CHAPTER – I
INTRODUCTION

1.1 Background

NEPSE is an organization, operated under Securities Exchange Act, 1983. The basic objectives of NEPSE is to impart free marketability and liquidity to the Government bonds and corporate securities by facilitating transactions in its trading floor through financial intermediaries such as broker, market maker etc. NEPSE appointed eleven issue managers and twenty-seven brokers to avail the daily transaction of buying and selling of securities under its restructure program in 1993 (2050 BS). NEPSE opened its trading floor on 13th January 1994 for its newly appointed brokers and market makers. NEPSE has adopted an "Open Cut-Cry" system. It means transactions of securities are conducted on the open auction principle on the trading floor.

Securities Board, Nepal was established in May 26, 1993 A. D. under the provision of Securities Exchange Act 1983 A. D. (first amendment). Since its establishment, SEBO/N has been concentrating its effort to improve the legal and statutory framework, which one the bans for the healthy development of capital market. As a part of its continuous effort to build a sound system, the Securities Exchange Act 1983 was amended for the second time on January 30 1997 A. D. This amendment paved the way for establishing SEBON as an apex regulatory body as it livened the horizon of SEBON by bringing market intermediaries directly under its jurisdiction and also made it a mandatory for the corporate bodies to report to SEBON annually and semiannually. Although the second amendment in the Act established to make direct relationship of SEBON with market intermediaries and the listed companies, supremacy in its jurisdiction is yet to be established and clearly recognized.

Capital market plays a vital role in the national economy. It mobilizes savings from surplus units and organized the funds for the productive investment. It renders very valuable services to the community by increasing the productive capacity of the

country and thereby accelerating the pace of economic development. In short, the growth of economy is tied with the growth of capital market in the country. The capital market facilitates the allocation of funds between savers and borrowers. This allocation will be optimum if the capital market has efficient pricing mechanism. If the capital market is efficient, the current share prices of companies fully reflect available information and there is no question of share price being under priced and overpriced.

NEPSE is the stock exchange in the country owned by the government (58.67%), Nepal Rastra Bank (34.60%), Nepal Industrial Development Corporation (6.13%) and Security Businesspersons (0.60%). [Annual Report SEBO, 2001 (2058/59): p 4] The securities businesspersons such as stockbrokers, market makers and securities dealers registered with SEBO have to get membership of the stock exchange for conducting security business. Similarly, the managers who are engaged in the primary issuing activities also have to get membership of the stock exchange to conduct business. According to The Securities Bylaws, 1996 and the membership of The Stock Exchange and Transactions Bylaws, 1998, it is mandatory for the issuing companies to have their securities listed in the stock exchange within three months of the closure of offering. The stock exchange provides its' floor for the trading of shares of the listed companies. Hence, it creates liquidity on shares of the listed companies.

After the restoration of democracy in 1991, the government has adopted liberalization and open-market policy. As a result, there have been continued financial reforms and frequent amendments of bylaws related to the financial market to create a conducive environment for the development of competitive and efficient stock market. Accordingly, the Nepalese stock market is taking its pace for the development. However, here a question arises whether the Nepalese stock market is efficient enough to maintain the MPS according to financial position of a company. The highly fluctuating stock market prices at NEPSE may not be the symptom of the efficient market. In the recent stock market turmoil, most of the investors complain that they are suffering from unexpected fluctuations of share prices at NEPSE. Therefore, this study attempts to relate the share price with major financial

indicators and the risk and return analysis for providing suitable bases for investment in common stocks of the sampled companies.

Standard Chartered Bank Nepal Ltd., Nabil Bank Ltd. & Himalayan Bank Ltd. are the three joint venture banks out of twenty-one joint venture banks operating within tertiary of Nepal. . These banks are established in different time period .So, I think these sample banks with difference service can cover all information for the thesis and make meaningful. Such banks are studied to identify and to analyze statement of the problems.

Risk and Return

The Relationship between expected return and risk is linear in finance, we assume that individuals base their decision on what they expect to happen and their assent of how likely it is that actually occurs will be close to what they expected to happen. When evaluating potential investments in financial assets, these two dimensions of the decision making process is called expected return and risk.

1.2 Statement of the Problem

The public limited companies are increasing tremendously in response to the economic liberalization and globalization policies adopted by the Nepalese government. Such institutions provide banking, insurance and financing services as well as participating in developmental works, manufacturing and processing and other various areas. After the emergence of NEPSE in 1997, the concept of capital market has been developed and growing rapidly within a short span of time.

The recent trend of investment shows that the general people are interested to invest their small money on the common stock of financial institutions like commercial banks. But due to the lack of proper information about market status and situation and poor knowledge, market intermediaries exploit investors. Some times they think that investing in common stocks is intolerably hazardous.

Due to this, many investors afraid to invest into stocks. This is the main problem that does not allow gearing up the capital market of the nation. People invest their

hard earned money for satisfactory and expected return. To these objectives, firms distribute the earnings to their shareholders. Earning is that amount which remains after deducting or submitting all operational and non-operational expenses. Stockholders expectations may vary with their investment priorities. So capital market investment in this present context plays the major role in the economic development of the country. The main problem for the individual investors are lack of proper information about market whereas the problem for financial sector to enhance the goodwill among the public due to frequent collapse of some finance companies being unable to utilize public funds properly. The investors are responsible to make rational investment decision. For this rational analytical knowledge is essential.

Due to lack of investment opportunities due to the country's prevailing situation, public are attracted towards the shares purchasing. People are unknowingly purchasing their shares to utilize their unused funds i.e. especially of commercial banks, which seems to be the blue chips to the potential investors. Market price of shares fluctuates with different factors. The investor's attitude and perception also plays a vital role in rational decision regarding whether the investment should be made or not.

The market rumors play a significant role in the fluctuation of share price of the companies. So we can say that the Nepalese stock market is the weak form of the market. The policy makers are unable to make the appropriate policy for the development of the stock market. There is poor contribution of government efforts for the development of the stock market in Nepal. Due to the lack of proper implementation of the policy adopted by government under the extended structural adjustment program (ESSP), the stock market has not achieved sustainable development.

Most of the investors are not aware of the financial position of the companies in terms of their financial indicators, in which they are investing their funds through secondary market- NEPSE. The market price of common stock (share) does not seem to be in accordance with the financial indicators- Earning per share (EPS),

Dividend per share (DPS) and Net worth per share (NWPS). Instead, in determination of the market price of share, there has been major influence of rumors rather than strength of the companies.

Generally, the trend is that the MPS of public quoted companies is above their book value. The market value is determined by the supply and demand functions. However, in an efficient market MPS fully reflects all the historical information publicly available.

The high movement of share prices may be the outcome of the efficient behavior. Our stock market is not efficient enough since all the listed companies do not make past information available to shareholders. Many listed companies do not produce timely financial statements or annual reports. The Security Exchange Act strictly prohibits the misuse of inside information but the regulating authorities can make no advance notice of how there is the use of inside information. It denotes that every investor should be well aware of the degree of risks in which they are investing or going to invest their saving funds. There are very few practices of analyzing this aspect in the Nepalese context. Here raises the question of efficiency of the Nepalese stock market. Most of the investors are investing their funds haphazardly without considering risk involved in their investment. That's why the major issues might be whether the MPS of listed companies, especially for selected companies, are really representing the financial indicators, i.e. EPS, DPS and NWPS.

1.3 Objective of the Study

The main objective of the study is to analyze the performance of stock market and the behavior of share price of listed commercial banks. However, the specific objectives of the study are as follows:

1. To analyze and present the Nepalese stock market.
2. To ascertain the share price behavior of the commercial banks listed in NEPSE
3. To analyze the risk involved in the common stock investment of the sample commercial banks.

4. To evaluate relationship between and risk in sampled commercial banks.
5. To provide suggestions, finding of the study.

1.4 Significance of the Study

It is important to increase financial and economic activities of the nation. Thus this study has tried to fulfill the need in this aspect. The study may also help for interested management. A part from above, this study will be a matter of interest for academicians, students and practitioners. The focus of the study is on the analysis of investment in shares of Nepalese Commercial banks with risk and return perspective, which will enable all the related persons to guide the investment related activities.

General people are not so much aware about the fact of this news that by which the prices of shares are being changed every day. What are the major reasons behind the fluctuation of price of the shares of the companies, which they hold? The cause of price change may be signaling or informational effect, low return, high risk, lack of knowledge, low income of the investors and high price of the stock. Since the market price of the share is the function of information, this research will be focused on how well the share prices absorb information in the Nepalese capital market. In the other words, this study is focused on to know how Nepalese investors react to the in Benefits of the study will receive primarily by potential investors. Security business persons, issue manager, broker and marketing managers will also be benefited by this study. The people's participation in security investment and stock trading is increasing unexpectedly. The recent trend and people's attitude towards common stock investment shows that there is a high potentiality in stock investment, which results an increase in economic activity. Daily we go through news regarding the fluctuation of price of share of the companies based on which we confer to the fact. Whether the business is having weak days or enjoys great days. General public is accustomed to read the news over these in the newspaper everyday and that takes the matters as a part of news and nothing else. Formation disseminated to capital market.

1.5 Limitations of the Study

For the sake of ease this tries to study its subject matter by concentrating on some important variables and ignoring others. Due to various reasons this research work is not able to study the whole Nepalese capital market in detail. That is why this research is also not free from limitations. The major limitation of the study is presented below:

- The study has been designed (to concentrate on some of the banking sector, which is a part of total capital market). So the conclusion cannot be generalized on the total capital market.
- For the purpose of study only common stocks or ordinary stocks are taken.
- There might be various techniques and method to perform the study on stock price movement, but the study is focused only on the run test, risk and return analysis and some ratios analysis.

The core of this study is based on the secondary sources of information. Hence any incorrectness in the key information like NEPSE index gathered from the secondary sources might affect the accuracy of the outcome of the study.

- This study has been conducted to fulfill the requirement of the MBS programs of T.U. for a prescribed time, not for generalization purpose.
- As a research student the study will be unbiased but resources and time period is limited.

1.6 Organization of Study

The study is divided into five chapters as follows:

Chapter I: Introduction

First chapter provides background of the study, It contains background of study, statement of problems, objectives of study, significance of study and limitation of the study and Organization of the study.

Chapter II: Review of Literature

This chapter is devoted for the brief review of literature available. Review from books, journals (articles), thesis etc are included in this chapter. Conceptual framework about risk and return is briefly reviewed.

Chapter III: Research Methodology

Third Chapter presents the Research Methodology. It deals with the research design, population & sample and source of the data. It also includes tools for analysis and methods of presentation of analysis.

Chapter IV: Data Presentation and Analysis

In this chapter, data collected from various relevant sources is presented and analyzed using various statistical and non-statistical methods.

Chapter V: Summary, Conclusion and Recommendation

This chapter is for major findings, summary conclusion and recommendation. Bibliography and appendices are incorporated at the end of the study.

CHAPTER-II
REVIEW OF LITERATURE

These theses are also reviewed to the extent they found related. In addition, independent studies carried out by well-known Nepalese financial experts are also taken into consideration. The chapter review of literature includes the review of concept and finding of previous research on the field. Books, journals and unpublished thesis are reviewed for this purpose. In this regard, basic academic course book on finance, recently published books specially related to this topic, some of the major research based journals and the related studies are reviewed.

To develop the concepts and ideas about the selected topic, the review of relevant materials is very important and crucial. In fact, review of literature begins with a search for a suitable topic and continuous throughout the duration of the research, either a dissertation or a thesis. Review of literature means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further search can be conducted.

There is no any special book and research work about the topic Risk and Return analysis of common stock, and we do not have sufficient required journals and relevant books. Some master degree thesis is available in Tribhuvan University, which are related to this topic to some extent. This chapter provides some glimpses on the literature that is available in the topic. It is an integral and mandatory process in research works. It deals with a literature survey of existing volumes of similar or related subjects and a careful check should be made that the proposed study has not carried out previously. Completely new and original problems are very rare, however a previous study should not exactly replicate unless the techniques used facilitate to trace out the doubtful conclusions or some new sources of information identified.

