1	Defensive stock	Less risky than the market
Exactly 1	Average stock	Equally risky as the market
Greater than 1	Aggressive stock	More risky than the market

d) Analysis of Systematic and Unsystematic Risk

- **Systematic Risk**

Total risk of any individual stock can be measured by variance or standard deviation. The total risk can be partitioned as (i) systematic and (ii) unsystematic. Systematic risk is that portion of total risk caused by market factors that simultaneously affect the prices of all securities and can not be avoided or diversified. Undiversifiable risk, market risk, beta risk are equally used terms. It is calculated as:

Systematic Risk = β_{jm}^2 Var (R_m)

Where β_{jm} = Beta coefficient of stock j with market return

Var (R_m) = Variance of market return.

The percentage of systematic risk is measured by the coefficient of determination.

$$\textbf{Proportion of Systematic Risk} = \frac{\text{Systematic Risk}}{\text{Total Risk}}$$

$$= \frac{\beta_{jm}^2 \text{ Var}(R_m)}{\text{Var}(R_j)} = \frac{\beta_{jm}^2 \sigma_m^2}{\sigma_j^2} = \rho_{j,m}^2$$

- **Unsystematic Risk**

Unsystematic risk is that portion of total risk of an individual stock that can be diversified away. It is also called diversifiable risk, company specific risk or non-market risk. It is calculated as:

Unsystematic Risk = Total Risk – Systematic Risk

$$= \text{Var}(R_j) - \beta_{jm}^2 \text{ Var}(R_m)$$

$$= \sigma_j^2 - \beta_{jm}^2 \sigma_m^2$$

- **Capital Asset Pricing Model (CAPM)**

Assets with high degree of systematic risk must be priced to yield high rates of return in order to induce investors to accept high degrees of risk that are undiversifiable with in that market. Hence, CAPM illustrates the positive relation between assets' systematic risks and their expected rates of return. CAPM is also called Security Market Line (SML). The SML equation is as:

$$E(Ri) = R_f + (R_m - R_f)\,\beta_j$$

Where,

E(Ri) = required rate of return on security j

R_f = risk free rate of return (government security)

R_m = return on market i.e. risky assets

β_j = Beta of security j (systematic risk index of security j)

3.7 Limitations of the Methodology

Every research methodology has some kinds of limitations. The research methodology adopted in this study also may have some limitations. Research design is descriptive as well as analytical. Only five insurance companies listed in NEPSE are taken as sample. In selecting samples, purposive and judgmental sampling method has been adopted. Most of the data used in this study are secondary in nature. However, in analyzing risk and return of the samples, the tools applied may not best describe the relationships between the variables under the study.

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

4 Introduction

This chapter focuses on the presentation and analysis of common stock of the sampled five insurance companies. The chapter attempts to evaluate and analyze the stock of the individual insurance companies on the basis of risk and return, systematic and unsystematic risk, market sensitivity, expected rate of return required. Financial tools are used in this section. Tables and diagrams have been used wherever possible for the clear presentation and analysis of the data.

4.1 Data Presentation and Analysis

There are only 19 companies are listed in NEPSE. This study has been focused only on five listed insurance companies. The presentation and analysis of data has been made in the order of insurance companies published by NEPSE Ltd. in the heading of "classification of the listed companies under the Listing Bye- law (2053 BS)". The positional order of insurance companies is as follows:

1. National Life & General Insurance Co. (NLGIC)
2. Himalayan General Insurance Co. (HGIC)
3. United Insurance Co. (UNIC)
4. Everest Insurance Co. (EVIC)
5. Premier Insurance Co. (PRIC)

4.1.1 Analysis of Market Price Per Share

Market price per share is the price at which shares are traded in the stock Financial. Those shares are transacted in the secondary Financials which are already issued to the public. Organized stock exchange centre are known as secondary Market where trading of the stocks are conducted. Market value in the secondary Market is determined by supply and demand factors and reflects the consensus opinion of investors and traders concerning the value of the stock (Cheney and Moses, 1993:417-418) The Market price per share of listed companies is a good measure of performance. A higher Market price per share indicates the better performance of the company and vice versa. Whether a Market price per share is high or low it is difficult to determine. For this, the Market analyst has to compare it with the book value per share and also with the Market price share of other companies.

Table 4.1: Market Price Per Share of Insurance Companies

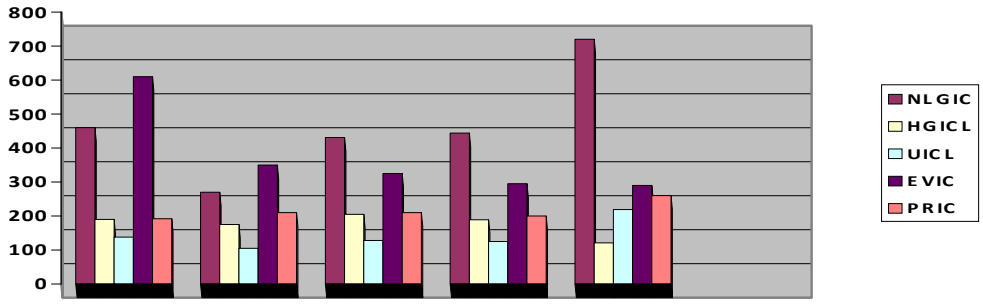
Year	NLGIC	HGIC	UNIC	EVIC	PRIC	Average
2002/03	460	190	138	610	192	318
2003/04	270	175	105	350	210	222
2004/05	431	205	128	325	210	260
2005/06	444	189	125	295	200	251
2006/07	720	121	219	290	260	322
Average	465	176	143	374	214	

Source: NEPSE Annual Reports

The above table shows the status of Market price per share of sampled insurance companies from 2002/03 to 2006/07. NLGIC has highest MPS in 2006/07 and lowest MPS in 2003/04 i.e. 720 and 270 respectively. The MPS of HGIC is Rs.190,

Rs.175, Rs.205, Rs.189, and Rs.121 in 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 respectively. The MPS of UNIC is ranging from Rs.105 to Rs.219 for the year 2003/04 and 2006/07. The MPS of EVIC is Rs.610, Rs.350, Rs.325, Rs.295 and Rs.290 in 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 respectively. Similarly, PRIC has same MPS for the year 2003/04 and 2004/05 i.e. Rs.210. The lowest MPS of PRIC is Rs.192 in 2002/03. The MPS of insurance companies are ranging from Rs.105 to Rs.610 of UNIC and EVIC. The MPS of EVIC and NLGIC is better then rest of companies. The MPS of NLGIC and EVIC is fluctuating ups and down and the MPS of rest of the companies have normal trend. The range of average MPS is Rs.143 to Rs.465 among the companies.

Figure 4.1: MPS of Insurance Companies



4.1.2 Analysis of Dividend Per Share

Dividend per share is the amount availed to the holders of each common stock by the company. Evaluation of performance of listed companies in terms of dividend per share (DPS) is considered as an appropriate measure which shows the companies' earnings and dividend paying capacity. DPS is the net distributed profit belonging to the shareholders divided by the number of ordinary shares outstanding. It measures the financial performance of the company. It is calculated as under:

$$\text{DPS} = \frac{\text{Amount paid to equity shareholders}}{\text{Number of ordinary shares outstanding}}$$

Dividend per share includes dividend decision in earning per share. Although the behaviour of companies towards dividend payment is disappointing in Nepal. The insurance companies, commercial banks, other market institutions, and some other companies have brought greater revolution in this trend. They are competing for paying larger amount of dividends in recent years.

