CHAPTER 1

INTRODUCTION

1.1 Background of the study

Nepal is a south Asian and land locked country situated between two other Asian countries China and India. Politically the kingdom is divided into 5 regions, 14 zones and 75 districts. Nepal is a developing country so it has been laying emphasis on the uplifting of it's economy. The development of a country is measured by its indices upliftment of nation's economic growth and and solving the problem of underdeveloped economy is widely depending on the nature of it's economic infrastructure. The process of economic development depends on various factors. One of the basic elements in achieving a self-reliant growth of the economy for sustaining the desired level of economic development is an accelerated rate of investment or capital upon the efficiency of the financial system. Therefore, a developed financial system is a hallmark of any free enterprises.

Commercial Banks, financial markets or institutions occupy an important place because of it's vital role in the economy like mobilization of domestic resources, capita formation and it's proper utilization. The financial system or market performs the function by channeling the nations saving into best uses. This can be done by brining together those who have surplus funds to lend and those who wish to borrow the funds to finance their expenditures.

The history of the financial market in Nepal is not so old and it is in the growth stage. In the absence of developed securities market the government was the sole issuing authority of development bond and national saving. Therefore the securities generally floated in the market were mainly the government securities. Institutional development of the securities market in Nepal started from the year 1976 when securities exchange center (SEC) was established with the joint capital contribution of NRB and NIDC.

Securities market can be defined as a place for bringing together buyers and sellers of financial assets in order to facilitate trading. The securities market is not basically different from financial market in general. Securities markets are primary markets and secondary markets. Market indexes are the indicators of performance of the market. For example either the market is moving upward, downward or stagnant. The term primary market denotes the market for the original sale of

securities by an issuer to the public. Similarly secondary market facilitates the immediate buying and selling of securities by the investors. It provides liquidity to the assets.

Securities are traded in an expectation of either the price of share will increase or decrease in the future. Market price of the stock/share moves daily in the Nepalese securities market. Either it is moving upward, downward or is stagnant. All the media explains the massive decline and increase. There are various reasons or causes of movement in share price which may be signaling effect, low return, high risk etc. The random movement in price of sock may affect the decision of buy and sell rules. Since from past few years, the situation of country is deteriorating day by day due to political instability. Uncertainty and fear is bounded every sectors. This has seriously hit not only the economic growth of the country but also in the stock market of our country. On this ground, securities markets have to implement effective plan and policies in order to facilitate effective trading system. Development and expansion of capital market is essential for the rapid economic growth of the country. Capital market helps economic development by mobilizing long term capital needed for the productive sector. The capital market was initiated in the country with the establishment of the Security Market Center in 1976 in government sector according to the industrial policy of that time. But there was no such plan or programmed for the development of the capital market until the sixth plan. For the first time, the activities and programs of the Security Market Center were set out and included in the capital market in the seventh plan. However, the planned development of this sector was initiated only after the eight plans.

The main objective of the capital market is to create opportunity for maximum number of people to get benefit from the return b directing the economy towards the productive sector by mobilizing the long term capital. The objective can be fulfilled only by the rational and accountable behavior relating to the three factors of the capital market such as institutions, mediator and investor.

Rational and high moral character and accountable behavior of the institution such as the government, central bank, stock exchange board, organized institutions for accumulating capital from the market, mediators in the form of manager for issuing security, creator of the market manager for investment security dealers such as brokers and investors in the form of government bond holders and ordinary mutual fund unit holders help to develop healthy capital market (the ninth plan, p 30)

Solving the problem of underdeveloped economic markets and enlistment of economic growth of nation is widely dependent on corporate success of its

economic infrastructure. Manufacturing industries, financial institutions and capital markets are major components of this economic infrastructure. The corporate success or positive financial performance of every industry and every firm is almost necessary for the overall development of economic market. This positive financial performance brings satisfaction to the investors because every corporate organization is made up of public investment, which helps to increase the volume of organization. The increment of the value of corporate firm means, it makes investors to feel safer and the investment less risky. The corporate success and increased value of investment helps to increase the stock price because there is possibility to give sufficient dividend or return on investment. This offers an opportunity for investors in the long term ventures again.

Strategies developments of economic markets require a steady supply of capital funds for productive investment. For the mobilization of enviable resources, capital market is an important intermediary through which effective bridging if the deficit units and surplus units can be assured. Capital market institutions are engaged in mobilization of saving from surplus units and supply funds into the deficit units for the productive investment. In this respect, capital market plays crucial role in mobilizing constant flow of saving and channeling the financial resources for expanding productive capacity in the countries. Capital market can be decomposed into the security market and non security market. Stock market is the major component of the securities market. One of the mechanisms of financing the industries from the external sources in the modern time is the capital market through which the industrial enterprises with corporate organization assemble the funds by using various forms.

A person buying a stock invests on faith, in the hope of receiving dividends. The common stock certificate makes no mention of ever repaying the principal or purchase price. Therefore, playing on stock is purely estimation like bidding the cards,

In these countries like Nepal, where security market is in infancy stage and is handle by few players, including promoters of company, market makers and VIP share holders, to pay a days prevailing price for stock investment is sometimes suicidal. It is equally suicidal to make investment decision relying on financial statement of companies.

These are some companies which were earning profits and were paying dividends during initial stage but from the day raised money from public they continuously been showing operational losses even though increase was noticed in production and sales. This gave raise to the suspicious that same people may simply be trying to raise funds by manipulating performance data or intending to manipulate public

funds. This requires immediate attention of securities board but action was noticed so far.

Still one has to predict something to pay a roughly reasonable price for the stock. One such prediction is about the future dividends.

People just tends to grab shares of any company because they are forced to do so by the family, relatives and friends, other type of people to do so just because of the goodwill of the company. If the company is going to open the branches on other districts then also common people seem to be interested in grabbing the shares. If the management and corporation of staff and manager is highly effective, then also people want to invest in that type of company. So these non financial terms force them to buy the shares without knowing the actual financial conditions of the company. Each and every company that came in the market because successful in tapping the capital from market and the issue close within the minimum stipulated time of 7 days. With huge over subscribed to the extent of 19 times and became simply overwhelming to the company concerned as well as the issue managers, which lead to delay in allotment of shares, refunding and distribution of shares certificates to the allotters. But the public response varies from one business sector to another business sector. And, recently, company has been facing problems in issuing their shares to general public. Since the first quarter of 1995, number of issuers and investing community remained limited in the absence of equality culture due to strong equation in the minds of the average investors that a stock market is showing a downward trend and is only speculative. The company which issues shares to the general public had predicted higher dividends and earning per share but most of them are failed to deliver. The performance of issue manager is also not as expected. The mismanagement while subscription list is open and delay in allotment of shares is over subscribed tends to undermine investors confidence and thereby hinders the future growth of primary markets. In the same way, other non-financial factors like strike in the company, lack of coordination, misbehave by the company staff, appointment to the inexperienced and untrained staff etc. can play negative roles on stock pricing of the company.

When people buy common stock, they give up current consumption in the hope of attaining increased future consumptions. They expect to collect dividends and eventually sale the stock at a profit. But the future earning as well as lifetime stock prices is uncertain. Not knowing what lies ahead; investors are unable to plan life time consumption patterns with the certainty, because the return from investment and timing of those returns are uncertain, they compute the lack of certainty by requiring an expected return sufficiently high to offset it.

Rational investors should buy a stock at a price at least not reducing his or her current net worth or values. For this some reasoning must be made that what

maximum price for a stock of the consider company ought to be paid. What value of stock deserves could be paid for it. Value is an amount equivalent to the recent worth of future assets. For e.g. could be expected from a stock? Two things:

1. Dividend in future, but only if the company makes profits.
2. Price from stock, which can be sold at some future date.

Then what relationship can be drawn between the dividends and stock prices? Just see the effects of bonus shares which are also a type of dividend, stock dividend

There are different opinions and thoughts regarding the effects of bonus issue. Some regards bonus issue to lease to increase, the market value of the form by increasing the equity capital base without affecting the dilution of share's ownership. Other regards issue of bonus shares only conserve the cash consistent with the corporate firm's motivate to finance it's growth and expansion from internal source. There by enhancing the future market value. Generally bonus share doesn't change the ownership pattern but it affects the book value per share and the earning per of the increased numbers of the shares as a result of issue of bonus shares. (Shrestha, 1999, pp 35-38)

1.2 Financial Market in Nepal:

The history of the financial marker in Nepal is not so old and it is in growth stage. However, the development pace of said market is not completely satisfactory compared to the development and emergence of various financial and non financial institutions.

According to the Lawrence J. Gitman – "Financial markets provide a form in which suppliers of fund and demanders of loan and investments can transact business directly."

There are mainly two types of financial market, first one is money market and second one is capital market. Short term funds of firm are raised from money market and long and middle term funds of firms are raised from capital market. Money market is also known as short term financial market. The financial market in which funds are borrowed for short period. Generally, money market trades commercial papers, certificates of deposit, short term bonds and Government Treasury Bill.

Similarly, capital market is known as long term financial market. Long term funds of firm are collected from capital market. Hence, capital market is a long term credit market. The meaning of capital market can be made clear from it's definition.

According to Peter S. Rose – "The capital market is designed to finance long term investments, financial instruments traded in the capital market have original maturities of more than one year."

The capital market is broadly categorized into two main markets, they are:

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1. Primary Capital Market
2. Secondary Capital Market

Primary Capital Market:
The primary capital market denotes the market for the original sate of securities by an underwriter to the public. The use of the words original sale may be somewhat misleading, however, for e.g. the issuer may initially have sold common stock to the public several years ago and has now decided to issue additional share will be sold in the primary market and ones the sales is completed, the new share will be indistinguishable from the share sold in the initial public offering.

The issuer (company) collects amount and invest in the productive sector to earn the profit. Price of the stocks ever is in the par value so there is no problem of price.

Secondary Capital Market:
After securities have been purchased from the primary market, they can be traded in the secondary market. Secondary market provided the liquidity and marketability opportunity to the stock market. The secondary market comprises organized security exchanges and a specialist facilitates the transaction. The majority of all capital market transaction occurs in the secondary markets. The proceeds from sales of securities in the secondary markets do not go to the organizational issuers instead to the initial owners (sellers) of the securities.

Trading of stocks:
In Nepalese practice, the trading of securities viz. government bonds and listed corporate securities is done through Nepal Stock Exchange Limited (NEPSE). In short, NEPSE is a non-profit organization operating under Securities Exchange Act 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government bonds and corporate securities by facilitating transaction in it's trading floor through market intermediaries such as, brokers, market makers etc.

NEPSE opened it's trading floor on 13th January 1994 through licensed members. Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present there are 27 member brokers operating on the trading floor as per the rules and by laws of the exchange.

Besides this NEPSE has also licensed to dealer for primary and secondary market. The primary market (Dealer) operates as a manager to the issue and underwriter whereas the secondary market operates as a portfolio manager. Presently, the NEPSE has licensed 11 dealers for primary market and 2 dealers for secondary market.

The rate of brokerage on equity transactions ranges from 1% to 1.5% depending on the trade amount. The rate of brokerage commission on debenture ranges from 0.15% to 0.75%. As per the rules the rate of brokerage commission is listed below. If the trade securities are shares:

Table 1.2.1

Trade Amount	Rate of Commission
Upto Rs 250000	1.5%
Rs 250001 to Rs 50000	1.4%
Rs 50001 to Rs 100000	1.3%
Rs 100001 to Rs 500000	1.2%
Rs 500001 to Rs 1000000	1.1%
Above Rs 1000000	1.0%

Table 1.2.2

If the trade securities are corporate bonds or debenture

Trade Amount	Rate of Commission
Upto Rs 100000	0.75%
Rs 100001 to Rs 500000	0.60%
Rs 500001 to Rs 1000000	0.45%
Rs 1000001 to Rs 5000000	0.30%
Above Rs 5000000	0.15%

Trading floor of the NEPSE is restricted to listed corporate securities and government bonds. At present, 135 companies have listed their securities to make them eligible for trading.

Table 1.2.3

S.N	Issued Capital	Listing Fee	Annual Fee
1.	Upto Rs 10 million	0.20% or minimum Rs 15000	Rs 15000
2.	Rs 10 million to Rs 50 million	0.50% or minimum Rs 45000	Rs 25000
3.	Rs 50 million to Rs 100 million	0.10% or minimum Rs 75000	Rs 35000
4	Above Rs 100 million	0.075% or minimum RS 100000	Rs50000

NEPSE has adopted recently computerized system. It means transactions of securities are conducted in the trading floor by matching the price of buying and selling. When the price matches the buying and selling broker declares the quantity and settlement the transaction.

NEPSE has fixed the trading days and hours during which the members are allowed to enter the floor to make the transactions

Table 1.2.4

Types of trading	Days	Trading time
Regular Trading	Monday to Friday	11 AM to 1 PM
Odd lot Trading	Monday to Friday	2 to 3 PM and 11AM to 12 noon

NEPSE has fixed the board lot of 10 shares if the face value is Rs 100 or 100 shares if the face value is Rs. 10. The transaction on regular trading should be done fro at least one broad lot. The transactions of less than 10 shares are permitted only on odd lot trading hours.

The opening price of and day shall not be more or less than 5% of the previous trading day's closing price. Once the transactions are done within this range, the price can be changed within of 2% in each consecutive transaction.

NEPSE adopted a T+ 5 system. The existing system of settlement system of settlement has been changed from T+5 to T+3. the changed system has been implemented since 17 July 2003. Under the prevailing system the transaction done on the trading floor need to be settled within 3 working days excluding the transaction date. Settlement will be carried out on the paper versus payment basis. The rate of brokerage on equity transactions ranges from 1% to 1.5% depending on the trading amount. The rate of brokerage commission on debenture ranges from 0.15% to 0.75%

There are many changes taking place in the financial system of Nepal due to financial liberalization. The business activities are increasing rapidly. After the restoration of democracy in our country, we can see the increasing role and importance of security market. Our security market has just shown some changes of facilities in the real sense. May be it is also because of the already passed recession period that people have become much more optimistic that they want to save some of income to invest in the security market. Knowingly or unknowingly, what we perceive is, it is also due to the lack of other investment opportunities that people and their money flock into the Great Walls of NIDC Capital Market. Here the role of the medial that is to say the newspapers, the different new management related magazine and the advertisement of the satellite television have played a very important role to make this small security market attractive. But, the underlying reason for the attractiveness and energy of our security market has to

be repeated, it's the increased competition between the various types of firm striving for the survival.

As usual, we have two markets under the capital market, the primary market and the secondary market. Primary market is a market where the public buys shares directly from the company through the initial offer. Sometimes brokerage firms, agents underwrite the company shares. Therefore in the primary market the public apply for the shares and the company does the allocation. Normally, NSEB and NIDC Capital Market control the value per share of the equity.

After being listed in the Secondary Market, trading of shares begin so in the secondary market, already bought shares are traded especially for capital gain purposes. Therefore the basic difference is in the primary market, ownership of the company is shared, and ownership is transferred among the public. The price in the primary market is said to be the par value and that in the secondary market is the market value.

In our context, NIDC Capital Market is the primary and the NEPSE is the secondary market.

After the IPO is done with, shares are traded in the secondary market. For this purpose, the NEPSE has appointed and listed brokers who are already entitled to trade shares in the floor. As in practice everywhere, there are probable investors and sellers of shares in the market. Both the parties contact brokers (authorized) through brokerage firm, negotiate the price as per ones ability and market condition. Here, normally the seller wants to get as much as possible and the buyer wants to reduce as much as possible. When both parties agree to a particular price the broker makes the toss by taking the responsibility of transferring the ownership of the equity. For this broker charges 0.5% to 1.5% of the total transaction amount from both the sides depending upon the amount. Normally, the higher the transaction amount, the less is the percentage of commission. It normally takes 7 days for one to complete cycle of the transaction.

1.3 Focus of the Study

The stock market is the part and parcel of corporate development. Corporate business is a business organization established under company act consisting of billions of rupees of smaller stockholder and holders of debt certificates of small denomination. The corporate firm collects it's capital by issuing shares and debt certificates. The two types of shares are preference share capital and equity share capital. The magnitude of preference share is very small in corporate firm. Equity/ordinary share comprise the largest category of securities in corporate firm. With this connection, the concerned study primarily focuses on the relationship between the price and financial performance and between the stock and non-financial factors. Similarly the study tries to focus on movement in stock price, reasons and causes in it's movement.

Marker price of the stock moves daily in securities market. We do study in the newspaper; listen in the radio and other medias about the movement of securities prices. The random arrival of information that came in the market causes the securities price to fluctuate and the decision to buy and sell rules, long and short position, arbitrage and hedging help to align the prices and value. Price of stock is determined by the demand and supply. Theories say that the stock pricing in market is guided by the intrinsic value. Through the EPS, DPS, ROE, ROA are the main causes of change in stock prices, sometimes misleading and inadequate information can also influence the price resembling insufficient market situation for the short period. Similarly the study tries to depict about the performance of Nepalese Commercial Banks? About their financial performance? About stock prices? What is the impact of price trend? Do the investors see the price trend? Do the investors see the volume trend and other views while making investment decision?

These are the burning issues regarding stock price determination of secondary marker in Nepal.

1.4 Statement of Problem

Financial performance means the financial activities of the company directed towards achieving it's value maximizing objectives. For better financial activities and efficient decisions are necessary and those financial activities contribute to excellent financial performance, which interns results into growth of the organization. Financial activities involve decision regarding:

) Forecasting and planning of financial requirements
) Investment decision
) Financing decision

Rational decisions enhance the financial performance of the company. The outcome is reflected on ROE, ROA, ROI, EPS, DPS growth. Moreover, better performance reduces the associated risk which aids to achieve high rating.

Theories say that the stock pricing in marker is guided by the intrinsic value which is calculated by the aid of company's result of financial performance such as dividend(d), required rate of return(k), and the growth(g). In an efficient market stock price used to be equal to the intrinsic value since the buyers and sellers are fully informed about the fact and the figures of the company. Therefore, one can say that market price and financial performance are positively correlated. However, the degree of correlation depends upon the efficiency of the market. In an efficient stock market like NYSE and AMEX correlation between two variables

is near to unity where as and inefficient stock market like NEPSE, correlation may not be close to + 1.

