Chapter I

Introduction

1.1 General Background

The growth of economic depends on availability of funds to finance the increased needs. Not only the needs of government and business but the most important is of the individual investors. Privates domestic, and public in vestment can be the major contributor to economic growth and employment generation in the developing country. For the economic development of any country, public participation plays a vital role. If the peoples are rich and aware, people will have enough and be interested to invest. This will play a vital role in the economic growth of the country.

"To the extend that public investment. Expenditure result in the provision of public services which reduce the cost of production of the private sector , they have a positive effect on private profitability and investment '' (Chhibbeer Ajay & Darlami Mansoor, Dec 19900). An investment in any funds is made to have some positive rate of return. Nobody is ready to bear risk without any return. But to have return, one must be ready to face some risk.

To minimize the risk at the given rate of return the concept of portfolio diversification is necessary. Portfolio is simply a collection of securities gathered to achieve certain investment goals. Usually investors diversify their portfolio to have minimum risk maximum return. So, to meet the investment goals there should be well-managed portfolio. Most investors hope that if they hold several securities then even one goes bad, the other will provide some protection from an external loss.

"A systematic investment process should be followed to win the stock market. Investment process describes how an investor should go about making decisions with regard to what marketable to invest in, how extensive the investment should be and when the investment should be made. A five-step procedure for making these decisions form the basis of the investment process:-

Set investment policy

Perform security analysis

Construct a portfolio

Revise the portfolio

Evaluate the performance of the portfolio (Sharpe, William F. Alexander, Gorden J. Bailley, Jeffery V. 1995:9)

Among these investment processes the research s focused on security analysis and portfolio selection. Security analysis involves examine of individual securities or group of securities within the broad categories of financial assets.

Portfolio construction identifies those specific assets in which to invest determining the proportion of the investor's wealth. Diversification should be done to minimize the risk and maximize the return. Portfolio performance involves determining periodically how the portfolio performs in terms of not only the return earned, but also the risk experienced by the investor.

Financial market facilitates the flow of funds from surplus to deficit units. Those financial markets that facilitate the flow of shot-term fund, i.e. less than one year are known as money markets, while those that facilitate the flow of long-term funds are known as capital markets.

There are two types of securities. Securities having long life, generally of more than one year are called capital market securities. Money market securities generally have higher liquidity whereas capital market securities are used to generate a annual return to investors.

"Stock market is a financial market which probably has the greatest glamour and is perhaps the least understood. Some observers consider it as a

legalized heaven for gambling and many investors consider stock marker investing as a game in which the sole purpose is pocking winners" (James H. Lorie & Peter Dodd. 1985)

The well functioning stock market allows stockholders to achieve efficient diversification, which reduces risk, which in turn, lowers the risk premium component in the cost of capital. Stock markets lower the cost of capital by liquidating investors' investment.

It encourages investors to retain their earning and convert it into cash by selling shares in the stock market. The stock market provides an opportunity to the portfolio managers and public for direct participating and sharing the gain of economic progress.

The economic liberalization policy of His Majesty's government has done much to strengthen the financial sector in Nepal. The financial sector has witnessed a period of boom since the liberalization.

Today, the economy can boost as much as 58 Finance Companies, 17 Commercial Banks, 13 Development Banks, 11 Rural Micro Finance Development Banks as many Co-operatives with limited banking activities, credit NGOs and several Insurance Companies; and many more pipelines.

Operation of these financial institutions is largely affected by the interest rate policy of the state.

Though interest rate policy is not a new topic to deal with the financial institutions as we can review the interest rate policy of Nepal amidst four decade, finance companies came to active and visible operation after 1992 even after the enactment of Finance Company Act 2042, the first finance company, the Nepal Housing Development Finance Company Limited, began operation in 2049 after the restoration of democracy.

After the enactment of finance company act on 2042, interest rates affect on finance companies was felt. However, after the initiation of liberalization policy by Nepal on Mid-eighties, and establishment of finance companies after 1992, due accentuation was given to the rates of interest fixed by the central bank of Nepal NRB keeping in note the welfare of finance companies.

Major source of funds of finance companies are the public borrowing and return on investment of various portfolios. Public borrowing commonly termed as public deposits and investment portfolios in fact, are spruce up by the interest rate structure of the state which is controlled and regulated by central bank.

Central bank's policy also takes keen interest in investment portfolio of not only commercial banks but also other financial institution like finance companies. It has set some priority areas of investment where some investment facilities in addition are provided.

In Nepalese contest the concept of security market began with the set up of "Nepal Stock Exchange" former known as "Securities Exchange Centre" in 1976. This is the only stock market in Nepal. In spite of considerable development of stock market there is lot more to be done for the development of stock market in Nepal.

Many investors are still afraid of investing in securities because of inadequate knowledge in this field and most investors are exploited from market intermediaries. For this purpose potential investors must be able to analyze risk and return of individual stock to increase market efficiency and consequently speed up the economic development.

The history of non banking financial institutions is not very old. When banking sector started carrying out current activities of finance company, large numbers of finance companies were established and they expanded at a rapid pace in the development countries, UK and USA in 1960s.

Their growth was very rapid in comparison to commercial banks as they used to offer higher interest rate on deposits, lower interest rate on loans and swifter service than commercial banks.

In the context of Nepal, there were few insurance companies and Karmachary Sanchay Kosh working as non banking financial institution before enhancement of Finance Company Act 2042. Need of finance company act was felt because unorganized sector was collection saving from the common public in the name of Uphar and Dhukuti programs. People showed great interest and enthusiasm in these programs but they were cheated by most of the organizers of these programs.

Considering peoples' interest in such programs, benefits of mobilizing such saving in productive sector, banking sectors' inability to carry out capital market activities and to meet consumers' need for credit, government felt the need of finance companies and introduce the Finance Company Act 2042. However, no finance company was set up till 2049 because the act came in to being only in 2049 with some amendments.

Wave of establishing finance companies began only when NRB authorized co-operative institutions set up under Co-operative Act 2048 to accept deposit and give credit. "Nepal Awas Bikash Bitta Company Ltd" is the first finance company established in 2049, promoted by Rastrya Beema Sasthan.

Nepal Bank Ltd., Rastriya Banijaya Bank, Agriculture Development Bank and Nepal Arab Bank Ltd. In the even year, Nepal Finance and Saving Company Ltd was established from private sector.

In sort span, number of non-banking financial institutions has drastically grown up. Now, finance companies are 58 in numbers. The number of insurance companies, co-operative institutions, NGOs authorized for limited banking activities postal saving banks are growing.

The reason for their seedy growth is higher interest rate on deposits, low administration cost, swift decision, less liquidity and high demand for consumer credit. Moreover, they have curtailed Dhukuti and Uphar programs and have removed demerits there of.

However, collapse of banking sector, especially finance companies in South East Asia had adversely affected finance company in Nepal. They had not yet earned public confidence. People had started judging the safety of their deposits instead of interest rates.

The concept of banking system was introduced in Nepal with the establishment of Nepal Bank Ltd. in 1937 A.D. But the financial scenario of Nepal changed with the establishment of joint venture banks in 19884 A.D.

Nabil Bank Ltd., formerly known as Nepal Arab Bank Ltd, is the first joint venture bank introduced in Nepal. Since the joint venture banks introduced in Nepal did well, the set up of joint ventures banks are increasing day by day and domestic banks like Nepal Bank Ltd. and Rastriya Banijya Bank no longer been able to enjoy monopoly. Nowadays, even banks are established fully promoted by the Nepalese investors with or without the management support from the foreign banks.

Banks like Kumari Bank Limited, Lumbini Bank Ltd. etc. are running under fully Nepalese investment and management as well. There is cut throat competition among these banks, which is healthy sign for the economic development of the country. Among the established commercial banks in Nepal, twelve banks are listed in NEPSE and for this research only eight joint ventures banks are taken.

Financial activities play vital role in the development of country. Financial development is one of the key indicators of economic development of the country. Financial activities are integral part of national plan to accelerate the pace of economic development. The main objective of finance companies should be directed to support industries first and then to consumer credit.

The relation between production and consumption are very important in the economy. As industry grows on the support of finance companies, other economic development indicators follows such as creation of employment, income generation and saving to recycle for further collection of deposits by finance companies and then again extending credit to industries.

The process should repeat to have significant relationship between growth of finance companies and overall economic development on the other hand. Finance companies are involved in different investment activities within the boundary of environment facilitated by the state government.

Environment here is mean to the policies regarding investment and components being the interest rate structure, portfolio management, priority sectors, and the like. In Nepal, finance companies are involved in various activities of type money making and increasing its net worth.

To boost and safeguard the investment and their return NRB has facilitated many reforms including interest reform and investment portfolio which is still on. Besides these initiatives why some finance companies fail? There is dearth of finance companies whose performance has been satisfactory.

Their investment portfolio is said to be defective. What are these defections? What are the factors that make it defective and sick? Need not

to mention, interest rate has its own major role to guide the investment portfolio and the interest rate? These some of the research problem need prompt and specific answers. Without finding a problem there would not be solution for it.

Finance companies heave and collect scattered capital and utilize for investment activities. However, it is alleged that finance companies are not utilizing thus amassed capital to productive investment. This study would try to find actual state of investment of finance companies in both investment and loan portfolio.

Till the date, 58 finance companies are registered and in operation. Billions of rupees are tied with them. Interest for deposited amount by the public is to be paid and interest is received for advancing loan. The difference between these tow accepting deposit and lending rates is what termed as spread.

This spread in fact, affects the rate of return of investment thus is connecting itself to the investment portfolio. If effective relationship in between the interest and investment portfolio could be predicted, return on investment could be increased which in turn would shove its contribution to GDP and enhance the economic development of the nation.

Besides, this study would try to pin out new field for further research that would enhance the effective operation of finance. Some suggestions would be cited at the of the research paper.

1.2 Focus of the study:

Portfolio management:

Harry M Markowitz originally proposed portfolio theory in 1952. it is concerned with selecting optimal b risk adverse investors.

Risk adverse investors selects efficient portfolio that maximizes return at a given level of risk or minimizes risk at a given level of return. What the collection of those efficient portfolios the optimal portfolios can be obtained for given investors. The level of risk return is depended upon the investors' preferences.

Risk and return on portfolio:-

It is common problem of investment manager how to maximize the expected return of the portfolio subject to some target level of volatility. That is investment is made to have best performance for an expected level of standard deviation. The targeted standard deviation is determined by the investor's tolerance for risk.

Expected returns depend upon the firm's life cycle and returns of mature firms with those of growth firms. Time variation can play an important role in determining expected returns of mature firms than of growth firms. Effective risk and return management strategy should be applied in order to manage portfolio risk and return.

1.3 Statement of the problem:-

Portfolio management is relatively new concept in Nepalese context. Many companies still have no awareness towards it. The study has examined the investor's awareness the portfolio management of the financial institution while investing. In this study investors refer to the institutional investors.

Investors can be classified into three categories on the basis of risk and return. First types of investors are risk lover investors who became ready to face high risk in the hope of high return. The second types of investor are risk avoider investors who try to avoid facing high risk and became ready to be satisfied in low return.

These are the three types of institutional investors. The study has examined whether these are investors are aware about the portfolio management of the institutions they are investing or not.

How effectively the financial institution are mobilizing their investment and whether the return that investors get back is sufficient or not in compare to the risk they are bearing. It is not necessary that the investors who bear high

risk have high return. The portfolio return is the straight weighted average of return from the individual assets.

But the portfolio return is the affected by the variance of returns as well as the covariance between the returns of individual assets included in the portfolio and their representative weight.

The study has examined about the condition of portfolio management in financial institution whether the institutions have maintained portfolio management or not.

If they have portfolio management then what is the rate of risk in their institutions? And for bearing that risk what is the rate of return they are having. But if the institutions are careless about the portfolio management how much profit maximization that portfolio management.

The study has also tried to find out the relationship between earning per share and market price per share of these financial institutions.