The main reason for a full review of research in the past is to know the outcomes of those investigations in areas where similar concepts are methodologies had been

used successfully. In this connection, a review of previous related research, articles reports, findings, books will help the researcher to formulate a satisfactory structure for the study.
Mainly it helps:

Most shareholders accept two forms of return from the purchase of common stock. These are capital gains and dividends. Capital gain may be defined as the market value of the common stock over time. The shareholders expect, at some point, a distribution of the firm's earning in the form of a dividend. Form mature and stable corporations, most investors expect regular dividends to be declared and paid on the common stock. This expectation takes priority over the desire to retain earnings to finance expansion and growth. So, shareholders expectation can be fulfilled through either capital gains or dividends. Financial management is therefore concerned with the activities of corporation that affect the well being of stockholders that well being can be partially measured by dividends received but a more accurate measure is the market value of stock. Since dividends would be more attractive to stockholder, one might think that there would be tendency for corporations to increase distribution of dividends. But one might equally pressure that gross dividend would be reduced somewhat, with an increase in net after tax dividends still available to stockholders and increase in retained earnings for the corporation.

2.1 Conceptual Framework:

So, Dr. Mahat made first priority to establish stock exchange for the development of stock market. He also writes that Nepalese stock market is still in infancy stage and some drawbacks to the development of stock markets are strong historical and social reasons as well as mass poverty and illiteracy in Nepalese society. A book about capital market by D: r. R. S. Mahat entitled "Capital Markets Financial Flows and Industrial Finance in Nepal" was written in the early period of the development of capital market and before the establishment of stock exchange. He further points out that some conscious and educated people of urban areas are also not investing in the industrial sector instead they are investing on the real estate especially building construction. Although the book is written in the early stage of the development of

stock market, the limitations of Nepalese society regarding the investment in stock market is still reality of Nepalese Capital market.

Similarly, the next book by Dr. R. S. Pradhan's is very valuable for the purpose of analyzing the capital market in Nepal. In his book, he writes about the Stock Market behavior in Nepal that "A number of studies have been conducted on the stock market behavior in developed and big capital markets but their relevance is yet to be seen in the context of smaller and underdeveloped capital markets"(Pradhan, 1994:42-43).

Thus, it if felt necessary to study stock market behavior in the context of smaller and underdeveloped capital markets, and this chapter prepared with reference to Nepal is a small attempt towards that end.

"In Nepal, the listing of shares in Stock Exchange Centre (SEC) and their trading in the stock market is a recent phenomenon. As per the book, the stock market behavior in smaller and underdeveloped capital markets is thus one of the important areas of the study in finance. Information on stock market behavior in such smaller and underdeveloped capital market would help development of realistic theoretical models and formulation of relevant hypotheses for empirical testing in finance. The Nepalese stock market is characterized by low trading volume, absence of professional brokers, early stage of growth, limited movement of share prices and limited information available to investors.

Among the various empirical contradictions to the Assets Pricing Model of Sharpe (1964), Linter (1965) and Black (1972), the most prominent is the size effect of Banz (1981). He finds that average returns on large stocks are lower while average returns on small stocks are higher. The positive relation between leverage and average returns on US stocks and firm's book value of common equity to its market value is documented by Stattmen (1980) and Rosenberg, Reid and Lanstein (1985). Similarly, Chan Hamao and Lakonishok (1991) find the strong role of book-to market equity explaining the cross-section of average returns on Japanese stocks. Again, Ball (1978) finds that earnings price relation is likely to be higher for stock

with higher risks and expected returns. Though there are these findings in the context of developed and big capital markets, their applicability is yet to be seen in the context of smaller under-developed market. This chapter therefore attempts to assess some of the cross-section behavior of stock market to ones as described above in Nepal, it specifically examines the relationship of market equity, market value to book value, price earning and dividends with liquidity, profitability, leverage, assets turnover and interest coverage.

A number of researchers are available on government owned public enterprises but researches on enterprises whose stocks are listed in SEC and traded in stock market are yet to come up in Nepal. Viewed in this way, this chapter is expected to provide at least some insights into stock market behavior in Nepal. This chapter can be considered important, as Nepal has already started the process of privatization of public or government owned enterprises."

In the book, "Shareholder's Democracy and AGM feedback" Prof. Manohar Krishna Shrestha has focused various issues related to protection of shareholder's expectation. Success of companies directly depends on the protection of their owners. Nut how can this be accomplished is the main question. Thus it is necessary to develop a possible guidance for enhancing the efficiency for public limited companies to contribute directly in the growth of national economy on one hand and ensuring handsome return to the shareholders on the other hand to make their investment meaningful and worthwhile. At present, the overall shareholders' democracy in terms of protection their interest is basically focused on the payment of satisfactory dividend and maximization of shareholders' wealth by appreciating the value of shares they sold (Shrestha, 1999:25).

The overall policy environment has not been conducted to the development of stock market. Therefore, it is difficult to develop more efficient secondary market. Treading system for both equity and debt securities. anta, Rekha analyzed in her, "Current status of share market in Nepal", the trend of Nepalese stock market and present state of primary and secondary market was found satisfactory. According to

her study, the development of stock market primarily depends on program and implementation in Nepal.

It is concerned with that private saving; individual as well as corporate that is turned into investment through the new capital issue and also new public loan floated by government and semi government bodies.

Capital market means any body or individuals, whether incorporated or not, constituted for the purpose of regulating or controlling the business of buying selling or dealing in securities (Bhalla, 1995:21).

a. Classical Approach

Fundamental approach forecast stock price on the basis of earnings and dividends of the company whereas technical analysis forecast stock prices on the basis of past price behavior of the company.

The classical approach includes fundamental analysis and technical analysis theories. One of the major divisions in the ranks of financial analysis is between those using fundamental analysis (known as fundamental analysis or fundamentalists) and those using technical analysis (known as technical analyst or technicians).

i. Fundamental Analysis

The investor's task is to study certain fundamental factors that may enable them to select undervalued stock for purchase and sell overvalued stocks. After extensive analysis, the investor derives an estimate of the 'intrinsic' value of the security, which is then compared to its market price. If the value exceeds the market price, the security should be acquired and vice versa (Reily, 1986:347).

Fundamental analysis theory claims that at any point of time an individual stock has an intrinsic value, which is equal to the present value of the future cash lows from the security discounted at appropriate risk, adjusted discount rate. The value of the

common stock is simply the present value of all the future income, which the owner of the share will receive (J. Clarks, 1991:398).

In the simplest form, fundamental analysis begins with the assertion that the true value of any financial asset equals the present value of all cash flows the owner of the assets expects to forecast the timing and the size of these cash flows and then converts the cash flows to their equivalent present value using an appropriate discount rate (Gordon, 2000:12).

In the fundamental approach, the security analyst or prospective investor is primarily interested in analyzing factors such as economic influence industry factors and pertinent company information such as product demand, earnings, dividends and management in order to calculate an intrinsic value for the firm's securities. The fundamentalist reaches an investment decision by comparing this value with the current market price of the security. He tends to look forward and is concerned with such matters like future earnings and dividends. It is sometimes said that the fundamental analysis is designed to answer the question 'what' (Gordon, 1999:844).

Fundamental analysis approach is not possible if capital markets are semi strong form efficient, since securities prices will already fully and fairly reflect all publicly available information (Denzil, 1998:31).

Fundamental analysis approach involves working to analyze various factors like economic influences, industry factors, firm's financial statement and pertinent company information such as product demand, earnings, dividends and management in order to calculate an intrinsic value for the firm's securities. The theory assumes that knowledge about the future companies is not perfect, some stocks are under priced and others are over priced.

The objective of the fundamental analysis is to appraise the intrinsic value of the security. The intrinsic value is the true economic work of the financial assets. Therefore, fundamental analysts work to find new information before other investors, so they can get into the position of profit form the price changes they

anticipate. Fundamental analyst use different models like Top-Down versus Bottom-up forecasting, probabilistic forecasting, econometric models, financial statements analysis etc. to estimate the value of security in an appropriate manner for making investment decision.

Some limitations of the fundamental analysis approach are as follows:

The approach, though sound and based on basic financial figures does not suffer from the drawbacks and to make this approach work effectively, one must be aware of them. The fundamental approach is based on rational scientific analysis of data, but the market is rarely rational.

The information and analysis may itself be incorrect.

Many companies with the help of creative and innovative accounting and accounting cosmetic disguise the real earnings.

The fundamentalist's estimate of intrinsic value may be incorrect. This is not only possible but also probable that he often forecast growth, profit and other factors without grasping all the facts.

The fundamentalists may not fully understand the economy or the industry, as there are several external factors.

Therefore, fundamental analysis is a never ending process because values change overtime. Ideally, revision in analysis should occur whenever new information affecting the future benefits to security holders become available.

ii. Technical Analysis:

In its simplest form, technical analysis involves the study of stock market prices in an attempt to predict future price movements. Past prices are examined to identify recurring trend or patterns in price movements. Then more recent stock prices are analyzed to identify emerging trends or pattern, the analyst hopes to predict accurately future price movements for a particular stock (Gordon, 1999:12).

Technical analysis is based on the widely accepted premise that security prices are determined by the supply of and the demand for securities. The tools of technical analysis are therefore designed to measure certain aspects of supply and demand (J. Francis, 1991:521).

The technical analyst usually attempts to predict short-term price movements and thus makes recommendations concerning the timing of purchase and sales of either specific stocks or group of stock (such as industries) or stock in general. It is sometimes said that fundamental analysis is designed to answer the question 'what' and technical analyst seems to trying to forecast 'when' (Gordon, 2000:844).

The technical analyst tries to forecast short run shifts in supply and demand that will affect the market prices of one or more securities. The technical analyst can tell whether the price of a share is on upswing or on the downswing in future. Technical analysis involves the examination of past market data, such as prices and the volume of trading, which lead to an estimate of future piece trends and therefore, an investments decision. Market value is determined by interaction of supply and demands. Supply and demand is governed by numerous factors, both rational and irrational. Security prices tend to move in trends that persist for an appreciable length of time, despite minor fluctuations in the market. Changes in trend are caused by the shifts in supply and demand. Shifts in supply and demand, no matter why they occur, can be detected sooner or later in charts of market transactions. Some chart patterns tend to repeat themselves (Francis, 1958:86).

Thus the technical analyst believe in the changes in the pattern or trend of security price take place on account of changes in the demand and supply of the securities, and that crucial insights into these patterns can be obtained by keeping track of price chart Whereas fundamental analysts use economic data that are usually separate from the stock or bond market, the technical analyst believes that using data from the market itself is a good idea because ' market is its own best predictor'. Technical analysts base trading decisions on examination of prior price and volume data to determine past market trends from which they predict future behavior for the market as a whole and for individual security.

Barron's Confidence Index

In the literal sense, the confidence index is defined as the ratio of high-grade bond yields divided by low-grade bond yields. The ratio is supposed to reveal how willing investors are to take investment risks. Barron's confidence index is constructed by using Barron's index of yields on the high-grade bonds to low grade bonds. The confidence index is usually, but not always, a leading indication. Like most of other technical indicators, the confidence index may sometimes issue erroneous signals and should therefore not be used without confirming evidence from other indicator (Francis, 1991:531).

Odd Lot Theory

An increase in the index suggests relatively more buying, a decrease indicates relatively more selling. During most of the market cycle, odd lots are selling the advances and buying the declines. This theory concerns the purchase and sales of securities by small investors. These investors do transactions of less than 100 shares. Some technicians take the ratio of these odd lot purchases to odd lot sales as an indicator of the direction of the future prices.. Odd lotters try to do the right thing most of the time; that is, they tend to buy the stocks as the market retreats and sells stocks as the market advances. However, technicians feel that odd lotters are inclined to so the wrong thing at critical turns in the market (Fischer, 1995:515).

b. Efficient Market Theory

The new equilibrium price will hold until another bit of information is available for analysis and interpretation. An efficient market is one where shares are always correctly priced and where it is not possible to out perform the market consistently except by luck (Richard, 1995:41).