Though EPS, DPS, ROE, ROA are the main causes of change in stock prices, sometimes misleading and inadequate information can also influence the price resembling insufficient market situation for the short period. However the situation will overcome through the capital gain or loss.

In Nepalese stock market, most of the professional says that whatever the theory has depicted is not applicable in Nepalese context. Most of the investors do not know to interpret the information and so they cannot come to a rational decision regarding transaction of the stock. Therefore the stock price in Nepal is determined more by other factors rather than the financial performance of the concerned company. Therefore to find out whether it is fact or not, this study will give meaningful result.

A commercial bank overcomes the limitations of unlimited liabilities and limited capital as in the sole proprietorship and partnership firms. A commercial bank consisting of billions of rupees of capital dividend into millions of ownership and debt certificates of the small denomination and ownership certificates of common stock are compulsory to begin a commercial bank. These common stocks are firstly marketed by the capital raising companies through primary capital market. A common stock neither guarantees for the annual return nor does it ensure for the return of price or the stock.

Therefore, it needs a faith of investors upon stock certificates. But how to rely on these stocks? What price could be paid for a stock? Greater the faith of investors in stock, higher will be the chance of emerging new companies in the country and rapid will be the economic growth.

Obviously average investors will simply plan the price to be paid for a stock based on:
   1) Expected annual return interms of dividend
   2) Expected worth of the stock in future time

But what could be said about the performance of Nepalese commercial banks? About their financial performance? About stock price? What is the correlation between the DPS and their stock prices? Do the investors at least seethe real financial performance while paying price for the stocks? If not, what other factors might influence the price of stock?

These are the burning issues regarding stock price movement which encourage conducting this research study. The main problems of the study are as follows:
   1) What factors might influence the stock price?

2) Do the investors at least see the effect of events while paying price for a stock?
3) Do investors see the price trend and volume of the stock traded and other views while making investment decision?
4) Investment in common stock is risky in comparison of others. Still why most of the investors want to invest in common stock.
5) What is the relationship between EPS and price, DPS and price?

1.5 Theoretical Framework of Summary

Figure 1.5.1
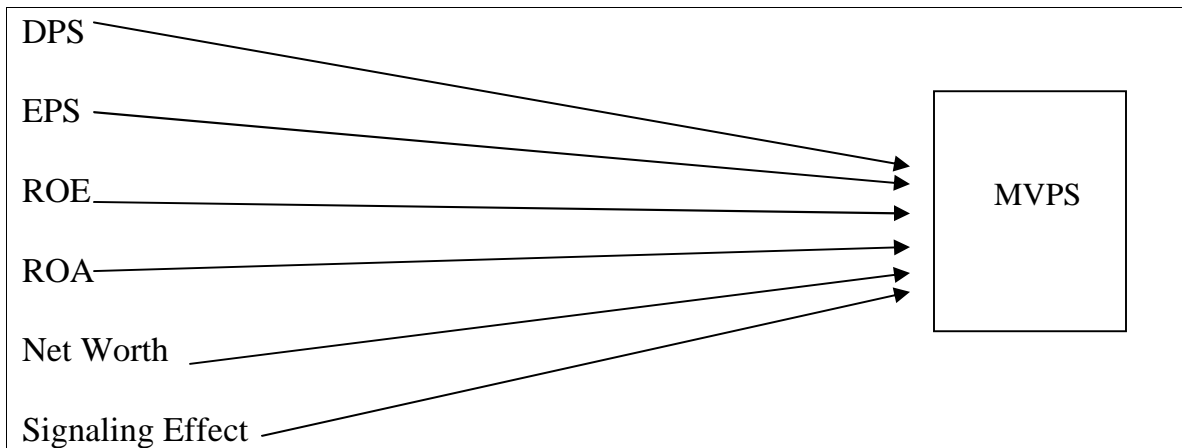
 The model above summarized that the market value per share is the accumulated effect of the changes in the financial performance indicators like DPS, EPS, ROE, ROA, Net Worth and finally the signaling effects. In the more perfect market where the system runs on the basis of demand and supply of the shares of the companies, the above mentioned variables have significant positive impact on the price determination

Talking about the profitability ratios like ROA, ROE and EPS, there ratios are higher where the company's net profit after tax is higher. ROA is higher when higher net profit can be earned with the same level of assets or same level of net profit can be earned with low employment of assets. Whatever be the cases, the increased profitability cab enhance shareholder's welfare by two ways, either through cash dividend or through capital gain. If the company has no profit balance in the balance sheet, it cannot distribute the cash dividend as positive profit balance is the foremost condition for the dividend to be distributed. In that condition, the shareholders cannot be benefited by the immediate cash benefit. The next way they can be benefited is through capital gain. Capital gain/loss is the difference between the selling price and purchase price of the share. The higher

the price is over the investment, the more capital gain will be there. But the price to be higher, according to the stock price theories, there should have sufficient retained earning in the company, which further increases the size of the net worth in the balance sheet. To have positive retained earning also, there should be positive profit balance in any particular year. In the perfect market condition, the increase in retained earning contributes one by one to the stock price. But in practice, it is determined by so many other factors other than the profit ability.

In addition to the financial performances of the company, signaling effects do also have a great deal of effect on price determination. According to economies theories, the price is determined with the demand and supply of particular thing. Whatever be the quality of your product, if it does not have a good demand in the market, the price should have to come down to increase the existing demand. On the other hand, demand is not only based on the quality or inherent other features. It largely depends on the perception of people towards it. And perceptions are formed in so many ways other than the real attributes of the product. One of the main determinants is the market whim or rumor or signaling effect, which has a great impact on the demand formulation, and later on the price fixation.

1.6 Objective of the study

The main objective of the study is to examine the impact of financial performance on common sock pricing. These basic objectives can be further elaborated as:
1) To study and examine the relation of financial performance and stock price.
2) To study and analyze the stock price and volume.
3) To examine the relation of dividend and stock price.
4) To explore the signaling effect on the stock price determination.
5) To suggest the findings of the study to the interested parties related to stock investment.
6) To study and analyze the investors view regarding the decision on stock investment.
7) To examine either the market index of commercial bank is in random order or not.

1.7 Significance of the study

This study will provide some indicators based on facts to the potential investors of commercial bank's securities. Secondly, this study is assumed to be helpful to the financial managers of commercial banks to make financing and dividend decisions. Similarly it will provide a useful feedback to different academic institutions like universities students, further researcher, trainees, investors,

NGO's, INGO's policy making bodies and those concerned with financial market in the formulation of appropriate strategies.

1.8 Limitation of the study

Like every research study this study also has some limitations. They are given below:

1) The study is based on all Commercial Banks listed on NEPSE.
2) Only 5 years observation data has been taken
3) The study relies on the secondary data which are collected from annual reports
4) Time and budget limitation.
5) Financial performance represents profitability ratios, dividend and net worth per share.
6) The depend variable only the market value per share of common stock.

1.9 Organization of the study

This study includes five chapters altogether. Chapter one includes basic understanding of the problem. The second chapter is about review of literature, which deals with the study of related articles, journals, reports and past thesis writing. The third chapter concentrates on research methodologies, techniques that are applied to collect and analyze the data. The fourth chapter is Presentation and Analysis of Data, where financial tools and statistical tools are used in the analysis of data. This chapter also provides major findings of the study. Finally, the fifth chapter presents with summary, conclusion and recommendation to formally close the thesis report.

CHAPTER 2

REVIEW OF LITERATURE

The concerned study primarily focuses on the relationship between stock price and financial performance and between stock and non-financial factors. Here, the predominant emphasis is on the price of the stock of a company and its fluctuation with the impact of financial and non-financial factors. But, for simplicity, this chapter is divided into; Theoretical Framework of the study, the Literature Review form foreign previous studies, Nepalese previous thesis studies relating to Nepalese Stock Market, Conclusion of Literature Review, and Research Gap Analysis.

THEORITICAL FRAMEWORK:

COMMON STOCK

Common stock represents ownership interest in the corporation. The ownership capital generally referred equity, when issued to the public for subscription in the form of divisible units of equal value is termed as common stock. Unlike, dept, once a corporation issues common stock; generally it has no obligation to redeem the stock by purchasing it from the investor. Usually common stock is issued with the perpetual like. These stocks are subject to issue and trading in primary and secondary market. The original issue takes place in primary market where it is generally issues with its face value and once the stock is listed in the stock exchange, the trading starts to take place and this particular market is called secondary market.

Stock is the ownership interest of a corporation. Each share of stock is a fraction of the rights and privileges that belongs to the owners of a business. A stock certificate is evidence of that fractional ownership; it is tangible evidence, a certificate of title, to part of the company. (Henderson, Trennepohl and Wert, 1984, p.98).

Common stockholders of the corporation are its residual owners, their claim to income and assets come after creditors and preferred stockholders have been paid to full. As a result, a stockholder's return on investment is less certain than the return to a lender or to a preferred stockholder. On the other hand, the return to a common stockholder is not bounded on the upside as are returns to the others. A share of common stock can be authorized either with or without par value. The par

value of a stock is merely a stated figure in the corporate character and is of little economic significance. A company should not issue stock at price less than par value, because stockholders who bought stock for less than par value would be liable to creditors for the difference between the below par price they paid and the par value. (Van Horne, 1997. p.124)

COMMON STOCK VALUES:

Par Value:
The face value when the stock is initially issued at a price as mentioned in article and memorandum of the company is called par value. The par value doesn't change until there is a stock or other such initiative by the board of directors. In Nepal, the par value of new issue is usually Rs. 100, as directed by Company Act 1993.

Book Value:
It represents the asset value per share after entire obligation of the corporation is met. It is calculated by dividing the total common equity on the balance sheet by the number of common shares outstanding.

Market Value:
This is the value, which is determined by the demand and supply factors and reflects the negotiation between investor and seller for the transaction. The market value is influenced by many factors like economic and industry conditions, expected earnings and dividend, and other signaling effects.

2.1.3 CLASSIFICATION OF COMMON STOCK:

Blue Chip Stock:
Stocks of very large, well established and of corporation have been dominant positions; strong balance sheets and size are called blue-chip stocks, e.g. stocks of IBM, Microsoft, American Express Company, Citicorp, etc.

Growth Stock:
Stock which price grows with the growth of corporation's earning and dividends with a comparatively higher growth than the average price appreciation.

Income Stocks:
Stocks having stable cash dividends record are often called as income stocks.

Cyclic and Defensive Stocks:
Stocks, which are influenced by economic and industrial cycles, are called cyclical stocks, where as stocks, which are less susceptible to economic cycles, are called defensive stocks.

Speculative Stocks:
Stocks, which are viewed by investors with some speculative motives, are called speculative stocks.

Small Stocks:
Stocks depending in the capitalization norms are generally known as small or even blue chip stocks.

Treasury Stocks:
If a corporation decides to buy back its own stock, the acquired stocks are called treasury stocks.

In Nepal, growth stocks, income stocks, and speculative stocks are generally seen in practice and are common in the security market.

2.1.4. CHARACTERISTICS OF COMMON STOCKS:

The characteristics of common stock are well studied in relation to the rights and privileges enjoyed by the common shareholders as owners.

Control: The common stockholders have voting rights to elect the Board of Directors, which in turn, elects the management committee. The stockholders also have voting rights on issues which have substantial effect on corporations, on issues which brings about change in their ownership percentage, any contract or financial arrangement.

Preemptive right: In this right, the stockholders are the first party to purchase any new issued shares so that they would not lose their voting right, control and there is protection in the value of the shares being diluted. This right is substantiated by the use of the right offerings.

Right to income and distribution of other shares: As a matter of fact, shareholders have no right to receive income distribution from the corporation. As practice prevails, BOD declares cash dividends if enough financial resources are available. The dividends can be cash dividends, stock dividends, property dividends etc.

2.1.5 INVESTMENT ANALYSIS OF COMMON STOCKS IN BRIEF

There are many mathematical models developed, which are used for the valuation of common stocks. In reality, there are many other non-financial factors (Presented in Analysis Part), which determine the value/price of the stock. Hence, in the real complex and intricate world of security market, these models may not be justifiable; however, it can provide a useful framework for the analysis.

Mathematical valuation model gives a quantitative procedure which implies precision and accuracy but what the real world says that the valuation of common stock is an art rather than only being mathematical analysis and forecasting. Models are just tools for making decisions but not as a decision making in them.

What theory says is that the value of a common stock is determined by twp prime factors, i.e., the future earnings the common stock can provide and the riskiness of the income stream. Hence, the evaluation of common stock can be taken as function of income and the risk associated with the income as shown below:

$$Vn = f \text{ (income, risk)}$$

Where, Vn=intrinsic value of the common stock in period n. Lets suppose an investor would estimate the price in one year, henceforth then, Vn is the likely price at which the stock will be sold.

Basically, there are three models of stock valuation, which are based on different assumption of dividend growth and its relationship to the discount rate used to calculate present values. We will name these models as dividend discount model (DDM).

1. <u>Zero growth DDM</u>

$V_0 = D/K$

Where,

V_0 = Intrinsic value of stock or value at period t = 0
D_t = DPS in period t
K = Investor's required rate of return consisting of risk free rate of return and risk premium.

We can write the module considering the dividend as perpetuity: $Vo = D/K$

2. Constant growth of DDM

$$V_0 = \frac{D_0(1+g)}{K-g}$$

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The above models holds true under the assumption that the growth rate is less than the investor's required rate of return ($g<k$).

3.Super Normal Growth DD

$$V0 = \frac{Do\{(1+g_2) + A+B(G_1-G_2)\}}{K-g_2}$$

Assumption:

$G_1>K$
$G_2<K$

Other Models:

Price earning Model

$V_1 = M_1 . E_1$
Where, V_1= intrinsic value at the end of year1
M_1 = estimates of earnings multiplier or P/E ratio at the end of year one.
E_1 = estimated of earnings per share at the end of year one.

INVESTMENT DECISION:

After the completion of analysis, it is now time to make decision. The general mode of decision making is to compare the estimated expected return and estimated required holding period return.

Expected return; $E(HPR1) = \frac{V_1-P_0+D_1}{P_0}$

Where,
     $E(HPR_1)$ = Expected holding period return over 1 year.
     V_1 = Value at the end of one year.
     P_0 = Price at the beginning of the year.
     D_1 = Dividend paid at the end of one year.
Now, the estimated required return as suggested by CAPM

$E(Rj) = R_1 + Bi[E(R_m)-R_f]$

Where,

$E(Rj)$ = Expected required holding period return

R_f = Risk free return

Bi = beta for the stock

$E(R_m)$ = Expected Market Return

Now the analyst should compare $E(HPR)$ and $E(Rj)$ and if $E(HPR > E(Rj)$, the analyst should invest for long term and if $E(HPR_0 < E(Rj)$ should invest for short span.

2.1.7 FINANCIAL PERFORMANCE ANALYSES:

Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and the profit and loss account. Financial analysis can be undertaken by management of the firm, or by parties outside the firm viz. owners, creditors, investors, and other. Investors, who have invested their money in the firm's share, are most concerned about the firm's earnings. They restore more confidence in those firms that show steady growth in earnings. As such, they concentrate on the analysis of the firm's present and future profitability. They are also interested in the firm's financial structure to the text it influences the firm's earnings ability and risk. (Pandey, 1997, p. 36)

Net Profit After Tax (NPAT):
It is also called EAT (earning after tax) which is the earning after the obligation of corporate taxes are met.

Earning Per Share (EPS):
EPS are the per share profits after taxes and after preferred stock dividends that are available to stockholders. It can be calculated quarterly or for full year. EPS shows earning made by each share or the after tax and preferred dividend return on each share. The higher the EPS, the better it is an subsequently higher the stock price is expected.

EPS = Profit after taxes – preferred stocks dividend
      Number of share of common stock outstanding

Dividend Per Share (DPS)
The above mentioned (EAT-Preferred Dividend) which is the earning available to the stock holders may by either retained fully i.e. ploughed back for further

expansion or growth purpose in the form of bonus shares or may be partly retained and the rest may be distributed to the stockholders in the form of cash, as enough financial resource is available to the corporation, which is called dividend. This earning available to each share is called dividend per share. Usually, all the stockholders invest their funds in expectation of this income stream. The dividend may be in the form of cash dividend, stock dividend, property dividend etc.

DPS = earning per share (1-b)/no. of outstanding share

Where, b = retention ratio

Capital gain

As seen in the stock market the price of the share of the corporation excellently are rising in the speedy rate. Lets suppose the market price of ABC bank today is Rs.400 and after the year the market price becomes Rs500, and the difference i.e. Rs500-400=Rs100 is the gain due to the valuation of the stock of the security market, which is termed as capital gain and calculated as follows:

Capital gain = $(p_1-p_0)/p_0 \times 100$

Here, p_1 = Rs500

P_0 = Rs 400

Return on investment (ROI)

The term investment may refer to the net asset. The conventional approach of calculating ROI is to divide PAT/2 by investment. Investment represents pool of funds supplied by shareholder and lenders, while PAT represents residue income of shareholder; therefore, it is conceptually unsound to use PAT in the calculation of ROI. Also as discussed PAT is affected by capital structure. It is there fore more appropriate to use following measurement:

ROI = ROA = (Operating profit/total assets) x100

Return on equity (ROE)

Common share holders are entitled to the residual profit. The rate of dividend is not fixed. Nevertheless, the net profit after tax represents their return. A return on share holders equity calculated to see the profitability of the stockholders investment.

ROE = (profit after tax/Net worth) x 100

ROE indicates how well the firm has used the resources of stockholders. In fact, the is ratio is one of the most important ratios for common stock pricing.

Price Earning Ratio (P/E Ratio)

The reciprocal of the earning yield is called P/E Ratio.

P/E Ratio = Marker value per share/earning per share

The price earning ratio is widely used by the security analysts to value, the firm's performance as expected by investors. Therefore, P/E Ratio can be a yard stick measurement of stock pricing.