1.4 Objectives of the study

The basic objective of the study is the analysis of Risk and Return on investment on common stock of commercial banks in Nepal

1.   The specific objectives of the study are as follows:

2.   To provide the suggestions and recommendations on the basis f findings.

3.   To promote & the interest of the investors by regulating the issuance, sale &

      distributions of security.

4.   To examine the performance of Nepalese Commercial banks under study in terms

      of profitability.

5.   To analyze portfolio attributes of investment in Nepalese Commercial Banks in

      relation to risk and return.

1.5 Significance of the study:

Today, the commercial banks are the major role player in the stock market. Among the 17 commercial banks, some are performing very well, some are moderate and some are below standard.

Thus, this research gives a feedback to the interested investors in the common stock of commercial banks that whether to invest in a particular bank or not. Invertors may be of different characters. Some may be risk lover, some neutral and some risk avoiders.

Hence, taking the risk in calculation, comparing to the market rate of return, whether the investment in a particular bank or the entire banking industry is profitable or not, whether the investment gives back the sufficient return according to the risk born, is thoroughly analyzed in this research work.

Thus, this research may play a vital role or help the investors, who are interested in common stock investment, basically in the banking industry.

1.6 Limitations of the study:

The problem of non-availability of required data and information regarding portfolio management may limit the scope of the study.

The study has covered only eight listed commercial banks in Nepal Stock Exchange.

1.   The study mainly depends on secondary data.

2.   Risk and return measurement is taken as the tools of the methodology.

3.   Average return of the individual bank is taken as expected return.

4.   Since the treasury bills issued by NRB are only of short term of 91 days, there is confusion in calculation risk free rate. So the required rate of return is calculated using treasury bills annualize rate and national saving bond interest rate as risk free rate.

1.7 Chapter plan :

The research has been classified into five basic chapters.

Chapter I Introduction:

The first chapter includes general background, focus of the study, statement of the problem, objective of the study, scope and limitation of the study.

Chapter II Review of literature:

The second chapter includes theoretical review, review of related studies and review from journals.

Chapter III Research methodology:

The third chapter includes research design, data collection procedure, sample, tools for analysis and method of analysis and presentation and chapter plan.

Chapter IV Analysis and presentation of data:

The fourth chapter includes analysis of individual banks, inter firm comparison, comparison with market, analysis of profitability and analysis of correlation coefficient of risk and return with profitability and analysis of correlation coefficient of risk and return.

Chapter V Summary, Major, Findings, Conclusions and Recommendations:

The fifth chapter includes summary findings, recommendations and suggestions.

CHAPTER – II

REVIEW OF LITERATURE

This chapter is mainly concerned the competent exploration of the background to the work and a comprehensive review of recent and relevant literature. In this regard some basic academic course books, journals and other related studies are reviewed.

But so far nominal research has been performed in this topic in Nepal. Our stock market is on emerging state and unable to provide necessary information concerning to this study.

Some master degree thesis available in Tribhuvan University Library, related to some extends to the topics "Risk & Return" are reviewed. Apart from these, independent studies carried out by well known expert are taken in consideration.

-The economic liberalization policy of His Majesty's Government has done much to invigorate the financial sector in Nepal. Establishment of finance companies is result of liberation of HMG of Nepal. The 8th plan (1992-1997) stresses.

The vacuum in the present national financial system need to be filled by institutionally developed capital market like investment companies, financial companies, leasing and housing finance in order to create healthy competitive financial sector.

-Finance companies came in to operation under the finance company Act 1986. They re registered as limited companies at the office the register of the companies according to the provision made in the company Act 1965. A finance company can accept time deposit of maturity of minimum three months to six years to a maximum limit of twelve times of primary capital of the institutions.

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Need not to state non-banking financial institution like finance companies are the out come of the financial liberalization in Nepal. Before restoration of democracy because of the tight economics situation financial liberation was not behaviorist.

After democracy the finance company Act becomes active and as a result Nepal Housing and Development Finance Company Limited evolved the finance company act in 1985 but before registration pf democracy no finance companies activities took place in Nepal.

The ninth plan committed that the finance companies will be expanded and investment for saving will be diversified in order to enhance domestic saving mobilizations through financial institution. Finance companies are source of revenue collection. They are bound to collect 30% of their income as government revenue or income tax.

2.1. CONCEPTUAL FRAMEWORK

Various books releasing to theoretical aspect of portfolio management and risk & return are taken into consideration. In this research, risk & return has been taken as special tool to analyze the rate of return that the investment gives from.

People now a days, are seen very much interested towards investing in the shares of various organizations. In Nepalese context, the major share trading

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2.2. THEORITICAL REVIEW

PORTFOLIO ANALYSIS

So far in Nepalese context the previous researches share that many Nepalese private investors placed their wealth in a single assets or investment. It is because of the lack of proper awareness and knowledge about portfolio management.

If they construct a portfolio for investment they can reduce unsystematic risk without losing considerable return.

Therefore analyzing risk & return on portfolio context is necessary project which will lower risks and fetch higher return. Portfolio management plays vital role for diversifying total investment in different areas.

This is mean to say not putting all the eggs in single basket. Portfolio management reduces the systematic risk involved in any investment.

Portfolio management means allocation of fund in different components having different degree of risks and varying rate of returns in such a way that the confliction goal of maximized yield and minimized risk can be achieved.

The objective of portfolio management is to analyze different individual assets and delineate efficient portfolios. The group of all efficient portfolios will be called the efficient set of portfolios. The efficient set of portfolios comprises the "efficient frontier".

The efficient frontier is the locus of paints in risk – return space having the maximum return at each risk class. The efficient frontier dominates all other investments. the commercial banks. Besides, the trading price of these banks share is also the highest.

But though the share price of various banks can be observed different. This variety of the market price of shares depends upon the risk of investment and the return the

Portfolio management is very important for every investor. In each investment risk is involved. Risk is the chance of loss or the variability of the returns of a period. Greater variability means more risks. So it is kept in mind while investing in the

On investment we must be well informed about the factors which affect investment decision related with saving, capital formation capital market, risk involved on it, return, inflation, prevailing rate or interest etc.

According to J.K. Francis (n.d.:1) an investment is a commitment of money that is expected to generate additional money. Every investment entails some degree of risks, it requires a present certain sacrifice for a future uncertain benefit.

In commercial sector investment is the use of fund at present for the benefit in the future. There is the sacrifice of present consumption of fund for earning more in the future.

While talking about investment we cannot forget that saving is primary factor for investment. If there is been no saving, none of the investment can be expected. So saving is back bone of investment. Saving is needed for capital formation.

It is commonly known fact that an investment is only possible, where there is adequate saving. If all the income is consumed to solve hand to mouth problem, there would be no saving. And without saving no investment can be expected. Therefore, savings and investment are interrelated.

Capital markets also plays very important role in investment. The shares issued by the company to raise capital for investment are traded in capital market. Since future is uncertain and investment decision involves risks, benefits of investments are difficult to measure and cannot be predicted with certainty.

But capital market provides a means for distributing risks among various parties. Capital market brings together those who have surplus and those who desire to borrow to finance the investment in industrial and commercial venture.

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But capital market provides a means for distributing risks among various parties. Capital market brings together those who have surplus and those who desire too borrow to finance the investment in industrial and commercial venture.

"While the portfolio expected return is a straight forward weighted average of returns on the individual securities, the portfolio standard deviations. To take a weighted average of individual security, standard deviations would be to ignore the relationship or covariance between the returns on securities. This covariance, however, doesn't affect the portfolio's expected return .

"(Van Horne, 1995:96)".

Portfolio management reduces the systematic risk involved in any investment. Portfolio management means allocation of fund in different components having different degree of risks and varying rate of returns in such a way that the conflicting goal of maximized yield and minimized risk can be achieved.

Thus though the investors like to invest on the Bank, they can still minimize their risk by investing in deferent shares. Thus in a year, or forever, if one bank goes to loss, his investment will not be fully post.

RETURNS :-

A major purpose of investment is to get a return or income on the funds invested .On a bond an investor expect to receive interest and on a stock dividend may be anticipated .

So return from investment has different meaning to different investors. Some companies seek near term cash inflows and give less value to more distant returns.

Other investors are concerned primarily with growth. Still others measure return using financial ratters. They might seek to invest in a company that has a high return on investment.

Investor wants to maximize expected return subject to their tolerance for risk. Return is the motivating force and it is the key method available to investors in comparing alternative investments.

Realized returns and expected return are two terms which is often used in the language of investment. Realized return is after the fact return. Return that was earned or it is history.

Expected return is the return from an asset that investor will earn over some future period. It is a predicted return, which may or may not occur.

EXPECTED RATE OF RETURN

The expected rate of return or holding period return is based upon the expected cash receipts over the holding and the expected ending or selling price. Depending upon the assumption made about cash receipts and ending price, a number of expected rates of return are possible. Those possible rates of return estimated by the investor are summarized in an expected rate of return. The expected rate of return must be greater or equal to the required rate of return in order for the investor to find the investment acceptable.

"(Cheney & Moses, 1993:34)"

RISK

Risk and uncertainty are real in life. When ever is uncertainty, there is risk. Every one encounters uncertainty in everyday life, like uncertainty about the weather, about the performance of ones investment and about ones wealth.

Uncertainty exists though a decision maker knows all the possible outcomes of a certain act but one reason or another cannot assign probabilities to the various outcomes.

Risk on the other hand exists when the decision maker knows not only the various outcomes but also the probability associated with each one.Risk & uncertainty are on integral part of an investment decision.

Risk can be defined as a situation where the possible consequence of the decision that is to taken is known uncertainty is generally defined to apply to situations where the probabilities can not be estimated.

The supply of the capital depends upon savings. Rather upon the will to save and the power to save of the community. Some people save of interest were zero.

There are others who save because the current rate of interest is just enough to induce them to save. They would reduce their saving if the rate of interest fell below this level.

Still there are potential savers who would be induced to save if the rate of interest were raised. To the last two categories of savers.

The sacrifice of waiting when they forgot present consumption in order to earn interest. The higher the rate of interest. The lower will be the community savings and more will be supply of funds.

The supply curve of capital thus moves upward to the right. How ever Risk & uncertainty are used inter changeably. In finance risks have a very special meaning.

It refers to the uncertainty associated with the returns on a particular investment. A risky investment is thus one whose returns are volatile.The monetary authority determines the institutional interest rate after analyzing the economics system adopted by the country.

Interest rate depends upon economic activities and existing policies of the nation. In every economy. We find the inverse relationship between interest rate and investment and direct relationship between interest rate and saving.

Interest rate plays very important role in developing countries like Nepal where the demand of capital is increasing day by day. An appropriate interest rate can divert investment in proper and targeted field.

For sound financial development and to mobilize the available resources interest rate should be positive. The interest rate is an effective rationing device for th allocation of scarce resources between alternative investments.

Before 1990 the interest rates of banks and financial intuitions were fully controlled by the monetary authority of the country (NRB) . the interest rates were completely liberalized effective from commercial banks.

Accordingly, commercial banks and financial institutions were granted autonomy in fixing their own deposit and lending rates. The rational for ending the administered interest regime was to let market forces to determine the interest rate structure bring flexibility in the mobilization of financial saving and make efficient allocation of available resources.

The unorganized rural credit is prevailing in the rural areas of Nepal unorganized sector rural financers ware traditional and important source of rural credit in Nepal. In the unorganized sector, the credit suppliers are indigenous bankers and traditional money lenders.

The traditional money lenders try to keep the peasants and the poor people permanently in dept. the supply major part of the credit. The aim of these money lenders is to hold money and lend to needy persons in order t earn higher orate of interest. The interest rate they charges varies from place to place and it also depend upon the need and condition of the borrower.

A study conducted by Nepal Rastra Bank revealed of the rural borrowers have access to organized sector for arranging a certain part of their total financial requirements. Dominance of the unorganized sector in the

economy requires to be gradually reduced by increasing bot number of financial institution and financial instruments.