In an efficient capital market, current market prices fully reflect available information. (Eugene, 1196:133).

There are several concepts of market efficiency and there are many degrees of efficiency, depending on the market. Markets in general are efficient when Prices adjust rapidly to new information. There is a continuous market, in which each

successive trade is made at a price close to the previous price (the faster that the price responds to new information and the smaller the difference in price changes, the more efficient the market. The market absorb large amount of securities without destabilizing the prices. (Stanley, 1998:420).

In a competitive market, the equilibrium price of any good or service4 at a particular moment of time is such that the available supply is equated with the aggregate demand. This is the true worth of the goods or services, based on all publicly available information. Therefore, if the market is efficient, it uses all the available information to it setting price. When security prices at all times rationally reflect all available, relevant information, the market in which they traded is said to be efficient. This implies that any new information coming to light, which bears on a particular firm, will be incorporated into the market price of the security. An efficient capital market is one in which security prices adjust rapidly to the arrival of new information and therefore the current prices of securities reflect all information about the security.

An efficient market is defined as market where there are large numbers of rational profit maxi misers actively competing with each other trying to predict the future market values of individual securities, and where important current information is almost freely available to all participants. In an efficient market, competition among the many intelligent participants lead to a situation where at any point in time, actual prices of individual security already reflect the effects of information based on both events that have already occurred and on events which are of row, the market expect to take place in the future. In other words, in an efficient market any point in time the actual price of a security will be a good estimate to its intrinsic values (Eugene, 1970:384).

In an efficient market, a security's price would correctly reflect the important variables for that security and would represent and unbiased estimate of its investment value (Mosses, 1992:746).

The efficient hypothesis suggests that investors cannot expect to out perform the market consistently on a risk-adjusted basis over an extended period of time. This hypothesis is based on the premise that security prices reflect all available information concerning a firm and that security prices changes rapidly in response to new information. Market efficiency also implies that as new information becomes available, the market quickly analyses it, and any necessary price adjustment occur rapidly.

The requirements for a securities market to be efficient are as follows:
Information is generated in a random fashion such that announcements are basically independent to one another. Investors react quickly and accurately to the new information, causing stock prices to adjust accordingly (Charles, 1988:425).

In an efficient market all prices are correctly stated and there are no bargains in the stock market. Efficiency in this context means that ability of the capital markets to function so that prices of securities react rapidly to information. Such efficiency will product prices that are appropriate in terms of current knowledge and investors will be less likely to make unwise investments. A corollary is that investors will also be likely to discover great bargains and thereby earn extraordinary high rates of return.
The degree of market efficiency has important implication for the economy and for investment decision makers. In an economic sense, it is important that security prices provide accurate signals that can be used to allocate capital resources correctly. Incorrectly priced securities would result in incorrect allocation of capital (Cheney & Mosses, 1992:746).

Although efficient market may be vital and pleasing from an economic perspective, it presents complexity to investors in terms of an appropriate investment strategy.

If a market is efficient then there is a very important implication for market participants: all investments in the market are zero NPV investments. The reason is not complicated. If the prices are neither too low nor too high, then the difference between the market value of an investment and its cost is zero; hence the NPV is zero. As a result, in an efficient market, investors get exactly what they pay to when

they buy securities and firms receive exactly what their stocks and bonds are worth and sell them (Ross, 2003:405).

In an efficient market, liquid capital will channel quickly and accurately where it will do the community the most good. Efficient market will provide ready financing for worth while business venture and drain capital away from corporations that are poorly managed or producing obsolete products. One of the main reason that some underdeveloped countries do not advance is that have inefficient capital markets, where prices may be fixed or manipulated rather than determined by supply and demand. An efficient market is assumed perfect market in which there are many small investors, each having the same information and expectations with respect to securities; there are no restrictions on investment, no taxes, and no transaction costs and all investors are rational, view securities and are risk averse, preferring higher returns and lower risks.

Others argue that it is mere luck that would allow market participants to correctly anticipate new information. The security prices have been observed to move randomly and unpredictably. This randomness of security prices may be interrupted to imply that the security prices quickly adjust to such information. In an efficient market, there are neither free lunches nor expensive dinners. It is possible to systematically gain or lose abnormal profits form trading on the basis of available information (Weston & Copeland, 9th edition: 93-94). Not all market participants are believers in the efficient market hypothesis. Some feel that it is worthwhile to search for undervalued or overvalued securities and to trade them to gain profit form market inefficiencies. Therefore, the capital market efficiency can also be defined as the ability of securities to reflect and incorporate all relevant information of its prices. So there is no question of the share price being under of overvalued.

Although it may not literally be true that all relevant information will be covered, it is virtually certain that there are many investigators hot on trial of most leads that seem likely to improve investment performance. Competition among these may be well backed; highly paid, aggressive analysts ensure that, as a general rule, stock

prices ought to reflect available information regarding their proper levels (Zvi, 2002:342).

If new information becomes known about a particular company, how quickly do market participants find out about the information and buy or sell securities of the company on the basis of the information? How quickly do the prices of the securities adjust to reflect the new information? If prices respond to all new information in rapid fashion, can we say the market is relatively efficient? If instead the information disseminates rather slowly throughout the market, and if investors take time in analyzing the information and reacting, and possibly overreacting to prices may deviate from values based on a careful analysis of all available relevant information. Such market could be characterized as being relatively inefficient. (Haugen, 2001: 573).

There are three forms of efficient market hypothesis based on type of information used in making market decisions. They are:

- Weak form efficiency
- Semi-strong form efficiency
- Strong-form efficiency

In other words, studying past prices in an attempt to identify misplaced securities is futile if market is weak form efficient. Although this form of inefficiency might seem rather mild, it implies that searching for patterns in historical prices that will be useful in identifying mispriced stocks will not work (Ross, 2003:407).

Under semi strong form, all publicly available information is pre assumed to reflect in securities' prices. This includes information in the stock price series as well as information in the firm's accounting reports, the reports of competing firms announced information relating to the state of the economy and any other publicly available information relevant to the valuation of the firm. The difference between these forms relates to what extent information is reflected in the stock prices. Under the weak form, stock prices are assumed to reflect any information that may be contained in the past history of the stock price itself (Haugen, 2001:575).

This hypothesis holds that no investor can earn excess returns by developing trading rules based in historical prices or return information. Weak form efficiency, suggests that, at a minimum, the current price of a stock reflects the stocks own prices (Haugen, 2002:575).

This form of efficiency is most controversial. The reason this form is controversial is that if implies that a security analysts who try to identify mispriced using, for example, financial statement information is wasting time because that information is already reflected in the current price (Ross, 2003:407).

The strong form takes the notion of market efficiency to the ultimate extreme. This form includes private of inside information as well as that which is publicly available. Under this form, those who acquire inside information act on it, buying or selling the stock. Their action affect the price of the stock and the price quickly adjusts to reflect the inside information (Haugen, 2001:575).

One obvious way to check the validity of the strongly efficient market hypothesis is to examine the profitability of traders in securities made by insiders to see if the insider's access to valuable information allows them to earn statistically significant trading profits (Francis, 1991:5).

Thus the strong from of the efficient market correctly prices securities adjusting quickly to new information either public or private.

i. The Random Walk Theory or Theory of Weakly Efficient Market

At any point in time, there exist implicitly an intrinsic value of each share but in the world of uncertainty the intrinsic values are not known exactly. Therefore, there can be disagreement among the participants about the estimated intrinsic value of the shares and actual price differ form its intrinsic values. Over the time, the intrinsic value itself changes as new information appears, that affects the prospects of the company. New information may be about deregulation in the quota system on the efficiency licensing, a change in management, success in research and development and tariff imposed in the raw material etc. If steady inflows in various types of

information (i.e. pessimistic, optimistic and so on) arise independently across time and if participants do not show dependent tendency about intrinsic value, the subsequent price changes in stocks will be independent. However in the real world, these conditions always do not hold true. There may be dependencies in the reaction of participants towards the estimation of new intrinsic value or whimsical tendency. For example certain individual's or institution's action on new anticipation of value may induce many people. This reinforcing behavior lead to deviate the anticipation value for below or above form its true value' which result unhindered dependencies in subsequent price changes. In this situation, we can assume that there exist many sophisticated traders of two types:

The weakly firm of efficient market hypothesis states that current prices fully reflect the information contained in the historical price movements. According to Kean, the market is efficient in weak sense if share prices fully reflect the information implied by all prior price movements. Price movements in effects are totally independent of previous movements, implying the absence of any price patterns with prophetic significance (Francis, 1991:10).

So, the past prices have no meaningful information to predict future course of price fluctuations, which can be used to earn above average return. The movement of future prices is independent form previous prices or the series of price change are random phenomenon. Actually, the weak form of efficient market hypothesis is referred to as random walk theory of share price behavior. Weak form of market hypothesis is popularly known as random walk theory (Fischer, 1995:540).

Random work theory implies the future path of the price level of a security is no more predictable than the path of a series of cumulated random numbers. The series of price changes has no memory; i.e., the past cannot be used to predict the future in any meaningful way. It means that current size and direction of price changes is independent and unbiased outcome of previous price changes. The random walk model in pristine form includes two main hypotheses state that Successive price changes are independent and the price changes confirm to some probability distribution (Eugene, 1965:35).

Statistically, independence means probability of distribution for the price change during time periods. More precisely in algebraic term.

Pr(X t =X/Xt-1, Xt-2) = Pr(X t=X)

Where the term on the left side of equation is the conditional probability that the price change during time t will take the value of X, conditional on the knowledge, the previous price changes the values Xt-1, Xt-2 etc. but the term on the right of the equation is unconditional probability that the price change during t will take value X. The expression means the conditional and marginal probability distribution of an independent random variable are identical. (Gupta, 1989:31)

Out of the two hypotheses of the random walk theory, the independence of successive price changes is strong and most important one to make the theory valid. The second one is price changes conform to some probability distribution but its shape or form of distribution need not to be specified i.e. any distribution is consistent with the theory as long as it correctly characterizes the process generating the price changes (Eugene, 1965:36).

However the parameter of the distribution should be stationary but not so strongly imposed of independence hypotheses is hold true. However, still the form of distribution of price changes is important form investment decision, academic and research point of view. (Eugene, 1965:41)

Proponents of random walk theory recognize that in general perfect independence assumption does not exist in real world. So they argue that for practical purposes, it cannot be used to forecast future to earn more than average market return. Random walk model is valid as long as knowledge of the past behavior as the series of price change can be used to increase expected gains (Eugene, 1965:35).

That is, for practical purposes, independence hypothesis is accepted as long as the degree of dependence considered in the series of price changes is not sufficient to forecast the future from the historical price movements in away that makes higher profit that they would be under the naïve buy-and -hold policy. Actually market

mechanism establishes the existence of random walk theory that the successive price changes to be independent. The stock market poses steady inflow of information that have a whole market-wide impact such as change in monetary and fiscal policy on security prices and another information have an effect on industry-wide impact such as change in government's tax policy on specific industry. There are information such as announcement of earning and dividend that affect price of the particular security. The change in the set of anticipations resulted from either of the above information is unique to ach individual and may be caused by psychological or whimsical and other factors, which impinge then to bid on prices of the securities of the market. There are other groups of participants who estimate the intrinsic value of the individual securities from the received information. The existence of intrinsic value for the individual is not consistent with random walk hypothesis (Eugene, 1965:36).

Traders having much better capacity to predict the appearance of new information and estimate of its effects on intrinsic values than others generally named superior intrinsic-value analysts, Traders having much better skills at doing statistical analysis of price behavior named technical analysts. The sophisticated traders can recognize the situation where the price of the stock is beginning to run up or down from the intrinsic value because of inappropriately under or over discounting or information and its adjustment in the security prices. This situation provides them incentive for speculation in the market because the price is expected to move eventually to its intrinsic value. Thus, the existences of profit maximization strategy of these sophisticated traders lead to neutralize the dependence in the price changes and the price changes and the price changes follow to independence of successive price changes.