Earning Yield
Earning yield shows the return to stock holders as a percentage of current market value per share. Since the stock holders have to sacrifice their worth for reveling market price per share, earning yield gives a good reflection of the current profit on stock investment.
Earning yield = (earning per share/market value per share) x 100

Dividend Yield
Since the company is not legal liable to pay a specified dividend to common stock holders. It may vary from company to company and year to year within a company. The return what the stock holders get on their stock is indeed, the dividend yield.
Dividend yield = (dividend per share/market value per share) x 100

2.2 REVIEW FROM FOREIGN PREVIOUS STUDIES

Lois Bachelor first tested the random walk model in 1900. He tested the model in the commodity prices and that those prices followed a random walk. He presented the evidence that the commodity speculation in France was a 'fair game' model. He also concluded that the current price of the commodity was an unbiased estimate of its future price. Unfortunately his insights were so far ahead that was largely unnoticed for a long period until his paper was rediscovered and eventually translated into English and was printed in 1964.

In 1927, Slutsky proved that the randomly generated price change look like stock price changes and they appear to exhibit cycles and other patterns. Alfred Cowles in 1933 found little evidence that stock marker analysis could predict future price. Halbrook Working extensively analyzed commodity prices and noted that speculative price patterns might be shown to be random comparing with artificially generated series of price. According to him, it has several times been noted that time series commodity posses in many respects the characteristics of series of cumulated random numbers. The separate items in such times series are by no means random in character, but changes between successive items tend be largely randoms.

Alford Cowles and Herbert E. Jones in 1937 reported that stock prices moved with predictable trends. They gave a controversy to the random walk model as a

valid share price behavior model in USA. This finding remained a challenge against the random walk hypothesis more than two decades. After the working in 1960 had pointed out an error occurred because, where each unit of a time series even where the original series is an average of points with in the unit, the effect of such averaging will be to introduce positive first-order correlation in the first differences of such a series even where the original series a random series. In the study of serial correlation in price series it is important to bar the mind that the use of the average can introduce correlations not present in the original series.

In 1953, Kendall examined the behavior of weekly changes in 19 indices of British Industrial Share prices and in spot prices for cotton (New York) and wheat (Chicago). He found no relationship between share price change in the current week and previous week. After extensive analysis of serial correlation, he suggested that the series look like a wandering one, almost as if once a week the demon chance of drew a random number from a population of fixed dispersion and added it to the current price to determine the next week's price.

H.V. Roberts carried his next study in 1959. He concluded simulation tests by comparing the cumulating of random numbers and Dow Jones Industrial Average Index (DIZAI) for about a year starting 30 Dec. 1956. He further observed that the first difference of these tow series produce the dame pattern. His work was significant in that be gave a number of methodical suggestion for testing what he calls the chance model. In particular, he suggested run analysis for testing independence of price change. Another study conducted by Osborne, one of the distinguished physicists, ignorant about the stock market at that time watched the numbers representing stock prices to see whether they conformed to certain law governing the motion of physical objects. He found the movement of stock prices similar to that of the movement of small particles suspended in a chemical solution so called "Brownian Motion". Although, Osborne attempted to give the empirical justification for his theory, most of his data were cross sectional and could not be provide an adequate test. Though, his point of view is different, the findings are consistent with Robert's work (1959). Alexander (1961) tested the filter rule technique on the closing prices of two indices, the Dow Jones Industrials from 1897-1959 and Standard & Poor's Industrials from 1929-1959 reported that in general, filters of all different sizes and all different periods yield substantial profits, significantly greater than that of simple buy and hold policy. Finally he concluded that the independence assumption is not validated as a description of reality by his data. But later in 1964, he corrected the shortcomings on his previous study were the failure to realize that dividends were cost rather than benefit. Alexander found that his filter rules produce very large rate of return, particularly for small filters. However when transaction cost are considered the abnormal returns disappear for all filter rules.

In another studies carried out by Granger and Moorgenstern (1962) applied special methods of analysis to the weekly, monthly and volume series from the New York Stock Market which involved of Dow-Joned, Standard and Poor and various indices as well as price series of individual stocks. The result coffined the random walk hypothesis for weekly and monthly price data from the New York Stock Market. Again, Godfrey, Granger and Morgenstern tested the same methods broadly and found that random walk model a reasonable one.

In 1962, A.B. Moore examined changes of 29 randomly selected stocks for 1951-58 and found that average serial correlation co-efficient of -0.06. This value is extremely low, indication that data on weekly changes are valueless in predicting future changes. This interpretation of his test is that a low coefficient estimate suggests that previous price change do not provide any reliable information in estimating any future price changes. Cootner (1964) tested the randomness of the series by using serial correlation on the logarithm of daily price changes of 45 companies stock from New York Exchange. In this study he found low correlation coefficient of -0.046, which are insufficient to predict the future price changes.

In 1965, Samuelson though lacked theoretical discussion in his paper, but his findings support the independence hypothesis of random walk theory in stock price. He concluded that if market has zero transaction costs of all available information are free to all interested parties and if all participants either potential and existing have the same time horizons and expectation about the prices, the market will be efficient and prices will fluctuate randomly.

In 1965, Fama analysed the movement of stock market price changes of all the stocks that make up the Dow Jones Industrial Index for the period end 1952-1962 and investigated the daily proportional price changes of those 30 industrial stock and auto correlation were estimated for a variety of lags ranges from 1 to 10 days. In his study, he found that the auto correlation coefficients for daily average being 0.03, near to 0. Out of thirty, eleven auto correlation coefficient was significantly different from zero and lagged price changes show degree of dependence. He further analyzed the data by length. He found slight tendency for this to occur, but again the results were sufficient to accept the random walk hypothesis.

King in 1966 investigated on the monthly price change from 1927 to 1960 of 63 socks and authenticated the random walk model. The estimated average serial correlation coefficient was +0.018, which is close to zero.

In 1966, Fama and Blume used the filter technique to overcome the shortcomings of Alexander's mechanical rules. They tested the profitability of 24 filters ranging from 0.5 percent to 50 percent to buy and hold return of each of the stock of the Dow Jones. Ignoring the transaction costs, only two out of thirty were superior to buy and hold policy, when commissions were taken into consideration only four out of thirty have positive returns and not comparable with buy and hold return. Therefore, according to their demonstration, it seems that filter technique can not provide returns larger than those under native buy and hold policy.

Brealy (1970) examined the various stocks using similar methodology to that used by Fama in 1965 also supported the random walk model and concluded that successive price changes in the stock market are independent.

Dryden (1970) concluded that the share price movements were non random. However in his later study, he used serial correlation and runs analysis to examine the daily closing prices of 14 individual stocks UK Market and supported the independence hypothesis of successive price changes. Similarly, Kemp and Remp's study (1971) was also against the random walk theory. They derived the conclusion that share price movements were conspicuously non random over the period considered.

In 1971, Narchos studied price series of 15 individual stocks from Athens Stock Exchange for the period from 1957-1968. He found the serial correlation coefficient for individual stock as 0.036, close to zero. So he concluded that the price fluctuations were random walk and past price has no meaningful information to predict future prices.

Sweeny (1988) developed a filter rule that was able to earn modest profits. He replicated Fama and Blume's resulted in the short position usually generated the trading losses. In contrast, Sweeny found that long position were often profitable. So, he used an X% filter rule. If the price of a security rises at least X%, buy and hold the security until its price drops at least X% from a subsequent high. Then, liquidate the long position and invest the proceeds in risk free short-term bonds until price reaches its next through and then rises X%.

Sweeny also found that filter rule trading tended to be fairly and consistently profitable in some stocks while being fairly consistently unprofitable year after year in other stocks. This filter rules could mechanically trade some stocks and earn a statistically significant rate of profit after deducting tiny trading costs incurred. However this filter rule seems to be unprofitable if the higher commission rates that most investors pay were deducted.

Fama, Fisher, Jension and Roll examined the effect of stock splits on security prices. A number of prior studies had suggested that stock splits increase the value of the firm. This was disturbing to many because stock splits simply involve changing the percentage ownership of any shareholder or the asset or earnings of the company. Fama and other scholars argued that stock splits might be associated with other more fundamental changed and the effects that researchers were attributing to stock splits might be better attributed to these other phenomenon.

2.3 REVIEW FROM JOURNAL AND ARTICLES

There are many loopholes in our stock-exchange Act. Investors feel insecure here. A few years back there was a company called Nimrod Pharmaceutical Company that floated in shares but where are they now? Similarly, it has been more than a year that Bansbari leather has allotted its shares but why didn't the company lists its shares in the stock market? It has been three years that Gorakhali Rubber Udyog hasn't called for its AGM Government had remained silent in all these cases. This is why the general public as well as the institutional buyers are not feeling secure in investing in stock market. (Business age, Jan 2000;25)

Investment in share has traditionally been done by rating the institutions on the basis of price earnings ratio or dividend. Hardly do investors compare current assets with current liabilities or take a look at the debt equity ratio. Unless investors are analyzing the intricate financial details of corporate institutions before making investment decision the market can not develop smoothly.

Share investment has traditionally been guided by the investor's returns. Most earnings of investors here have been in the forms of dividends rather than capital gains, through high dividend are often seen in corporate finance theory as a wasteful use of scares capital. With the commercial bank becoming the only potential investment destination, with other stock market participants hardly making profit and even if they did failing to meet investor's expectations, demand for shares of commercial banks outpaced supply and their prices boomed.

Now the latest sums in secondary market, despite a pretty good performance by commercial banks, make it more apparent that investment in the past was done on whim. Even officials at stock exchange and the securities board, refuting investors, allegations of the market manipulation and insiders trading of last

February discreetly claimed that the Nepalese stock market is in a has cent stage and that investment are made more in an impulse rather that through market study and credit rating. (Business age, June 2001; 25)

"Return from investment in stock is not short run phenomenon". Investment have to learn few things before they make investment on stock. First of all they should know the financial health of that company. For example; if somebody want to invest in investment of bank's share, he/she must see its balance sheet or at least paid-up capital, last year net profit, current years anticipated profit and calculate earning per share and price earning ratio. These two numbers would give a fair idea about company's health and then market price would judge through the discount factors based upon one of the sound company's data. Market price is equal to earning per share divided by discount factor. EPS can derive by dividing total net profit after tax by total number of share and price earning ratio by dividing market price with capital gain and other.(Business age, July 2001:20)

The essence of the massage is that investors should be careful at this time while investing in the secondary market. For example, buy shares of Standard Chartered Bank Ltd, when they come down to Rs.1500, because the dividend yield then will be more than 7 %. Investors should be considered also while investing in the primary market. Do not get excited to make heavy investment on primary issue because the allocation would be and you may have to wait for six months before the scrip you invest on will be open for trading on the secondary market. Even it will not offer the price sufficient to compensate for the wait. (Business age, February 2002;56)

Various factors such as fall in gold price and attraction of investment abroad provided decision slightly igniting their coyness in the stock market. The political instability market by continuous rejection of Thapa Government by major parties, inability to get the peace talks renewed, end of one fiscal year's activities and investment unfriendly atmosphere also contributed to the dismal show in NEPSE, say observers. The budget presentation patterns, fractured for the last year due to absence of House of Representative, the highest body elected by the people, could also be responsible in bringing about uncertainty in the stock market. (Business age, July 2003;23)

The private sector had many points to rejoice in the budget and it felt encouraged by this government to go forward in investment. The scheduling of peace talks in Nepalgunj for translating the current ceasefire into permanent feature also help the environment to be investment-friendly. The monetary policy announced by Nepal Rastra Bank promptly after the Governmental proposal for income and expenditure for the year provided some assurance in its own way. The agitation

of political parties, although continuing and highly opposed to the Government, does not seem to be highly effective in deterring investor's confidence in mobilization of capital. All these factors combined should have prompted NEPSE to go up. (Business age, August 2003;19)

The political situation in the country got complicated recently with the disruption of peace talks, resumption of violence and climaxing of the five party political agitation sending disappointing signals to the whole economy. The Government's banning of protest of any kind in Kathmandu and the five parties decision to lunch civil disobedience challenging it made investors disturbed but they showed no direct edginess, said an observer of NEPSE index behavior. To avoid flood of people scheduled to gather in Kathmandu in connection with the protest, Prime minister introduced tough antidemocratic measure. But it could not stimulate the economy. It somehow helped the stock market to gain as compared to the last week of August. The investors appear to have moved cautiously and positively in the NEPSE floor. (Business age September 2003;35)

Investment in the capital market now has become very uncertain sending the investors in search of avenues of more certain retains. The equity investment is considered riskier than investment in bond and preferred stock etc. the secondary market is not performing well. The NEPSE index is moving around 208 and 215 since long. After great sump in Nepal stock market in fiscal year 2000/2001, dissatisfaction has increased in the mind of investors. The NEPSE index on 3rd November 2000 had reached the peak of 545.82 and after that is continuously on the decline. (Business age, March 2004;42)

Nepal stock exchanges securities price (NEPSE index) during the month of June remained fluctuating. It remained bullish till June 10 reaching 216.75 and then it turned bearish continuously searching the level of 211.31 on June 15. The rise was started with the appointment of new government and the main leader was commercial bank group market dominating sector in the exchange understandably enough, the increase in the price was fueled by the expectation for early end of conflict between government and political parties after the appointment of Deuba as a prime minister. But the publication of the quarter financial result (where showed the operating profit increasing more than 50 percent over the competition amount the banks) was no way less important factor for such positive impact on commercial bank sector as been in June 2004.

NEPSE index fell after reaching 216.75 on June 10 and plummeted to 211.31 over a short span of three days. This fall was however caused by noticed published by some companies inviting applications for their new issue (Paschimanchal Development Bank and Kist Merchant Banking and Finance LTD both on 10 call of NBL for application on purchase its holding on SCBNL,

Issuance of right share by the NB Finance Ltd.). As well as the possible strike of the NEPSE employees and wrangle among the political parties that delayed the formation of coalition of government.

Since June 16, the index turned bullish again till the end of the month. Despite the strike of employees of NEPSE, the market increased on June 16, one day before the strike and continued to increase, during and after the strike till the end of the month. There were no any major event to cause the price of share goes up. However, the expectation of fewer disturbances after the four parties suspended the outgoing demonstration and the Maoist student union called off the education strike, the country budget and positive development reported for the formation of coalition government etc. increased the expectation of investors.

The NEPSE index since sensitive to political, economical and financial sectors development it has raised after the discloser of financial situation by the companies and when there were positive sign of political stability and it decreased for some companies' shares. It shows that the investors becoming aware about when to buy and sell the securities. (Business age 2004 July; 53)

The stock market is showing a bullish trend ever since February 1, 2005, why? Some analysts argue that the Nepali stock exchange is following the global trend. Globally, the stock markets are in the bullish trend. For example, in India, the sensex recently crossed the 10000 marks, recording the new high. The index one year ago was in the range of 6000. Similarly, Dow Jones Industrial Average in the USA has crossed 11000 from 9000 a year ago.

But that seems to be too simplistic an analysis. The Indian economy is reaching a double digit growth rate and the market there is connected with the global phenomenon with a lot of direct foreign investment coming in, both in a real sector as well as in the stock market. But till date, we can not say that the Nepali stock market is able to sense the global effect. This market can not even sense the domestic environment.

The NEPSE index increased by 25 percent during one year of the King's direct administration. The index reached 309.04 on February 1, 2006 increasing by 61.63 points from the level of 247.41 on February 1, 2005. But this is not a result of the King's move. The market had started to increase much earlier than February 1. There were a number of other factors that helped to push the NEPSE.

First, more than 90 percent of the market is dominated by banks, finance companies and insurance companies and the financial performance of these companies is continuously improving. Second, the stock market is totally

concentrated in Kathmandu valley and the people feel safer in this area. So, the people here feel safer to invest in the stock market. Third, the Nepali stock market has no impact from the situation out of the valley. If there is some such effect, the people who had their investment in the assets outside the valley have diverted it to the stock market in the valley. Fourth, the buying and selling pressure in the market is totally dependent on the valley's limited investors. Fifth, there is the diversion of the investment from gold to the stock market. Lastly, as the opportunities to invest in other sectors are limiting, the people are increasingly investing in the stock market. (New Business Age, February;2006)

The NEPSE index rose to 492.46 on November 29th. Gaining 84.08 points with in a month. It was only 408.38 at the end of October. A similar bullish trend was observed in the stock exchange after the reinstatement of the parliament on April 24th and the revision of monetary policy in July.

However, the latest bullish trend was not sustained for long. The market turned bearish from early December, losing 15 points in few days. This is attributed to the news that the price actions on the market were not based on strong fundamentals.

This phenomenon is attributed to the new confidence of receive in better returns in the future from investments in the market. The regular market speculators were trying to cash in on the political agreement by spreading rumors of better economy in the future.

Similarly, speculators spread propaganda about NB Bank's future prospects after its management was taken over by Nepal Rastra Bank (NRB) NB Bank's share gained over Rs100 reaching Rs335 after a NRB took over NBB's management. This was quit unjustified on the basis of Bank's fundamentals. The book value of the bank at the end of fiscal year 2004/05 was only Rs 65 per share. Just before NRB's takeover depositors had withdrawn over Rs 3.5 billion from the Bank drastically reducing its business capacity. (Business age December 2006;60)

One should analyze and develop various alternatives to anticipate the best returns before making a decision. That however is not enough. Investors have to use their own common sense to make a right decision. Considering the risks, investors also need to be gutsy while investing in stock. Starting the journey somehow and learning the tricks alone the way. It is commonly known that profit and loss is part of the game. There may be some monetary loss in beginning, but investors should not worry as they learn lesson in this way, which can prove to be an asset in the long seem. Start by playing safe and along the journey, be patient and try to develop a proper understanding of market

language, investor's psychology and market behavior. (Business age February 2007;32)

The NEPSE index was bullish this month experiencing a revival after an abysmal performance in the past months. The index ended up gaining a swashbuckling 62.66 points when compared to the last month's opening at 512.38 and closing 575.04. The sensex though increased less proportionately by 17.4 points opening at 128.18 and closing at 145.58. Shares trading also increased in comparison to the previous month. (The Boss, Jul-Aug; 2007)

Nepali shares closed at 813.77 points on the last day of the trading from the opening of 796.34 points on Sunday. On the first day of the trading, the sole secondary market index set a record by crossing 800 points mark for the first time in its 14 year long history and posted 811.98 points.