MEASUREMENT OF RISK

STANDARD DEVIATION

It is a statistical concept and widely used to measure risk from holding a single asset. The standard deviation is derived so that a high standard deviation represent a large dispersion of returned and is a high risk a low deviation is a small dispersion and represents a low risk.

It provides more information about the risk of the asset. Its advantage is that the uncertainties of returns can be summarized in to a single easily calculated number. The measure disadvantage is that the standard deviation considers possible returns above the expected value to be as risky as returns below the expected value.

COEFFICIENT OF VARIATION

If risk is measured by the standard deviation then risk per unit of expected return can be measured by the coefficient of variation (C.V.).The larger the c.v. the larger the relative risk of the investment. The coefficient of variation shows risk per unit of return and it provides a more meaningful basis for comparison when the expected return on two alternatives is not the same.

The coefficient of variation is more useful when we consider investments, which have different expected rates of return and different levels of risk.

"(Weston & Brigham , 1993)"

2.3 <u>REVIEW FROM JOURNALS:-</u>

2.3.1

Timothy Bates and William Branford's analysis on the portfolio behavior of black owned commercial banks reveals that the commercial banks have traditionally been formed to service loan demands of local market with funds derived primarily from depositors in that same market.

According to the researchers "Data analyzed in this study do not support this pessimistic view of black banks. These institutions face a number of problems that are completely unrelated to the presence or absence of management risk."

Black banks have lower average deposit account rises than non minority banks and the variability of these deposits is substantial. Following findings have been found from the research.

The lack of significance of the age variable for explaining Black bank liquidity may be caused by

    i)   The fact that all of the sampled banks had been in existence for at least three full years and

    ii)   Small sample.

Explanatory variables describing deposit structure and behavior were extremely important determinates of the composition observe in Black bank portfolios.

The high correlation between demand deposit and time deposit variability is a noteworthy fact

From the research following

Conclusions have been made:-

Black bank liquidity has been incorrectly interpreted by the existing banking literature.

Bank racial grouping per se doesn't appear to be causally related to bank liquidity.

Because of government programs to assist then, Black banks hold U.S. government deposits that are relatively large proportion of their total deposits.

2.3.2

Michael J. Brennan and H. Henry Cao.'s study on international investment follows has developed a model of international equity portfolio investment follows based on differences in international endowments between foreign and domestic investors.

It is shown that when domestic investors possess a cumulative information advantage over foreign investors about their domestic market, investors tend to purchase foreign assets in periods when the return on foreign assets is high and to sell when the return is low.

The article has developed a model of international equity portfolio flows that relies on informational differences between foreign and domestic investors.

The model predicts that if foreign and domestic investors are differentially informed then portfolio flows between two countries will be a linear function of the contemporaneous returns on all national market indices, and if domestic investors have a cumulative information advantage over foreign investors about domestic securities the co – efficient of the host market return will be positive.

portfolio flows are associated with returns on national market indices as the systematic information hypothesis implies.
The examination of U.S. portfolio investment immerging markets shows the evidence that U.S. purchases are positively associated with local market returns in many countries.

This model is able to explain only a small proportion of the variance of international equity portfolio flows.

2.3.3

Expected return, realized return and asset pricing tests " by Ednein I. Elton's article on expected return, realized return and asset pricing test is concentrated in the factors that affect expected return on assets, the sensitivity of expected return to those factors, and the reward for bearing this sensitivity.

The data set covers the period from july 1,1991 through December 31, 1997. The history almost all the testing is done taking realized return as a proxy for expected return using realized return as a proxy for expected return is that the unexpected returns are independent, so that as the observation interval increases they tend to a mean of zero.

The purpose of this article is to convince the reader there is a distinction and worth to find out alternative ways to estimate expected return.

Following preliminary tests are done in the study

A constant risk premium

Forward rates and risk premium

 Factor analysis

Changing risk premiums

According to the researcher "Realized returns are a very poor measure of expected return and that information surprises highly influence a number of factors in asset pricing model." The empirical use of judgment and factor dependability can used to draw implication which will given to the great extent the pricing decision fix and accurate.

2.4 <u>REVIEW OF PH.D THESIS</u>

<u>Shreestha's study</u>

The portfolio behavior of commercial banks in Nepal includes five commercial banks under study. They are Nepal Bank Ltd, Rastriya Banijya Bank, Nabil Bank, Nepal Indosues Bank and Nepal Grinlays Bank Ltd. Data are collected from various sources from 1975 to 1990 A.D. The objective of the research was to revaluate the financial performance of the commercial Banks, to analyze the investment pattern of commercial banks on securities and loans, to observe the relationship of bank portfolio variables with national income and other fiscal variables.

Among these objectives financial performances of the commercial banks and observe bank portfolio variables is some now related to this research.

From the analysis of commercial banks, the researcher has made following conclusions.

The general trend of commercial banks asset holding is growing.

Spread of foreign banks is relatively higher than that of Nepalese banks.

The relationship of banks portfolio variables is found to be best explained by log linear equations.

Borrowing of commercial banks from the central bank has been found to be positively effected by the cash reserve requirement bank rate and treasury bill rate.

The researcher has painted out the following suggestions:-

The evaluation of the performance of the commercial banks can be made only with reference to the government policy and regulation frame work.

Some of the problems of resource mobilization and resource development by the commercial banks in Nepal can be directly traced to the fiscal policy of the government and heavy regulatory procedures of the central bank.

The joint venture between foreign banks and Nepalese banks should be encouraged in Nepal, specially in merchant and investment banking, leasing and other new creative financial services.

The entry of foreign joint venture banks hopefully will bring healthy competition in the environment that will improve work and service efficiency of Nepalese banks too.

Mentioned tat an increase in interest represents cheapening of future commodities with respect to present ones. Savings are positively related to the interest rate. Interest rate affects the amount demanded. So a decrease in the interest rate will decrease the amount of bonds demanded.

He said that the possibility of profitable investment in a production economy. We automatically provide that additional stimulus to the desire to borrow which was shown above to be necessary for the assurance of appositive equilibrium rate of interest.

In fact, practically all of the borrowing in the economy can now be assumed to originate from entrepreneurs who require funds to finance investment and who are therefore willing to pay interest in keeping with its marginal productivity.

The development of equity markets in suppressed by low lending rate ceilings. This makes formal credit artificially cheap for those firms that can obtain it. Low lending rate ceilings cause credit to be allocated to the large, established firms with greater collateral.

Lending rates are based on the cost of deposits the rate paid to depositors plus a margin covering the cost of intermediation, like reserve requirements, taxes, risk, administrative costs, overhead and the return to equity.

It is the best tool to mobilize savings and canalize them to desired channels. It is possible because the interest rates are sensitive to changes in both deposits and loans. But e should not accept that changes in deposits and credits occur only due to the change in interest rates.

There are many other variables to affect the volume of deposits and credits of the banks. The inflation rate, the trade condition, the policy legs of State Corporation, a seasonal variations in some loans, the monopoly of banks, the non-development of money markets, the lending policy of the banks, the tax rate, the margin rate and so on may affect the policy of interest rate as well as the credit deposit operation of the banks.

The loan which is provided to the customer is greatly affected by the interest rate. There is inverse relationship between the interest rate and the loans and advances.
If the interest rate charged by the bank is very high, the demand for he loans and advances will be low and if the interest rate is very low the demand for the loans and advances will be high.
The principal issues in an empirical one: which rates approximate the rate of interest and exerts the most significant influence on the demand for will be equal to the long rate minus a risk premium measured in terms of foregone interest earnings.money. The short and long term rate of interest is determined by many factors. The short rate

2.5:1 REVIEW OF THESIS

2.5.1.1   Gopal Prasad Bhatta's(1996) study

The assessment of the performance of listed companies in Nepal is based on the data of ten listed companies from 1990 to 1995.One of the major objectives of this study is to analyze the performance of listed companies in terms of risk and return and internal rate of return, systematic risk and diversification of risk through portfolio co text.

Following are the findings of this study:-

 A highly significant positive correlation ship has been addressed between risk & return character of the company. Investors expect higher return from those stock which associates higher risk. Nepalese capital market is not efficient one.

So the stock price doesn't contain all the information relating to market and company itself, neither investors analyze the over all relevant information of the stocks nor does the member of stock exchange try to disseminate the information.

So the market return and risk both may not show high priced stocks such as BBC, NIB,NIC has higher risk than others. These companies thus require

higher returns to satisfy the investors for their risk premium Investors in Nepal have not yet practiced to invest in portfolio of securities.

An analysis of the two securities portfolio shows that the risk can totally minimize if the correlation is perfectly negative. In this situation, the risk can totally be diversified, but when there is perfectly positive correlation ship between the returns of the two securities, the risk is not diversifiable.

The analysis shows some has negative correlation and some has positive on. Negative correlation between securities returns is preferred for diversification of risk.

2.5.1.2   **Shanker Kumar Mishra Study**

Shanker Kumar Mishra Study (2001) analyzed Risk & Return on common stock investment of commercial banks in Nepal with special reference to five listed commercial banks. The major objective of this study was to promote & protect the interest of the investor by regulating the issuance, sales and distribution of securities and purchase, sale or exchange of securities.

He also intend to supervise and major the activities of the stock exchange and of other related firms carrying on securities business in addition, he

tried to render contribution to the development of capital market by making securities transaction fair, healthy, efficient and responsible.

Following are the findings of this study:-

It was noticed that there is a positive correlation between risk & return character of the company. Nepalese capital market being inefficient the price index itself is not sufficient to give the entire information about the prevailing market situation and the company.

Proper regulation should be introduced so that there is more transparency in issuance, sales and distribution of the securities. Investors do not have any idea about the producers of security issuance.

Neither company nor the stock broker transmits any information to the investors about the current market situation and hence it becomes difficult for a common investor to invest in the securities. Both government authorities and the stock exchange regulatory body should try to promote healthy practices so that the stock brokers do not give false information to the investors for their personal benefit which is a common practice in Nepal.

Investor should get regular information about the systematic risk (Beta). Return on equity and PE ratio of various listed companies in the same way as it is given in Economic.

Times for the companies listed in Indian stock exchange, security exchange Board of Nepal should make this mandatory so that it is easier for the investor to calculate risk and return of the portfolio and transparency is increased.

2.5.1.3 Nirmala Shrestha's (2001) study

The corporate portfolio management based on the study of few commercial banks listed in NEPSE. The study is concentrated in the investor's portfolio management, who would like to invest in the common stock in Nepalese banking industry.

The finding are:-

1. Highly risk investment in banks are not always the high return giving. Low risk also does not always mean the low in terms of return too. However there is relatively positive correlation between the risk of the investment and return from it.

2. The share broker should be given adequate training so that they can assist their client to invest in the portfolio of securities. If the correlation between return of two securities is perfectly negative the risk can be minimized while on the other hand if it is positive the risk can not be diversified. Thus the

broker should encourage their clients to invest more in a portfolio in other to reduce the market risk.

2.5.1:4   Dinesh Bhatta's (2003)study

The portfolio management of listed finance companies is fully based on analysis of market parameters with risk free assets. In his study, he completed the holding period return of listed finance companies which he sampled on. On the basis of HPR, he performed several financial and statistical analyses and come in result of efficient management of portfolio.

His analysis is based on portfolio management of risk free investment on government assets i.e. treasury bills by different listed finance companies with market return. He tried to basic idea of portfolio management of risk free assets and market return.

He evaluates the efficiency of portfolio by Sharpe's single index pricing model and several descriptive analyses were performed for finding out the market problem and consumer awareness. His main objective in thesis is to present portfolio in such a way that is shall easily understandable for the investors. The basic study of his study is to analyze and interpret the portfolio risk and return analysis of several listed finance companies with risk free assets.