Of course in the certain world, sophisticated traders cannot always estimate intrinsic value exactly and their efforts towards erasing the dependencies may not be sufficient. In this case, sophisticate chartists can reinforce the neutralizing mechanism, because as long as there are important dependencies they can easily discern the 'trends' and 'patterns' and initiate value maximization strategy.

Over the time, the infusion of the new information in the market may move dependently which will tend to create dependence in the successive price changes of security. For example optimistic information tends to be followed more often by optimistic information than pessimistic information and pessimistic news tends to be more often followed by pessimistic news than good news. In this case also, the sophisticated traders eventually learn that it is profitable for them to estimate price changes of current new information and subsequent dependence of the same information. Though their active speculation on the opportunity to erase the subsequent dependence in price series and establish independence assumption in the random walk theory of stock market price behavior. The random walk theory says nothing more than that successive price changes are independent. This independence implies that prices at nay time will on the average reflect the intrinsic value of the security. If a stock's price deviates form its intrinsic value because, among other things, different investors evaluate the available information differently or have different insights into future prospects of the firm, professional investors and smart non professionals will seize upon the short term or random deviations from the intrinsic value, and though their active buying and selling of the stock in question will force the price back to it equilibrium position. (Fischer, 1995:553).

If the random walk hypothesis holds, the weak form of efficient market hypothesis must hold (though not vice versa). Thus, evidence supporting the random walk model is evidence supporting weak form of efficiency (Elton, 1991:404).

If the prices follow a random walk, price changes overtime are random (independent). The price change for today is unrelated to the price change of previous days. Any new information arrived randomly in the market results in the random changes in the prices. Random walks theory that involves selection of securities is represented as the modern approach to investment decisions.

2.2 Stock Exchange

Without exchanges, investors might have to hold debt securities to maturity and equity securities indefinitely. It is doubtful that many people would be willing to

invest under such conditions. A continuous market also reduces the volatility of securities prices further enhancing liquidity (Gitman, 1992: 458).

The key function of securities exchange is to create a continuous market for securities at a price that is not very different from the price at which they were previously sold. The continuity of securities market provides the liquidity necessary to attract investor's funds.

The stock exchange is an institution where quoted securities are exchanged between buyers and sellers. The stock exchange provides market a wide range of traded securities, generally of medium to long-term maturities, issued by companies, government and public organization (Winfield, 1985:22).

Most are the investors are attracted to the equity shares because of its marketability and liquidity. One may like to buy more shares or selling existing shares from time to time when he is in need of money or when he wants to shuffle his portfolio. Since the stock exchange is a place where a large number of buyers and sellers congregate, once can, by and large, easily find his counterpart for sale or purchase of shares. The investor can convert his shares into cash at the prevailing market prices readily. The existence of stock exchange facilitates all these functions without which it is almost impossible to do so.

The securities exchanges help us to allocate scare fund to the best uses. That is by disclosing the price behavior of securities and requiring the disclosure of certain corporate financial data; they allow investors to access the securities risk and return and to move their fund into the promising investments. An efficient market is one that allocates fund to the most productive uses. Along with this, there is lot of functions of security exchange such as ready market and continuous market, evaluation of securities, safety of transactions, and canalization of savings and widening the share ownership etc. however, besides these functions, there are three things a security exchange must do:

- Determine a fair price for the securities it trades or price discovery function.
- Enable transaction to be made at as low cost as possible or minimization of transaction cost.
- Enable transaction to be made at this price quickly and easily or provision for liquidity.

2.3 Security Market

There are two important functions of securities market, namely the raising of funds in form of shares and debentures and trading the securities already issued by companies The most effective use of idle and surplus resources can be brought into practice only by means of market mechanism which mobilized the fund of savers to the user and thus this financialization boosts the industrialization and trading activities, which will bring the positive result to the economy as a whole (Sharma, 2002:16).

While the first aspect is obviously much more important form the point of view of economic growth, the second aspects is also considerably important. In fact, if facilities for transferring of existing securities are abundant, the raising of new capital is considered assisted as the buyer of a new issue of security become confident that whenever he wants to get cash he can find buyer of the security without much difficulty. This aspect is called the liquidity of the stock market. Thus the liquidity of the stock market affects the raising of new capital form the market (Levine, 1992:33).

Security market sets a price for the securities it trades and makes it easy for people to trade them. Securities market facilitates the sale and resale of transferable securities. The security market can be defined as mechanism for bringing together buyer and sellers of financial assets to facilitate trading. Securities market is classified into two: the market in which new securities are sold is called the primary market and the market in which the existing securities are resold is called the secondary market. Securities market is created by brokers, dealers and market makers. Brokers bring buyers and sellers together with themselves actually buying or selling; dealers set price at which they themselves are ready to buy and sell (bid

and ask price respectively). Broker and dealer come together organized market or in stock exchange (Gitman, 1992:457).

a. Securities Market in Nepal

Securities Exchange Centre was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Nepal government, under a program initiated to reform capital markets 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 history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the Company Act in 1964, the first issuance of Government Bond in 1964 and the establishment of Securities Exchange Centre Ltd. in 1976 were other significant development relating to capital markets.

The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994. Nepal government, Nepal Rastra Bank, Nepal Industrial Development Corporation and members are the shareholders of the NEPSE

b. Trading System

NEPSE has adopted an "Open out -Cry" system. It means transactions of securities are conducted on the open auction principle on the trading floor. The buying broker with the highest bid will post the price and his code number on the buying column, while the selling broker with the lowest offer will post the price and code number on the selling column on the quotation board. The market makers quote their bid and offer price on their own board before the floor starts. Once the bid and offer price

match, contracts between the buying and selling brokers or between the brokers and market makers are concluded on the floor.

2.4 Securities Board of Nepal

The Governing Board of SEBO is composed of seven members including one full time chairman appointed by HMG/N for tenure of four years. Other members of the Board include representatives one each from Ministry of Finance, Ministry of Law, Justice and Parliamentary Affairs, Ministry of Industries, Commerce and Supplies, Nepal Rastra Bank (the central bank), Federation of Nepalese Chambers of Commerce and Industries and Association of Chartered Accountants of Nepal.

There are two departments, six divisions and ten sections in the organization of SEBO. Under the Corporate Finance and Administration Department, there are three divisions namely Corporate Finance and Reports Review Division, Accounts and Administration Division and HRD and Education Division. Securities Board, Nepal (SEBO) was established as an apex regulator of the securities markets in Nepal by Government of Nepal on June 7, 1993 under the Securities Exchange Act, 1983 (first amendment). The main objective of SEBO is to regulate and promote the securities market and protect investors' interests. As per the Securities Exchange Act and regulation, following are the major functions of SEBO. Develop and implement policies and programs for the development of securities market and advice Nepal government in this regard. Register securities and grant issue approval. Provide license to corporate bodies to operate stock exchange business. Provide license to operate securities businesses. Supervise and monitor stock exchange and securities businesspersons. Conduct research, study and awareness programs regarding securities market.

There are also three divisions under the Securities Market Regulation Department, which are Legal, and Enforcement Division, Market Regulation and Compliance Division and Market Analysis and Planning Development Division.

The major source of financing of SEBO is basically the government grant. Other financing sources include registration of corporate securities, registration and

renewal of stock exchange and market intermediaries and the income from mobilization of its revolving fund.

2.5 Review of Relevant Studies

As stock market is in infancy stage in Nepalese context, there are limited books, journals and research studies concerning stock market and its pricing behavior. So, the available articles, books, previous research works, which are related to stock market are consulted and reviewed.

Jitendra Dangol (2008)' "A survey of stock market reaction to public information"(PYC Journal of Management 2008vol. II)

According to his survey, he got following major findings.

- Shares of commercial Banks, developments banks and finance companies were more popular among the Nepalese investors.
- Capital appreciation is the main important motive behind investing in the common stock.
- Based on the flow of new information most of the respondents have been found to have strong belief on impact of new information of Price movements.

Neeraj Vasistha, T**he Boss, 2007 Asmita publication: 112; in his article** Companies listed on the stock markets offer another avenue to retail and institutional investors to invest their capital into prospering businesses. This is known as the Secondary market and is open to investment from general public. Usually a host of market participants including brokers, sub-brokers and other intermediaries, general investing public, funds, banks and investing institutions (public and private), fund managers and analysts who typically track listed companies, among others are the key players of this market.

Before these companies can actually list their stock on the stock exchanges, they need to follow the process of listing of listing their company's shares on the stock exchange in their respective countries. For this they must get follow other listing

norms, meet government regulations and host of other local laws. In pursuance of this, once the companies meet these norms, they need to prepare a detailed prospectus and undergo a mass distribution process to sell the shares of their company to the investing public at large, which includes retail investors, wealthy individuals and institutional players.

In this pre-listing process, host of players are involved apart from the above, which include institutions like the local stock exchanges (where the stock will eventually be listed) and depositories banks and financial institutions (who provide funds for such transactions), merchant bankers, underwriters and registrars to the issue, who collectively are responsible for preparing the draft prospectus, conducting road shows for investors awareness and ultimately take care of the back office processing of the public issue application process, including the allotment process as well.

For the retail investor this primary market and the IPO (Initial Public Offering) route offer considerable scope of handsome returns, with relatively low risk, as compared to investing in the secondary market directly. Investor can invest into good companies through this route at attractive prices, in which the allotment usually happens either at a price discovered through the book building process based on investor demand or a fixed price indicated beforehand.

Before one starts to invest into IPO's, read the offer document or the draft prospectus carefully to understand the company better and assess the associated risk factors. A detailed draft prospectus usually contains historic information on the company and its business operations, detailed industry analysis and competitive scenario, financial statements including the balance sheet, profit and loss accounts along with other selected financial data, and information on the promoters, current management team and their track records, government approvals in place, along with highlights of any outstanding litigations, contingent liabilities and material developments etc. the prospectus usually also contains information on the potential market size and the opportunity pricing details of the company products, any key raw material supply issues. If such data is not available in the prospectus, the investor must refer to the

company's website, industry sources or contact the underwriters to the issue or the company for more information.

Last but not the least, the IPO or a public issue is done with a particular purpose in the mind for example undertaking a capital expenditure plan for capacity up gradation, increase spending on marketing and sales, opening new offices in new geographies, increase spending on research and development etc. Usually this is highlighted in the prospectus/offer document as part of the object of the issue and the capital structure, and should be read carefully along with the terms of the issue, the issue structure and procedure. Companies usually go to the investors to raise money when the markets are bullish and participants are optimistic about the company and the economy in general. Although these and other market factors help a company to positions it's IPO and sell it to the investing public at the highest possible price, the retail investor should be cautious and do their homework on the company, the lead managers, merchant bankers to the issue, before getting sucked into the general frenzied activity during a bullish phase in the markets.

Usually it is seen in bullish market, all kind so companies tend to flick the market to raise money from the unsuspecting public, with relative ease, for all kind of businesses and fancied plans. Retail investors should be careful and avoid such issues and shady promoters with lousy track records of implementing projects. Just as a large wave tends to lift both big and small boats in the ocean, a bull market also lifts both good and penny stocks to list during a bullish phase in the stock markets. And penny stocks with little or no fundamental value should be avoided.

B.R (2009) "Define Your Objectives before Buying Stocks in new age, 2009."

People invest in the share market for different purposes. If someone if not clear about his/her purpose, the strategy followed can be wrong and the benefits are not satisfactory, or there she/he may even occur a loss. So, define your objectives first and then start paling with the market. Some possible objectives would be to maximize dividend income, to maximize capital gain in the short run, to maximize total gain and to minimize the risk. A proper setting of objectives helps to identify the category of shares that help to accomplish the set objectives. If we observe stock

market regularly, we find various patterns of movement in different stocks. Thus setting clearly defined objectives will help to gain from such movements.