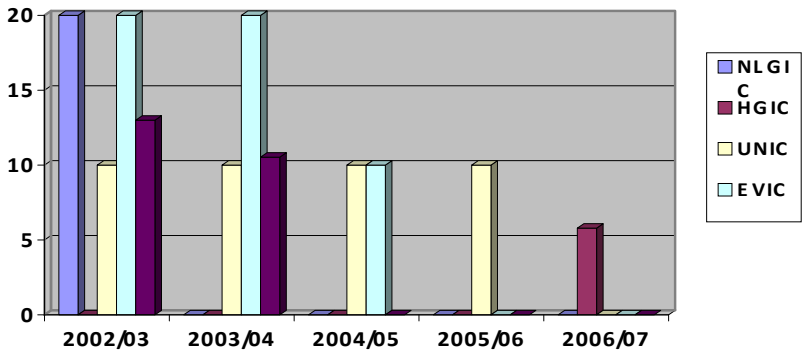
Table 4.2: Dividend Per Share of Insurance Companies

Year	NLGICL	HGICL	UNIC	EVIC	PRIC	Average
2002/03	20.00	0.00	10.00	20.00	13.00	12.6
2003/04	0.00	0.00	10.00	20.00	10.53	8.11
2004/05	0.00	0.00	10.00	10.00	0.00	4
2005/06	0.00	0.00	10.00	0.00	0.00	2
2006/07	0.00	5.79	0.00	0.00	0.00	1.16
Average	4.00	1.16	8.00	10.00	4.70	

Source: NEPSE Annual Reports

Table 4.2 shows the influence of Market indicators i.e. DPS of insurance companies from 2002/03 to 2005/06. NLGIC paid dividend per share of Rs.20.00 for the year 2002/03 only and has not paid any dividend for the year 2003/04 to 2006/07.The dividend per share of HGIC is Rs.5.79 in 2006/07 and rest of the year i.e. since 2002/03 to 2005/06, it has not paid any dividend to its share holder. UNIC has paid fixed dividend per share of Rs.10.00 for continuous four year i.e. from 2002/03 to 2005/06.Similarly EVIC has paid dividend per share of Rs.20.00 for two years i.e. in 2002/03 and 2003/04 and decreased by Rs.10.00 in 2004/05. There was no dividend distributed by EVIC for two years of 2005/06 & 2006/07. PRIC paid dividend per share of Rs.13.00 and Rs10.53 in 2002/03 and 2003/04 respectively; no dividend was paid since 2004/05 to 2006/07. The dividend per share ranges from Rs.20.00 to Rs.5.79 of NLGIC, HGIC, UNIC, EVIC and PRIC for five years period. UNIC has regularly paid dividend for four years of Rs.10.00. It indicates that UNIC has good performance among the five insurance companies. NLGIC and HGIC has poor performance towards dividend per share. It has paid Rs.20.00 for one year only in 2002/03 and HGICL has paid Rs.5.79 for one year only in 2006\07. Similarly, EVIC and PRIC has fluctuating trend of DPS for five years period.

Figure 4.2 **DPS of Insurance Companies**



4.1.3 Risk and Return of Common Stocks

The return on common stock is the percentage increase/decrease in share price and any cash receipts such as dividends over a specific period of time and the risk is the possibility that the actual return from holding a stock may deviate from the expected rate of return. It is measured by variance or standard deviation of returns. Here, every five year holding period return (R_i) or average rate of returns, variance of returns, standard deviations and coefficient of variation of all five company are presented separately in Table 4.3 to 4.7 The calculations are shown in **Annex I.**

NLGIC

Table 4.3 - Average rate of returns, variance, standard deviation and coefficient of variation

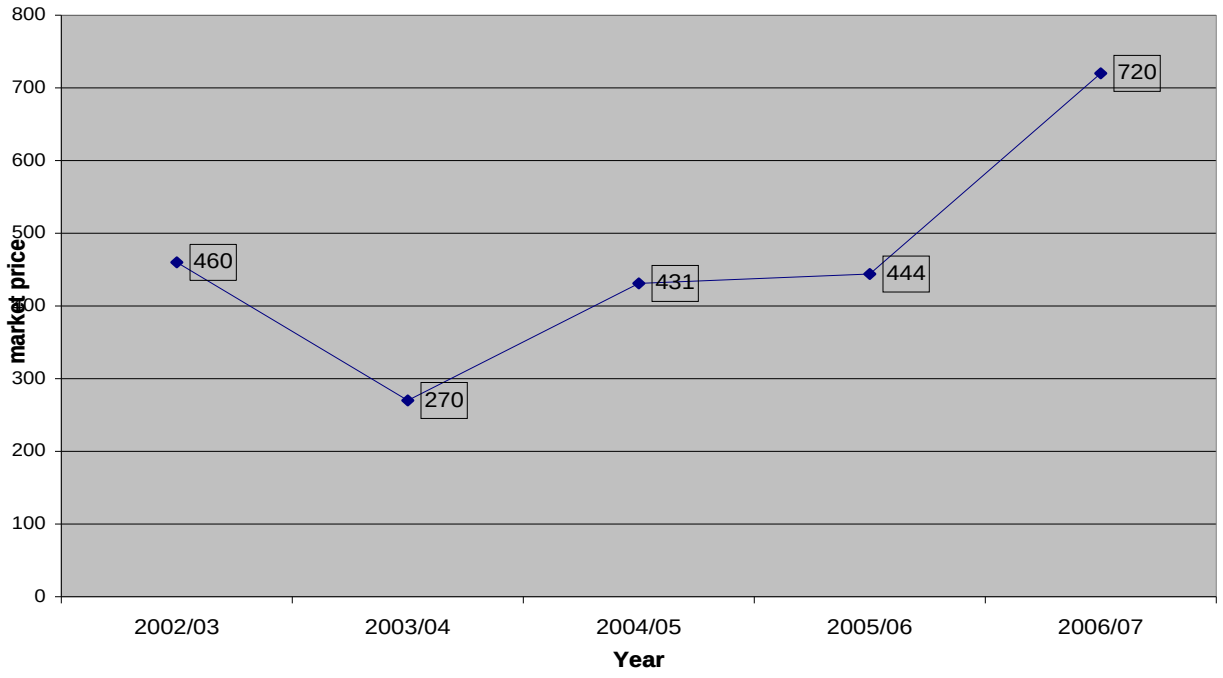
Year	Year end price	Dividend	**Ri=** $\frac{P_t - P_{t-1} + D_t}{P_{t-1}}$	**$(R_i - \bar{R}_i)$**	**$(R_i - \bar{R}_i)^2$**	**CV=** $\frac{\pm}{\bar{R}}$
2002/03	460	20	4.35%	-13.23%	1.75%	0.40
2003/04	270	0	-41.30%	-58.88%	34.67%	-0.83
2004/05	431	0	59.63%	42.05%	17.68%	0.29
2005/06	444	0	3.02%	-14.48%	2.10%	0.69
2006/07	720	0	62.16%	44.58%	19.87%	0.31
		$\sum R_i$	87.94%	**$\sum (R_i - \bar{R}_i)^2$ = 76.07%**		
		$\bar{R}_i$	17.58%	**Var (Ri) = 15.21%** σi $X\sqrt{\text{Var (Ri)}}$		

Source: NEPSE Annual Reports

The statistical results presented in Table 4.3 imply that the year end price of NLGIC. Where we can see the share of NLGIC is highest in year 2006/07n ie 720 and the lowest price of NLGIC IS 270. NLGIC price is highly fluctuated in the market. And did not pay any dividend in year 2003/04 to 2006/07 except 2002/03

i.e. The share price of NLGIC offers the highest average rate of return i.e. 62.16% in 2006/07 where as the lowest average rate of return i.e. (–41.30%) in 2003/04.The different year have different rates of return with in the range of -41.30% to 62.16 %. The return of the company seems 4.35%, -41.30%, 59.63%, 3.10% and 62.16% since 2002/03 to 2006/07 respectively. On the basis of rate of return 2006/07 year seems to be the best for investment. Furthermore, analyzing the risk characteristics, the year 2003/04 has the highest standard deviation i.e. 58.88% and 2002/03 has the lowest standard deviation i.e. 13.23%. The market price of NLGIC is depicted in Figure 4.3 Calculation are shown are annex I and II.