Finding of his study are:-

In Nepal, no technical analysis is applied for investment purpose and for little bit increase in portfolio return, the investor has to ear higher portfolio risk.

The major problem to manage the portfolio is volatility of different securities in Nepalese capital market.

For eradicating stock market difficulties such as transaction facilities, investor's interest and investment facilities should be managed in effective way by formulating investor's protection act.

2.5.1:5   Prakash Kumar Dangol's(2004)

comparative study of portfolio management practice and portfolio risk and return. Analysis of finance companies with commercial joint venture banks of Nepal are concerned with diversification of risk and obtaining optimum return.

Dangol has considered the stock of different finance companies and banks for the portfolio investment and optimal portfolio is computed to select the feasible set, by simply finding the weight of return which is most feasible.

Major findings of Dangol's study are:-

Activities of finance companies and banks are dependent upon the rules and regulations of central banks i.e. Nepal Rastra Bank.The rules and regulations, which changes frequently confuse the investors as well as the companies to make their market and investment strategy.

Security market is Nepal is not yet matured enough and due to lack of sufficient information, proper investment is not possible in our market. The potential investors have least information regarding the stock market which is main barrier to the rational investors.

The review of the above relevant literature has no doubt enhanced the fundamental underrating and foundation of knowledge base which is perquisites to make this study meaningful and purposive.

Although, number of article have been published and various research works have been conducted on interest rates, interest rate structure and impact of interest rate structure on investment portfolio of commercial banks and finance companies of Nepal sample among all listed finance companies so far.

Therefore this research attempts to study in this area: probably this study will be the first study on the impact of interest rate structure on investment portfolio of listed finance companies of Nepal: analyzing primary data.

To mobilize capital for economic development and for the stimulation of trade and industries, and to develop the banking system in the country. Interest rate policy as a monetary policy instrument was employed by the NRB since September 1996.

It has also been assumed that the depositors regulate the interest rate secondary role in their decision for keeping deposit in the banks. Absence of better investment opportunities, expectation of inflationary pressures, and the associated safety, liquidity and profitability, what ever are their respective roles, must have been the factors responsible for increased volume of deposits despite.

2.5:2 <u>RESEARCH GAP</u>

The studies reviewed above are for very short periods. Most of them are only for 5 years, which may not be sufficient to reflect the actual scenario. Secondly, the data collected may not be relevant enough since they are only secondary data.

The companies generally, refuse to provide data to the researchers. Hence, he might not be provided the original data which could affect the findings.The sample sizes in the studies are also to small, which may not be sufficient to give the actual reflection of the whole financial industry.

Besides Banks there are other financial institutions too, which also plays the vital role in stock market. But these are not covered in the study. Hence one can say that the above study can only give rough estimation.

Besides, when primary data's were collected through questionnaires were put into the bankers and staff who are not actually the investors. But the investors, who are directly related to the risk and return of the bank, were left to be given the questioners.

Thus the primary data collected were of no significance in this study. Since, this thesis is mainly based on the secondary data; it may be unable to derive the actual recommendation as the secondary data may be manipulated by the concerned companies.

The study covers 9 years of study. Since accuracy of the results shown in the study. Few banks under study were enlisted in NEPSE in the mid time the study. Hence, the study of such banks is for the fewer period. As a result, the data of these banks are for shorter periods. The study also doesn't cover all banks listed in NEPSE.

Chapter III

RESEARCH METHODOLOGY

The research is based on scientific method. On the based of historical data, using both statistical tool and financial tools, detail analysis is performed of different variables. Results are presented in simple way in order to easy to understand. Detailed research methods are described below:

3.1 Research Design:-

The research is based on recent historical data of nine year. The end of fiscal year is taken as 15 July and the data range is from 15 July 2003 July 2008 The research is mainly focused on profitability, risk and return and portfolio management of the listed commercial banks in NEPSE. More part of the research is analytical rather than descriptive.

3.2 Data Collection Procedure:

Most of the used in the research are secondary data. Annul reports of commercial banks, annul reports of NEPSE, trading report of NEPSE and periodicals of NRB are used as secondary data

3.3 <u>Population:</u>

Banking industry in Nepal is not too old. Though, since the establishment of Nabil Bank limited,(Formerly established as Nepal Arab Bank Limited),the first joint venture Bank in Nepal, The industry has flourished in the country and at present there are already 25 commercial Banks in operation and still few are on pipeline. The present commercial banks in Nepal are as listed below.

1. Nepal Bank Limited
2. Rastriya Banijaya Bank
3. Nabil Bank Limited (Formerly Nepal Arab Bank Limited)
4. Nepal Investment Bank Limited
5. Standard Chartered Bank Limited
6. Himalayan Bank Limited
7. Nepal SBI Bank Limited
8. Bank of Kathmandu Limited
9. Nepal Bangladesh Bank Limited
10. Nepal Industrial and commercial Bank Limited
11. Nepal Credit and commercial Bank Limited
12. Everest Bank Limited
13. Lumbini Bank Limited
14. Machhapuchre Bank Limited
15. Kumari Bank Limited
16. Siddhartha Bank Limited
17. Laxmi Bank Limited
18. Nepal Arab Bank Limited
19. Public Development Bank Limited
20. Corporate Development Bank Limited
21. Yesh Development Bank Limited
22. Sunrise Development Bank Limited
23. Citizen Development Bank Limited
24. Global Bank Limited
25. Rural Development Bank Limited

3.4 SAMPLE:-

There are 25 commercial Banks in the Banking industry, among of these , only 3 commercial banks listed in Nepal stock exchange are selected to attain the objectives. They are as follows:-

1. Nepal Bangladesh Bank Ltd.
2. Everest Bank Ltd.
3. Nepal SBI Bank Ltd.

The basis for selecting the above mentioned banks only is few of the banks were not listed in NEPSE during the period under study some were listed but later removed temporarily from BEPSE for their internal reason, which if taken under study would complicate the data analysis and would not reflect the correct data.

3.5 Method of Analyses and presentation:-

Data collected from various sources are properly organized, analyzed and presented in appropriate tables and formats. Such tables and formats are interpreted and explained as necessary and obtain the results.

The profitability and risk measures are obtained by using ratio analyses and risk analysis techniques. Standard deviation and data test are used to test the Risk of different listed companies and correlation between these posts is done.

Following financial tools are used for the data analysis.

Market price of stock (MPS):-

There are mainly three types of MPS available in NEPSE annual report. They are high MPS, low MPS and closing MPS. Closing price is not an average price of high and low MPS but rather it's calculated by considering the whole years MPS. For the closing MPS trading report is followed.

Dividend (D):-

Dividend can be given in the form of cash or shares. If the company declare dividend in cash having no difficulty in calculation. But if the company declares stock dividend or bonus share, shareholders gets shares as dividend instead of cash. So there is little difficulties to calculate the exact amount in cash. In case of stock dividend the formula for total dividend amount is considered as follows :-

Total dividend amount = Cash dividend + stock dividend % X next years MPS.

Return on common stock investment (R):-

This is the annual realized return received on an investment and any change in market price, usually expressed in a percent of the beginning price of the investment.

Where,

  R = Actual realized return on common stock at time t.

  Dt = Cash dividend received at time t.

  Pt = Price of a stock at time t.

  Pt_{-1} = Price of stock at time (t-1).

Following statistical tools are used for the data analysis

Expected return is simply arithmetic mean of the past year return. This is an average return on common stock.

 Expected return on common stock $(\overline{R})$

Expected return is simply arithmetic mean of the past years return.

$$E(Rj) = \overline{Rj} = \frac{\sum Rj}{n}$$

Where,   E(Rj) = Expected rate of return on stock j.

           n   = Number of years that the return is taken

           $\sum$ = sign of summation.

Standard deviation (†)

Standard deviation is a statistical measure and is widely used to measure risk from holding a single asset. the standard deviation represents a large dispersion of return and is high risk and vice versa.

$$\sigma j = \sqrt{\frac{\sum\left(Rj - \bar{R}j\right)^2}{n-1}}$$

Where,

σj. Standard deviation of returns on stock j during the time period n.

Coefficient of variance (C.V.)

Coefficient of variance is the ratio of the standard deviation of a distribution to the mean of that distribution. It is a measure of relative risk.

Coefficient of variation (C.V.) $\dfrac{\dagger}{\bar{\bar{R}}}$ =

Chapter IV

Analysis And Presentation Of Data

This Chapter includes analysis of collected data and their presentation. Detail data of market price of stock, earning per share, dividend of each bank and relevant data of NEPSE index is presented and their interpretation and analysis is done. With reference to preceding chapters, effort is made to analyze the recent Nepalese stock market movement and performance of listed commercial banks. To make the analysis and interpretation easier, different tables and diagrams are drawn.

4.1 Analysis of individual commercial banks:

Among seventeen commercial banks in Nepal only thirteen are listed in NEPSE From those thirteen commercial banks only eight are included in this research. Data collection is being done for nine years from 16 july 2003 to 15 july 2007.

Realized Return (R), expected $\overline{\text{Return}}$ (R), Standard Deviation ( ) Coefficient of Variance (C.V) & Earning per Share (EPS) of each bank under study is calculated in order to find our the measurement of risk and Rate of Return or each bank.

Table 4.1

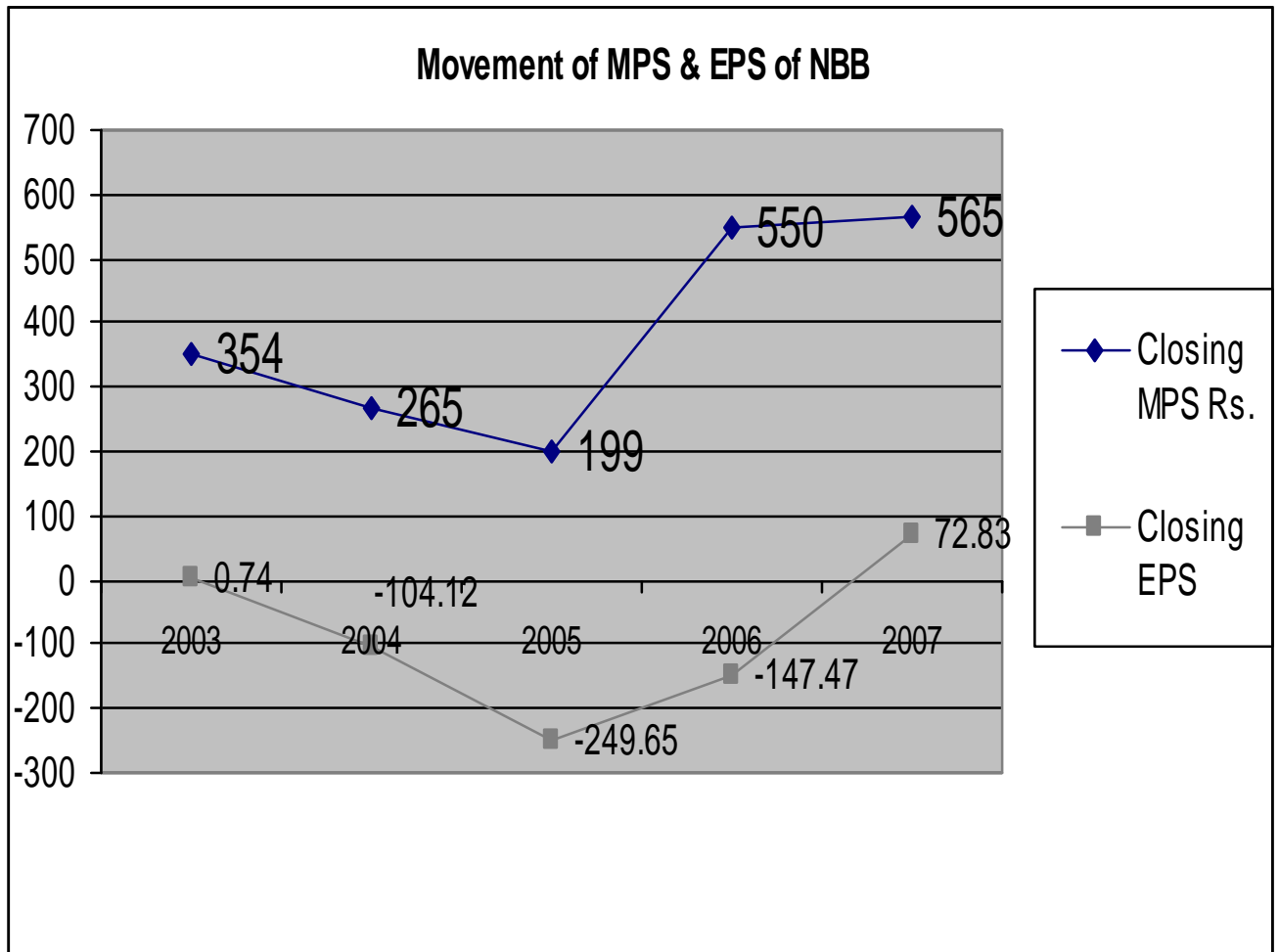**Calculation of R, R, , C.V. & $\overline{EPS}$ of NBB Bank**