On the second day of the trading, NEPSE index registered 828.77 points and it witnessed an investment of 12.12 points on the third day as the index posted 833.56 points. However, the NEPSE index could not continue its growth throughout the week as it posted 821.44 points on the fourth day. Finally the NEPSE index closed only 1.79 points higher on the last day of the trading from Sunday's closing, as one of the current market driver hydropower group registered a loss of 43.62 points.

Buyers were continuous on the unnatural growth of share prices of the institutions that have negative net worth and PE ratio. Unnatural growth also forced NEPSE to issue precautionary notice to the investors. (The Himalayan Times, 16 September,2007)

After continued rises, the stock market felt by 12.13 points over the week, as investors were skeptical over the sustainability of overhead market. NEPSE opened at 718.09 points and closed at 705.96 points. The commercial banks group, which drives the market, saw a sharp fall. Its index fell to 782.55 points, down from 801.53 points. Market analysts termed the fall as the market correction. The shares prices were rising unjustifiably in the past, and they were bounded to retreat. They said that the market had rising significantly over the months and the market correction would simply return the price to the previous level. (The Kathmandu Post, 19 August; 2007)

India share claimed Thursday tracking regional markets and helped by gains in banking and automobile shares. The Bombay Stock Exchange's 30 share sensex index moved up 170 points, or 1.1 percent to close at 15616 points on the broader National Stock Exchange, the 50-company S$P Nifty index moved up

42 points, or 1 percent, to end at 4518 points. (The Kathmandu Post, 7 September; 2007)

The trend that market analysts have termed as a "mad growth" continued as the share price kept soaring this week with the NEPSE reporting a growth of 40.29 point over the week. The NEPSE opened at 756.05 points and closed at 796.34. Market analysts said investors are locking in money, envying profits made by others, instead of analyzing any fundamentals. There is no change in the corporate and economy scenario to push the price up like this, but the price are moving up. This trend shows that the market will see a downturn sooner or later, they added. (The Kathmandu Post, 9 September ;2007)

The overheated stock marker showed signs of cooling down growing by just 1.79 point this week with the market secondary a steep fall towards the end of the week. The market had grown 40.29 points in the previous week.

Market analysis said as the market has raising too much, it was now starting to correct. The share prices had been raising even though there wasn't any favorable development. The commercial banks group, the leading sector, posted a rise of 3.82 points. In the previous week it had soared by 38.53 points. Its index finished off at 910.37 points this week, from 906.55. (The Kathmandu Post, 16 September; 2007)

Nepali equities market this week bounced back after a long spell of bearish trend as NEPSE recorded a growth of 34.87 points to 771.33 points from last week's closing of 736.46 points.
The sensitive index posted 9.98 points growth to 203.48 points from Sunday' closing of 193.50 points. The secondary market ended in the green zone on four of the five-day trading, loosing only one day on Thursday by 5.64 points to close at 771.33 points from Wednesday's closing of 776.97 points. On Sunday, NEPSE surged by 3.72 points to 740.18 points from last week's closing of 736.46 points. Similarly, on Monday it posted a growth of 8.74 points to 748.92 points. On Tuesday, it recorded a growth of 19.01 points to 767.93 points. However, it slowed down on Wednesday and posted only 9.04 points to 776.97 points. On Thursday the last day of the weekly trading, it plunged by 5.64 points to close at 771.33 points.
In terms of monetary value Nepal Bangladesh Bank (with Rs 77.48 million), Bank of Kathmandu (with Rs48.40 million), Standard Chartered Bank, Nepal (with Rs43.97 million), Birgunj Finance (with Rs34.40 million) and Chilime Hydropower (with Rs 27.97 million) are this week's toppers.

Nepal Bangladesh Bank also topped the chart in terms of numbers of share units traded with 1,27,000- units of its shares being traded this week. ICFC Finance Co. topped the chart in terms of number transaction with 900 transactions.

Finance company and hotel groups ended in the negative territory. Hotel group lost 2.47 points to 400.47 points from last week's closing of 402.83 points. The finance company group closed at 938.27 points on Thursday from Sunday's closing. Commercial bank group registered 41.31 points growth to 777.49 from Sunday's closing. Similarly, development bank group also posted a healthy growth of 101.20 points to 1037.59 points from the Sunday's closing. Insurance and hydropower groups have also posted 16.06 points (to 749.60 points from last week's closing of 733.54 points) and 11.02 points (to 1046.05 points from last week's closing of 1035.03 points), respectively.

NEPSE barred share trading of eight financial institutions this week until further notice as they have announced merger but do not yet have letter of Intent from the central bank.(The Himalayan Times, 10 May 2008)

As the fiscal year is going to end, the secondary market is flooding with rights shares pushing the NEPSE up. This week, NEPSE posted a growth of 41.34 points to 812.67 points on the last day of the trading from last week's closing of 771.33 points.

Financial institutions, the dominant players at the secondary market, have to increase their paid up capital according to the capital plan they have already submitted to the central bank. Right share-worth billions-of more than 90 per cent of the financial institution are in pipeline fuelling the capital market, apart from the fiscal year-end syndrome that gives the boost to NEPSE.

The secondary market ended in the green zone on four of the five-day trading, loosing only on the last day. The sensitive index –an index of the A-class companies-also posted 9.90 points growth to 213.38 points from last week's closing of 203.48 paints.

On Sunday, NEPSE surged by 2.21 points to 773.54 points from last week's closing of 771.33 points. Similarly, on Monday it posted a growth of 11.81 points to 785.35 points. On Tuesday, it recorded a growth of 20.91 points to 806.26 points. On Wednesday, NEPSE flared to 825.61 points, a rise of 19.35 points from Tuesday's closing. However, it plunged by 12.94 points to close the weekly trading at 812.67 points.

In terms of monetary value, Ace Development Bank (with Rs120.21 million), Bank of Kathmandu (with Rs56.97 million), Nepal Bangladesh Bank (with Rs 36.53 million), Standard Chartered Bank, Nepal (with Rs29.32 million), and ICFC Finance Companu (with Rs27.13 million) are this week's top performers.

Ace Development Bank also topped the chart in terms of numbers of share units traded with 1,96,000-unit of its shares being traded this week. ICFC Finance Company topped the chart in terms of number transaction with 826 transactions.

The better performance of commercial banks, development banks, hydropower, insurance and finance companies groups have pushed the NEPSE up. However, hotel group ended in the negative territory. It lost 6.44 points to 394.03 points from last week's closing of 400.47 points.

The finance company group closed at 1040.21, a rise of 101.94 points from last week's closing of 938.27 points. Similarly, commercial bank group posted 35.23 points growth to 812.72 points from last week's closing of 777.49 points while, development bank group flared by 76.16 points to 1113.75 points from last week's closing of 1037.59 points.

Insurance and hydropower groups have also posted 3.77 points (to 735.37 points from last week's closing of 749.60 points) and 112.39 points (to 1158.44 points from last week's closing of 1046.05 points) growth. (The Himalayan Times, 17 May)

NEPSE ended in the green zone this week, too-despite only three-day session in five-day session in a normal week-as it posted to 833.18 points from the last week's closing of 817.64 points.

This week, unlike last week, saw trading on Sunday, Monday and Tuesday due to public holiday on Wednesday and Thursday.

The sensitive index-an index of the A-class companies-closed at 217.57 points whereas banking index closed at 834.76 points.

Similarly, hotels, development banks, hydro, finance and insurance groups closed at 401.93 points, 996.37 points, 1161.64 points, 1103.4 points and 769.25 points, respectively.

On Sunday, the first day of the trading, the NEPSE surged by 14.50 points or 1.77 percent to 832.14 points.

However, on Monday, it plunged by 8.46 points or 1.02 percent to 823.68 points But on Tuesday, the last day of trading for this week. NEPSE bounced back by 9.5 points or 1.15 percent to close the weekly trading at 833.18 points.

The sole secondary market, NEPSE has been witnessing a continuously growth in the last couple of months on March 27, the NEPSE was at 716.37 points, but it closed at 729.01 points one month later on April 27.

Similarly, it closed at 833.18 on May 27 boosting the investor's confidence.

2.4   REVIEW FROM NEPALESE PREVIOUS THESIS STUDIES

It is found that numerous studies have been concluded pertaining to the stock market or stock prices behavior. In Nepali context, there are few studies on the stock market prices. Some of them have been reviewed here in brief.

Pradhan (1992) concluded his study by collecting the data of 17enterprises from 1956 to1990. the objective of his duty were to asses the stock market behavior in Nepal, to examine the relationship of market equity, market value to book value, price earning and dividend with liquidity, profitability, and leverage assets turnover and interest coverage. The major findings of his study were: the higher the earning of the stocks, the larger the ration of dividend per share to market price per share, stocks with larger ration to DPS to MPS have lower leverage rations, positive relationship existed between dividend payout and liquidity; positive relationship between dividend payout and interest coverage and DPS and MPPS are positively correlated.

Aryal (1995) has studied behavior of stock market prices with objective to discuss the movements of stock market prices and to develop the empirical probability distribution of successive price change of an individual common stock market as a whole. This study was based on secondary information obtained from Nepal Stock Exchange. This study covers almost 8 months period and the sample was 21 listed stocks. He applied serial correlation and runs test as statistical tools to analyze the data. The dependence nature of price series produces by general market fluctuation statistically implied; today's change is positively depending upon yesterday's price changes. This implied that there is a sufficient lack of financial and market analysis that are sophisticated and superior in analyzing the general market fluctuations, predicting the occurrence of future potential and economic events that their eventual effects on price series.

Shrestha (1999) has conducted research on stock price behavior in Nepal with the objective to examine the efficiency of stock market of Nepal, to examine the serial correlation successive daily price change of the individual stocks, to determine whether the sequence of price changes are consistent with changes of the series of random number expected under the independent Bernoulli process, to determine the efficiency of the stock market through the theoretical model of Efficient Market Hypothesis in the stock market. The finding of the study are when the log days increase, the mean value of serial correlation of coefficient is lower, that indicates that the past price changes may have low price to predict the future price changes in the long run. There exist no profitable trading rules to make greater profit that they would make under the native buy and hold strategy in their speculation through the information of past price changes and Nepal Stock Market is not efficient in pricing shares.

Paudel (2001) has undertaken his study on the share price movements of the joint venture commercial bank in Nepal by using financial and statistical tools

(standard deviation, correlation, beta, t-test etc). The major objectives of the study are to examine Nepal Stock Exchange and to judge whether the market shares of different banking indicators (book value per share and major financial ratio) explain the share price movements, analyze the scenario why the shares of selected banks emerge as blue chips to the potential investors and to make a conclusion on the basis of financial rations analysis. The findings of his studies were market price moves randomly, the market value per share does not accommodate all the available historical information. The beta coefficient, which measures the riskiness of individual security in relative term, suggests that the stocks of joint venture commercial banks are less risky as compared to other average stocks traded in the stock exchange.

Mainali (2003) undertook his study on the share price behavior of listed commercial banks with the major objectives as: to analyze the share price behavior of the commercial banks listed with NEPSE and to examine the risk involved in the common stock investment of the sampled commercial banks. His findings were that the past and present price changes can screen out some valuable information in forecasting future price changes and there exist a significant differences in the actual and expected numbers of runs for the series of daily closing price changes of the sampled commercial banks and today's price change is dependent upon the information of yesterday's price changes.

Paudel (2003) conducted his study on stock price movement of joint venture commercial banks with the use of financial and statistical tools. The major objectives of his studies were: to examine the movements of stock price in relation to Nepal joint venture commercial banks are either dependent or independent to historical prices of the stock to evaluate the risk and return proportion of investment on stock. The major findings of the study revealed that Nepalese Stock Market is not efficient but it builds hard to categories into the forms of Efficient Market Hypothesis and stock of the sampled banks were under priced and thus are suggested to buy and hold stocks of joint venture commercial banks.

Paudel (2005) examined monthly closing price of 6 listed commercial banks during the period of three consecutive years from 2002 to 2004 by means of correlation coefficient, Regression analysis, Run test and Autocorrelation. He found in his study that successive price changes were correlated with previous price series. He also found that most of the stocks did not follow random walk hypothesis. The present stock price was dependent to the historical prices. The EPS was the most affecting factor for the piece change of the stock. Most of the investors wanted to invest in the shares of commercial banks because the fluctuation in NEPSE index was due to the transaction of commercial bank's

shares. There was serious limitation in the study. Data use in this study, monthly closing price of stocks not enough to predict the behavior of shares.

Subedi (2005) conducted his study on stock price behavior in Nepal with the use of financial and statistical tools. He used Standard Deviation, simple regression, multiple regression, coefficient of determination, T-test, Z-test. The major objectives of his studies were:

- ➢ To evaluate the effect of earning to the stock price in stock market.

- ➢ To evaluate the book value to the stock price in stock market

- ➢ To evaluate the dividend to the stock price in stock market

- ➢ To assess the effect and efficient qualitative factors in the opinion of the employees of A grade companies listed in NEPSE during fiscal year 2060/61 that play major role of common stock pricing in NEPSE.

The major findings of his study are as follow:

- ➢ Nepalese investors have not adequate education about the capital market. They do not have good knowledge and to analyze the scenario and to forecast share price. Perhaps due to this reason, stock prices in NEPSE show rather irrational behavior.

- ➢ In NEPSE, DPS, BPS, and EPS individually do not have consistent relationship with the market price of share, among the listed companies. The pricing behavior varies from one company to another. But EPS, BPS and DPS, jointly, have significant effect in market price of shares. So, there may be other major factors affecting the share price significantly.

- ➢ Commercial Banking sector has dominated the overall performance of NEPSE. Manufacturing and processing, trading and hotel sector have week performance. So financial intermediaries are strong but their ultimate investment is suffering.

- ➢ There is deficiency of proper laws and policies regarding the capital market. Shareholders are feeling unsecured to invest in security markets due to poor regulatory mechanism to protect shareholders interest.

- ➢ Listed companies do not provide sufficient to their shareholders and they are not able to act according to the shareholders desire. The performance of most of the listed companies is not transparent.

- Since NEPSE is in an increasing trend, in spite of unfavorable environment for investment, Nepalese citizens have a huge amount of scattered fund remained idle, which cab be used in the industrial development through capital market to accelerate the economic growth of the nation.

Kasaju (2006) carried out the study on performance analysis of top 5 commercial banks in Nepal. The main objective of the study was to analyze the comparative financial status of top five commercial bank of Nepal i.e., Standard Chartered Bank Nepal Ltd., Himalayan Bank Ltd, Everest Bank Ltd., Nepal Investment Bank Ltd. He used arithmetic mean, standard deviation, co-efficient of variation and F-test as statistical tools for the study. He drew the conclusion about five commercial bank's performance indicator from the utilization of deposit, EPS, cash dividend, capital adequacy ratio. He concluded only the financial performance of selected five commercial banks.

Shrestha (2062) studied of the financial performance of Nepal Bank Ltd and Rastriya Banijya Bank. Primary objective of his study was to analyze and to evaluate the financial performance of Nepal Bank Ltd and Rastriya Banijya Bank and others are to analyze the financial performance indicators, to evaluate the financial performance of each bank. He used trend analysis, Karl Pearson's correlation co-efficient as statistical tools. He concluded that EPS is negative in F/Y 2000/01 to F/Y 2002/03 in both the banks. The new management team has improved the financial performance such as the EPS is positive and increased in F/Y 2003/04 to F/Y2004/05 in both the banks. The interest income to loan and advances is 10.17% and 5.48% in F/Y 2003/04 and 2004/05 in Nepal Bank Ltd. The interest income to loan and advances is 7.92% and 7.78% in F/Y 2003/04 and 2004/05 in RBB. The staff expenses to total operating expenses are decreased in 2003/04 than 2004/05 in both the banks. Interest expenses to total deposit and borrowing are decreased in F/Y 2003/04 than 2004/05 in both banks. Exchange change gain to total income is also decreased in F/Y 2003/04 than 2004/05 in both banks. The net profit to loan and advances has increased in F/Y 2004/05 of both banks than previous year. He also concludes only the performance of the bank after the management of both banks has been handed over the external management.

Shrestha (2006) has carried out the study on the daily stock price behavior of commercial bank of Nepal. The information of seven commercial banks for the period of 16 July 2005 to 16 July 2006 are used. He has tested mean, standard deviation and coefficient of variation. His study concluded that most of the sampled stocks exhibit large variation in their price. They are not doing well.

Commercial sector is more sensitive than the NEPSE index. Nepalese stock market is inefficient in pricing shares.

Thapa (2006) carried out the study on behavior of Nepal Stock Exchange index. The statistical tools used in this study are percentage, line charts, bar diagram and standard deviation. Standard deviation has been used to analyze the volatility of the behavior of NEPES index. The specific objectives of the study are as follow:

➢ To analyze the trend of annual turnover of NEPSE.

➢ To analyze the listed companies during fiscal year 2000 to 2005.

➢ To analyze the trend in market capitalization.

➢ To analyze the behavior of NEPSE index.

Conclusion of his study are as; Commercial banks total amount turnover stood at 89.1 percent by the end of Fiscal Year 2004/05 with those shares accounting for 67.25 percent of the total current capitalization during fiscal year. These indicators reveal that the shares of commercial banks have a dominant role in determining the key indicators of the Nepalese stock exchange. It is thus unsurprising that commercial banks have continued to appear as the most attractive investment alternatives since the opening of the floor.

2.5   CONCLUSION FROM REVIEW OF LITERATURE

On the basis of the review from previous studies may by concluded that the stock market prices shown a random movement and the security prices appear to be serially independent. So, the investors cannot develop any profitable trading strategy using the information of past series. Chartist claim that the statistical tests do not prove practically that more complex strategies can not be formulated through the past price data to earn an abnormal rate of return. Similarly, some advocates of technical analysis contended that these tests were too narrow an unsophisticated to pick up the complicated patterns in stock prices.

On the basis of review done from the Nepalese thesis studies we can say that only few research works are done in the field of share market behavior, specially of commercial bank. However are done, they conclude that today's change is positively depending upon yesterday's price change. Past price change may have

low price to predict the future price. The market value per share does not accommodate all the available historical information.