Figure: 4.3 Year end price of NLGIC



PRIC

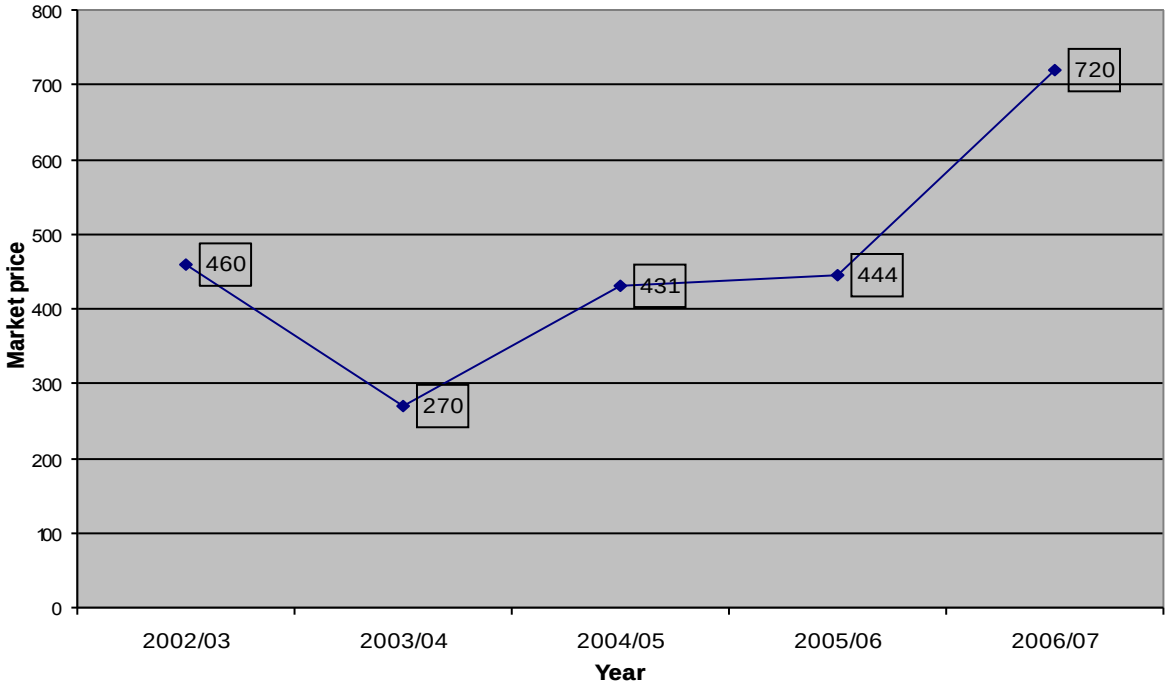
Table 4.4 - Average rate of returns, variance, standard deviation and coefficient of variation

Year	year end price	Divident	**Ri=** $\frac{P_t\ ZP_{tZ1}\ \Gamma D_t}{P_{tZ1}}$	**(R_i - $\bar{R}_i$)**	**(R_i - $\bar{R}_i$)2**	**CV=** $\frac{\pm}{\bar{R}}$
2002/03	192	13.00	20.59%	8.45%	0.71%	0.03
2003/04	210	10.53	14.86%	2.72%	0.07%	0.04
2004/05	210	0.00	0%	-12.14%	1.47%	0.00
2005/06	200	0.00	-4.76%	-16.9%	2.86%	-0.60
2006/07	260	0.00	30.00%	17.86%	3.19%	0.11
		pR_i 60.69%		**$\sum(R_i - \bar{R}_i)2$** = 8.30%		
		$\bar{R}_i$ 12.14%		**Var (Ri)** = 1.66% σi $X\sqrt{Var\ (Ri)}$		

Source: NEPSE Annual Reports

In Table 4.4, the statistical data shows that the year end price of PRIC where the year 2004/05and 2005/06 are same and the lowest price of 2002/03 is 192. PRIC had paid only two year dividend that is 2002/03and 2003/04. Other remaining years PRIC didn't pay any dividend. The share of PRIC offers the highest average rate of return i.e. 30.00% in 2006/07 where as the lowest average rate of return i.e. (–4.76%) in 2005/06. The different year have different rates of return with in the range of -4.76% to 30.00 %. The return of the company seems 20.69%, 14.86%, 0.00%, -4.76% and 30.00% since 2002/03 to 2006/07 respectively. On the basis of rate of return 2006/07 year seems to be the best for investment. Furthermore, analyzing the risk characteristics, the year 2006/07 has the highest standard deviation i.e. 17.86% and 2003/04 has the lowest standard deviation i.e. 2.64%. The market price of PRIC depicted in Figure 4.4. Calculations are shown are annex I and II.

Figure: 4.4 Year end price of PRIC



EVIC

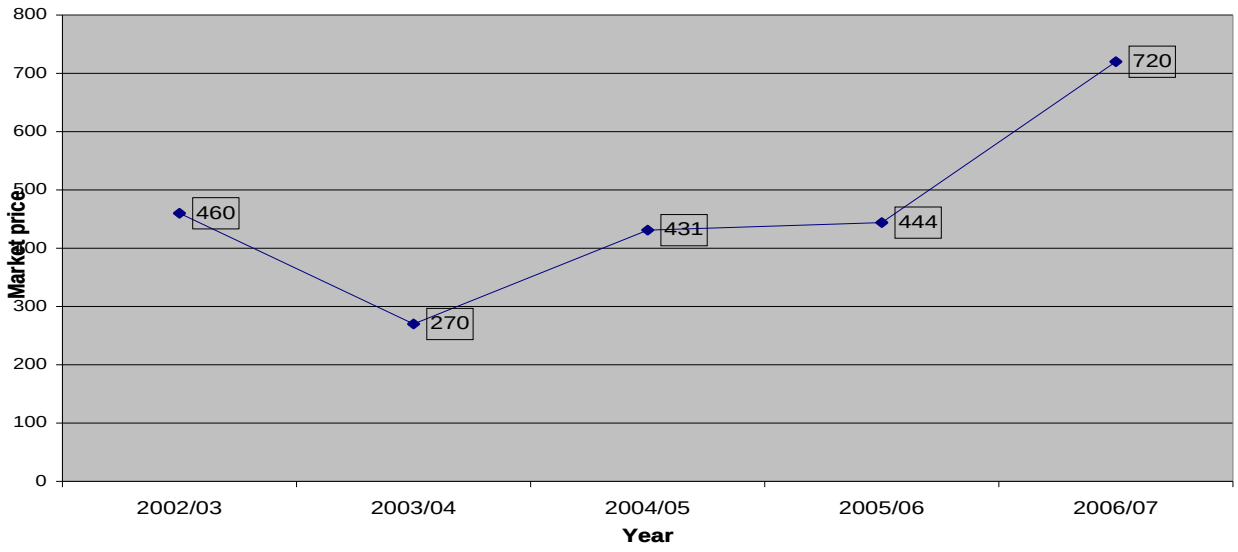
Table 4.5 - Average rate of returns, variance, standard deviation and coefficient of variation

Year	year end price	Divident	$R=\frac{P_t\ ZP_{tZ1}\ \Gamma D_t}{P_{tZ1}}$	$(R_i - \bar{R}_i)$	$(R_i - \bar{R}_i)2$	$CV=\frac{\pm}{\bar{R}}$
2002/03	610	20	3.28%	13.22%	1.75%	0.53
2003/04	350	20	-39.34%	-29.4%	8.64%	-0.22
2004/05	325	10	4.28%	5.66%	0.32%	0.07
2005/06	295	0	-9.23%	2.25%	0.05%	-0.05
2006/07	290	0	-1.69%	8.25%	0.86%	-0.51
			pR_i -49.70%	$\sum(R_i - \bar{R}_i)2$ = 11.62%		
			$\bar{R}_i$ -9.94%	**Var (Ri)** = 2.32% $\sigma i\ X\sqrt{Var\ (Ri)}$		

Source: NEPSE Annual Reports

The above Table 4.5 imply that the end price of EVIC which are 610, 350, 325, 295, 290 in year 2002/03 to 2006/07 respectively. EVIC year end price is very fluctuated, where we can see year 2002/03 is 610 and year 2006/07 is lowest price that is 290. EVIC paid only three year dividend other remaining two year EVIC did not paid any dividend i.e year 2005/06 and 2006/07 respectively. The share of EVIC offers the highest average rate of return i.e. 39.34% in 2003/04 where as the lowest average rate of return i.e. (–7.69%) in 2005/06. The different year have different rates of return with in the range of -7.69% to 39.34 %. The return of the company seems 3.28%, 39.34%, -4.28%, -7.69% and -1.69% since 2002/03 to 2006/07 respectively. On the basis of rate of return 2003/04 year seems to be the best for investment. Furthermore, analyzing the risk characteristics, the year 2003/04 has the highest standard deviation i.e. 29.39% and 2005/06 has the lowest standard deviation i.e. 2.23%. The market price of EVIC depicted in Figure 4.4. Calculations are shown in annex I and II.