Fiscal Year	Closing MPS Rs.	Total dividend Rs	$R = \dfrac{Dt + (Pt - Pt - 1)}{Pt - 1}$	$(R - \overline{R})$	$(R - \overline{R})^2$	EPS Rs.
16 July 2003	354	0	-	-	-	0.74
16July 2004	265	0	-0.25	-0.58	0.3364	-104.12
16july 2005	199	0	-0.24	-0.57	0.3249	-249.65
16july 2006	550	0	1.76	1.43	2.0449	-147.47
16july 2007	565	0	0.03	-0.3	0.0900	72.83
Total			1.3		2.7962	

Data source: NEPSE and annual reports of NBB:

Since NBB is an established bank it is doing not good in the stock market. Realized return of NBB is highest in the year 2006 which is 1.76 % because the change in closing market price is increased by 351 in this year. The highest closing Mps Rs 565 in the year 2007. The performance of NBB is good from 2006 & 2007. It do not declared dividend from 2003 to 2007. It show that NBB is not at well condition because this bank is running loss. The NBB expected return is 0.33 % , standard deviation is 0.97 & coefficient of variance is 2.94 . (For details, please see appendix 1).

Diagram 4.1

Movement of MPS and EPS of NBB

Movement of MPS & EPS of NBB

Closing MPS is in fluctuating and EPS is also decreasing trend from sample year 2003 to 2007. NBB don't provided dividend in sampled duration the reason behind the decreasing trend in NBB is, it declared stock dividend and no. of common stock is decrease. Closing MPS is highest in the year to 2007 and EPS are negative. The NBB diagram shows EPS is decreasing in smoothly negative trend but MPS is infatuating in trend. Due to NBB running in loss condition.

Table 4.2

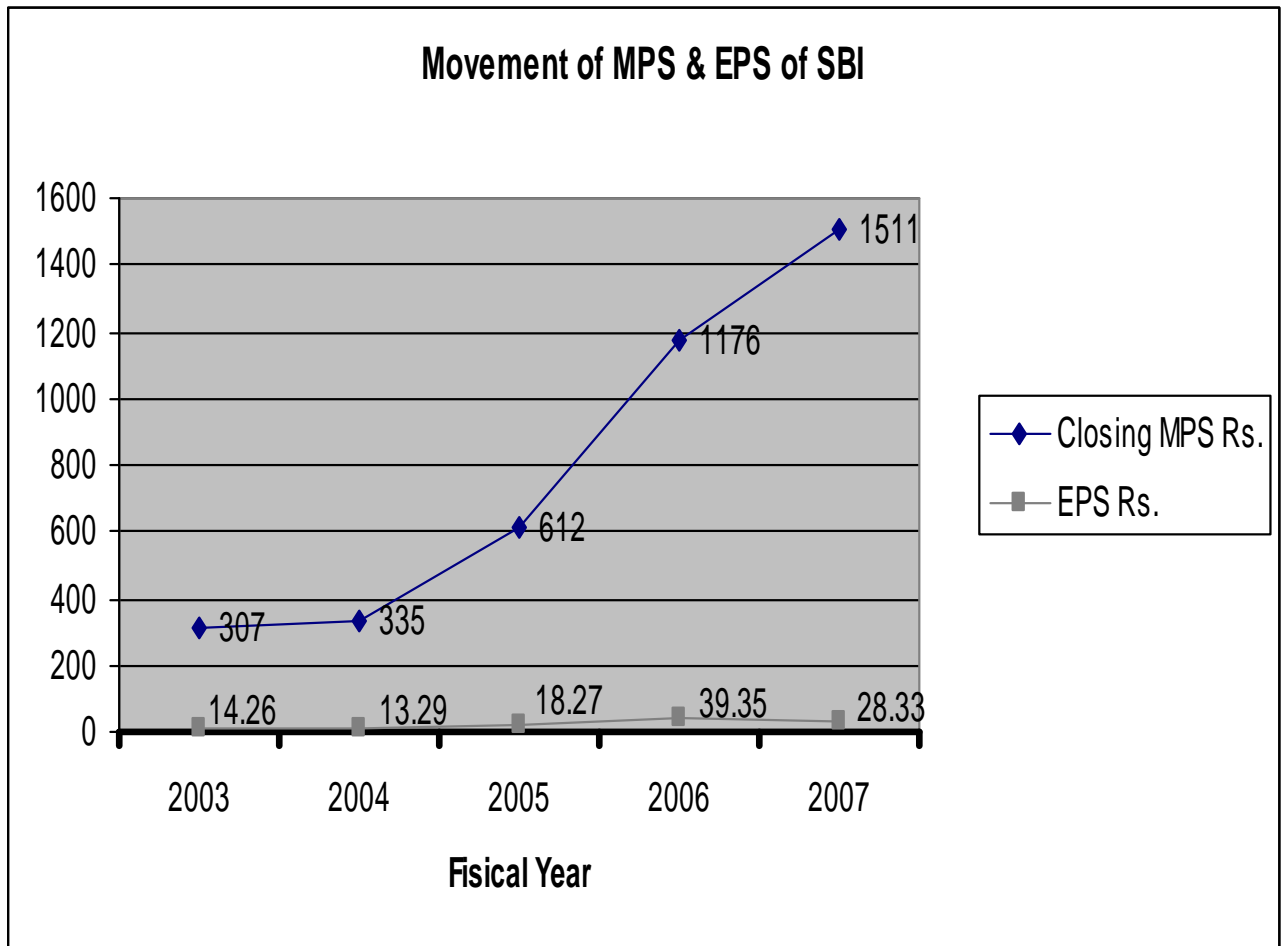**Calculation of $R, \overline{R}$, R, , C.V. & EPS of SBI Bank**

Fiscal Year	Closing MPS Rs.	Total Dividend Rs	$R = \dfrac{Dt + (Pt - Pt - 1)}{Pt - 1}$	$R - \overline{R}$	$(R - \overline{R})^2$	EPS Rs.
16 July 2003	307	0	-	-	-	14.26
16July 2004	335	0	0.09	-0.44	0.1936	13.29
16july 2005	612	0.91	0.83	0.3	0.0900	18.27
16july 2006	1176	4.95	0.93	0.4	0.1600	39.35
16july 2007	1511	0	0.28	-0.25	0.0625	28.33
Total			2.13		0.5061	

Data source: NEPSE and Annual Report of SBI

SBI's highest realized return is in the year 2006 with 0.93 % because this year's closing Mps Rs is increased by more than 95 % compared to previous year, in this year closing Mps Rs is 1176 which is positive than other previous year's. The trend of it's realized return is good . The SBI has declared dividend from year 2005 to 2007 . It means that, SBI is running in good condition . SBI has expected return is 0.53 %, stander deviation is 0.41 and co-efficient of variance is 0.77. (For details, please see appendix 2)

Diagram 4.2

Movement of MPS and EPS of SBI

Movement of MPS & EPS of SBI

SBI bank's EPS is very low in compare to closing MPS. It shows lack of investors' awareness. Investors are only attracted towards capital gain. Bank is running under low profit. The SBI diagram shows, EPS is slowly increasing in trend and MPS also increasing in trend. The highest MPS is Rs. 1511 in the year 2007 and highest EPS is Rs. 39.35 in the year 2006. SBI declared dividend in the year 2005 and 2006.

## Table 4.3

Calculation of R, R,   , C.V. & EPS of EBL bank

Fiscal Year	Closing MPS Rs.	Total dividend Rs	$R = \dfrac{Dt + (Pt - Pt - 1)}{Pt - 1}$	$R - \bar{R}$	$(R - \bar{R})^2$	EPS Rs.
16 July 2003	680	4.14	-	-	-	20.70
16July 2004	870	0	0.28	-0.21	0.0441	31.55
16july 2005	1379	11.45	0.60	0.11	0.0121	45.80
16july 2006	2430	5.72	0.77	0.28	0.0784	57.22
16july 2007	3132	10.85	0.29	-0.2	0.0400	54.27
		Total	1.94		0.1746	

Data source: NEPSE and annual reports of EBL

Realized return is highest in the year 2006. which is 0.77 % The bank distributed dividend in the year 2003 to 2007. The highest closing MPS Rs 3122 in the year 2007. The performance of EBL is good in the year 2007. Which may be because it declared dividend in the year 2003. The expected return of EBL is 0.49 %, standard deviation is 0.24 and co-efficient of variance is 0.49. (For details, please see appendix 3)

Diagram 4.3

Movement of MPS and EPS of EBL

Movemendt of MPS & EPS of EBL
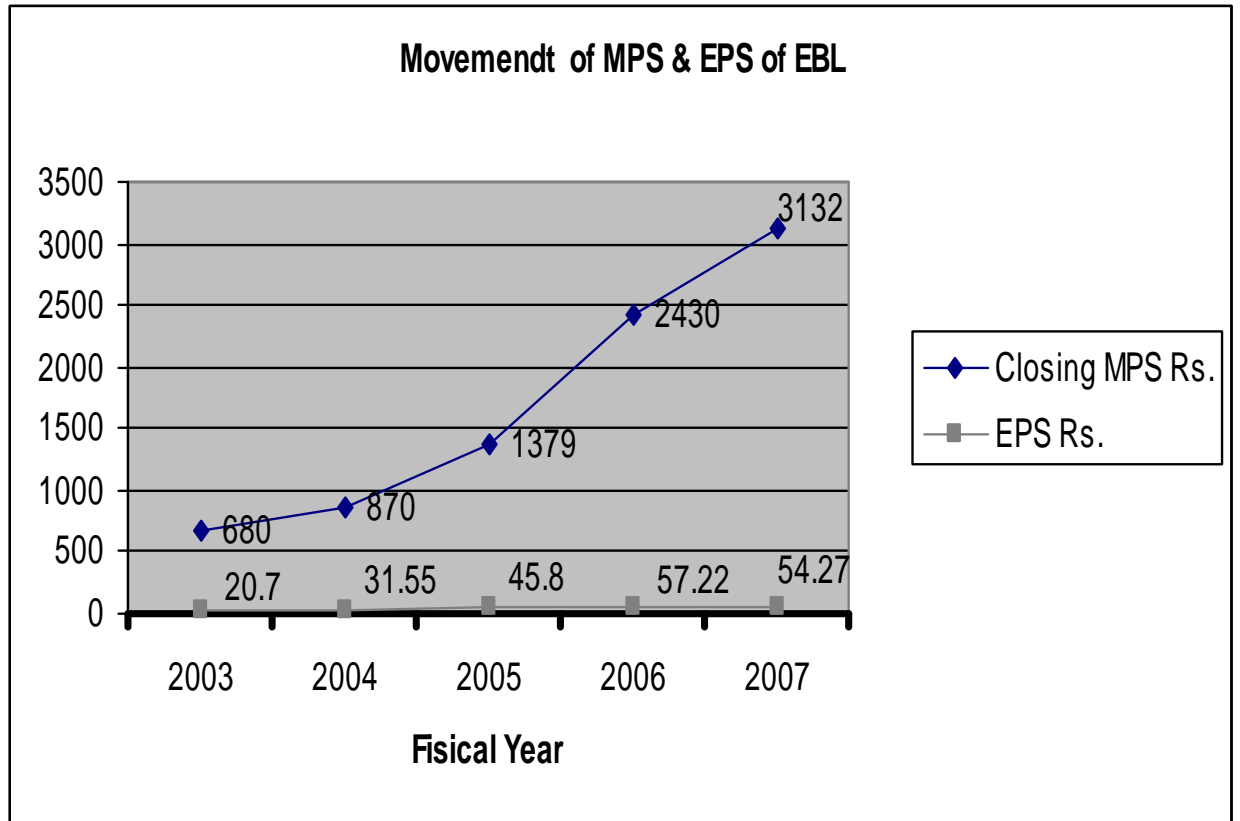
The highest difference between EPS and MPS is in the year 2003. EBL is doing well day by day. The diagram shows EBL's is in slowly increasing trend and the price of MPS is fluctuating.