2.6 RESEARCH GAP

Although some very valuable researches in the field of stock market have been done so far, there is still a great deal of opportunity remained for the researchers in this area to explore and identify new facts and figures about the immature stock market of Nepal. Till the date, this fellow has found following outputs in this field explored by the researches viz. stock market behavior after dividend declaration, legal requirements and their effectiveness in developing stock market of Nepal, Earnings and dividend co-relation in Nepalese firms, Impact of signaling effects on stock prices of Nepalese listed firms.

But consulting various literature, what I found, there are still many things to be done in the field of investor's interest. Researches are still unaware about the type of stock market prevails in Nepal, the co-relation between the financial performances indicators and stock prices and the appropriateness of decisions made on such indicators and etc. also currently, NEPSE index is increasing rapidly day by day. One week before it was 949.52 but this week on July 19 2008, it has reached to 991.52. So NEPSE set to cross 1000 point mark. In such a condition research had not done recently on this topic. I found on research work very close to research I have done which has covered only profitability aspect of the co-relation study. It is different from other research that, I have sued correlation coefficient analysis and run test as a took for new commercial banks also. Because of that I thought of conducting research work on the similar topic but with an intensive coverage both in terms of number of banks and time.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 RESEARCH DESIGN

This research has attempted two core aspects of the market price determination of common stock. Firstly, correlation between the financial performances and common stock price has been tested market index of commercial bank has been tested: either it is randomly or not, Secondly, non-financial factors which are known as signaling effects have been identified. Therefore, this study includes both statistical study as well as exploratory study to identify the exact scenario of the stock market. Correlation study is done in case of the quantitative analysis where quantitative data are sufficiently available. This is done identify whether there is a sufficient strong correlation between the variables under study prevail or not. Exploratory research is done to identify other factors affecting stock price which are beyond the financial performance, and could be the major factors to be considered while making decision regarding stock investment.

3.2 POPULATION AND SAMPLES

The population for this study comprises all the commercial banks listed to Nepal Stock Exchange to date. Till now, 15 commercial banks are listed to NEPSE. All commercial banks which have been regularly submitting the financial statements since last 5 years are taken for the study. In this way, this study covers all commercial banks, meeting the requirement of latest five years undisrupted submission of annual reports in SEBON, as the sample for the study and for the run test, three month (Baishakh 2064 to Ashadh) NEPSE index of commercial bank sector are taken as sample for the study.

3.3 DATA COLLECTION PROCEDURES

Primary and secondary, both, types of data are used in this research. All quantitative analysis and hypothesis testing are based on the financial statements of the selected commercial banks. Those financial statements were extracted from the website of NEPSE (nepalstock.com). Intensive and structures interviews were conducted with outstanding shareholders, potential investors, financial managers

of the banks, NEPSE authority, SEBO authority and market makers. Views and opinions of those stakeholders were collected through the interviews.

3.4 RESEARCH VARIABLES

A relationship between the independent variables (predictors) and dependent variables has been shown in this research work. Independent variables are financial performance and signaling effects. Financial performances for the purpose of the study have been defined in terms of ROA, ROE, EPS, DPS, Net worth, etc. Signaling effects represent the views, attitudes, opinions etc. of the stakeholders. Market value per share (MVPS) is the only one dependent variable for this study. Following is the brief description of the variables.

ROA (Return on Assets): Return of assets is the percentage of net profit after tax on total assets of the company. Net profit after is the profit to the company after deducting all expenses including non-operating expenses and taxes. Similarly, total assets are the total of assets side of the balance sheet which includes current assets, operating assets and fictitious assets. The purpose to calculate ROA is to identify how efficiently and effectively the assets of the company are utilized or exploited. The higher the ROA, the better it is considered to be because it is the representative return of all the stockholders of the company including creditors.
Symbolically, ROA=NPAT/TA*100
Where, ROA= Return on Assets
NPAT= Net Profit After tax
TA= Total Assets

ROE (Return on Equity): It is the rate of return earned by the equity shareholders of the company who are also the real owners. Since they are the ultimate stakeholders of the company, the success or failure of the company finally is measured in terms of their return. Even if the ROA of the company comes lower, ROE can be higher due to the high use of the debt capital because it leads to the leverage effect.
ROE = Earning available to equity shareholders/shareholder's equity* too

EPS (Earning Per Share): It is the rupees return earned by a share of the company. High amount of total profit does not mean a higher EPS all the times; rather it can be higher if the company has low total profit. If the two companies are having equally net profit after tax or earning after preferred dividend are met, the company which has less number of shares will have higher EPS because it is allocated over less number of shares.
EPS= Earning available to equity shareholders/No. of outstanding shares*100

DPS (Dividend Per Share): It is the cash dividend earned by one share of the company. Generally, there is the positive correlation between profitability and DPS of the company. Out of total profit earned, one portion is retained within the company for the growth, which is called retained earning and the rest is distributed among the shareholders, which is called dividend declared.
DPS= Total amount of dividend declared/No. of outstanding shares*100

BVPS (Book Value Per Share): It is the book value of assets per share after settling all liabilities and preferred stocks of the company. If the company retains hundred percent of its earning, it's BV will be increased equally by the amount of profit it earns. Therefore, to increase the book value, there must be retention of profit in the organization. It is also called net worth of the company.
BVPS= (Total net worth/No. of outstanding shares

Signaling Effects: Signaling effects are the changes in the market value per share of the company due to the effect other than the financial performance of the company. These are happened when positive or negative rumors regarding the future price of the shares are spread in the stock market. Generally, when some special events are occurred in an economy which could have significant impacts on the smooth running of the business operation, these effects are even becoming more vital.

3.5 ANALYSIS TOOLS:

The data are analyzed on the basis of different statistical, financial and accounting analytical tools. Statistical tools such as measures of central tendency (Mean, Mode), Correlation, Regression analysis are used to identify the average figures, degree of relationship and trend line study of variables under study respectively. Collected data are stratified, tabulated and analyzed in an appropriate and purposive way. Hypotheses are tested on the basis of Pearson's correlation coefficient and run test. Therefore; R, R2, Se, Regression co-efficient, t-statistic, and p-value have been calculated to accept or reject the null hypothesis. Besides these statistical models, other simple financial tools, such as ratio analysis have been applied. Signaling effects have been analyzed in a descriptive way.

To compute the value of R, R2, Se Regression coefficient (a and b), t-statistics and probability value, a computerized SPSS program model has been used, which output are presented in the annex for the detail study.

3.6 HYPOTHESIS:

To make the research more specific, following hypothesis have been set:

Hypothesis: 1
H0: There is no correlation between the profitability and stock prices.
H1: There is a significant correlation between the profitability and stock prices.

Hypothesis: 2
H0: There in no correlation between the dividends paid and stock prices.
H1: There is a significant correlation between the dividends paid and stock prices.

Hypothesis: 3
H0: There is no correlation between the Net Worth per Share (NWS) and stock prices.
H1: There is a significant correlation between Net Worth per Share (NWS) and stock prices.

Hypothesis: 4
H0: There is no correlation between the financial performance indicators and stock prices.
H1: There is a significant correlation between financial performance indicators and stock price.

Hypothesis: 5
H0: Market index of commercial bank sector is in random manner.
H1: Market index of commercial bank sector is not in random manner.

Various studies have been taken in the field of share price behavior. The significant of this study is to find out whether the financial performance indicators (DPS, EPS, ROE, ROA, Net worth) effect on the market price of commercial bank or not. For this study, signaling effect also to be taken for more specific of the study.

CHAPTER IV
PRESENTATION AND ANALYSIS OF DATA

This thesis was mainly undertaken with a purpose to study and examine the relationship between financial performances and stock pricing in Nepalese commercial banks' stock market. To fulfill this core objective, two kinds of information have been acquired. Firstly the financial position of selected commercial banks and market index of commercial bank sector and secondly, signaling effects covering the views and attitudes of outstanding shareholders, potential share holders, financial manger of the bank, market makers and regulators. Analysis has been classified in to four main parts to generalized the facts of the information.

1. ***Financial performances of selected commercial banks:***

Under this, profitability ratio and other financial indicators have been presented in tabular from by industry and also by individual firm and these key indicator have been explained. Firstly it is tried to compare the correlation of different financial indicators of a firm with the market price of the share of the same firm. In this way, five performance indicators of nine commercial banks are presented and their graphical and tubular presentation are also made. Tabular presentations are done to identify to figure to figure compression with the market price in the passage of time. Graphical presentations, which are done on the percentage growth basis, are done to understand of growth of industrial variables and the trend of MVPS and relative study between the independent variables (ROA, ROA, EPS, DPS, BVPS) and dependent variable (MPVS).

2. ***Statistical analysis And Hypothesis Testing.***

Under this sub-unit, statistical tools including correlation (R), Co-efficient of determination (R2), stander Error (PER), Regression coefficient (a & b), t-statistic and prob. Value (P) and run test have been applied to test the pre–stated hypothesis.

3. ***Experts of Interviews and Questionnaires.***

Under this , the view and opinion of different stakeholders have been presented in a descriptive way. These points are collected from two types data collection methods,

namely interview and questionnaires. Interviews are taken to experts of the same field so that more and more information regarding share market could be explored. It might not reflect sufficient information but due to the time limitation and the technically of the study, this had to be done . to cover the common investors opinion, questionnaires are distributed and collected, which in corporate both yes and NO questions and open-end opinions.

4. Signaling Effects (Non-financial factors affecting stock price)

This part deals with the factors affecting stock prices other than the financial performance. It is quite known that stock price determination is the out come of the interaction of the demand and supply of the stock of the company. On the other hand especially in the country where there is a high chance of information manipulation, demand is again the result of subjective judgment of the investors regarding present and future performance of the company. So I have tried to disclose the variable that are quite influencing in determining the price of the stocks in Nepalese stock market. It is tried to disclose the effect of singling effects from the interviews of experts and investors, questionnaires method from the investors regarding with investors awareness and their views for invest in stock market.

4.1 FINANCIAL PERFORMANCES OF SELECTED COMMERCIAL BANKS

TABLE- 4.1.1

Nabil Bank Ltd.

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	1.54	2.51	2.72	2.96	2.85
ROE	23.69	31.67	30.73	30.69	33.88
EPS	55.25	84.66	92.61	103.45	129.21
DPS	20	50	65	70	85
BVPS	233.18	267.3	301.37	337.16	381.36
MVPS	734.01	734.01	998.66	1502.98	2236.99

Source: Annul Report (2001-2005), SEBO Nepal

Graph 4.1.1 (I)
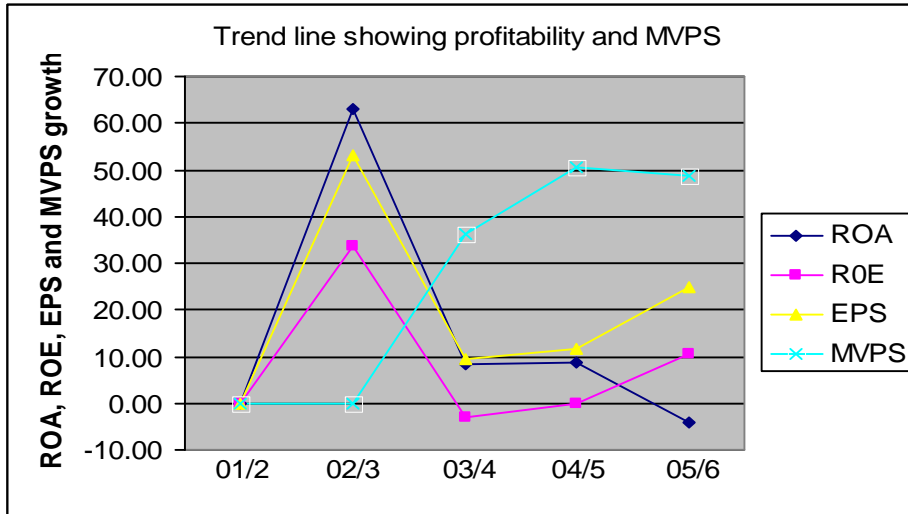
Graph 4.1.1(II)

Graph 4.1.1(III)

A trend line of BVPS & MVPS growth
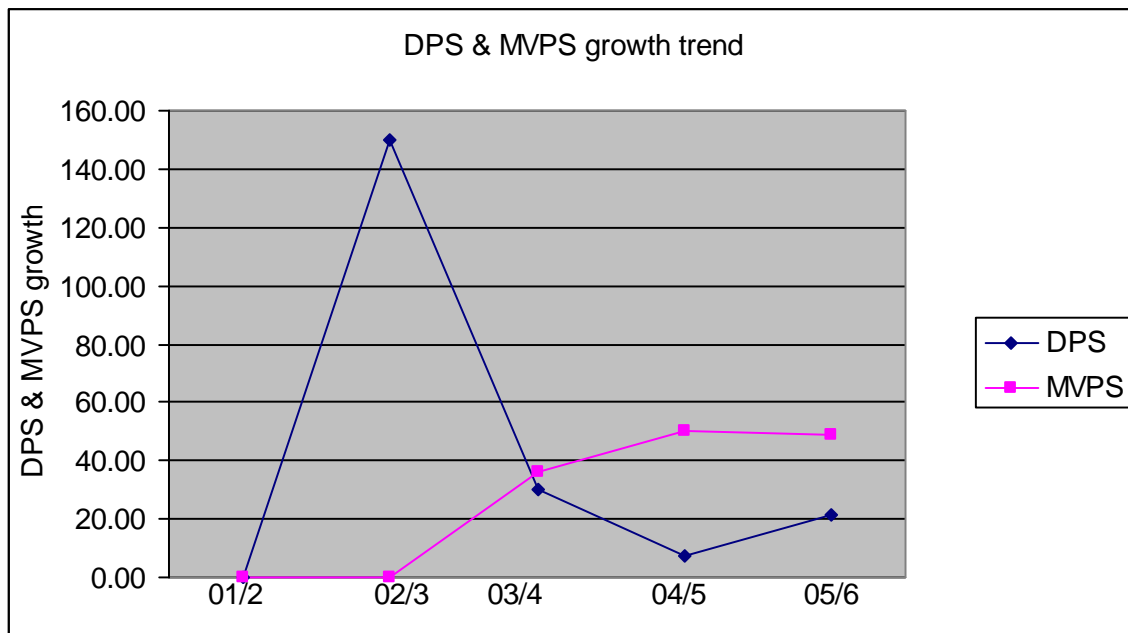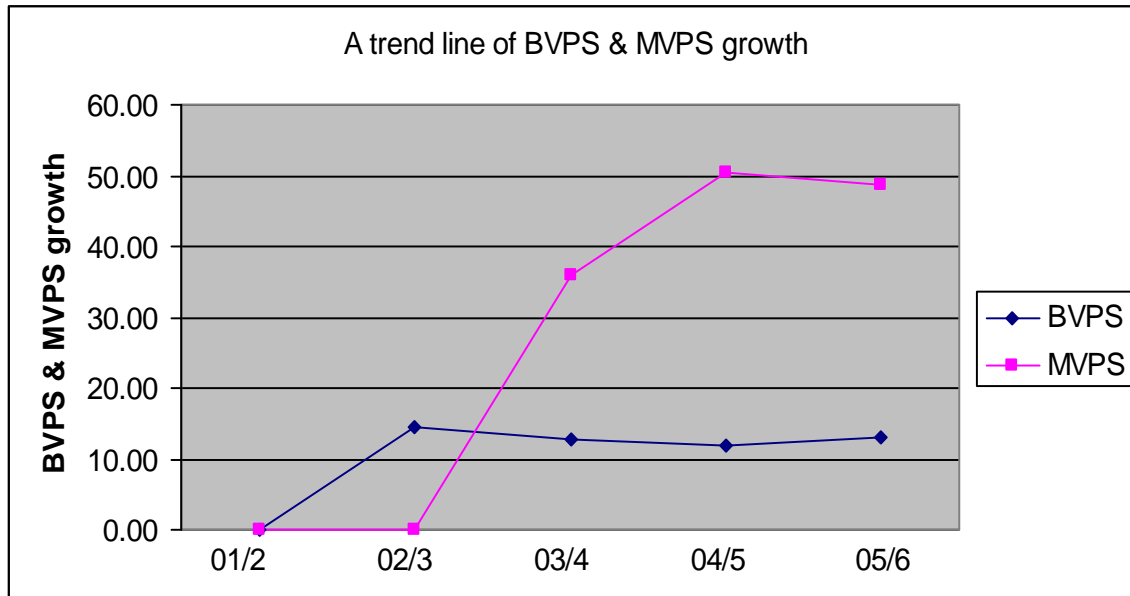
From the TABLE – 4.1.1*, we saw that, there is a strong correlation between profitability and MVPS. But there is not positive correlation of ROE in the year 2004/5, where ROE is decreasing but the MVPS growth rapidly.*

While looking at the GRAPHS-4.1.1(I, II & III)*, we can observe that there is a very strong correlation between the rate of growth of profitability and MVPS growth rate except in the year 2003/04. The growth rate of MVPS is negatively correlated with the growth of DPS but positively correlated with the BVPS.*

TABLE- 4.1.2

Nepal Investment Bank Ltd.