Figure: 4.5 Year end price of EVIC



UNIC

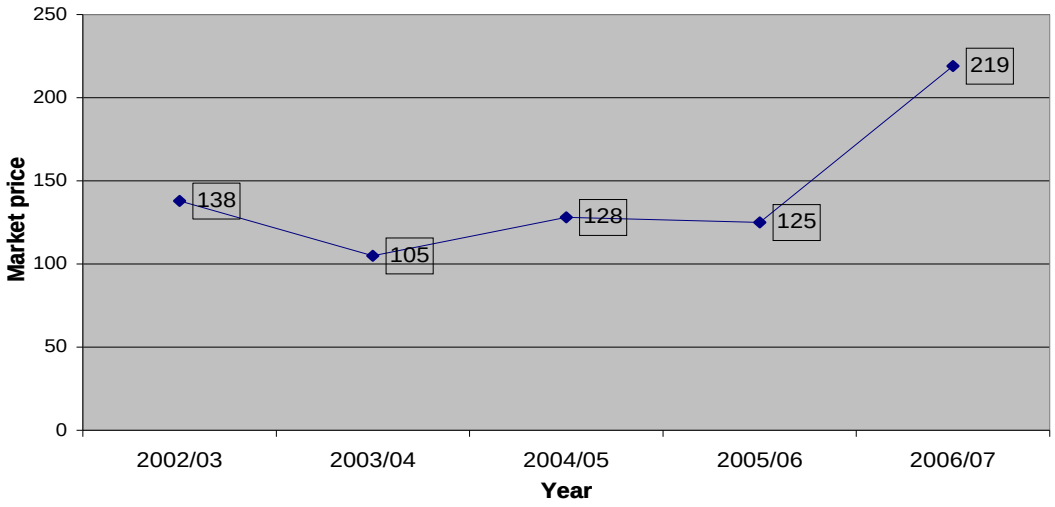
Table 4.6 - Average rate of returns, variance, standard deviation and coefficient of variation

Year	year end price	Divident	**Ri=** $\frac{P_t\ ZP_{tZ1}\ \Gamma D_t}{P_{tZ1}}$	**(R_i - $\bar{R}_i$)**	**(R_i - $\bar{R}_i$)2**	**CV=** $\frac{\pm}{\bar{R}}$
2002/03	138	10	22.10%	-36.77%	13.52 %	0.61
2003/04	105	10	-16.67%	31.34%	9.82%	-0.59
2004/05	128	10	31.43%	16.76%	2.81%	0.08
2005/06	125	10	5.47%	9.2%	0.85%	0.15
2006/07	219	0	75.20%	60.54%	36.65%	0.48
		pR_i	73.33%	**$\sum(R_i - \bar{R}_i)2$ = 63.65%**		
		$\bar{R}_i$	14.67%	**Var (Ri) = 12.73%** σi X $\sqrt{\text{Var (Ri)}}$		

Source: NEPSE Annual Reports

The statistical results presented in Table 4.6 imply that the year end price of UNIC where the highest price of UNIC is 219 in year 2006/07 and lowest price of UNIC is 105. UNIC paid Rs 10 for four year ie 2002/03 to 2005/06 respectively only one UNIC did not paid dividend. The year the share of UNIC offers the highest average rate of return i.e. 75.20% in 2006/07 where as the lowest average rate of return i.e. (–16.67%) in 2003/04. The different year have different rates of return with in the range of -16.67% to 75.20 %. The return of the company seems 22.10%, -16.67%, 31.43%, 5.47% and 75.20% since 2002/03 to 2006/07 respectively. On the basis of rate of return 2006/07 year seems to be the best for investment. Furthermore, analyzing the risk characteristics, the year 2006/07 has the highest standard deviation i.e. 60.53% and 2005/06 has the lowest standard deviation i.e. 9.22 The market price of UNIC is depicted in Figure 4.6. Calculation are shown in annex I and II

Figure: 4.6 Year end price of UNIC



HGIC

Table 4.7 - Average rate of returns, variance, standard deviation and coefficient of variation

Year	year end price	Divident	**Ri=** $\frac{P_t\ ZP_{tZ1}\ \Gamma D_t}{P_{tZ1}}$	**$(R_i - \bar{R}_i)$**	**$(R_i - \bar{R}_i)2$**	**CV=** $\frac{\pm}{\bar{R}}$
2002/03	190	0	-15.56%	-6.15%	0.38%	-0.02
2003/04	175	0	-7.89%	1.52%	0.02%	-0.002
2004/05	250	0	17.14%	26.55%	7.05%	0.41
2005/06	189	0	-7.80%	1.61%	0.03%	-0.03
2006/07	121	5.79	-32.92%	-23.51%	5.53%	-0.17
		pR_i -47.03 %		**$\sum(R_i - \bar{R}_i)2$ = 13.00%**		
		$\bar{R}_i$ -9.41 %		**Var (Ri) = 2.60%** $\sigma i\ X\sqrt{Var\ (Ri)}$		

Source: NEPSE Annual Reports

The above statistical data in Table 4.7 imply that the market price of HGIC where the lowest price of HGIC is 175 in 2003/04 and highest price of HGIC is 205 in year 2004/05. It shows that the price of HGIC is not very fluctuated and did paid dividend early four year. Only last year of this study HGIC paid dividend i.e. 5.79. The share of HGIC offers the highest average rate of return i.e. 17.14% in 2004/05 where as the lowest average rate of return i.e. (–32.92%) in 2006/07. The different year have different rates of return with in the range of -32.92% to 17.14 %. The return of the company seems -15.56%, -7.89%, 17.14%, -7.80% and -32.92% since 2002/03 to 2006/07 respectively. On the basis of rate of return 2004/05 year seems to be the best for investment. Furthermore, analyzing the risk characteristics, the year 2004/05 has the highest standard deviation i.e. 26.55% and 2003/04 has the lowest standard deviation i.e. 6.25%. The rates of return and the risk are depicted in Figure 4.8 Calculations are shown in annex I and II.

Table 4.8 - Overall performance of sample Insurance companies

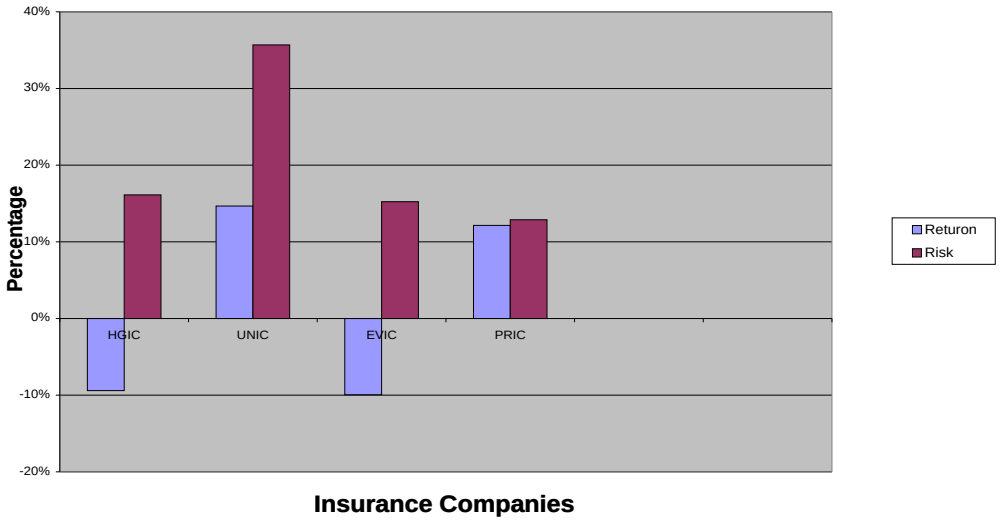
Insurance Companies	$\bar{R}_i$	Var (R_i)	σ_r	CV= $\frac{\pm}{\bar{R}}$
National Life & General Insurance Co. (NLGIC)	17.58%	15.21%	39.00 %	2.22
Himalayan General Insurance Co. (HGIC)	-9.41%	2.60%	16.12 %	-1.71
United Insurance Co. (UNIC)	14.67%	12.73%	35.68 %	2.43
Everest Insurance Co. (EVIC)	-9.94%	2.32%	15.23 %	-1.53
Premier Insurance Co. (PRIC)	12.14%	1.66%	12.88 %	1.06

The statistical results presented in Table 4.8 imply that the share of NLGIC offers the highest average rate of return i.e. 17.58% where as the share of EVIC offers the lowest average rate of return i.e. (–9.94%) over the years. The different shares have different rates of return with in the range of -9.41% to 17.58 %. Himalayan General Insurance Co, Premier Insurance Co., United Insurance Co., National Life & General Insurance Co., and Everest insurance co. has -9.45%, 12.14%, 14.67%, 17.58%, and -9.94% respectively. On the basis of average rate of return, the share of NLGIC seems to be the best for investment. Furthermore, analyzing the risk characteristics, the NLGIC also has the highest standard deviation i.e. 39.00% and PRIC has the lowest standard deviation i.e. 12.88%.

Analyzing the return characteristics separately may mislead the investment decisions. Each and every return carries an uncertainty or risk. Risk can explain the variability of returns from its central tendency. The risk is measured by the standard deviation of the returns. Observing the standard deviation of returns of individual insurance companies, National Life & General Insurance Co. has the highest i.e. 39.00%. Himalayan General Insurance, United Insurance, Premier Insurance, Everest Insurance have 16.12%, 35.68%, 12.88%, 40.98%, and 15.13% respectively and Premier Insurance has the lowest standard deviation i.e. 12.88%.