The highest MPS is Rs. 3132 in the year 2007 and highest EPS is Rs. 57.22 in the year 2006. EBL is running in good condition from calculated year 2003 to 2007. which means that, EBL is in the profit from top to button. The diagram shows EBL'S EPS is in increasing trend and the price of MPS is also increasing trend.

4.2 Inter firm comparison

In this part, analysis of individual banks is combined together and analyzed the whole banks. Comparative analysis of return and unsystematic risk is performed here. In the following table expected return, standard deviation and coefficient of variance of each bank from 2003 to 2007 is summarized.

Table 4.4

Expected Return, Standard Deviation and C.V. of each bank

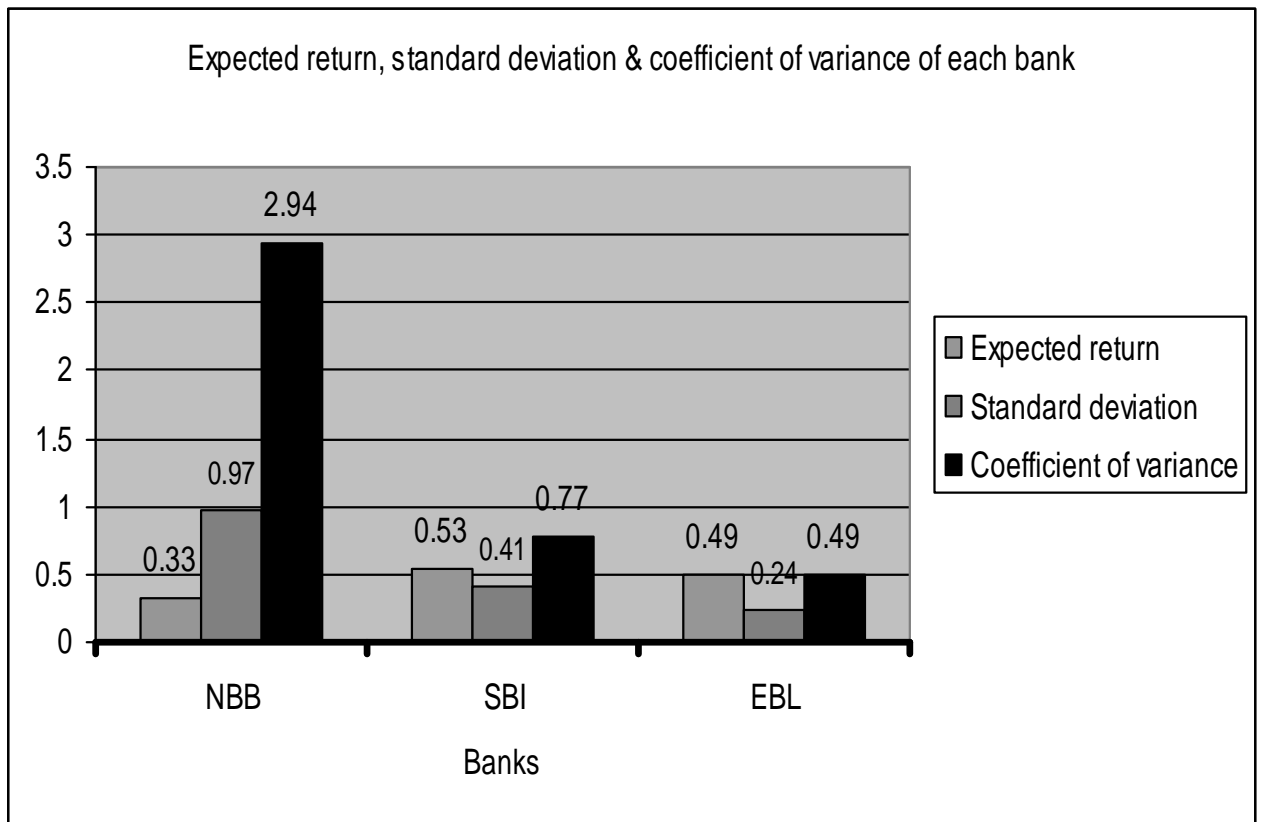| Banks	Expected return	Standard deviation	Coefficient of variance	Remarks
NBB	0.33	0.97	2.94	Higher return and higher risk
SBI	0.53	0.41	0.77	Moderate return and moderate risk
EBL	0.49	0.24	0.49	Moderate return and moderate risk

Investors expect to get highest return from SBI and lowest return from NBB bank. SBI has highest return, though its risk is nominal. Where as SBI has high return, but it's high risk does not motivate the investors to invest. On the other hand NBB is having higher risk and return is also higher as compared to SBI & EBL banks. From the analyses it is easy to interpret that more the return more will be the risk. Coefficient of variance shows per unit

risk bearing to have expected return. In terms of coefficient of variance lower the variance it will be better. On the basis table, The NBB has higher return and higher risk. SBI has moderate return and moderate risk and EBL has also moderate return and moderate risk.

The comparison can be also shown with the help of diagram:

Diagram 4.4

Expected Return, Standard Deviation & Coefficient of Variance of each Bank

The NBB Coefficient of variance is highest (2.94) than other banks. This diagrams shows expected return, standard deviation & coefficient of variance of NBB, SBI& EBL. Risk is also highest of NBB due to running in the loss. SBI expected return is highest (0.53) .

4.3 Analysis of Profitability:

Profitability ratio indicates the financial performance of the company. Profit earned by the company can either be retained in thee business or distributed to the shareholders. The retention of profit shows the growth prospects for the company and promises future capital gains to the investors. Profit distribution through dividends render a signal to investor that the company is doing good and their investment in the company is safe and profitable. Thus higher profitability indicates positive impact on price of the stock .
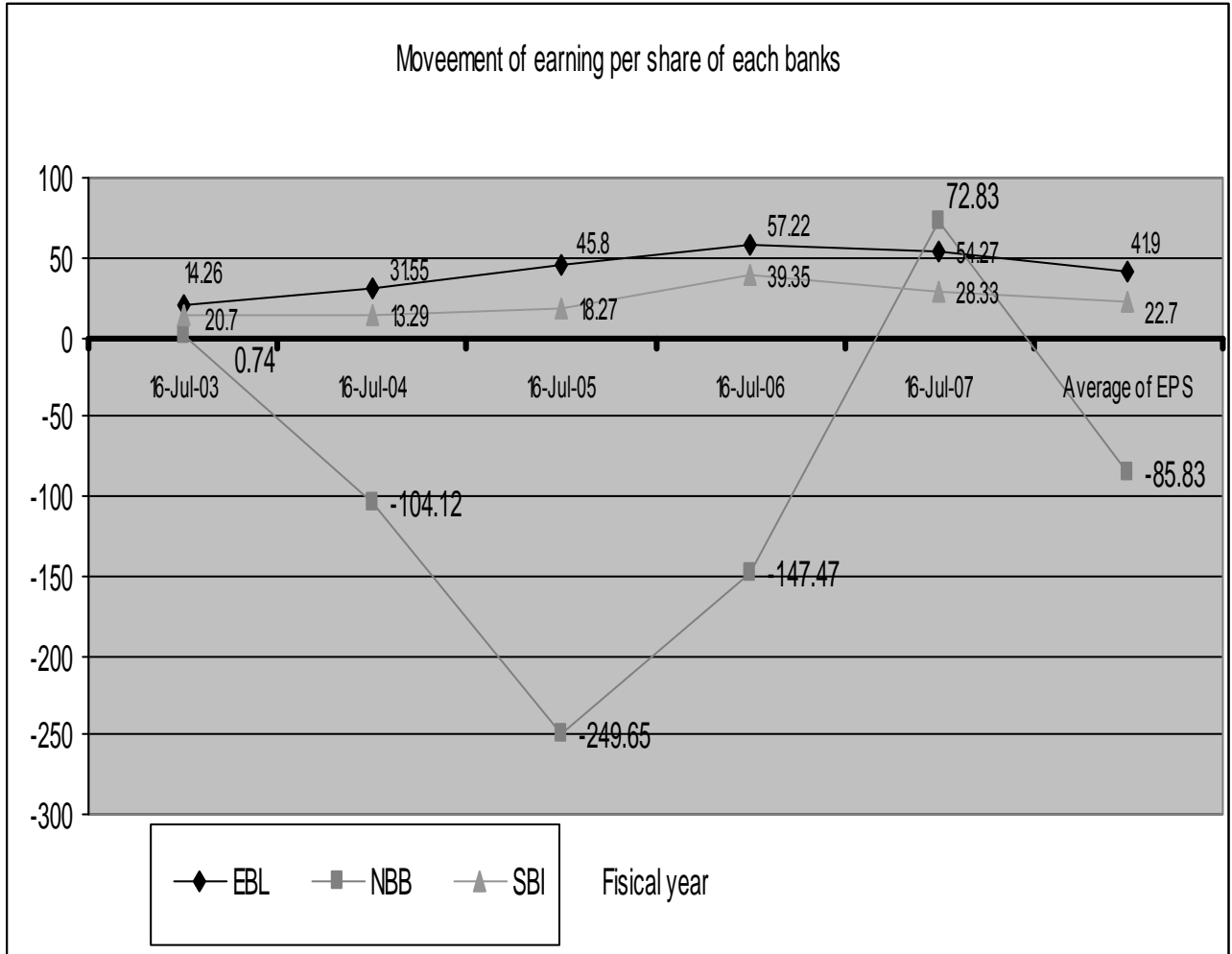
Table 4. 5

Earning Per Share (EPS)

Fiscal Year	EBL	NBB	SBI
16 July 2003	20.70	0.74	14.26
16July 2004	31.55	-104.12	13.29
16july 2005	45.80	-249.65	18.27
16july 2006	57.22	-147.47	39.35
16july 2007	54.27	72.83	28.33
Average of EPS	41.90	-85.83	22.7

In an average of three sample banks as NNB, SBI & EBL. EBL has the highest EPS i.e Rs. 57.22 and NBB has the lowest EPS i.e. -249.65. The another Bank SBI EPS is moderate. The greater EPS is better for the investment. The NBB is running in loss condition that's why NBB EPS is being negative in the calculated year 2003 to 2007.

Diagram of EPS (4. 5)

Moveement of earning per share of each banks

|	16-Jul-03	16-Jul-04	16-Jul-05	16-Jul-06	16-Jul-07	Average of EPS
EBL	14.26	31.55	45.8	57.22	54.27	41.9
NBB	0.74	-104.12	-249.65	-147.47	72.83	-85.83
SBI	20.7	13.29	18.27	39.35	28.33	22.7

EBL   NBB   SBI   Fisical year

In this diagrams EBL has the highest EPS i.e. Rs. 57.22 among three sample
banks like NBB, SBI, & EBL but NBB has the lowest EPS i.e. Rs. -249.65
because the NBB is running in loss. The another bank SBI EPS is moderate
. This diagram shows the NBB EPS is Moving bottom to top in the
calculation year 2003 to 2007. The EBL & SBI EPS is better in the
calculation year.