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The next fundamental objective of buying shares is for the purposes of borrowing. Investors can borrow money by using shares as collateral. Banks and finance companies provide loans up to 50 percent of the market price of the shares. To borrow in this way, you should have those securities that promise more certain return as well as growth. Such stocks are those of Standard Chartered Bank Nepal Ltd., Nabil Bank Ltd., Bishal Bazaar Company Ltd., Unilever Nepal Ltd. and Nepal Investment Bank Ltd. Therefore, it is better to buy these high priced stocks if you intend to borrow by pledging them. Such borrowings can be used to buy more stocks and the selection of such stock will again depend on the purpose for which you want to buy them. It the objective is to minimize the risk, investors require selecting stocks that remain less fluctuating in the market. For example, Bishal Bazaar

Company Ltd., Bottlers Nepal Ltd., Rastriya Beema Sansthan and Unilever Nepal Ltd. are f found to be such stocks.

Making a decision before buying a share without proper knowledge about the particular company is like plunging head on into an unknown pond. Before diving into a pond, one should have sufficient information about its depth, the contents at the bottom and some other related matter. Similarly, a person wanting to buy shares of any company must have sufficient knowledge about different aspects of that company and among those, the financial aspects is most important. If a decision is made without proper knowledge of various facts affecting the market value and profitability of the stock concerned, it may result in heavy loss.

These advices are especially for those buyers who do not intend to hold the shares for long period or buy shares in huge quantity with motive of influencing future decisions of that company. The main interest of such people is to maximize their profits in a reasonably short period. Such interest may be to take advantage from rising market price, to add the stock of shares on holds incurring minimum extra cost, to gain maximum in terms of dividend and so on. Similarly, minimizing the probable financial loss from the stock purchased should always be given top priority. For this, the financial statements, especially annual report submitted in the annual general meeting of the company, should be studied and analyzed seriously. Apart from this report, the future programs of the management and the history of the company should also be studied. If possible the buyers should develop the habit of studying the quarterly financial reports too and compare such reports of one company with that of another similar company. Finance companies or banks publish their financial reports very three or six months in the national dailies. Such reports can also be obtained from the company's corporate office.

Looking at the trend of our share market, it is recommended that new investors choose shares only form the banking or finance sectors initially because such shares can be more easily sold and involve less risk compared to shares from manufacturing or other sectors. When one has gained some experience in buying and selling such shares and does a lot of homework, he/she can gain sufficient knack for

future transactions. If possible, it is advisable to record the homework before deciding to choose a particular stock, such as why it was chosen, what was the estimated profit from that choice and what was the logic used to estimate that profit. This estimation should be compared with the actual result periodically. If the estimate is nearer to the actual result, congratulate yourself, and if it very far from the actual result, try to find out what may have been the cause behind it. In this way, one will gradually gain experience, and will not be easily fooled in future.

Generally it is safe to purchase shares when the price is going up gradually. But one should be very careful as no one knows when this trend stops. Furthermore, there are always some players who try to mislead the general public and manipulate the price of shares for their personal benefit. One should be careful about such possibilities and try to find out if this is the case with the stock in which the market price is steadily increasing or decreasing. Choosing a bank or finance company to invest is however a tough job, it demands a lot of homework and an analysis of various facts affecting the profitability and market price of the share concerned. For this, the interested person should be quite familiar with some frequently used terminology in financial reports and the way to analyze them properly and to interpret what the results indicate and where those reports are found.

Pradhan's Radhe S. (2009) has conducted a study on 'Stock Market Behavior in a Small Capital Market: A Case of Nepal, The Nepalese Management Review' based on the data collected for 17 enterprises from 1986 to1990.

The major findings of this study are as follows:

- Earnings, assets turn over and interest coverage ratio are more variable for the stock paying higher dividends.
- Liquidity and leverage ratio are more variable for the stock paying lower dividends.
- Positive relations between dividends pay out and turn over ratios. Positive relationship between dividend payout and interest coverage. Positive relationship between dividend payout and profitability.

Positive relationship between the ratio dividend per share to market price per share and interest cover

There are many masters Degree theses prepared by various researchers. Among them some thesis are reviewed here for analysis of literature.

Devkota R.M (2005) in his Master's Thesis, *"Stock Price Determinants in Nepal Stock Exchange",* has a major objective of identifying the prime determining factor of share price fluctuation of Nepalese Commercial Banks. The other supporting objectives of his research are:

- To examine and evaluate the relationship between MPS with the various financial indicators like EPS, BPS, DPS etc.
- To analyze the market trends of MPS with financial indicators.
- To conduct the opinion survey of potential investors regarding various aspects of share behaviors in Nepal.

The Major Findings Of Devkota Are As Follows:

DPS of BOK is much volatile in comparison to MPS, BPS and EPS. Bank of Kathmandu has positive correlation with between their Market price per share and DPS, BPS and EPS. This indicates that they directly affect the Share Price of BOK.BPS and EPS are positively correlated in the case of Everest Bank Limited whereas DPS is negatively correlated. This indicates that increase in DPS of this Bank don't contribute on the increase of Share Price rather it decreases it. But increase in BPS and EPS increase the share price and vice versa. DPS is much volatile in comparison with MPS, BPS and EPS. The correlation between MPS and other indicators are found to be insignificant for most of Banks. It shows that they individually influence very less but jointly they influence a lot. There can be other factors which influence the share price of the organization.

Dividend pattern plays a great role on share price movement. Higher the DPS more will be the Share Price. Most of the investors like to analyses the Dividend pattern of the company before they invest in their shares.

Ojha, Prasad Khagendra (2009) on "Financial Performance and Common stock pricing"

- To study and examine the difference of financial performance and stock price.
- To examine the relationship of dividend and stock price.
- To explore the signaling effect on stock price,

According to objectives, he got following major findings:

- Nepalese stock market is in infancy stage. In general it is very new and just started to develop.
- Dominance of banking sector is prevalent in the market due to other industries including finance companies, insurance and manufacturing is not encouraging.
- Due to the lack of the proper investment opportunity most of the investors have directed their savings towards the secondary market.
- Corporate firm with long history have a relatively stable profitability parameters than the firm established after the economize liberalization of 1990.
- Older firms have been issuing bonus share more times than the new one.
- Dividend per share is relatively more stable than dividend pay out ratio. That's why pay out ratio and dividend yield has been highly fluctuating.
- There is significant positive correlation between the dividend the dividend paid and stock prices of banking and manufacturing industries. All other industries have not the perfect correlation between the dividends paid and stock prices.

By the study of Mr.Ojha Nepalese stock market is in developing stage. Corporate firms with long history have relatively stable profitable parameters than that of newly established firms. Similarly dividend pay out ratio and dividend yield is more fluctuating and there is positive relationship between dividend and stock price of the firms. However, it may be affected due to the change in time period and other constraints at present.

Bachhu Ram Dahal (2007) A research paper on "Stock Market behavior of listed Joint Venture Company in Nepal describe the Nepalese Stock market as follows:
The main objective of his research study is to study, examine and analyze the stock market behavior. The specific objectives are:

- To study and analyze the stock price trend and volume of stock traded on the secondary market.
- To study and analyze the rate of listing of new companies and maintenance of listed company in Nepal Stock Exchange Ltd.
- To study and analyze the investors views regarding the decision on stock investment.
- To study and examine the signaling factors' impact on stock price with the help of NEPSE index.
- To suggest the abstract to the interested parties related to stock market.

In his conclusion, Mr. Dahal says that Stock Market is the backbone of investment sector of the country. So by promoting the stock market in sizeable economic sector raise the economic development by mobilizing swing into productive sectors y making suitable investment environment different elements like price trend NEPSE index, volume of stock traded, rate of listing. Signaling factors should be analyzed. Stock market was not properly analyzed for smooth operation of secondary market. It shows gap between theory and practice of investment. In Nepalese stock market the study of market behavior is very useful subject matter if properly analyzes for the development of stock market.

Nepal stock exchange limited is analyzing stock market behavior in very little area regarding the stock market. So experts should be recruited and analyzed market behavior in efficient way so that all parties interested with stock market can get benefit from this. The data analysis showed that Nepal Stock Exchange is not providing facilities for investors such as general awareness about investment, investment procedure for general public and movement of stock trend in different periods and their cause are not explained. Most of the investors are complaining that the market makers brokers and NEPSE's staffs are making coalition for fraudulent

activities towards investors. So NEPSE should clear this type of charge for the development of stock market.

Shrestha Surya Chandra (2012) has conducted research on "Stock Price Behavior in Nepal".

This study aims to examine the efficiency of stock market in Nepal. The objective of the study was:

- To examine the serial correlation of successive daily price changes of the individual stocks.
- To determine whether the sequence of price changes is consistent with changes of the series of random numbers expected under the independent Bernoulli process.
- To determine the efficiency of the stock market through the theoretical model of efficient market hypothesis in Nepalese stock market.
- To provide feedback policy towards institutional development of efficient market.

T**he major findings and conclusions drawn on this study were:**

After applying the required models and methodologies he found average correlation coefficient of 0.2055, 0.0825, and 0.0704 for 1, 2 and 3 lag days respectively. And for lags 5 to 15 days were less than 0.07 in overall, large number of serial correlation coefficients of the log price changes of the 30 stocks for the sample periods are significantly departed from zero. In addition runs analysis also followed the serial correlation results that mean there has significant difference between actual numbers of runs for series of daily closing prices changes of the market. By the result of his applied models and methodologies he concluded, the successive price changes are not independent random variable for the 30 sample stocks listed in the NEPSE. Therefore, the random walk theory is not suitable description for the stock market behavior in Nepal.

The security market to the general public so that they are interested to invest in security market and the previous investors could change as professional investors there have been several researches done before in the topic Stock Market and Stock

Market Prices. All of those researchers have muck useful findings and their limitations.

This study held updating since share price is the crucial phenomenon in the Stock Market and there is an increasing trend in the common stock investment. This research is helpful in different area. The finding of previous research are equal important. The main focus of the research is analyzing the behaviour of the share price of Commercial Banks.

All the market risk and return can be accessed through over all NEPSE index. Corresponding to the fluctuations in individual industries the overall market index has also moved accordingly. It has reached maximum in the initial observation month and it started decreasing trend till the month of April/May. But from the month of May/June the market index are going to increasing.

Conducted study on the "Stock Price Determinants in Nepal Stock Exchange" using different financial & statistical tools which cannot give full information about fluctuation share price. This topic will help to those investors who want to know and invest about share price behaviour of Commercial Banks.

Research Gap

There have been many national and international studies in the field of risk and return to date. All the concepts and practices of foreign author's model about risk and return practices not in used in our Nepalese risk and return analysis. The Nepalese capital market is in the early stage of development. The conclusion made by the international studies may not be relevant in the Nepalese context. So, it is recommended to devote some effort and think how to use those foreign model risk and return. The previous researchers have done investigation about the risk and return part of other different finance companies. The concerned finance companies taken as sample in this research is also the leading finance companies of the country having huge market share and their performance and activities significant impact on the national economy.

The study focuses on the performance of common stock of sample finance companies and overall Stock market. Not only this study analyses the return, risk and their required rate of return but also gives the comparative knowledge of their performance along with Stock market. This research will help the investors who want to know where and when to invest their hard-earned money in stock market. So, this study will fruitful those interested persons, parties, students, teachers and Government for academically as well as policy perspective.

CHAPTER- III
RESEARCH METHODOLOGY

The brief discussion of the methodology followed in the study is given below. This chapter includes the brief description of research design, population and sample, sources of data, data collection instrument and procedures and method and tools used for analyzing the data.

It refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view (C.R. Kothari, 1994. Research Methodology, Methods and Techniques. New Delhi: Vikash Publication, planets-19). Thus the overall approach to the research is presented in this chapter. Methodology is the research method to test the hypothesis. Research Methodology is a systematic way to solve the research problems. It describes the methods and process applied in the entire aspects of the study. This chapter contains the research design, sample size, sample selection procedure, data collection procedure, data processing tool and techniques, variables etc.

The main objective of the study is to analyze the risk and return of common stock investment of listed companies i.e. commercial Banks. Thus this chapter is designed to meet the set objectives.