However, the decision taken on the basic of risk and return separately may not be a rational decision. In such a situation, coefficient of variation (the ratio between risk and return) is the best measure to make the investment decisions. Coefficient of variation can depict the exact position of risk per unit of return. Lower CV is preferable. The risk per unit of return of EVIC is negative, PRIC is 1.06, HGICG is also negative, UNIC is 2.43, NLGIC is 2.22, and here, CV of PRIC has 1.06, which is the lowest among all whereas of UNIC i.e. 2.43 is the highest. On the basic of CV, the common stock of PRIC is attractive among all and the investors retaining the stocks of UNIC should assume more risk than other. The rates of return and the risk are depicted in Figure 4.8. Calculations are shown in annex II.

Fig. 4.8 – Average rates of return and standard deviation of the Common stock of insurance companies



4.1.4 Market Risk and Return

Nepal Stock Exchange Limited is the only secondary market of Nepal. Government of Nepal, under a programme initiated to reform capital Financials converted Securities Exchange Centre into Nepal Stock Exchange in 1993. Nepal Stock Exchange, in short NEPSE, is a non-profit organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free Financial ability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, Market intermediaries, such a broker, Market makers etc.

Hence, NEPSE index represents the market. Market return is calculated on the basis of NEPSE index. The market indexes of last five years and required calculations have been shown in Annex III and percentage change have been shown in Table 4.9

Table 4.9: NEPSE Index

Year	NEPSE Index	%Change
2002/03	204.86	-
2003/04	241.54	0.17
2004/05	286.67	0.19
2005/06	386.83	0.35
2006/07	383.95	-0.007

(Source: NEPSE Annual Trading Report)

The above table 4.9 shows the behavior of NEPSE index. By the end of fiscal year 2005/06, the price index of the listed securities (NEPSE Index) remained at 386.67 points, which is excess by 100.15 points than that of the last fiscal years' index 286.67 points. In this research fiscal year, the highest index of 386.67 was noted and the lowest index of 204.86 was noted on year 2002/03.

Figure: 4.9 Trend of NEPSE

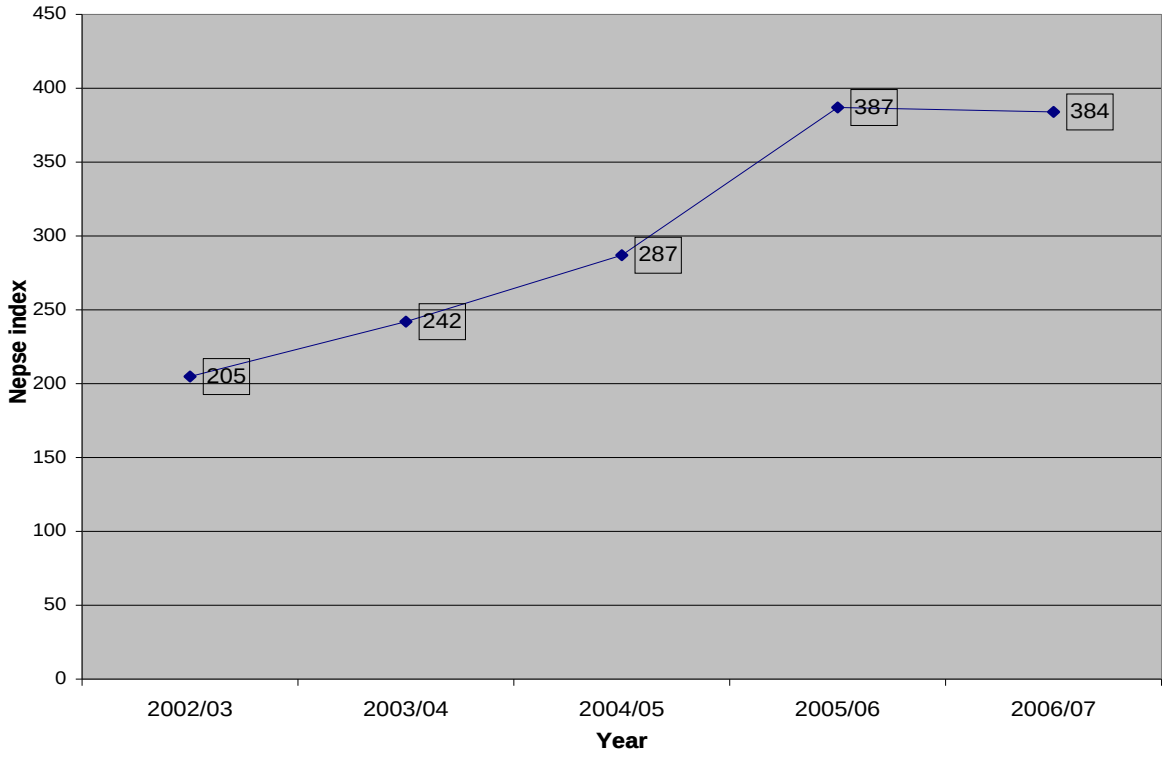


Table 4.10– Average Rate of Return, Variance, Standard Deviation and CV of overall Market Returns (NEPSE)

Year	NEPSE Index (NI)	Average Return	Variance	Standard Deviation	CV
2002/03	204.86	-9.59%	4.76%	21.82%	-2.27
2003/04	241.54	17.90%	0.32%	5.65%	0.16
2004/05	286.67	18.68%	0.41%	6.40%	0.34
2005/06	386.83	34.94%	5.15%	22.69%	0.65
2006/07	383.95	-0.74%	1.68%	12.96%	-17.51
In average		12.24%	3.08%	17.55%	1.43

In table 4.10, Average rate of market return is only 12.24% with a standard deviation of16.25%. Coefficient of variation of the market return is 1.33, which is more than the coefficient of variation of individual insurance companies. The market is more risky with lower return than the return of individual companies. Calculations are shown in annex -III.

4.1.5 Market Sensitivity of Stocks

The covariance measures how two variables co-vary. It is a measure of the absolute association between two variables. Here, how the returns of individual stocks and the market return co-vary has been measured by covariance between the return of individual stocks and market return.

The variability of a security's return with the return of the overall market - NEPSE return is called systematic risk and which cannot be avoided. It is un-avoided risk and is measured by beta coefficient. Beta depicts the sensitivity of the security's excess returns to that of the market portfolio.

4.5.2.1 Calculation of beta of market

We have,

$$\beta_j = \frac{COV(R_j R_m)}{\sigma_m^2}$$

$$= \frac{\sigma_j \sigma_m \rho_{jm}}{\sigma_m^2} = \frac{\sigma_j \rho_{jm}}{\sigma_m}$$

The Covariance, correlation of the return on common stocks of insurance with that of market return and the beta coefficients are shown in Table 4.11 and Figure 4.10

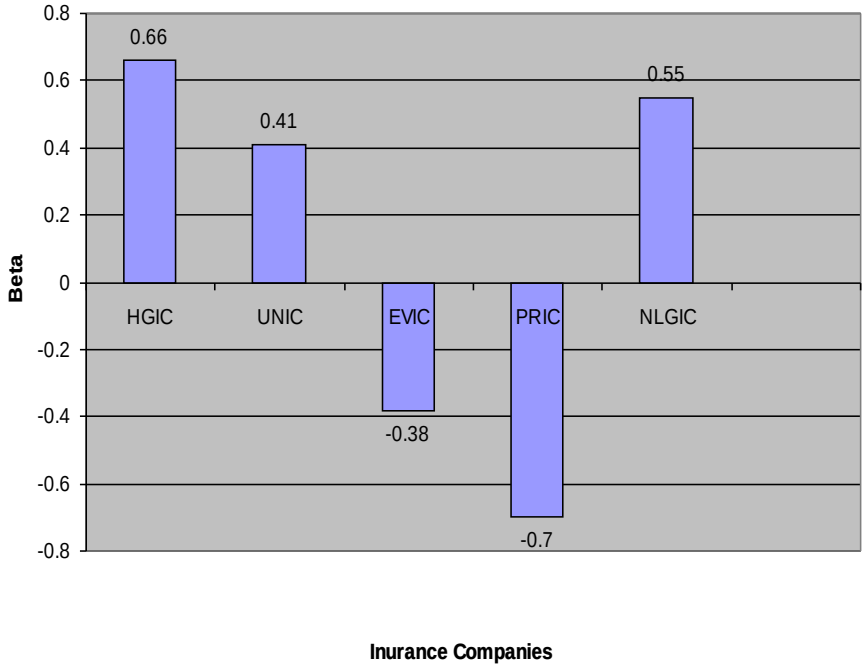
Table 4.11 Covariance and Beta Coefficients of Insurance Companies

Insurance Companies	Cov (R_i, R_m)	$_{im}$	Remarks
HGIC	1.62 %	0.66	Defensive
UNIC	1.02 %	0.41	Defensive
EVIC	- 0.95 %	-0.38	Defensive
PRIC	- 1.73 %	-0.70	Defensive
NLGIC	1.36 %	0.55	Defensive

Observing the table, covariance of the returns of HGIC, EVIC, UNIC, PRIC and NLGI, with the overall market returns are 1.62%, - 0.95%, 1.02%, - 1.73%, and 1.36% respectively. Covariance measures the absolute association between the returns and market. Covariance between the returns of HGIC and market is 1.62 %, which is the highest among all. Likewise PRIC and market is negative, lowest among all.