Table 4.6

Dividend Per share (DPS)

Fiscal Year	EBL	NBB	SBI
16 July 2003	4.14	0	0
16July 2004	0	0	0
16july 2005	11.45	0	0.91
16july 2006	5.72	0	4.95
16july 2007	10.85	0	0
Average of DPS	6.43	0	1.17

In an average of three sample banks as NNB, SBI & EBL. The DPS is depend upon the EPS. The highest EPS brings highest DPS and lowest EPS bring lowest DPS because Dividend per share is declared through earning of the bank. An average DPS of EBL is Rs. 11.45. Which is the highest DPS among three sample banks. NBB has the lowest DPS. It's means that there is no DPS of NBB up to 2003 to 2007 in the calculated year because the NBB is running in loss condition in that situation non of bank don't give DPS. The remaining bank SBI has moderate DPS i.e. Rs. 4.95.

Diagram 4.6

Movement of Dividend per share of each banks

Fisical Year

EBL — NBB — SBI
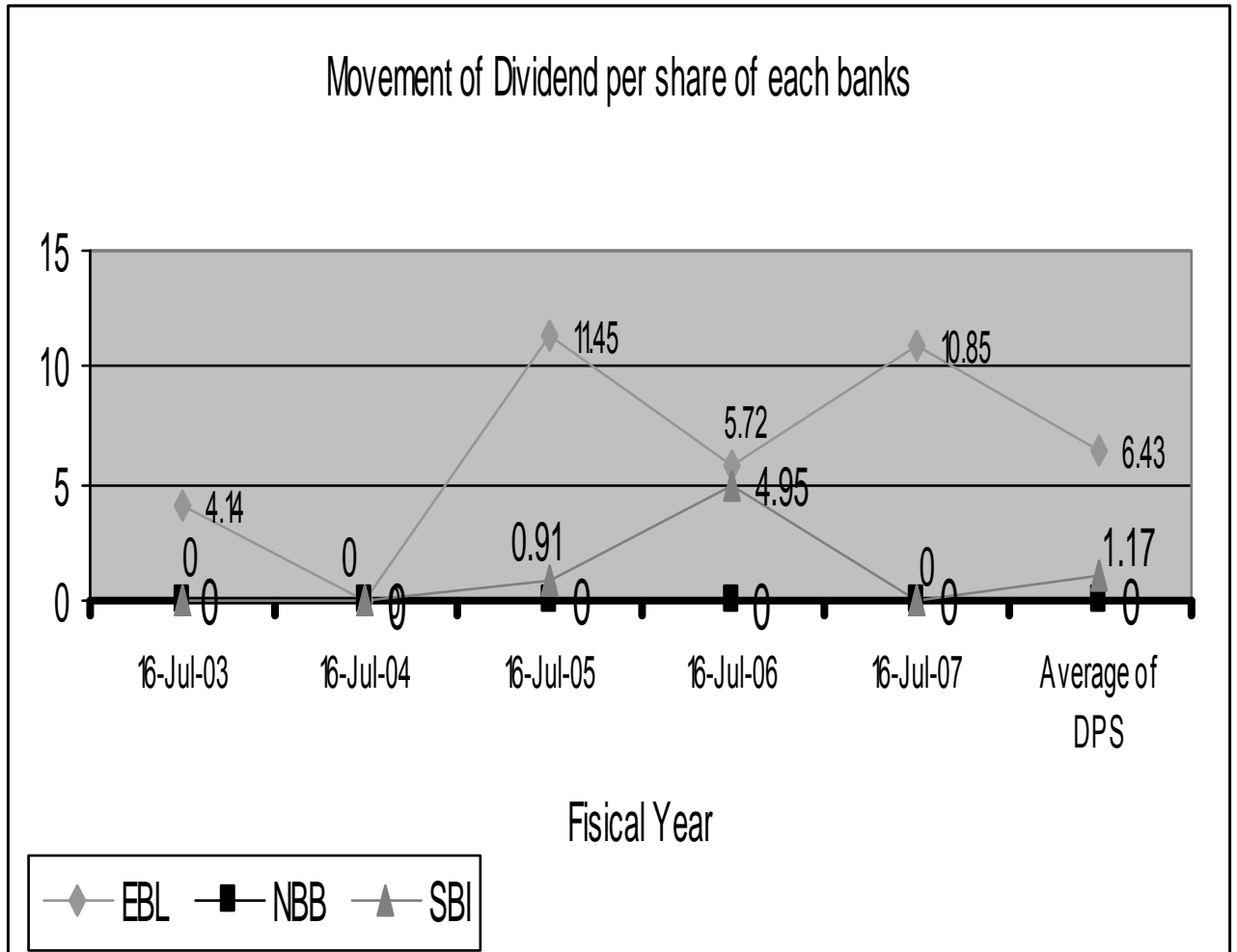
In this diagrams EBL has the highest DPS i.e. Rs. 11.45 among three sample banks like NBB, SBI, & EBL but NBB has no DPS in the calculation year 2003 to 2007 because the NBB is running in loss. The another bank SBI DPS is moderate . DPS depends upon EPS, it's means highest EPS bring highest DPS. The movement of EBL diagram is running top to top. But NBB movement is lowest.

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Table 4.7

Return On Asset (ROA)

Fiscal Year	EBL	NBB	SBI
16 July 2003	1.2	0.02	0.72
16 July 2004	1.4	-5.65	0.55
16 July 2005	1.5	-10.15	0.90
16 July 2006	1.4	-14.63	1.83
16 July 2007	1.7	5.21	1.44
Average ROA	1.44	-5.04	1.08

Formula, ROA = Net profit after tax / total assets × 100

The table average in terms of return on assets (ROA) are sample three banks NBB,EBL&SBI. ROA is measured in percentage. SBI has the highest ROA i.e. 1.83% and NBB has lowest ROA i.e. -14.63%. whch is measured in negative in the calculation because the reason behind this NBB is running in loss condition to calculated year 2003 to 2007. The remaining bank SBI has moderate ROA i.e. 1.7% .

Diagram 4.7
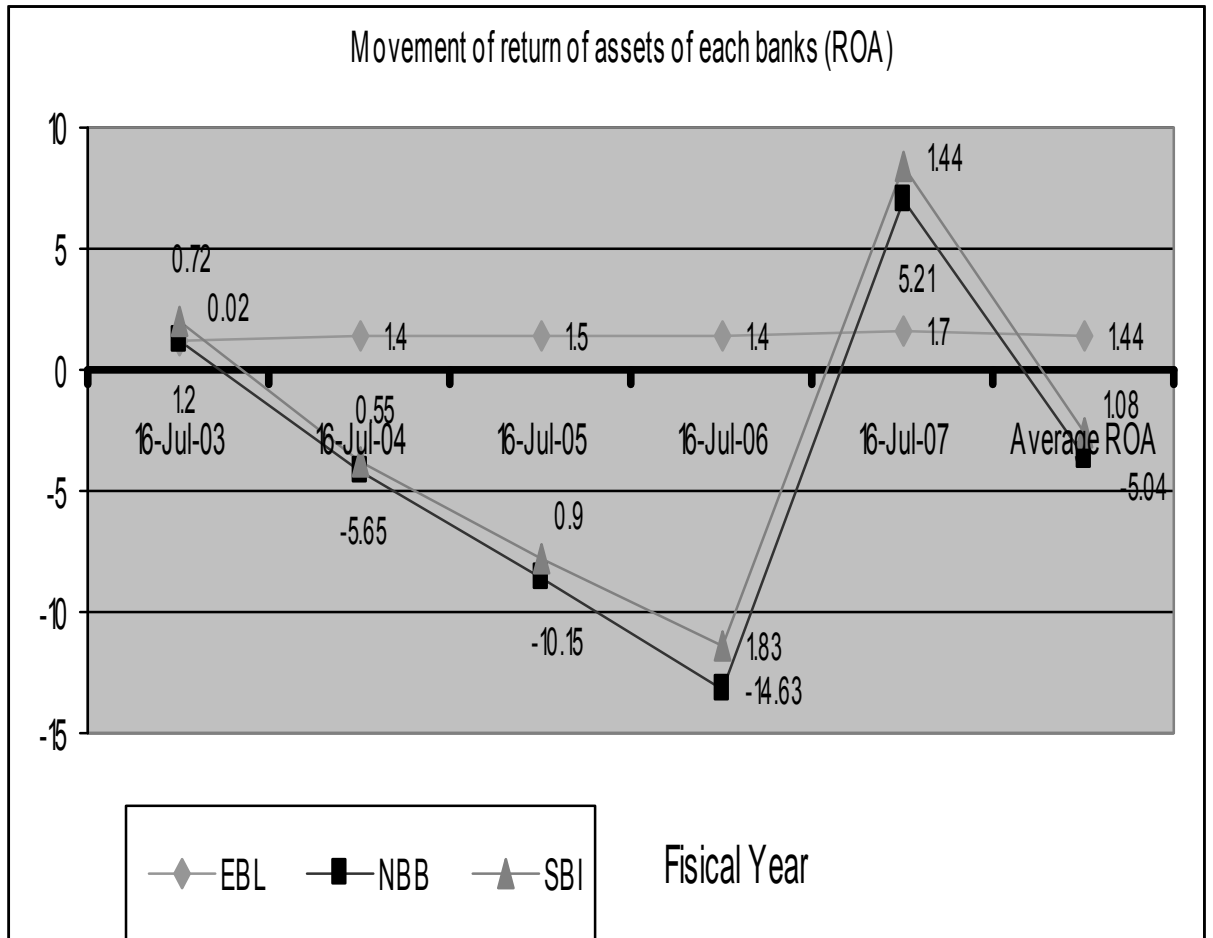
This diagram shows EBL ROA is highest in 2007. NBB has lowest ROA which is measured in negative because the reason behind NBB is running in loss. EBL ROA is similarly growing to 2003 to 2007 it means that EBL ROE is better than the others. SBI has moderate ROA which is measured in percentage.
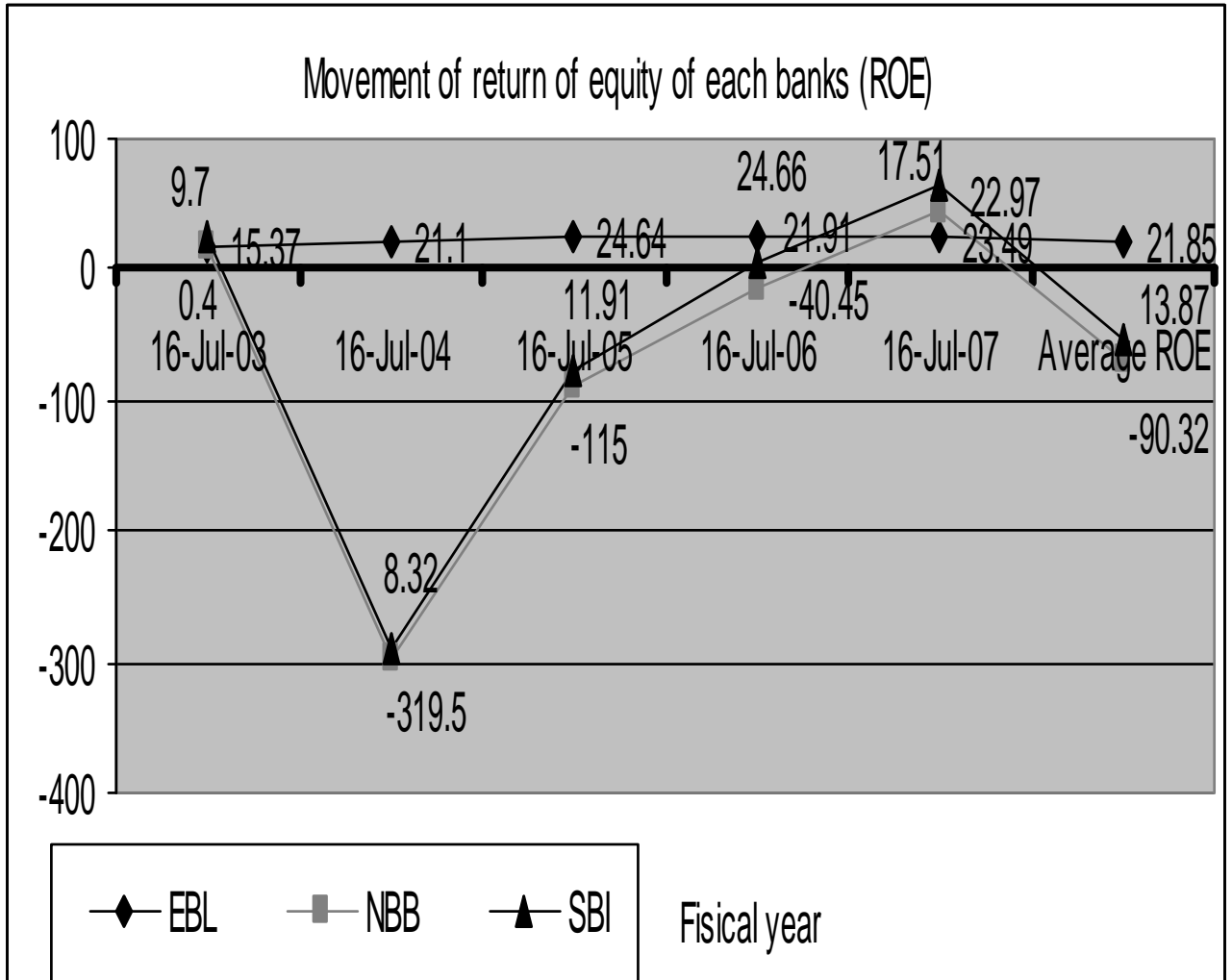
Table 4.8