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	1.15	1.3	1.15	1.43	1.64
ROE	10.91	18.39	20.94	19.67	24.77
EPS	33.6	39.56	51.7	39.39	59.35
DPS	30	20	15	12.5	55
BVPS	307.94	216.23	246.88	199.83	239.67
MVPS	756.4	637.09	939.97	400	1260
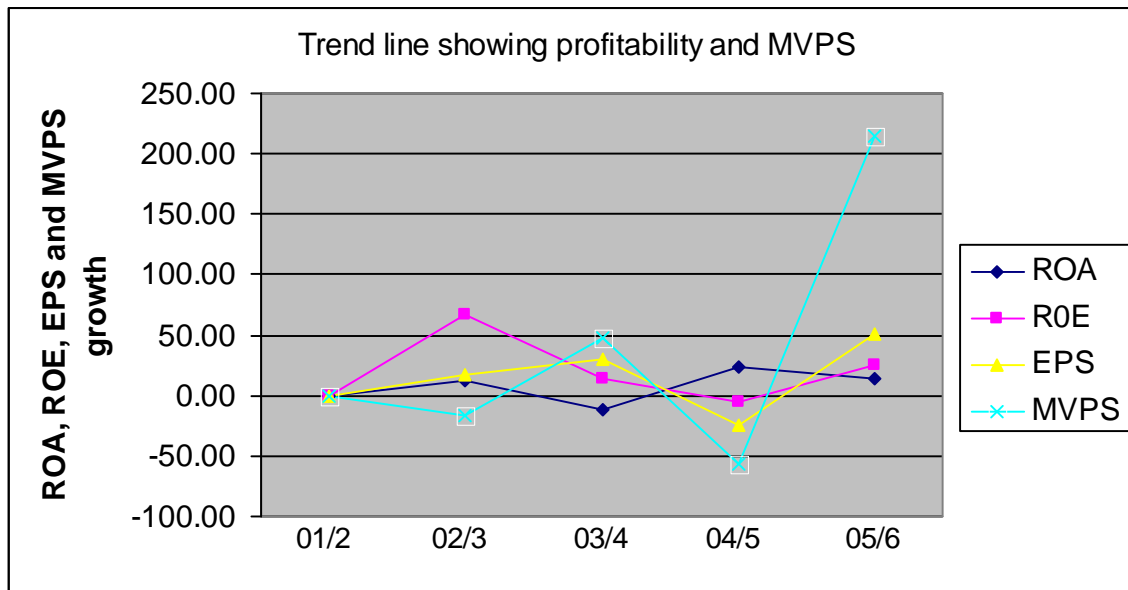
Graph 4.1.2 (I)

From the TAABLE-4.1.2, *we can observe that there is strong correlation between ROE and EPS with MVPS except in the year 2002/3 where as not in the case of ROA. Similarly, in* GRAPH-4.1.2(I), *we can observe that there is not strong relationship between Profitability and MVPS.*

Graph4.1.2(II)

DPS & MVPS growth trend

Graph 4.1.2(III)

A trend line of BVPS & MVPS growth
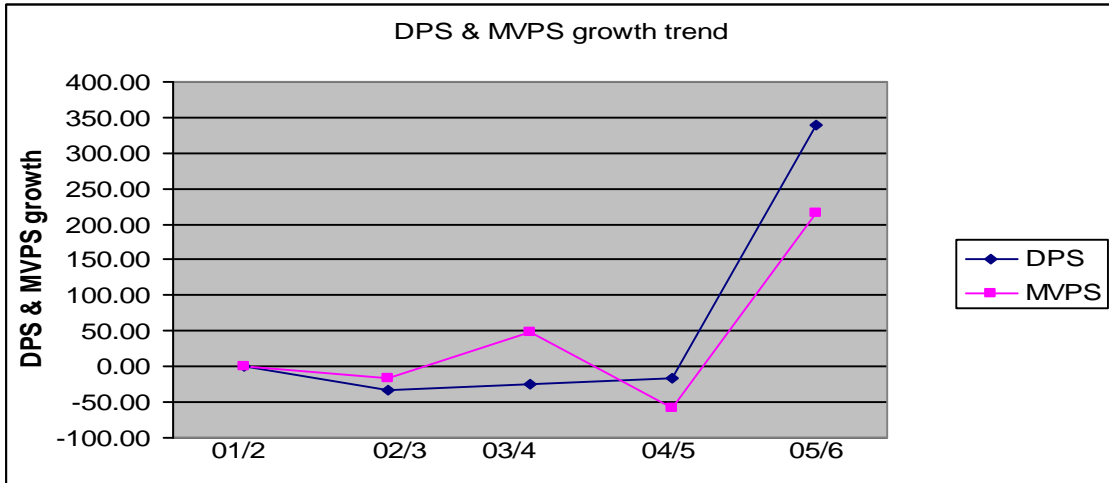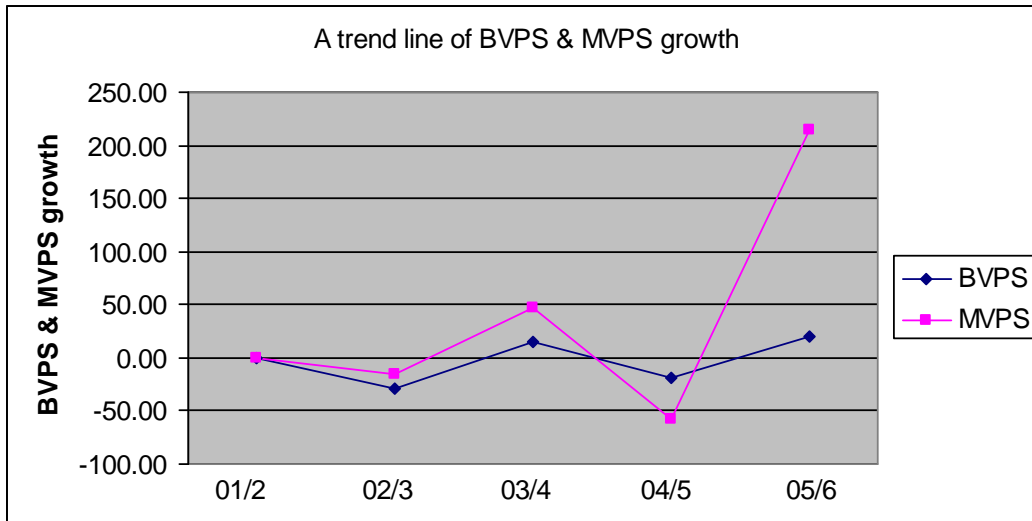
Observing the GRAPH-4.1.2(II &III), *we can see that there is strong positive correlation between DPS and MVPS except in the year 2004/5, where DPS is increasing order but MVPS is decreasing order. But BVPS is strongly correlated with MVPS.*

TABLE- 4.1.3

Standard Chartered Bank Nepal Ltd.

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	2.55	2.41	2.28	2.46	2.56
ROE	38.06	37.03	35.96	34.08	37.56
EPS	141.13	149.3	143.55	143.55	143.55
DPS	100	120	110	120	140
BVPS	363.86	403.16	399.24	422.37	468.22
MVPS	1550	1640	1745	2345	3775

GRAPH-4.1.3(I)

Trend line showing profitability and MVPS
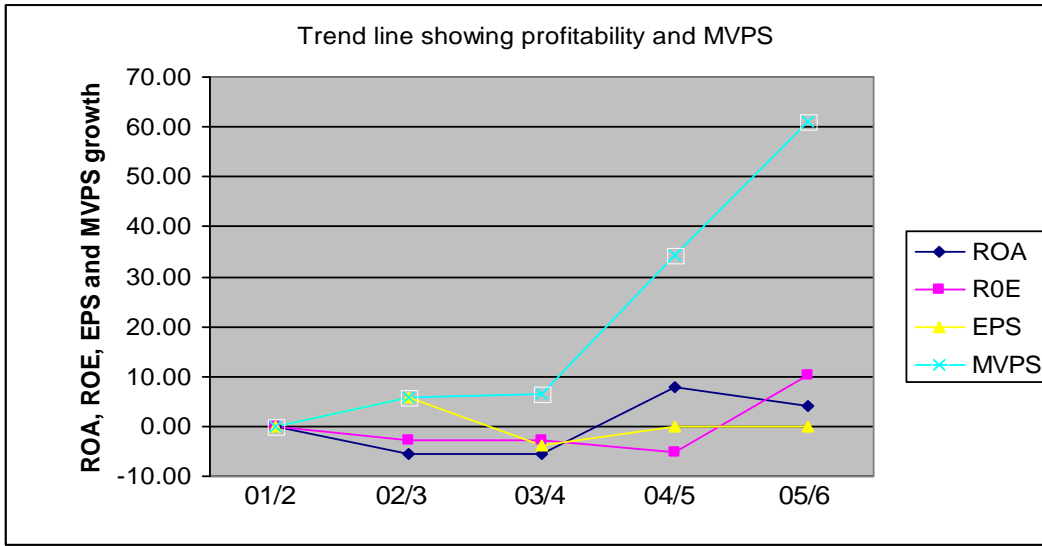
From the TABLE-4.1.3, we se that there is almost negative correlation between profitability ratios and and MVPS. In case of DPS, there is increasing trend of DPS except in the year 2003/04 but, controversy with the theory, MVPS is also in increasing trend. In CHART-4.1.3(I), MVPS is in increasing trend where as whatever bee in profitability ratio.

GRAPH-4.1.3(II)

DPS & MVPS growth trend

GRAPH-4.1.3(III)

A trend line of BVPS & MVPS growth
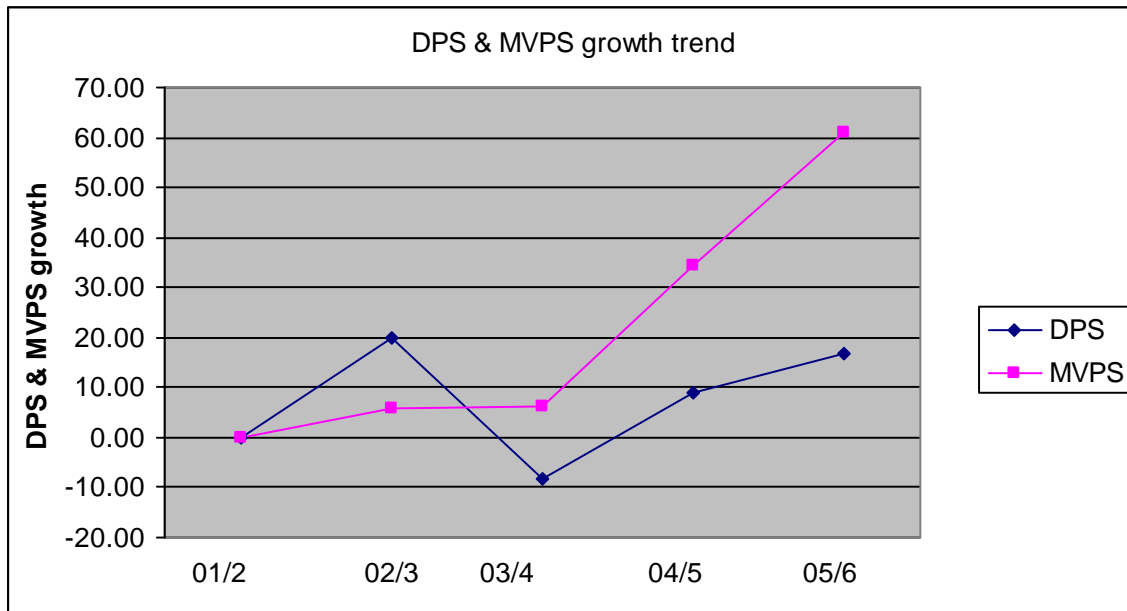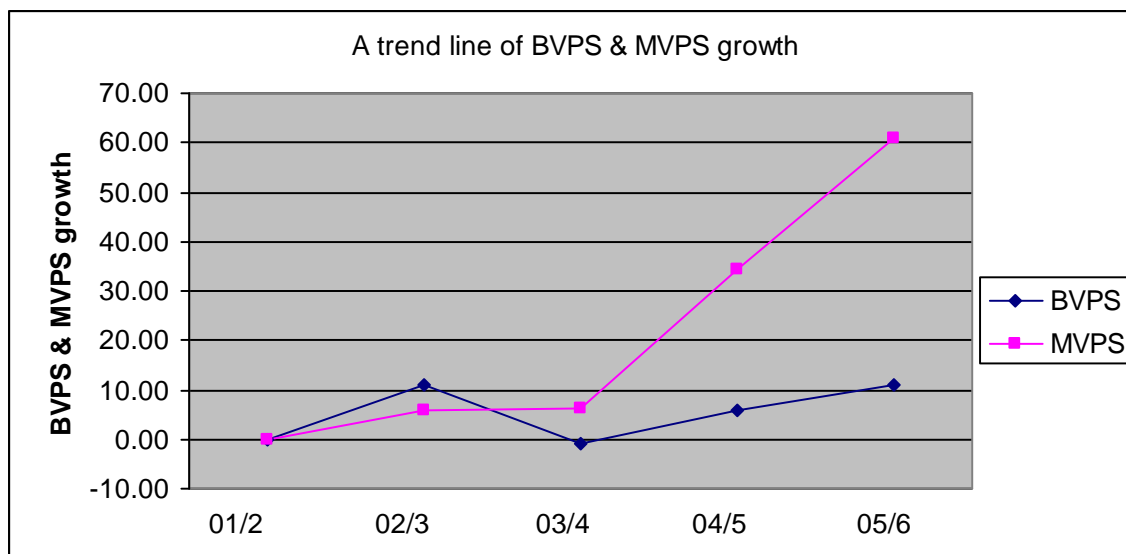
In CHART-4.1.3(II), *we can see that in the initial year, DPS is increasing more rapidly than MVPS but in the later, MVPS is increasing more rapidly than DPS. In aggregate, we can say that MVPS is perfectly positive correlated with DPS. Similarly, from the GRAPH-4.1.3(III), we see that, MVPS is perfectly correlated with BVPS.*

TABLE- 4.1.4

Himalayan Bank limited

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	1.14	.91	1.06	1.11	1.54
ROE	27.39	19.95	19.87	20	25.9
EPS	60.26	49.45	49.05	47.91	59.24
DPS	35	25	20	37	35
BVPS	220.03	247.82	246.93	239.59	228.72
MVPS	769.23	836	822.37	750.58	1100

Source: Annul Report (2001-2005), SEBO Nepal

GRAPH-4.1.4(I)

Trend line showing profitability and MVPS
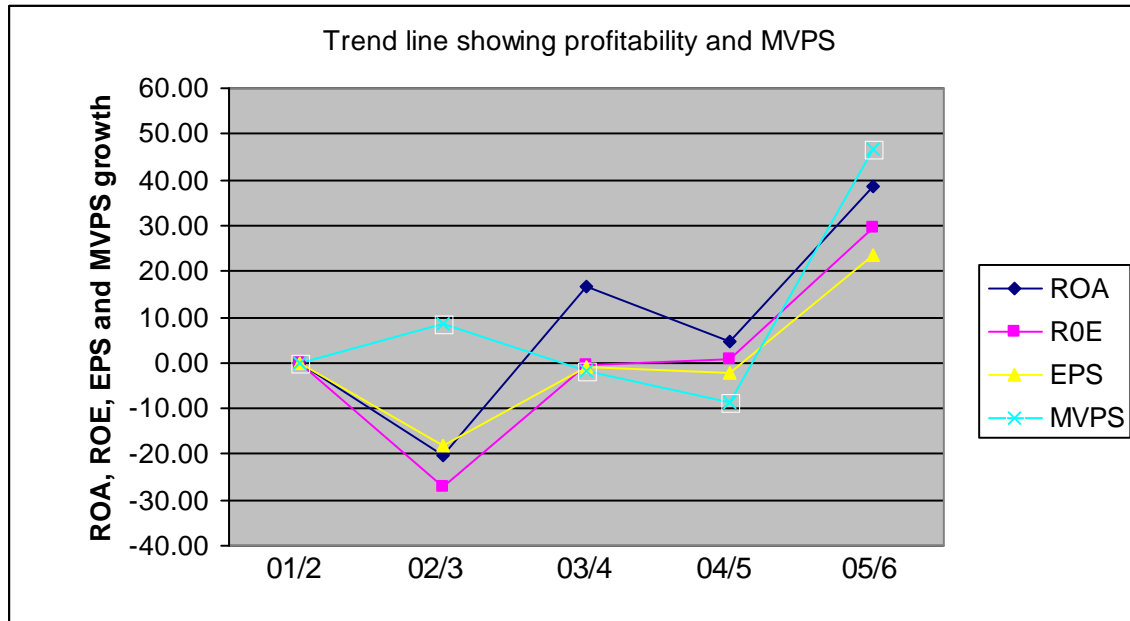
From the TABLE-4.1.4, *we can find out that, profitability ratios are decreasing in the year 2002/3, but even the MVPS is increasing. But in the later year MVPS is almost positively correlated with the profitability ratio. From the same table, we can conclude that MVPS is randomly moved with respect to DPS. But MVPS is perfectly positively correlated with BVPS except in the year 2005/06. Similarly from the* GRAPH-4.1.4(I), *we can say that MVPS is negative correlated with the profitability ratio in the first two year but later it is positively correlated with the profitability ratio.*

GRAPH-4.1.4(II)

A trend line titled "DPS & MVPS growth trend"

GRAPH-4.1.4(III)

A trend line titled "A trend line of BVPS & MVPS growth"
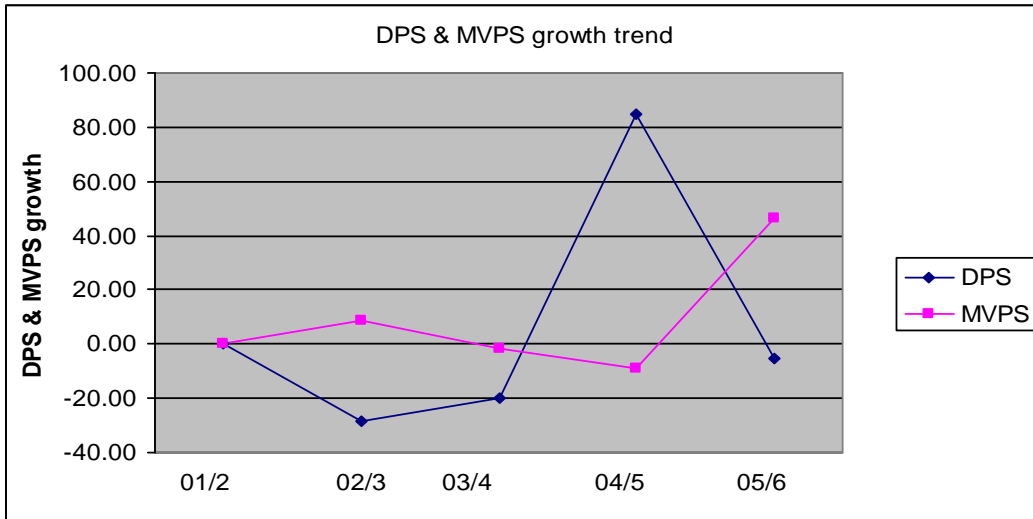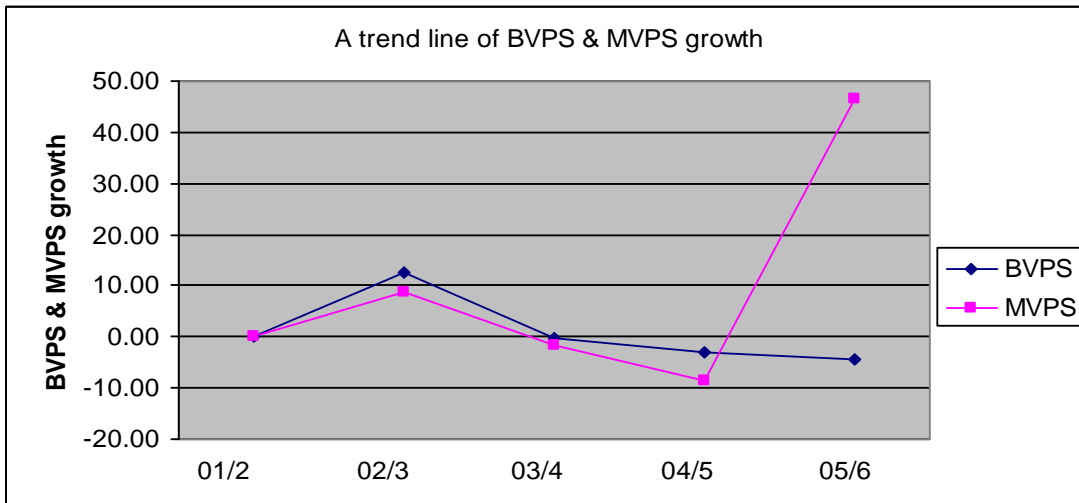
From the CHART-4.1.4(II & III), *we can observe that ,according to theory, DPS is negatively correlated with DPS, positively correlated with BVPS in the case of Himalayan Bank Limited.*