When looking the beta coefficients, the stock of HGIC 0.66, UNIC has0.41, EVIC has-0.38, PRIC has -0.70, NLGI has 0.55. The beta coefficient of HGIC is the greatest and PRIC has the lowest beta. The beta coefficients of PRIC, and NLGIC, HGIC, UNIC, EVIC are less volatile than market because the beta coefficients are less than 1Hence, all insurance companies are market sensitive. The beta coefficients of insurance companies are depicted in Figure 4.10.

Figure 4.10 Beta coefficients of individual insurance companies



Total risk is measured by the variance of returns and can be partitioned into systematic and unsystematic risk.

Total risk, systematic and unsystematic risk and their proportions of the stocks of the insurance companies are presented in Table 4.12 Calculation are shown in Annex v

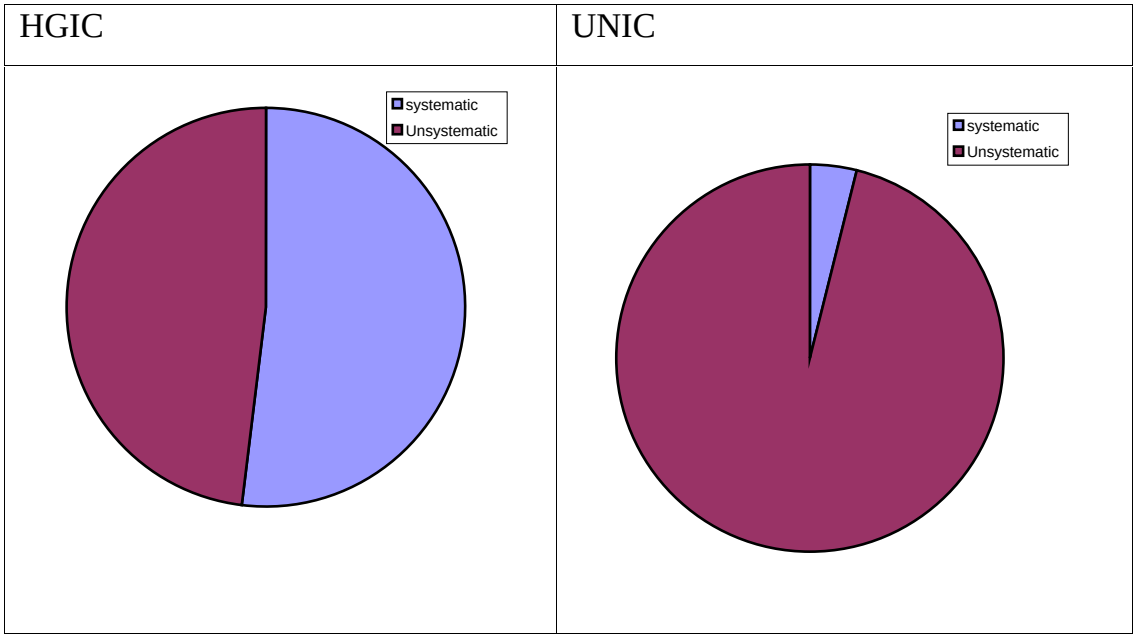
Table 4.12- Partition of Risk

Insurance Co.	Total Risk (VAR)	Systematic Risk [^{2}Var(R_m)]	Proportion of Systematic Risk	Unsystematic Risk	Proportion of Unsystematic Risk
HGIC	2.6%	1.34%	0.52	1.26%	0.48
UNIC	12.73%	0.52%	0.04	11.58%	0.96
EVIC	2.32%	0.44%	0.19	1.88%	0.81
PRIC	1.66%	1.51%	0.91	0.15%	0.09
NLGIC	15.21%	0.93%	0.06	14.28%	0.94

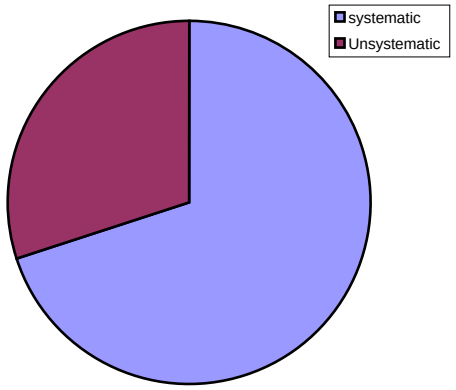
Statistical results presented in Table 4.11 reveal that the stocks of HGIC, UNIC, EVIC, PRIC, NLGIC, and have the systematic risks of 1.34%, 0.52%, 0.44%, 1.51% and 0.93% respectively. Out of the total risk, systematic risk of PRIC is the highest i.e. 1.51% which is 91% of its total risk EVIC has higher proportion of systematic risk than UNIC. The highest systematic risk of PRIC is due to highest correlation with market and the lowest systematic risk of EVIC is due to lowest correlation / covariance with market.

Out of total risk, 52%,91%, 4%, 19%, and 6%, of HGIC, PRIC, UNIC, , EVIC, NLGIC, and respectively are systematic and cannot be avoided. But 48% of HGIC, 9% of PRIC, 96% of UNIC, 81% of EVIC and 94% of NLGIC are unsystematic or company specific risk. Hence, these can be diversified away with an optimum portfolio construction or well-diversified portfolio.

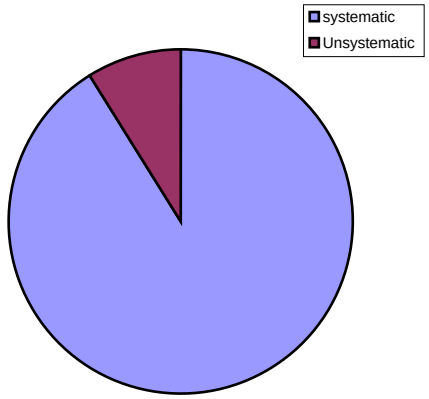
Figure 4.11: Systematic and Unsystematic Risk of Insurance Companies



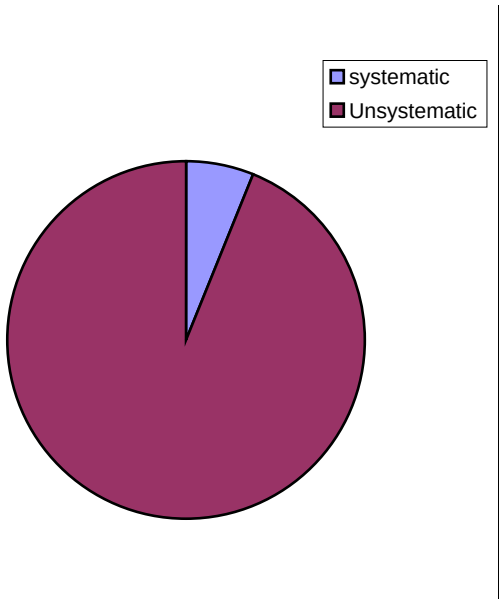
EVIC



PRIC



NlGIC



4.1.6 Price evaluation of the Stocks of Listed Companies

The required rate of return is the minimum rate of return that an investor expects from his/her investment in risky assets. It is the function of real rate of return and systematic risk. The required rate of return is the return on risk free assets i.e. government securities plus risk premium. Price evaluation is related to identification

of mis priced stocks and these include over-priced and under-priced stocks. The comparison of required rate of return and expected rate of return helps to identify overpriced, correctly priced and under priced stocks It is determined by Capital Assets Pricing Model (CAPM) / Securities Market Line (SML)

The greater the beta of a security, greater will be the risk and the greater the expected return required. Likewise, the lower the beta, lower will be the risk, the more valuable it becomes and the lower expected return required. There are three conditions of price evaluation, which are-

- Expected rate of return >Required rate of return Under priced
- Expected rate of return <Required rate of return Over priced
- Expected rate of return =Required rate of return Correctly priced

For price evaluation, the calculation of required rate of return is necessary. The required rate of return can be calculated as-

$$E(R_j) = R_f + \beta_j (E(R_m) - R_f)$$

In the above equation, the risk free rate of return (R_f) is used as the interest rate of Treasury bill issued by Nepal Rastra Bank. As suggested by Treasury Bill section of NRB, the interest rate of 91 days treasury bills converted to 365 days duration comes approximately to 4.8% at current period.