<u>Return On Equity (ROE)</u>

Fiscal Year	EBL	NBB	SBI
16 July 2003	15.37	0.40	9.7
16 July 2004	21.10	-319.5	8.32
16 July 2005	24.64	-115.0	11.91
16 July 2006	24.66	-40.45	21.91
16 July 2007	23.49	22.97	17.51
Average ROE	21.85	-90.32	13.87

Formula :- ROE = Net profit/loss / total equity

In terms of return on equity (ROE) of NBB,EBL & SBI. ROE is also measured in the percentage. EBL has the highest ROE i.e. 24.66% and NBB has lowest ROE i.e. -40.45%. Which is being in negative condition because the reasons behind this NBB is running loss to calculated year 2003 to 2007. The remaining bank SBI has moderate ROE i.e. 21.91%.

Diagram 4.8

Movement of return of equity of each banks (ROE)

- 9.7
- 15.37
- 24.66
- 17.51
- 22.97
- 21.1
- 24.64
- 21.91
- 23.49
- 21.85
- 0.4
- 11.91
- -40.45
- 13.87
- 16-Jul-03   16-Jul-04   16-Jul-05   16-Jul-06   16-Jul-07   Average ROE
- -115
- -90.32
- 8.32
- -319.5

100 / 0 / -100 / -200 / -300 / -400

◆ EBL   ■ NBB   ▲ SBI   Fisical year

This diagram shows return equity of each banks. EBL has highest ROE and NBB has lowest ROE which is being in negative because the reason behind NBB is running in loss condition that's why the movement of NBB ROE is bottom but EBL bank's movement of ROE is top . The remaining bank SBI has moderate ROE and it's movement of ROE is top to bottom in calculated year 2003 to 2007.

CHAPTER V

SUMMARY, MAJOR FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary:

The business world of today is entirely different from the past. The economy is growing rapidly, which force the life style change fast too. The changing life standard has always been challenging to the business community.

On the other hand, it also provides opportunities to produce different types of goods and services to fulfill the changing needs of people. In order to balance change and needs, continuous flow of investment is must. No investor invests his/her capital until he/she is fully assured that investment is safe.

Everyone invests expecting some return from their investment. According to the risk bearing nature, the investors can divided into three category, risk seeking, risk averse and neutral. Risk is the fact of life and return is reward for bearing the risk.

Risk and return is getting considerable attention in financial management. Risk and return is the key factor to analyze the financial condition of the company for investors.

The relationship between risk and return is described by investor's perception about bearing the risk and compensation demanded for bearing that risk. No investors will be ready to invest their capital on risky assets unless they are not assured of adequate compensation for accepting the risk.

Investors often ask about the total risk they will be assuming in an investment and like to know if the risk premium provided is enough. Higher risk command higher premium and assumes the linear relationship between risk and risk premium.

NEPSE is the only stock market in Nepal. Apart from being developed from the time it established, more effort is necessary for the better development of the stock market. Investors still hesitate to invest in securities because of lack of proper knowledge and well guidance in this field.

Investors want to have full information about risk and return form their investment and they should be confident about their investment being utilized in secured field. The main objective of the research is to examine

the performance of Nepalese commercial banks in relation to profitability and to analyze portfolio attributes of

Nepalese commercial banks in relation to risk and return. Eight listed commercial banks in NEPSE are taken as sample and their individual risk and returns are calculated and analyzed in a whole to find out the performance of each bank. To make the analysis easy to understand some related studies are reviewed.

Scientific methods are used to make the analysis more effective. Tables and diagrams are used to present the data and results. Secondary data are collected from NEPSE, NRB, and related commercial banks. From the analysis following findings are summarized and made conclusions as follows:

Major Findings

The Expected rate of return

$\Rightarrow$ The expected return is an income received an a investment, usually, expressed in percentage expected return is simply an average return of the investment. The expected return of SBI is highest i.e. 53% because the reason of expected return being so high is the effect of unrealistic annual issue of bonus share and increase in share closing price.

$\Rightarrow$ Expected return of NBB is the lowest i.e. 33% . Among the three sample commercial banks and remaining bank of EBL expected return is 49% . the three sample banks are SBI, NBB & EBL.

Standard Deviation (Risk)

$\Rightarrow$ Risk is the variability of returns. Which is measured by in the terms of standard deviation of returns. The standard deviation is simply risk of returns of the investment. It is measured by only unsystematic risk in the term of risk, common stock of NBB is most risky in return.

$\Rightarrow$ While EBL is least risky returns. NBB has standard deviation of 0.97 and EBL has standard deviation of 0.24. It's means that NBB standard deviation is highest bearing highest risk and EBL standard deviation is lowest bearing lowest risk. The reaming bank SBI has standard deviation of 0.41.

Coefficient of Variance

$\Rightarrow$ The coefficient of variation defined as the standard deviation divided by the mean of expected returns. It is used to standardize the risk per unit of return i.e. measure the risk per rupee.

$\Rightarrow$ The coefficient of variance should be used to compare investment when both the standard deviation and expected value differ.

$\Rightarrow$ NBB coefficient of variance is highest i.e. 2.94 . EBL coefficient variance is lowest i.e. 0.49. the remaining bank SBI coefficient variance is 0.77.

$\triangleright$ Analysis of some profitability ratio includes earning per share (EPS), Dividend per share (DPS), return on assets (ROA), and Return on equity (ROE) are done. These are calculated in the course of study and explained in brief.

Earning per share (EPS)

$\Rightarrow$ In an average of three sample banks as NNB, SBI & EBL. EBL has the highest EPS i.e Rs. 57.22 and NBB has the lowest EPS i.e. -249.65. The another Bank SBI EPS is moderate.

$\Rightarrow$ The greater EPS is better for the investment. The NBB is running in loss condition that's why NBB EPS is being negative in the calculated year 2003 to 2007.

Dividend per share (DPS)

$\Rightarrow$ In an average of three sample banks as NNB, SBI & EBL. The DPS is depend upon the EPS. The highest EPS brings highest DPS and lowest EPS bring lowest DPS because Dividend per share is declared through earning of the bank.

$\Rightarrow$ An average DPS of EBL is Rs. 11.45. Which is the highest DPS among three sample banks. NBB has the lowest DPS. It's means that there is no DPS of NBB up to 2003 to 2007 in the calculated year.

$\Rightarrow$ Because the NBB is running in loss condition in that situation non of bank don't give DPS. The remaining bank SBI has moderate DPS i.e. Rs. 4.95.

Return on Assets (ROA)

$\Rightarrow$ The table average in terms of return on assets (ROA) are sample three banks NBB,EBL&SBI. ROA is measured in percentage. SBI has the highest ROA i.e. 1.83% and NBB has lowest ROA i.e. -14.63%. which is measured in negative in the calculation year 2003 to 2007.

$\Rightarrow$ Because the reason behind this NBB is running in loss condition to calculated year 2003 to 2007. The remaining bank SBI has moderate ROA i.e. 1.7% .

Return on Equity (ROE)

$\Rightarrow$ In terms of return on equity (ROE) of NBB,EBL & SBI. ROE is also measured in the percentage. EBL has the highest ROE i.e. 24.66% and NBB has lowest ROE i.e. -40.45%.

$\Rightarrow$ Which is being in negative condition because the reasons behind this NBB is running loss to calculated year 2003 to 2007. The remaining bank SBI has moderate ROE i.e. 21.91%.

➢ The study finds out the risk and return on investment on common stock of commercial banks. Generally, it is assumed that higher the risk higher should be the profit and higher ther return more should be ther profit NBB calculation shows negative due to running in loss situation from 2003 to 2007.

➢ The result of this may be because sample size is too small. Another reason is because of lack of investment opportunity and lack of investor's awareness. It means's higher ther risk higher should be the retun and vice versa.

5.3 Conclusions:

From the data analysis it is revealed that the return is the one receives on his investment. Though all banks are in same banking industry of Nepal, their return and the risk in terms of variability or fluctuation of return is different.

As it is found that EBL, though having second highest return, is very risky investment as its risk. where as SBI giving return of 53% is much less risky.

Thus, the risk lovers and return seekers would prefer to invest in Banks like NBB, but risk avoiders but high return expecting investors would invest in SBI, EBL and . So on, investors who prefer low risk to high return, would choose EBL, SBI .

5.4 Recommendations and suggestions:

Based on the data analysis and major findings following recommendations and suggestions are prescribed as below :-

 ➢ The research is mainly focused on the risk and return of the listed commercial banks in NEPSE. From the analysis of individual securities, SBI shows the highest expected return, i.e.53%. So it is recommended for investors to invest on SBI securities. But EBL expected return is 49%. It shows that EBL is taking low risk and having low return.

➢ If EBL takes some more risk there is chance of higher return. So, EBL is recommended to face some more risk. However, the Risk seekers can invest in SBI. Where as the risk inverse investors are recommended to invest in the EBL.

➢ In terms of profitability EBL shows the highest average EPS of Rs.57.22. Similarly EBL has the highest average DPS i.e. Rs.11.55 and second highest average ROA of Rs. 1.7 . respectively, So considering the above position of the profitability it is recommended to invest on EBL securities.

➢ The result of analysis of standard deviation and coefficient of variance between profitability with risk and return shows either insignificant or inconclusive. The reason behind the unsatisfactory result may be sample size is too small. So it is suggested for further research with sufficient sample size.

- ➢ There is unrealistic relationship between required return and expected return of the individual banks securities. It shows that while investing in securities investors are not aware towards financial performance of the individual banks.

- ➢ In the age of digital technology NEPSE is having trading on open system.

- ➢ The trading system of NEPSE should be modernized. Effect information channel should be launched. Data available in the web of NEPSE should be up-to-date and he concept of on line trading should be developed.