TABLE- 4.1.5

Nepal SBI Bank Limited

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	0.58	0.64	0.72	0.55	0.9

ROE	7.29	8.56	9.71	8.33	11.91
EPS	9.61	11.74	14.25	13.29	18.27
DPS	0	8	0	0	5
BVPS	131.88	134.05	146.8	159.54	153.44
MVPS	135.9	259.06	310.44	334.84	619.23

Source: Annul Report (2001-2005), SEBO Nepal

GRAPH-4.1.5(I)
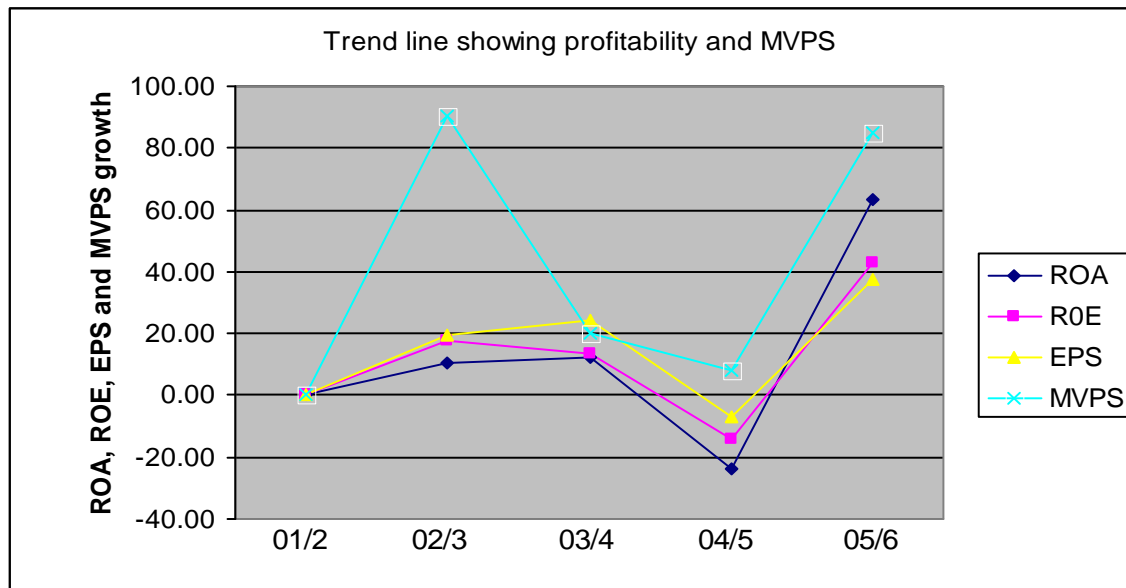
From the TABLE-4.1.5 *above, it has seen that there is positive correlation between profitability ratio and MVPS except in the year 2004/05, where all profitability ratios are decrease but the value of MVPS is increasing. Similarly, we can see that MVPS is positive correlated with BVPS except in the last year. In* GRAPH-4.1.5(I*), we can see that MVPS is positively correlated with the profitability ratio.*

GRAPH-4.1.5(II)

DPS & MVPS growth trend

GRAPH-4.1.5(III)

A trend line of BVPS & MVPS growth
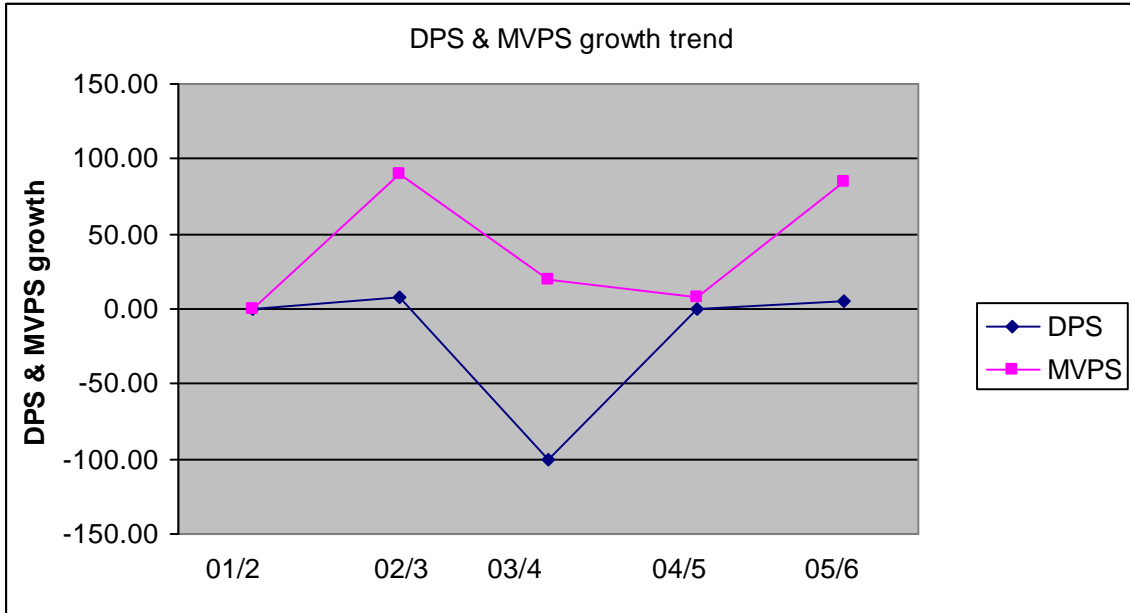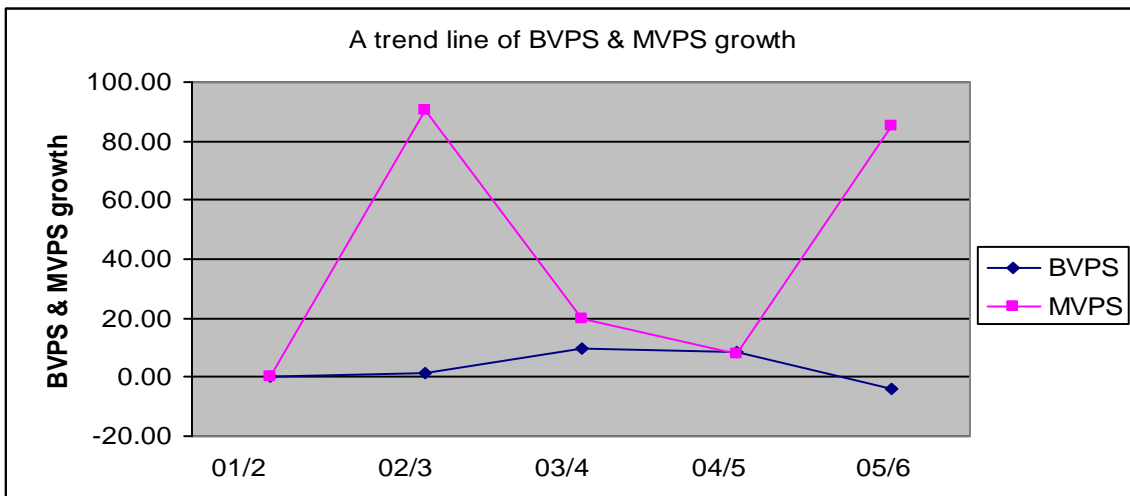
By observing the GRAPH-4.1.5(II & III), *we can say that MVPS is positively correlated with the DPS but increasing and decreasing trend of MVPS is stable than DPS and it cant be seen the relationship between BVPS and MVPS in the case of Nepal SBI Bank Limited.*

TABLE- 4.1.6

Everest Bank Limited

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	1.29	1.17	1.49	1.45	1.49
ROE	21.83	19.92	26.57	22.19	24.64
EPS	32.91	29.9	45.58	37.54	45.81
DPS	20	20	20	20	25
BVPS	150.74	150.1	171.53	169.15	185.87
MVPS	238.78	371.84	680	602.31	1006.3

Source: Annul Report (2001-2005), SEBO Nepal

GRAPH-4.1.6(I)
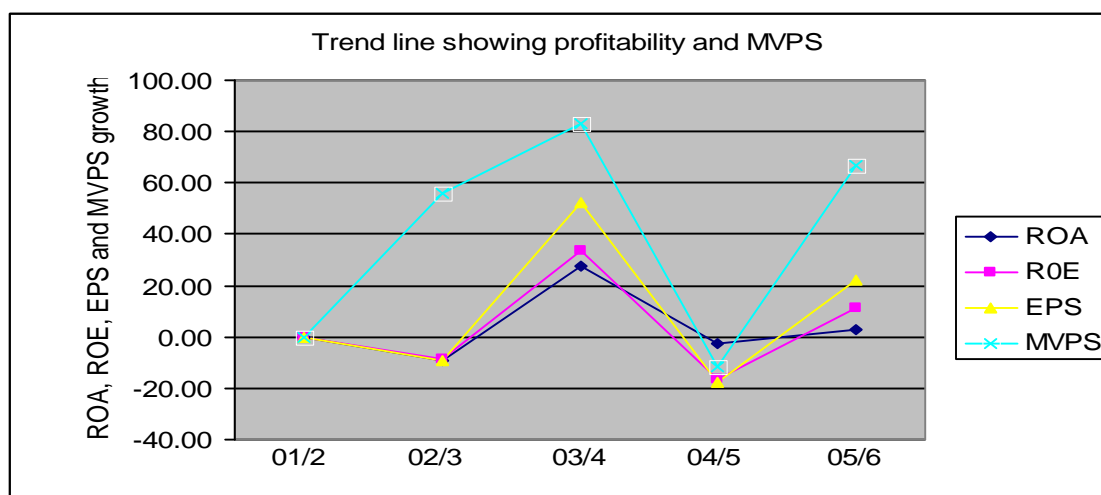
By observing the TABLE-4.1.6, *we can see that MVPS is positively correlated with profitability ratios expect in the year 2002/03, where profitability ratios are in decreasing trend but MVPS is in increasing trend. Similarly we can see in the table that also MVPS is more or less positive correlated with BVPS but we cant see the effect of DPS on MVPS. From the* GRAPG-4.1.6(I), *we can see that, there is positive correlation between profitability ratio and MVPS except in the year 2002/03.*

GRAPH-4.1.6(II)

DPS & MVPS growth trend

GRAPH-4.1.6(III)

A trend line of BVPS & MVPS growth
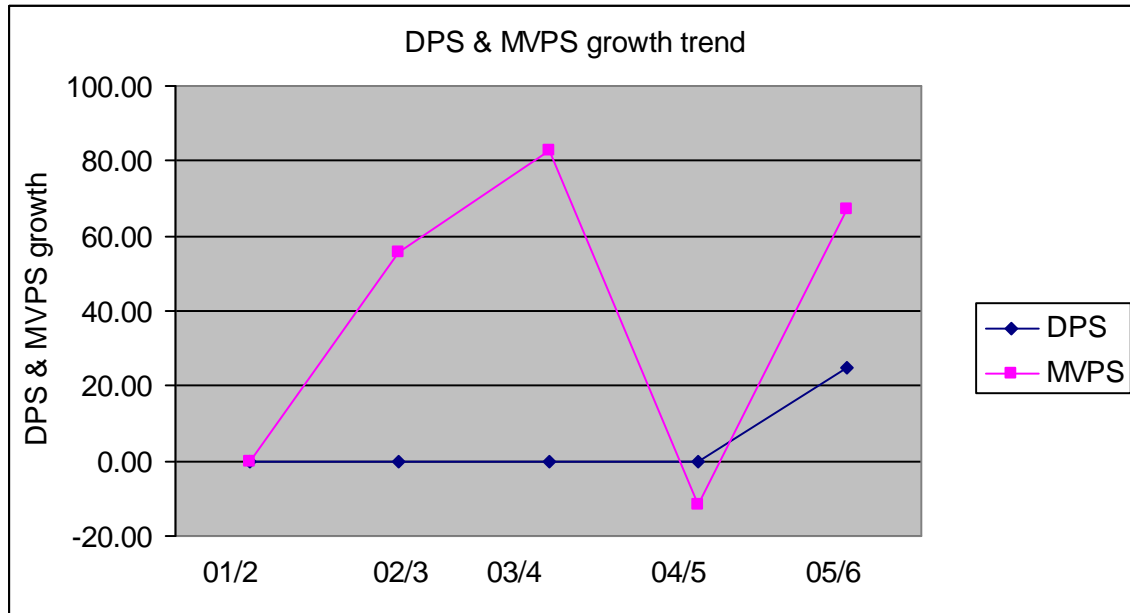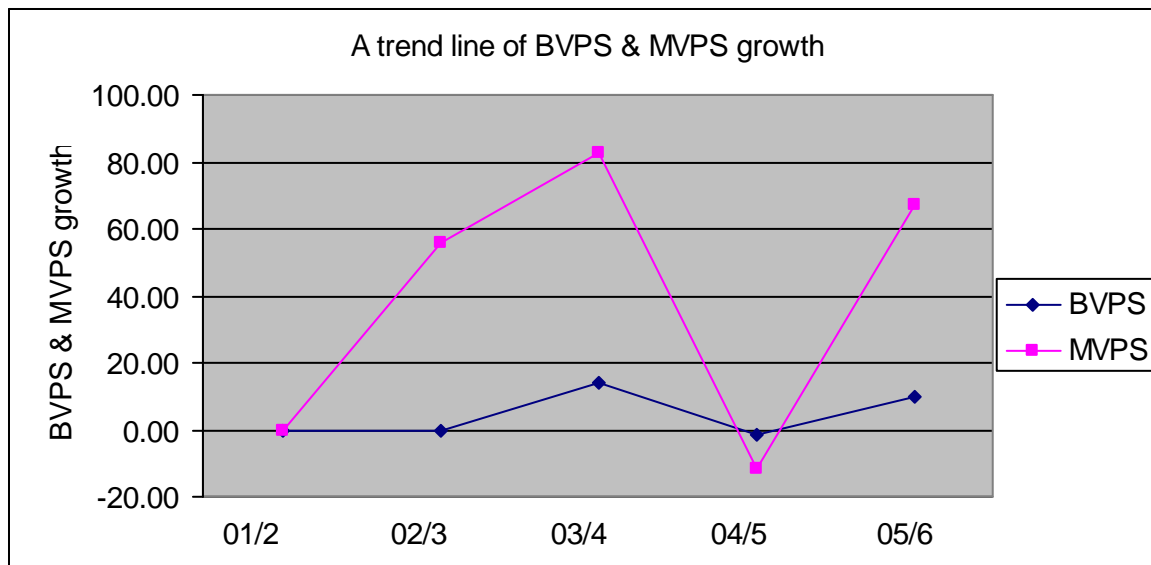
GRAPH-4.1.6(II) *shows that Everest Bank Limited hadn't give any dividend till the year 2004/05, but the MVPS is increasing till the year 2003/04 and there after it had fall rapidly for one year and then when it gives dividend to the shareholder, again its Market value growths.*GRAPH-4.1.6(III)*, MVPS and BVPS are positively correlated.*

TABLE- 4.1.7

Bank of Kathmandu Limited

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	0.13	1.10	1.34	1.32	1.65
ROE	1.59	14.18	19.52	18.11	31.65
EPS	2	17.72	27.4	30.1	43.67
DPS	10	5	10	15	48
BVPS	112.21	124.93	140.37	155.47	181.14
MVPS	128.21	198	295	430	850