Hence, the inputs for the equation are-

R_f XRisk free rate of return =4.8% = 0.048

$E(R_m)$ = Expected market rate of return =7.44% = 0.0744

The beta coefficients, risk premiums and required rate of return on the stocks of insurance companies are summarized in Table 4.12.

Table 4.13: **Beta, Risk Premiums and Required Rates of Return**

Insurance Companies	β	$\bar{R}f$ (%)	$\bar{R}m$ **(%)**	Risk Premium ($\bar{R}m - \bar{R}f$)	Required Rate of Return	Expected Rate of Return	Price Situation
HGIC	0.66	4.8%	12.24%	7.44%	9.71%	17.58%	Under Priced
UNIC	0.41				7.85%	- 9.41%	Over Priced
EVIC	-0.38				1.97%	14.67%	Under Priced
PRIC	-0.70				-0.41%	-9.94%	Over Priced
NLGIC	0.55				8.89%	12.14%	Under Priced

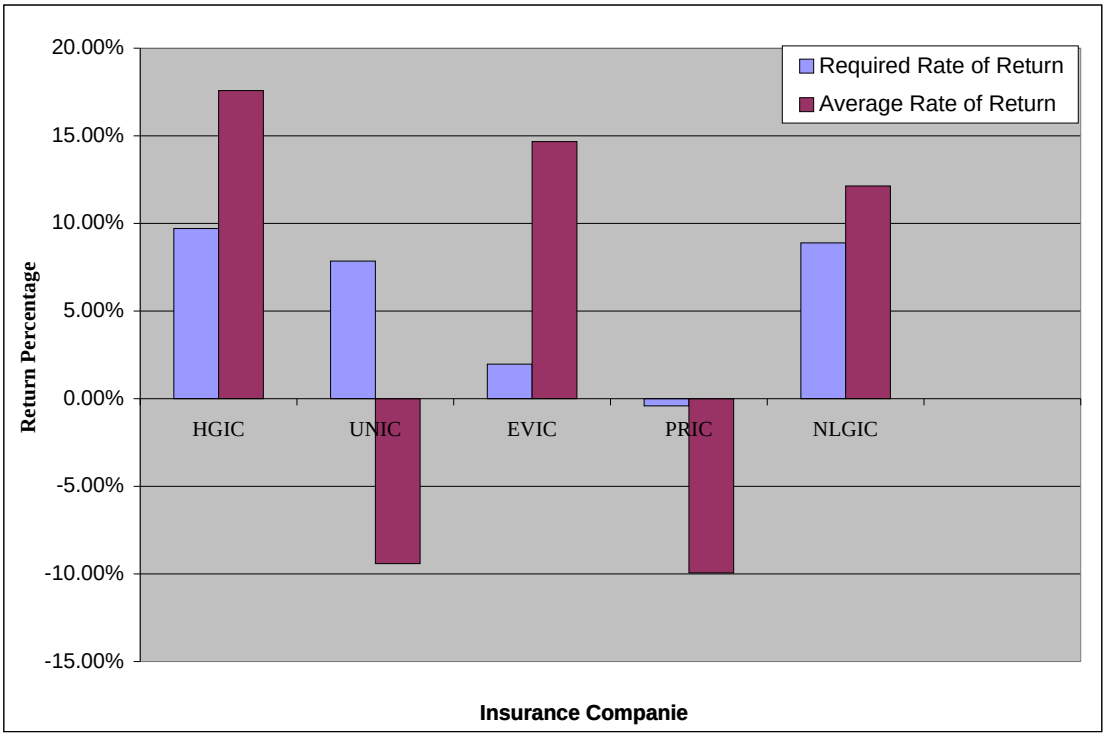
(Calculations are shown in annex VI)

From the results presented in Table 4.12, it has been observed that the overall average market return is 7.44 %. Average Treasury bill rate as of 2007 is 4.8%. The risk premium for the stocks of all the insurance companies in the market is the difference between risk free rate and market rate of return i.e.7.44%. Based on the riskiness of the stocks in terms of systematic risk only, the required rate of returns are 9.71% for HGIC,7.85% for UNIC, 1.97% for EVIC, -0.41% for PRIC and NLGIC for 5.36%. Higher systematic risk requires higher required rate of return and vice versa. Since the beta coefficient of the stocks of HGIC is the highest among all i.e 0.66, its required rate of return is also highest among all i.e. 9.71%. Lower systematic risk requires lower risk premium. PRIC has lowest systematic risk as represented by beta coefficient among all i.e. -0.70, which requires a minimum return of -0.41%

Comparing the required rate of return and the expected rate of return of the stocks of individual insurance companies, the required rate of return for HGIC, EVIC and NLIG companies are less than expected rate of return and for PRIC and UNIC companies are higher than expected rate of return. This is due to the fact that the stocks of almost insurance companies are least correlated with the market and the

stocks of these companies are less volatile than market. Consequently, their beta coefficients are less than 1. Since, average rate of returns of HGIC, EVIC, and NLGIC insurance companies are higher than their expected rate of returns, they are considered to be under priced in the market. The shares of insurance companies appear attractive to investors. The investors can gain from buying the under-priced stocks. Hence, investors are advised to purchase and hold the stocks of insurance companies rather to sell in the market. But the price of stocks will increase only up to the point where expected rate of return is equal to required rate of return. But average rate of returns of UNIC and PRIC insurance companies are lower than their expected rate of returns, they are considered to be over priced in the market. Hence, investors are advised to sell their stock rather to purchase in the market. (Calculations are shown in annex VI)

Figure 4.12 – The required rate of return and average rates of return of insurance companies



4.2 Major Findings of the Study

From the analysis of data collected from various secondary sources following findings have been made:-

- The share of NLGIC offers the highest average rate of return i.e. 17.58% where as the share of EVIC offers the lowest average rate of return i.e. -9.94% over the years. The different shares have different rates of return with in the range of -9.94% to 17.58 %. HGIC, PRIC, UNIC, have -9.41%, 12.14% and 14.67% respectively. Average rate of return of HGIC and EVIC is least.

- The DPS indicates that the most of companies are not paying dividend regularly. All sampled companies have not paid regular dividend during the period of study. PRIC has not paid dividend in the year 2004/05 to 2006/07. NGICL only paid dividend for one year i.e. 2002/03.HGIC has only paid dividend for one year i.e. 2006/07. UNIC Paid dividend regularly except year 2006/07. It implies bad message among the investor of insurance companies because it increases the risk for them.

- The MPS of insurance companies are ranging from Rs.105 to Rs.720 of UNIC and NLIGC. The MPS of NLIGC and EVIC is better then rest of companies. The MPS of EVIC and NLGIC are fluctuating up and down and rest of the companies has normal trend.

- The share of NLIGC seems to be the best for investment. Furthermore, analyzing the risk characteristics, the NLIGC also has the highest standard deviation i.e. 39.00% and has the highest average return and EVIC has the lowest standard deviation i.e. 12.79% and also lowest average return i.e.-9.94%. This is shows that where higher risk there is is higher return and visa versa.

- The risk per unit of return of NLIG is 2.22 HGIC -1.71 UNIC is 2.43, EVIC is -1.53 and PRIC is 1.06, Here, CV of HGIC has -1.71, which is the lowest among

all whereas of NLGIC i.e. 2.22 is the highest. On the basic of CV, the common stock of HGIC is attractive among all and the investors retaining the stocks of NLIGC should assume more risk than other. Those companies which has (-ve) C.V. Considered to be very risky assets

- Average rate of market return is only 12.24% with a standard deviation of 17.55%. Coefficient of variation of the market return is 1.33. The market is more risk than HGIC, EVIC and PRIC but less risky than NLIGC and UNIC companies.

- Co variances of the returns of HGIC, EVIC, UNIC, PRIC and NLGIC with the overall market returns are 1.62%, -0.95 %, 1.02 %, -1.73 %, and 1.36 %, respectively. Covariance between the returns of HGIC and market is 1.62%, which is the highest among all. Likewise covariance between PRIC and market is -1.73 % is lowest among all.