3.1 Research Design

The present study is basically related with the Nepalese stock market and share price behavior of the selected listed companies. A research design is a plan for the collection and analysis of data. In other words, it is an integrated frame that guides the researcher in planning and executing the research works. It presen a series of guide posts to enable the researcher to progress in the right direction in order to achieve the goal. The Study follow descriptive and exploratory research designs.

3.2 Population and Sample

The large group about which the generalization is made is called the population under study. Because of the large group size, it is fairly difficult to collect detail information from each member of population. Rather than collecting detail information from each number, the small portion is chosen as representation of the population is called the sample. Altogether twenty-one commercial banks operating in Nepal are considered to be the total population of the study. Due to lack of time and resource factor, it is not possible to study all of them. Hence, the four commercial banks have been taken as sample which are listed and doing shares transaction in NEPSE from population. The sample selections for this study are:

- Standard Chartered Bank Nepal Limited
- Nabil Bank Limited

This study will try to explore the objectives set in the previous section and it is also expected that this study will help in analyzing the stock market scenario. This study is aimed at producing tested affect of historical information on future price movements of the commercial banks' stocks.

Due to low volume of share transaction and insufficient data, other sectors like Mfg. Sector, service sector, insurance sector and other sectors have been omitted while taking the sampling companies from listed companies in NEPSE.

3.3 Sources of Data

The main source for data collection was from the office of Nepal Stock Exchange (NEPSE), Singhadurbar, Securities Board of Nepal (SEBON), Thapathali as well as economic survey published by Ministry of Finance and Nepal Rastra Bank. The main source of data is annual report of the SEBO/N and trading report of NEPSE. Bedsides annual report, various bulletin available, journals, articles and other publications published by different financial institutions and other useful resources are also taken into consideration. The study is based on the secondary sources of the data. The secondary source of data is the annual report of selected respective companies and Security Board of Nepal, Different books from library, periodicals,

newspaper cuttings company's magazines etc. related unpublished master degree thesis has also taken for the purpose of study. Significant and necessary information has also been collected form Internet and various websites.

3.4 Data Collection Procedure:

As the study is based on secondary data, has been collected through questionnaire distributed to the respondents and the response has been collected from the respondents duly filled and for secondary data, information is collected through the annual reports of selected companies and Securities Board of Nepal (SEBO/N), trading report published by NEPSE, Economic Survey, published by Ministry of Finance and different monthly, quarterly, half yearly and yearly bulletins published by Nepal Rastra Bank.

3.5 Data Processing Procedure:

Data collected from secondary sources were analyzed through various statistical and financial tools as follows.

a. Financial Tools

Financial tools are used for the analysis and interpretation of financial data. These tools can be used to get precise knowledge of a business, which are fruitful in exploring the strength and weakness of the financial aspects and strategies. Under the financial tools following ratios have been calculated:

i. Earning Per Share (EPS):

EPS ratio is used to measure the profitability of a firm from the owner's viewpoint. The market value of shares of a company is dependent on the earnings of the company. EPS also measures the return of each equity shareholder. It can be calculated by dividing the net profit after tax by the total number of the common shares outstanding. It reveals the earning power of each share over the period basically in one year. It is calculated as under:

$$EPS = \frac{\text{Net Profit after tax}}{\text{Number of common share outstanding}}$$

ii. Dividend per Share (DPS):

Dividend refers the percentage of earnings paid in cash to its stockholders. "As long as there are investment projects with returns exceeding those that are required, it will use retained earnings and the amount of senior firm has retained earnings left over after financing all acceptable investment opportunities, these earnings then would be distributed to stockholders in the form of cash dividends, if not there would no dividends" (Van Horne, 1990:328). People make investment in stock because they will get dividend in return. Therefore, the price they are willing to pay will depend on their expectations of dividends. 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:

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

iii. Expected Rate of Return

The expected rate of return is computed in the base of the expected cash receipts over the holding period and the expected ending or selling price (J. Fred Weston & Brigham; 1990:146). The expected return on an investment is the mean value of the summation of the possibility distribution of its possible returns (John. M. Chenny and Edward A. Moses, 1992:34). It can be expressed as an equation.

$$E(r_t) = \sum_{t=1}^{n} p_t r_t$$

Where,

p_t = Probability of the return for that event

r_t = Possible returns of each event

n = number of observations or returns

t = Different

In case of single holding period, the expected rate of return can be computed by cash dividends paid during the together with an appreciation in market price, or capital gain realized at the end of the year.

$$\text{Single Period Return (r)} = \frac{\text{Dividend} + (\text{Ending Price} - \text{Beginning Price})}{\text{Beginning Price}}$$

Here, ending price and beginning price indicates the cost of investment and the return realizes from that investment at the end of holding period. The nature of investment should be in revenue type of expenditure. The investors expect a regular payment of dividends over the Holding period with less chance of risk and price variations. The high expected rate of return is appreciated by investor s to invest such type of business and vice versa. Therefore, the investor decisions are larger influenced by the nature of investors.

iv. Required Rate of Return

Required rate of return is calculated as the risk free rate plus the risk premium on the risk of the particular stock. Total risk contains two parts diversifiable or unsystematic risk and under the assumption of CAM, investors are not compensated for total risk, rather they are compensated in the market for facing the systematic risk. According to the CAPM the required rate of return on any stock is equal to the risk free rate of return plus market risk premium times stock beta.

$$\mathbf{R_j = R_f + [E\,(R_m) - R_f]\,\beta_j}$$

Where,

R_j = required rate of return on stock j

R_f = risk free rate of return

$E\,(R_m)$ = market return or average return

B_j = beta coefficient of stock j

v. Market Return $\{E(R_m)\}$

Market return is the average return of the stocks of all companies in an industry. For this research purpose, market return has been calculated by dividing the difference of this year's market index and previous year's market index. Hence,

$$E(R_m) = \frac{\text{This year's market index} - \text{Last year's market index}}{\text{Last year's market index}}$$

B. Standard Deviation

Standard deviation, usually denoted by the letter σ (small sigma) of the Greek alphabet, which was first suggested by Karl Pearson as a member of dispersion in 1893. It is quantitative measure of total risk of assets. It provides more information about the risk of the asset. The standard deviation of a distribution is the square root of the variance of returns around the mean. The following formula is applied to calculate the standard deviation, using historical returns:

$$\sigma_j = \sqrt{\sum \frac{(R_i - \overline{R_j})^2}{n}}$$

Where,

σ_j = standard deviation of stock j

R_j = realized rate of return at a time.

$\overline{R_j}$ = expected realized rate of return.

n = number of observations in sample.

C. Coefficient of Variation

The relative measure of dispersion based on the standard deviation is known as the coefficient of standard deviation. The coefficient of dispersion based on standard deviation multiplies by 100 is known as the coefficient of variation (CV). It is suitable for comparing the variability, homogeneity or uniformity of two or more distributions. A distribution having less CV is said to be less variability or more uniformity homogeneity, consistency etc. and vice versa. The risk per unit of expected return can be measured by coefficient of variation, which is computed as follows:

$$CV = \frac{\sigma_j}{\overline{R_j}} X\ 100$$

Where, CV = coefficient of variation

$\overline{R_j}$ = expected realized rate of return

σ_j = standard deviation of stock j

D. Beta Coefficient

Total risk of stock consists two parts of risks; one is systematic (market risk) and another is unsystematic (unique risk) and commonly denoted by standard deviation (σ). Statistically, systematic risk and unsystematic risk can be measured by coefficient of determination or beta coefficient and by subtracting the systematic risk through 1 respectively. Less standard deviation and beta coefficient indicate less risk and vice versa. If beta is larger than one, then the assets is more volatile than the market which is called aggressive asset. If the beta is less than one, then the assets is considered defensive assets as its price fluctuations are less than the market. On the other hand, if the beta is equal to one, then the assets is said to average as its price moves proportionate to the market changes. So, these are applied to each sample commercial banks for testing and categorizing the form of stock relation to risk. Beta coefficient is computed by:

$$\beta_j = \frac{\text{Covariance } (R_J, R_m)}{\sigma m^2}$$

Where,

β_j = beta coefficient of stock

Covariance (R_J, R_m) = Covariance of the returns of stock j and market.

σm^2 = variance of the market

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

The chapter Data presentation and analysis is the main body of the study. The purpose of this chapter is to analyze and elucidate the collected data to achieve the objective of the study following conversion of unprocessed data to an understandable presentation. In this course of analysis, data gathered from various sources have been inserted in the tabular form and shown in diagram form. The data have been analyzed by using financial and statistical tools. The results of the computation have also been summarized in appropriated tables. On the background of various reading and literature review in the preceding chapter, it is tried to analyze and diagnose the recent Nepal stock market movement, with taking a special reference with commercial banks of Nepal. The samples of computation of each model have been included in annexes.

Among the listed commercial banks only three commercial banks are taken as sample namely,

- Nabil Bank Limited
- Standard Chartered Bank Nepal Limited

4.1 A Glimpse of Stock Market Trading

The main purpose of this section is to simply provide quantitative information of stock market functioning. The organized stock market is a recent phenomenon in Nepal. NEPSE has adopted an "Open Out -Cry" system. It means transactions of securities are conducted on the open auction principle in the trading floor. The buying broker with the highest bid will post the price and his code number on the buying column, while the selling broker with the lowest offer will post the price and code number on the selling column on the quotation board. The buying price will change when any other broker increases it and the selling price will change when someone will be ready to sell at low price. When the price matches the buying broker declares the quantity and the selling broker either accepts it or announces the quantity.

4.2 Behaviour of Nepse Index

This index is used as a benchmark by the individual and institutional investor to evaluate the performance of their own or institutional portfolio. Market indices are used to determine the relationship between historical price movements and economic variables and to determine the systemic risk for individual securities and portfolios. Market index has always been of great importance in the world of security analysis and portfolio management. The index can also be used as measuring tool whether the performance of stock market is good or not. This clearly focuses on the price of stocks that is increasing or decreasing in the market. Higher the index means the better performance of stock market and vice versa.

4.3 Present Situation Of Stock Market In Nepal:

The government has given higher priority to strengthen the Capital Market, and has lunched Corporate Financial Governance Project for the trading automation under the assistance of Asian Development Bank. Out of the 149 listed companies more than 68% of the transactions took place in the stock exchange related to the securities of the commercial banks and financial institution. Present Government is taking more seriousness to develop the securities market in the country. Currently, we are operating the exchange through manually basis. There are no custodians.

4.4 Number of Listed Companies in Nepse:

As concerned with the number of listed companies present in table shows that the rate of listing companies for the fiscal year 2006/07 is 9.65% which is highest increase rate.

Table 4.1

Number of Listed Company in NEPSE

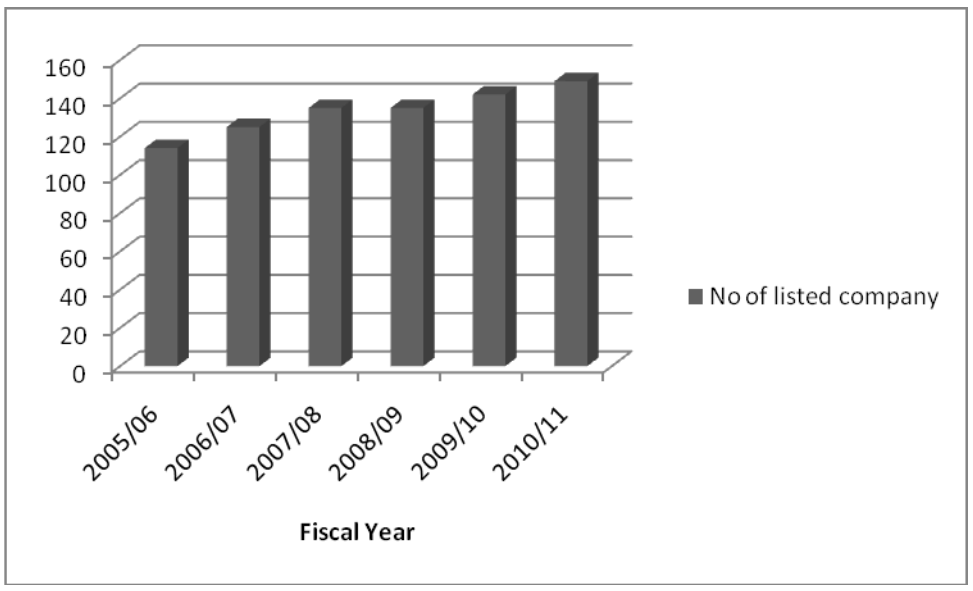
Year	No of listed company	Percentage change
2005/06	114	_
2006/07	125	9.65%
2007/08	135	8%
2008/09	135	0%
2009/10	142	5.19%
2010/11	149	4.93%

Source: Annual report of NEPSE, 2011

While talking about in terms of numbers it is 114 for the FY 2005/06. There are Increase in number of listed companies for the FY 2006/07 with 9.65% highest from 5yrs.there is no change in FY2006/07.The number of listed companies increased by 7(4.93%) to 149 in FY2010/11 while this number had increased by 135 in 2008/09 to 142 in FY2009/10.Increase in the number of listed companies indicates increasing interest of public towards the establishment of companies in the count.