- The stock of HGIC has 0.66, UNIC has 0.41, EVIC has -0.38, PRIC has -0.70 and NLGI has 0.55 beta coefficients. HGIC has the highest beta and PRIC has the negative beta i.e. -0.70. The beta coefficients of HGIC and NLGIC are less volatile than market because the beta coefficients are less than 1. All insurance companies are market sensitive.

- The stocks of HGIC, UNIC, EVIC, PRIC, and NLGIC have the systematic risks of 1.34%, 0.52%, 0.44%, 1.51% and 0.93%, respectively. Out of the total risk, systematic risk of PRIC is the highest i.e.1.51%, which is 91% of total risk. The highest systematic risk of PRIC is due to highest correlation with market and the lowest systematic risk of EVIC is due to lowest correlation / covariance with market.

- Out of total risk, 52%, 91%, 4%, 19%, and 6%, of HGIC, PRIC, UNIC, EVIC and NLGIC, respectively are systematic and cannot be avoided. But 48% of HGIC 94% of PRIC, 9 % of UNIC, 78% of EVIC, 81% of NLGIC, and 94% are

unsystematic or company specific risk. Unsystematic risk of the stocks of all the companies was high in comparison to total risk.

- Overall average market return is 12.24 %. Average Treasury bill rate is 4.8%. The risk premium for the stocks of all the insurance companies in the market is the difference between risk free rate and market rate of return i.e. 3.44%. Based on the riskyness of the stocks in terms of systematic risk only, the required rate of returns for individual stocks are 9.71% for HGIC, 7.46% for UNIC, 7.85% for EVIC, 1.97% for PRIC, -0.41% and NLGIC for 8.89%.

- Based on the riskyness of the stocks in terms of systematic risk only, the required rate of returns are 9.71% for HGIC, 9.71% for UNIC, 7.85% for EVIC, 1.97% for PRIC, 0.41% and NLGIC for 5.89%. Higher systematic risk requires higher required rate of return and vice versa. Since the beta coefficient of the stocks of HGIC is the highest among all i.e. 0.66, its required rate of return is also highest among all i.e. 9.71%. The beta coefficient of PRIC has lowest beta -0.7 its required rate of return is also lowest among all i.e -0.41. Lower systematic risk requires lower risk premium. NIC has lowest systematic risk as represented by beta coefficient among all i.e. 0.32, which requires a minimum return of 5.08%.

- The established insurance companies have good track record of their financial position and the newly established insurance companies are penetrating the market. Most of all the insurance companies are operating in profit although some of them suffered from losses during their initial stages. The investor's attitude towards the shares of these insurance companies seemed to be positive.

- Comparing the required rate of return and the expected rate of return of the stocks of individual insurance companies, the required rate of return for all the companies are less than expected rate of return. This is due to the fact that the

stocks of almost insurance companies are least correlated with the market and the stocks of these companies are less volatile than market. Consequently,

Their beta coefficients are less than 1. Since, average rate of returns of all insurance companies are higher than their expected rate of returns, they are considered to be under priced in the market. The shares of insurance companies appear attractive to investors. Hence, investors are advised to purchase and hold the stocks of insurance companies rather to sell in the market.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter is concerned with the summary of the study, conclusion and recommendation on the basis of the major findings of the study. Logically, this chapter is divided into three sections: (i) Summary, (ii) Conclusion and (iii) Recommendations.

5.1 Summary

Like blood is necessary for human beings, finance is for business organizations and industries. Each and every business organization should base their decision making in financial management. Financial management is mainly concerned with the acquisition and investment of funds for the purpose of enhancing value and wealth. Promotion of investment and utilization of financial resources is necessary for economic development of any country. For this, financial market plays vital role in utilizing financial resources for expanding productive sectors in the country. It mobilizes unproductive and unutilized financial resources towards productive sectors.

Capital market is a significant mechanism for the development of national economy. It reinvigorates and boosts up the economic activities by mobilizing especially domestic financial resources. Investment in capital markets collect necessary funds and divert the collected funds towards the productive sectors. Due to this, industrialization is possible. Capital market provides best investment opportunities

by transferring the funds from surplus savings to need based sectors through the transaction of financial instruments.

Financial instruments are traded in securities market. Stock market is the largest financial market all over the world where stocks of various business organizations are traded. It has the greatest role in the development of financial system. Capital market consists of (i) primary market, and (ii) secondary market.

Investment is made with the goal of earning some expected rate of return. Investors seek to minimize inefficient deviations from this expected rate of return. To minimize inefficient deviations, diversification is essential to the creation of an efficient investment as it can reduce the variability of returns around the expected return.

Investment is ever followed by risk. So an investor must think about the risk before making an investment in any securities. Nepalese individual investors do not seem to be investing their funds in stocks of different companies i.e. portfolio creation is not found in Nepalese context. In this regard, portfolio management is crucial for the minimization of risk associated to the return of their investment. Hence, this study is mainly focused on the risk and return of the securities of listed insurance companies in NEPSE.

Due to lower interest rate provided by the banks, Nepalese investors seem to invest their money in capital market in shares and debentures. Such tendency has been seen since the last decade significantly. After the establishment of NEPSE, private sectors initiated to raise funds through capital market. Capital market/stock market, thus, has created investment opportunities to investors.

5.1.2 The general objective of this study is to analyze return and risk consisting of different listed insurance companies in NEPSE and suggest for potential investors.

Each study is conducted under some constraints and limitations. Likewise, this study is also limited by some common constraints. This study is based on the fundamental analysis of the common stocks of listed insurance companies. The published data from F/Y 2002/03 to 2006/07 have been taken for study.

Insurance companies are playing the crucial role for the economic growth of Nepal. In Nepal, only 19 insurance companies have listed their shares in NEPSE in order to make their shares eligible for trading.

Data of the stocks of insurance companies traded in NEPSE within the last 5 years (2002/03-2006/07) have only been considered. For the study, 5 insurance companies have been selected for the study based on purposive and judgmental sampling method.

5.2 Conclusions

The following conclusions can be drawn on the basis of the analysis of the stocks of different insurance companies, market sensitivity analysis etc. Considering the return and risk characteristics of the common stock of all the select insurance companies, the common stock of NLGIC is more attractive. Nevertheless, the stocks of insurance companies are attractive for investment considering their average rate of returns. It was found that the returns on common stocks of all insurance companies in F/Y 2004/05 were highest among sampled years. The political and economic scenario was worsening day by day and it could have the adverse impact on the economic activities of the companies. The overall market return cannot be regarded as attractive with respect to its risk. The risk per unit of return is very high which proves that the market is more risky than the individual stocks of insurance

companies. Most of the stocks seem to be defensive. The unsystematic risk of all the companies is high in comparison to total risk. It seems that the variability of returns of the common stocks of most of the companies is company specific. The company specific risk can be diversified away with a well diversified. The stocks of insurance companies have least correlation with market and less beta coefficients indicating less volatility. Investors are required to purchase the insurance stocks rather to sell in the market. The stocks of 3 insurance companies are under priced and rest is overpriced. Since their required rates of return are less than their average rates of returns.

5.3 Recommendations

On the basis of major findings of the study based on fundamental analysis, the researcher thinks appropriate to recommend the concerned institutions, individuals, authorities as well as others in order to consider the following issues:

In Nepal, it seems that the stocks of commercial banks are only attractive for investment as the share application for the stocks of them are very encouraging. Though the stocks of commercial banks are offering better return, the stocks of insurance companies are also attractive considering their return and risk characteristics. Hence, Nepalese investors should also think to invest in the stocks of insurance companies.

There are no consultants rendering financial services to the investors. The investment practices are very unscientific and depend on the individual will and choice. Return and risk characteristics are not found analyzed when making investment in securities. Hence, it is recommended to carry out return and risk analysis.

Stocks of insurance companies were found to be under priced in the market since they were offering higher return than expected. Hence, it is the time to purchase the stocks when they are under priced in the market. The investment strategies adopted

by Nepalese individual investors are passive. They just hold the securities and wait for dividend. Active strategy should be followed.

Nepalese public limited companies that have listed their shares in NEPSE should disseminate the exact information to the general public. The financial statements should be exact and transparent and also should be submitted to NEPSE on regular basis without any delay. Since these are the public limited companies, general public have the right to have exact and timely information of financial matters of them.

Academicians are undertaking no sufficient studies regarding risk-return analysis and behavior of investors of forming well-diversified portfolio. Hence, the researcher strongly recommends future researchers to conduct researches related to portfolio management.

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