Figure 4.1

Number of Listed Company in NEPSE



In regards to the trends of listed companies in NEPSE, also presented in bar chart shows the increasing trend, which clears that, this aer positive position of listed companies.

4.5 Descriptive Analysis of Banks:

A. Standard Chartered Bank Nepal Limited

The Bank was originally established as a joint venture of Grindlays Bank PLC London and Nepal Bank Limited in 1985 with the shareholding ratio of ANZ Grindlays Bank Limited 50%, Nepal Bank 33.33% and the General Public 16.66%. Along with the change of ownership to Standard Chartered, the banking area of SCBNL saw the rise of a new dawn changing the general image of the bank. With this acquisition, Standard Chartered Bank now owns 50% shares of Nepal Grindlays Bank Limited (NGBL) previously owned by ANZ Grindlays. The name of the bank changed to Standard Chartered Bank Nepal Limited. With the mission statement "To be the leading international bank in our principal markets", the bank operates through 11 offices, spread throughout Nepal and focuses mainly on corporate, consumer and commercial banking, providing services for international firms, as well. The bank contributed to a large extent in the development of the country by way of loans to industrial projects, the priority and deprived sectors. Further, it's been a major contributor to the government offices as the highest private corporate taxpayer in the Nepal.

Table: 4.2

MPS, DPS, EPS, P/E Ratio & Market Book Value Ratio of SCBNL

YEAR	Closing Price(Rs)	DPS (Rs)	Stock Dividend%	EPS (Rs)	P/E Ratio	MBVR
2006/07	2345	120	-	143.14	16.38	5.55
2007/08	3775	130	-	175.84	21.47	8.06
2008/09	5900	80	10.00%	167.37	35.25	11.52
2009/10	6830	80	50.00%	131.92	51.77	17.01
2010/11	6010	50	50.00%	109.99	54.64	18.35

Source: Appendix A (I)

The above table shows that the highest closing market price of share is Rs.6830.00 in the year 2009/10. The MPS of SCBNL is ranging from Rs.2345.00 to Rs.6830.00. This bank has paid cash dividend to the investors ranging from Rs.50.00 to Rs.130.00. SCBNL has distributed stock dividend 10% in year2008/09 and 50.00% stock dividend in year 2008/09 and 2009/10. Company's EPS ranges from Rs.109.99 to Rs.175.84. P/E Ratio and Market Book Value Ratio are also fluctuating in the ratio of fluctuating trend of MPS. P/E Ratio and MBVR are highest in the year 2010/11 i.e. 54.64 times and 18.35 times respectively.

b. Nabil Bank Limited

Nabil Bank Ltd. was established on July 12th, 1984 under a technical service agreement with Dubai Bank Limited, Dubai, which was later merged with Emirates Bank Ltd., Dubai. Nabil Bank is the first and major joint venture bank in the country with key points of representation all over the Kingdom of Nepal sharing 50% is owned by N.B.International Limited, Ireland, sharing by 20% from financial institution on Nepal and sharing by 30% from general people. After 11 years of active participation, Emirates Bank International Limited (EBI) divested its 50% share holding in Nabil to National Bank Limited, Dhaka, Bangladesh. EBI's decision to divest this investment was influenced by restructuring their own worldwide activities and strategy to concentrate only in United Arab Emirates and Pakistan with increased economic co-operation under the SAARC frame work particularly in the field of trade and commerce and induction of SAPTA agreement, the participation of National Bank Limited of Bangladesh in Nepal, seemed to be most timely. However, the Board of Directors had decided to release the technical assistance contract with National Bank Limited, Dhaka, Bangladesh in May 2001 in a view to that the management of the Nabil Bank Limited could be handled by the Nepalese employees. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 28 points of representation across the kingdom and over 170 reputed correspondent banks across the globe. Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern

banking with customer satisfaction measured as a focal objective while doing business. Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world renowned software from Infosys Technologies System, Bangalore, India, Internet banking system and Tele-banking system. The bank has focused to improve its operational efficiency by upgrading the information capability. Among the many 'firsts' to credit of Nabil, the business of Credit Cards Issuance and Acquiring is one. It introduced MasterCard to the Nepalese Rupees and US Dollar and also issues Visa Card and Visa Electron. Nabil has been introducing and expanding a number of IT based products. During the review period, Nabil geared itself up and started to acquire Smart Cards. Similarly, Nabil launched 'Nabil prepaid' and 'Nabil Kool Cash', two convenient prepaid card products. Growing network ATM facilities are available to account holders. Debit cards with PIN numbers are issued to enable customers to avail of 24 hour ATM facility. Nabil is the sole Principal Agent Bank in Nepal of Western Union Financial Services & facilities transfer of funds, through an on-line computer system, instantly to or from more than 170,000 locations in 196 countries and territories.

Table 4.3

MPS, Dividend, EPS, P/E Ratio & Market Book Value Ratio of Nabil

YEAR	Closing Price(Rs)	DPS (Rs)	Stock Dividend %	EPS (Rs)	P/E Ratio	MBVR
2006/07	1505	70	-	105.49	14.27	4.46
2007/08	2240	85	-	129.21	17.34	5.88
2008/09	5050	100	-	137.08	36.84	12.08
2009/10	5275	60	40.00%	108.31	48.70	14.90
2010/11	4899	35	40.00%	106.76	45.89	15.12

Source : Appendix A(II)

The above table shows that the highest closing market price of share is Rs.5275.00 in the year 2009/10. The MPS of Nabil is ranging from Rs.1505.00 to Rs.5275.00.

Nabil bank has paid dividend per share of different amount from the year 2006/07 to 2010/11 in the range of Rs.35.00 to Rs.100.00 respectively. Nabil bank has distributed stock dividend 40% in years 2008/09 and 2010/11 respectively. Company's EPS ranges from Rs.105.49 to Rs.137.08. P/E Ratio and Market Book Value Ratio are also fluctuating in the ratio of fluctuating trend of MPS. P/E Ratio is highest in the year 2009/10 i.e. 48.70times and MBVR is highest in the year 2010/11 i.e. 15.12 times.

4.6 Nepse Market

Expected Return on Market E(Rm) = the market return is the return on the market portfolio of all traded securities. Year ended the NEPSE index is used as the market return into account.

Table 4.4

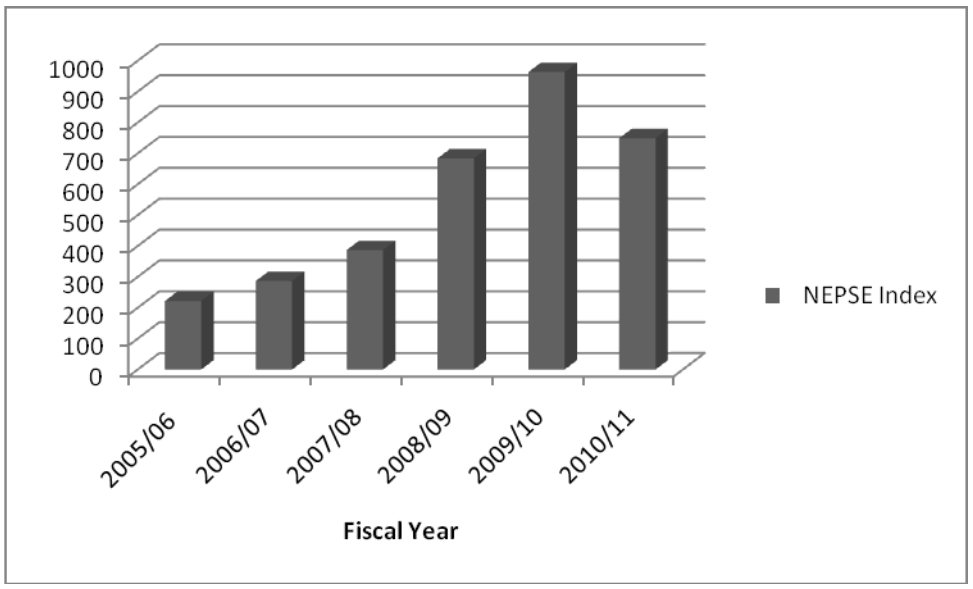
NEPSE Index & Annual Return

Year	NEPSE Index	Annual Return (R)
2005/06	222.04	_
2006/07	286.67	0.29
2007/08	386.83	0.35
2008/09	683.95	0.77
2009/10	963.36	0.41
2010/11	749.10	-0.22
Total		1.60

Source: Appendix B(V)

Figure 4.2

NEPSE Index



NEPSE Index

The above table shows that by the end of fiscal year, the price index of the listed securities (NEPSE Index) remained at 749.10 points, which is lower by
21426 points than that of the last fiscal years' index 963.36points. In this research fiscal year, the highest index of 963.36was noted on year 2009/10 and the lowest index of 222.04 was noted on year 2004/05.

4.7 Risk and Return Analysis

Risk measures the degree of volatility in the market price movements of individual securities. The higher the magnitude of fluctuations, higher will be degree of risk though it is difficult to measure risk, some statistical tools like standard deviation, coefficient of variation and beta coefficient are used to measure the risk involved in individual security. All these are calculated by using the formula described in research methodology chapter.

A. Standard Deviation

Standard deviation is a strong statistical device to measure the total risk involved in an investment, which consists of both market risk and diversifiable risk. Moreover it denotes the volatility of the expected rate of return. The calculated value of expected

realized return and standard deviation of four sampled different banks are presented in the following table.

Table 4.5
Standard Deviation of Sampled Commercial Banks

Stocks	Expected Realized Return (%)	Standard Deviation (%)	Ranking of riskiness based on Standard Deviation
Standard Chartered Bank Nepal Ltd.	34%	27%	3
Nabil Bank Ltd.	48%	48%	1

Source: Appendix B(I, II,III)

Based on the assumption of the standard deviation, investment in the common stocks of Nabil Bank is more risky. Stock of Standard Chartered Bank could be considered as less risky than the other three banks, being the standard deviation lower than other. The common stock of Nabil Bank is associated with 48% of the highest risk, which indicates that the expected return can be deviated, by 48% in case of common stock investment than the other three sampled banks taken into study. I have shown the above calculation in the Appendix -B (I), B (II), & B (III) respectively.

B. Coeeficient of Variation

The standard deviation may not be appropriate measure of risk when the realized rates of returns are not same in all of the companies taken under consideration. Hence also the average realized rates of return are not same for the entire sample. Therefore, it is recommended to use the coefficient of variation to measure the risk involved in individual bank. The coefficient of variation measures the risk per unit of return. The coefficients of variation of the realized rates of return of the sampled banks are shown in the following table.

Table 4.6

Coefficient of Variation of Sampled Commercial Banks

Stocks	Coefficient of Variation
Nabil Bank Ltd.	1
Standard Chartered Bank Nepal Ltd.	0.79

Source: Appendix B(I, II, III)

On the basis of coefficient of variation, common stock of Himalayan Bank seems to be most risky. The common stock of Standard Chartered Bank Nepal Limited seems to be less risky in comparison with the other sampled banks. The above calculation has been derived from the Appendix – B (I), B (II), & B (III) respectively.

C. Beta Coefficient

Standard deviation measures the total risk of an investment and the coefficient of variation measures the risk per unit of return. But the beta coefficient measures the market sensitivity or systematic risk of an investment. As we know, systematic risk is that portion of risk which is directly associated with market phenomenon and cannot be reduced by diversification. The beta coefficient of an individual stock provides the clear picture about the tendency of movement of the stock with market. It measures the stock volatility relative to that of the average stock. An average stock is that which trends to move up or down with the general market as measured by some index. Here, capital NEPSE index is taken into consideration to measure the movements of the general market regarding the stocks of listed commercial banks. Higher beta indicates the greater reaction by individual common stock with the given movement in the market status. The following table shows the degree of riskiness of each stock of entire sample in relation to the general market.

Table 4.7

Beta Coefficients of Sampled Commercial Banks

Stocks	Beta Coefficient	Ranking of riskiness based on Beta Coefficient
Nabil Bank Ltd.	1.23	1
Standard Chartered Bank Nepal Ltd.	0.68	3

Source: Appendix B(I, II, III)

By analyzing the above table, we note that Nabil Bank is much more sensitive to the market than other Bank because the beta coefficient of variation of this bank is more than one. The stock of Himalayan Bank and Standard Chartered Bank Nepal Ltd have beta coefficient less than one and can be concluded as defensive stock. Following the Nabil with1.23, For example in the case of Nabil Bank, the calculated beta coefficient imply that one percent variation in the market rate of return leads to 1.23 % variation in their realized rate of return. Hence highly sensitive stocks make quick response to the market change. The above calculation has been derived from Appendix – B (I), B (II), & B (III) respectively.

4.8 Price Analysis:

In this section the pricing of the shares of the sample companies were analyzed and interpreted. The result derived from the calculation by using Security Market Line equation was presented in the below table, studying the period of 2003/04 to 2009/10.

Table 4.8

Valuation of Stocks of Sampled Commercial Banks

Stocks	Required Rate of Return	Expected Rate of return	Status of the Company
Nabil Bank Ltd.	37.6%	48%	Under priced
Standard Chartered Bank Nepal Ltd.	24.17%	34%	Under priced

Source: Appendix B(I, II,III)

From the above table, it was found that four commercial banks taken as samples were found two are under-prices and one over priced this shows that the market of the sampled banks was very much inefficient. The detailed calculation of the values of shares is presented in the Appendix – B (I), B (II) & B (III) respectively.

4.9 Major Findings of the Study:

On the basis of the detailed study of the listed commercial bank in regards to investment in common stock including risk and return analysis following major findings have seen, they are presented as follows;

Talking about number of listed companies under NEPSE, the increasing trend shows the positive percentage change which indicates increasing interest of public towards the establishment of companies in the country.Because of the persistence in the stock price movements, professional traders either individual or institutional can beat the market. Therefore to make greater profit than naive buy and hold strategy, acute fundamental and other analysis are required which accurately predict the appearance of the new information in the market that have impact on prices.

The remaining two bank Nabil Bank and Standard charter Bank have Actual return more than the required rate of return so the stock price of those Bank is undervalued. All the market risk and return can be assessed through over all NEPSE index. Corresponding to the fluctuations in individual industries the overall market index has also moved accordingly. It has reached maximum in the initial observation month and it started decreasing trend till the month of April/May. But from the month of May/June the market index are going to increasing.

Stocks of Nabil Bank are more aggressive to market changes as revealed by the highest beta coefficient of 1.23 and the least beta coefficient is yielded by Himalayan Bank of four sampled banks. The finding of this study also implies that Nepal Stock Exchange is operated under the dearth of sophisticated financial and market analysts. Activities of such analysts with the skillful mind, talent and ability including statistical knowledge and react about incoming information and their

valuable suggestions in building of new regulations help to cut down the dependence in the stock price changes. But, unfortunately such kinds of activities were not found in Nepalese stock market. Thus, investors are not in attention of publicly available information and whimsically they response the information and accept the new price. Details of data, its presentation and analysis reveal that standard deviation of Nabil bank is 48%which is highest of all the banks selected for the study.

Depending upon this parameter i.e. S.D., SCBNL stock is said to be relatively less risky. Regarding the total risk, Nabil Bank Ltd.consists of highest 65.97% of total risk which is risky among the sample. The stock of Standard Chartered Bank Nepal ltd is recorded as least risky in comparison to it other sampled banks in terms of standard deviation. The average realized rate of return of all the sampled banks are not the same over the sampled periods.

CHAPTER- V
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 SUMMARY

Trade off between risk and return is the central focus of finance. And its major part stock market has greatest glamour, not only for the professionals or institutional investors but for the individual or private as well.

We have seen that every investment has the risk factor. And we should minimize the risk to maximize the return. For this we must follow the following statement, 'not to -put all the eggs in one basket' It means appropriate portfolio should be constructed instead of investing in a single security. A portfolio is the combination of different investment assets. It would be able to reduce unsystematic or diversifiable risk. Stock market investment is the main focus of the study. Stock market investment can be both rewarding and fun so long as sufficient tune is given to appreciate its many facets and characteristics.

Risk and return, a new and complex concept is also foundation of modern investment. The study was conducted to find out the behavior of stock price of three sampled commercial banks with respect to the movement of various financial indicators, tentative external events and some other factors. The chapter consists of three sections; the first section provides the summary of the study; the second section draws the conclusion of the study. Finally, the third section proposes recommendations to solve the problems observed on the basis of the findings.

The study was conducted with the main objective to analyze the share price behavior and risk and return attributes of investment of three sampled commercial banks namely Himalayan Bank, Nabil Bank and Standard Chartered Bank Nepal. It is mainly focused to developed the model accordingly and its empirical test in previous chapter. The model consists of standard deviations; coefficient of variations, beta coefficient and under and overpricing of shares were adopted as test methodologies.

Before analyzing the results of test, the overview of the Nepalese stock markets has been sketched. The recent position and performance of market in Nepal has been analyzed. The Nepalese stock market has not been developed remarkably in the economy because of various market imperfections like limited number of buyers and

sellers, stringent government policies, negligence in development of corporate sectors etc. Market price of stock is the main outcome of investor's psychology. The psychology of investors is affected by various factors. Here in Nepalese market, dividend and price appreciation of stock is major factors for the investors to decide about purchasing of shares. Along with DPS and price appreciation, EPS, market rumors, political and economic environment etc are the other factors to influence the buying and purchasing behavior of the investors. Every investor must consider the financial status of organization before making any decision regarding the investment.

The next objective of the study is about the identification of the price of stock whether it is overpriced, underpriced or equilibrium priced. For this purpose, different financial as well as statistical tools such as standard deviation, coefficient of variation, beta coefficients etc have been used. To find out the pricing status of stocks; expected rate of return and required rate of return has been compared. Generally, the trend is that the MPS of public quoted companies is above their book value. The market value is determined by the supply and demand functions.

The comparison it has been found that the stocks of two sampled commercial banks are underpriced and one sample commercial banks is overpriced. The main reason for underpriced of the stock valuation is that the price of the stock had reached the highest point during the study period but the NEPSE index did not follow the same speed and the rate of Treasury bill issued by NRB also heavily decreased during the study period. It makes the expected rate of return of the sampled banks are high and required rate of return low. Hence, sampled two banks' share prices are underpriced during the study period.

The decision for investment largely depends on the information about the performance of the company. In general, most investors prefer to buy shares of those

companies whose earnings are very attractive and dividend payout ratio is high. However, rational investors not only analyze earnings but also various information regarding the company's management, dividend policy, market penetration, financial situation, and other internal and external factors before making investment decision. It is also found that some of the investors invest in shares for dividend and price appreciation and most of them are not interested about the other indicators which could affect the price of shares. It also seems from the research that the investors are conscious about the market price of the share they have bought as many investors seek for their share's price daily or weekly. Although they seek for their share price, most of them are not trading their shares in secondary market, which shows that most of the investors are holding their shares for only dividend and they are not using the change in share price for speculative purpose**.**

5.2 Conclusions

The shares of commercial banks of Nepal are heavily traded in the stock market. These shares play a key role in determination of stock exchange indicators. This study tries getting the empirical result of the investment of shares of the commercial banks from risk and return perspective. As we all that the prices of shares tends to fluctuate from time to time as a result the investors can buy shares when the value of shares decreases and hold till the share price increase. The dependence in the series of price changes observed implies that the price changes in the future market will not be independent from the price changes of the future days. It brings about that the information of the past price changes is helpful in predicting future price changes. Therefore, sufficient opportunities are available to institutional and individual investors to make higher expected profits in future based on those historical price series. In the mean time while the statistical analysis regarding the risk and return of the sampled stocks shows that the all the banks seems to be risky than the average stock. But as most of the banks are offering cash dividends every year which may not be applicable to other types of no banking firms, there is race of investors towards the stocks of banking sectors.

Among the various financial indicators EPS seems to be most significantly related with the market price of shares. Two of sampled banks' stock price found to be

underpriced because their required rate of return is lower than the expected rate of return and one sampled banks' stock price found to be overpriced because their required rate of return is greater than the expected rate of return. The study also shows that Nepalese investors are more conscious towards the dividend and price appreciation of the shares they are investing but most of the investors are only using buy and hold strategy as only few of them are trading their shares in secondary market. This shows that there is lack of professionalism among Nepalese investors.

5.3 Recommendations

The findings of this study may provide important information for those who are concerned directly or indirectly with the stock market activities. Thus, the following recommendations can be outlined.

From the study it seems that Nepalese investors have limited knowledge about security market. It lacks of professional investors. Hence, the concerned authority is recommended to make aware about the security market to the general public so that they are interested to invest in security market and the previous investors could change as professional investors. As per the study, investors are trading the stocks without proper analyzing of the financial indicators of concerned companies. Hence, investors are recommended for the empirical study of the financial indicators of those companies before trading the stocks and they must be alert to exploit the opportunities through the short term speculation.

There should be separate body for regular monitoring and analyzing the strength and weakness of public companies, which will disclose right and value information and suggestion to public investors to take proper investment decision at the right time to avoid or minimize the level of risk. This study could not explore the movement of share price of whole sector of listed companies and no any separate software regarding to stock market is applied. Thus it is recommended to future researchers to under take comprehensive study by appropriate method, related to the whole sector wise share price movement.

At last, once again, common stock investment is risky. So investors should learn about the operations of the security market, the characteristics or various investment avenues available to them, the concept of time value of money, the basic models of security evaluation, the approach of fundamental analysis, the tools of technical analysis, the insights provided by modern investors research, and the war of resolving the key issues relating to the process of portfolio management. Now after learning above key factors and subject matter investors should translate the knowledge and insights to gain from common stock investment. Two of the stocks of sampled banks are undervalued in the stock market. So, investors are recommended to buy these undervalued stocks by selling their overpriced stocks. The public investors should not directly invest their savings in shares haphazardly. They should at least analyze or get suggestions from expert about the financial position and the level of risk prior to taking an investment decision. The pace of economic development should be accelerated and the political system should be stable in order to create its positive impact on the stock market development. The size of stock market is pitifully small in Nepal because of small size of the corporate sector in the economy. Besides, it is the general fact that until there is sophisticated development in the financial institutions, no other sectors could be developed in the full extent. So, government and other related sectors should try to stabilize and modify the rule and regulations concerning to the development of the effective pricing of the shares of such financial institutions as well as other sectors. For the concerned regulatory bodies such as SEBON and NEPSE, it is recommended to implement Computer Assisted Trading System (CATS) as soon as possible to meet the expectations of investors, brokers, other concerned bodies and individuals as the presently implemented Open-out-cry trading system was found to be out-of-date in present context. It will also be helpful for researchers to carry out further more research work on the stock price behavior to develop an efficient market. Because of the non randomness of the price movement in the Nepalese share market, professional traders either individual or institutional can beat the market. So, it is recommended that the investors should be aware of exploitation through short term speculation where above average return is possible to some extent from past information.