Source: Annul Report (2001-2005), SEBO Nepal

GRAPH-4.1.7(I)
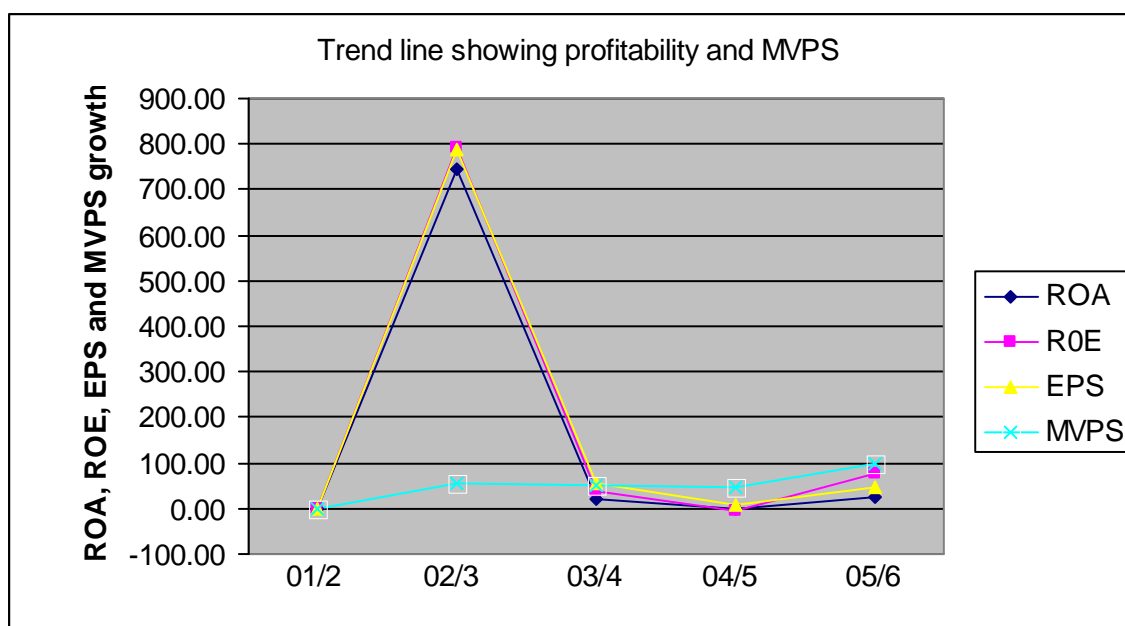
In the TABLE-4.1.7, *we can see that MVPS is increasing trend in all the year and EPS & BVPS also but ROA and ROE had decrease in the year 2004/05. In* GRAPH 4.1.7(I), *we can observe that, MVPS is increasing in slow way but the profitability ratios are not in that way.*

GRAPH-4.1.7(II)

DPS & MVPS growth trend

GRAPH-4.1.7(III)

A trend line of BVPS & MVPS growth
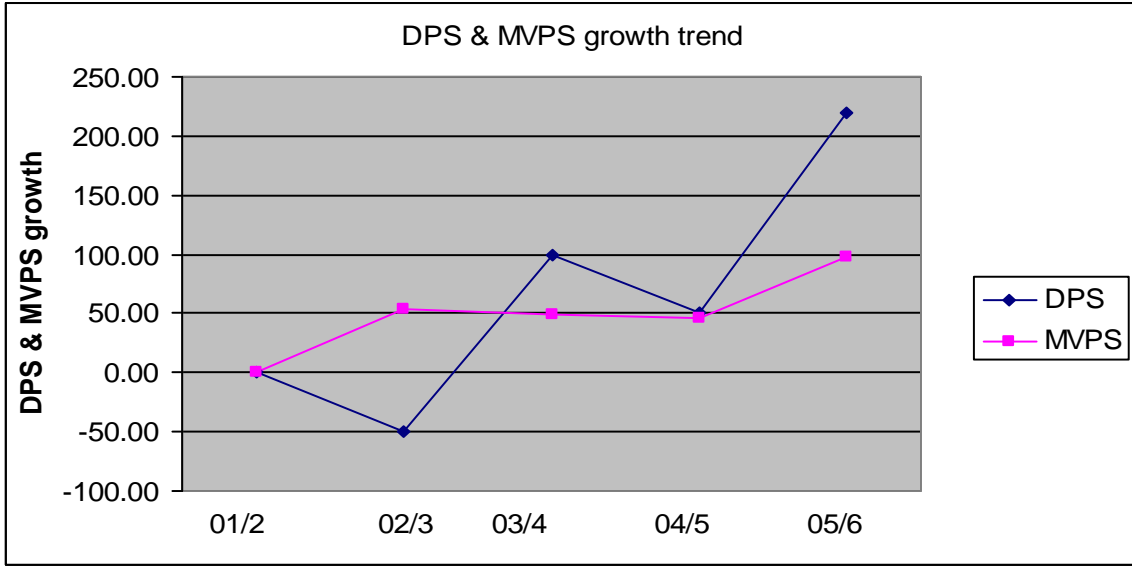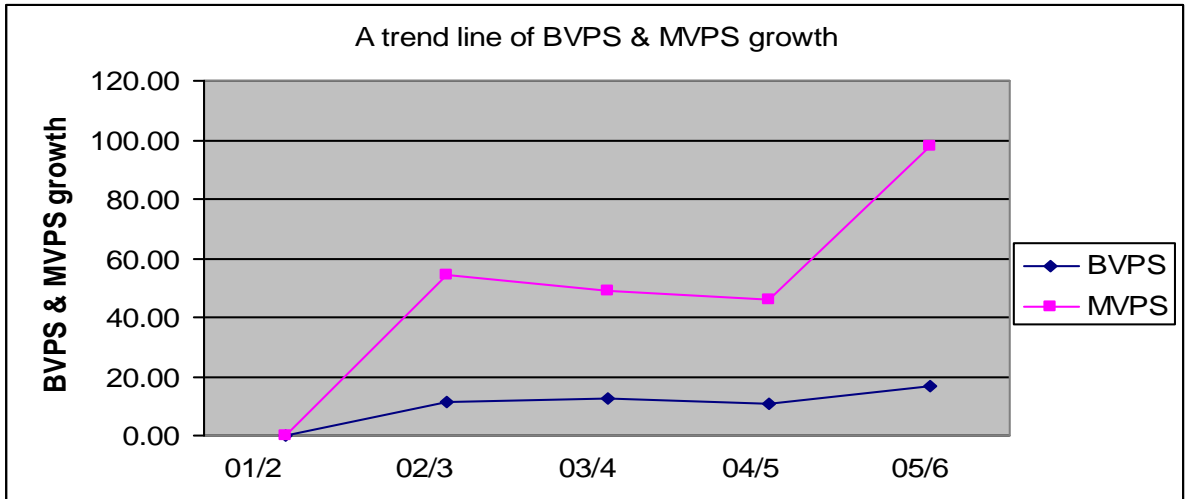
From the GRAPh-4.1.7(II & III*), we can say that there is no any relation in DPS and MVPS but in the case of MVPS and BVPS, they are positively correlated but the fluctuation of MVPS line is more than the BVPS line.*

TABLE- 4.1.8

Nepal Industrial and Commercial Bank Limited

Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	0.18	0.62	1.15	1.52	0.06

ROE	1.3	4.54	11	16.63	0.85
EPS	1.36	5.19	13.65	22.75	16.1
DPS	0	0	0	20	10
BVPS	105.19	110.42	124.08	136.84	127.74
MVPS	250	180	218	366	496

Source: Annul Report (2001-2005), SEBO Nepal

GRAPH-4.1.8(I)
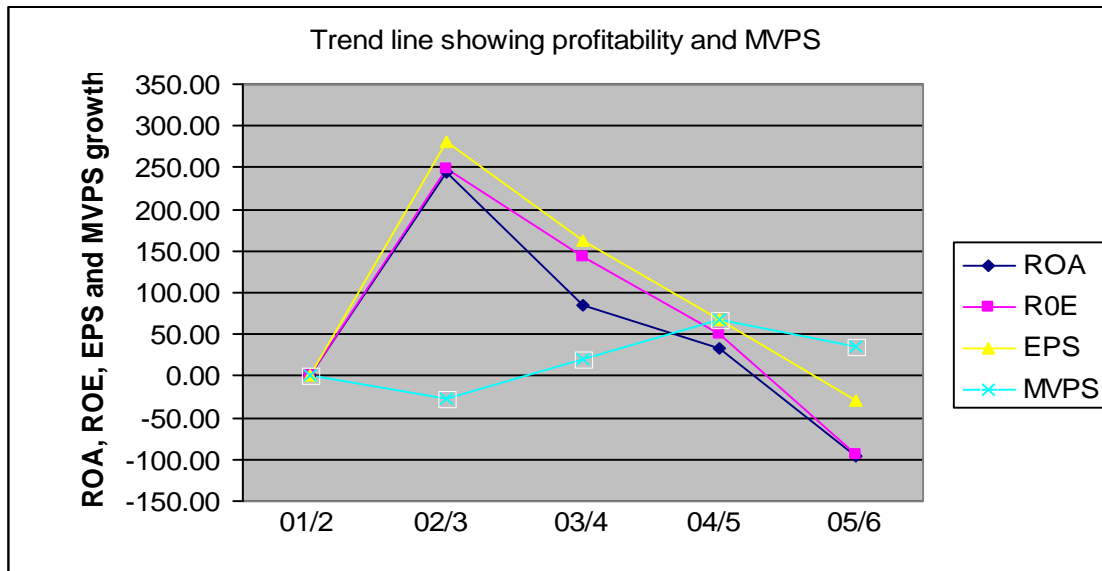
In TABLE-4.1.8, *we cant see any relation between the financial performance ratio and Market Value Per Share as a whole, where market value of share is increasing trend expect year 2002/03 but all other ratios are in random order. Similarly, in the* GRAPH-4.1.8(I), *we cant see any relation between profitability ratio and MVPS.*

GRAPH-4.1.8(II)
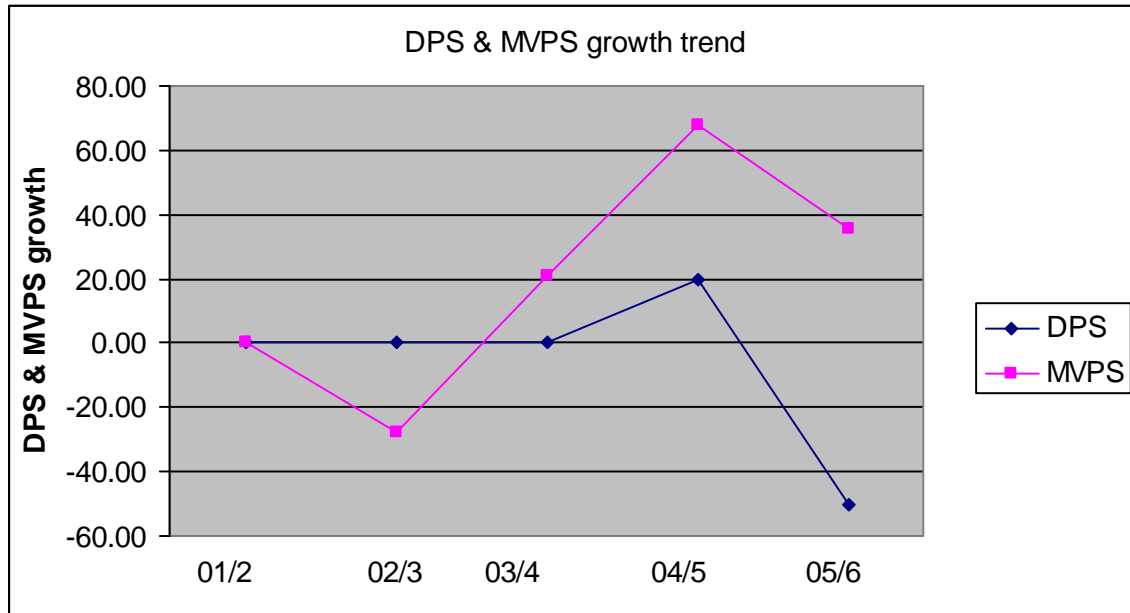
GRAPH-4.1.8(III)
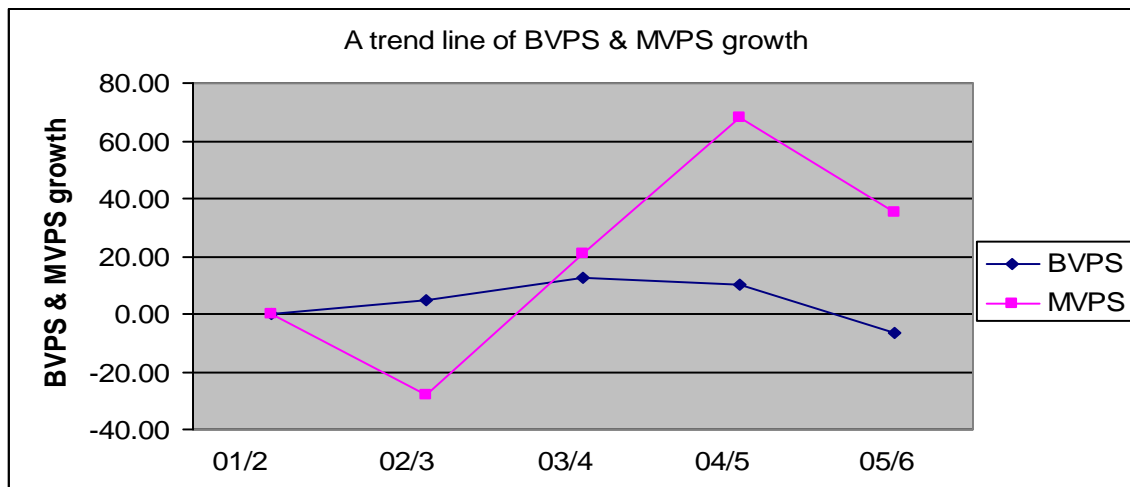
By observing the GRAPH-4.1.8(II*), the NIC Bank hadn't give any dividend till the year 2003/04 but when it starts to give dividend, then market value seems positively correlated with DPS. By* GRAPH-4.1.8(III*), we cant see any relationship between BVPS and MVPS in the case of NIC Bank.*
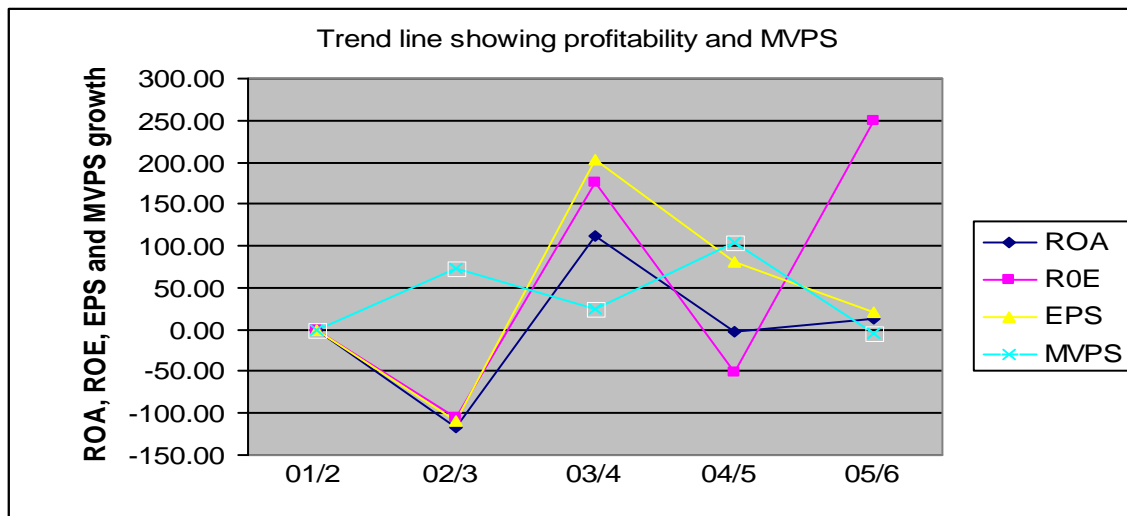
TABLE- 4.1.9

Machhapuchhre Bank Limited

| Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	-3.84	0.64	1.35	1.31	1.48
ROE	-53.24	3.05	8.42	4.11	14.39
EPS	-31.09	2.81	8.49	15.43	18.74
DPS	0	0	0	0	15
BVPS	58.4	92.19	100.77	115.95	130.22
MVPS	58.4	101.07	125	256	246.15

GRAPH4.1.9(I)

From the TABLE-4.1.9, *we can see that ROA, ROE, EPS of the Machhapuchhre Bank Limited is increasing except in the year 2004/05 but the MVPS of the bank is increasing also in the year 2004/05. where as dividend hadn't give to the shareholder except in the last year. Theoretically, MVPS and BVPS should be decreasing in that year but also BVPS is increasing in the year. By observing the* GRAPH-4.1.9(I), *we can see that, when MVPS is increasing trend, at that time all the profitability ratios are in decreasing trend and vice versa. But MVPS is relatively stable than other profitability ratio.*

GRAPH-4.1.9(II)

DPS & MVPS growth trend

GRAPH-4.1.9(III)

A trend line of BVPS & MVPS growth
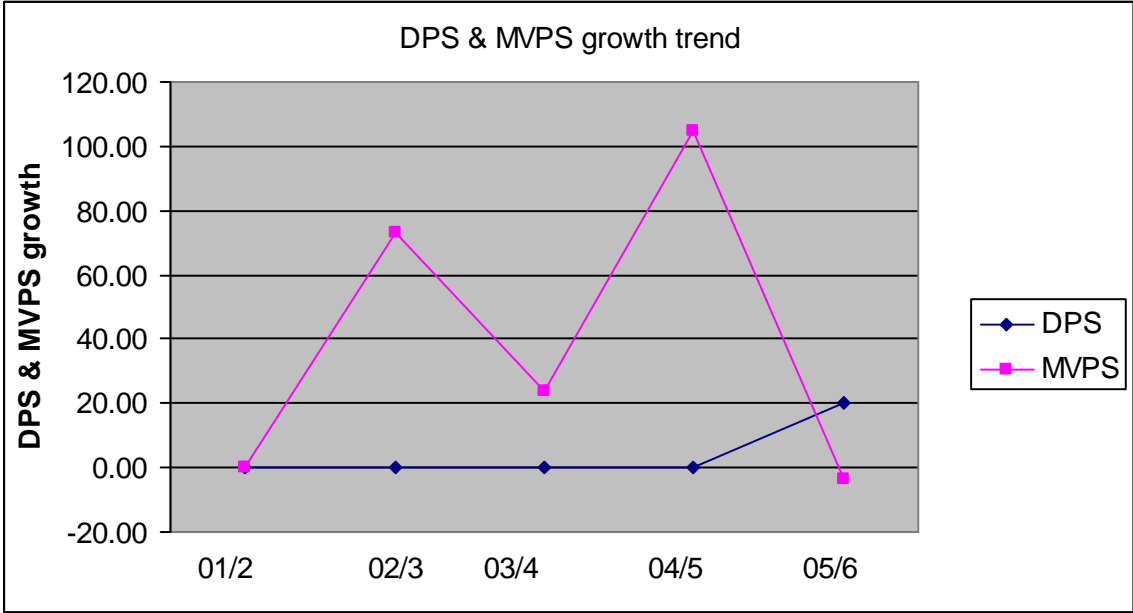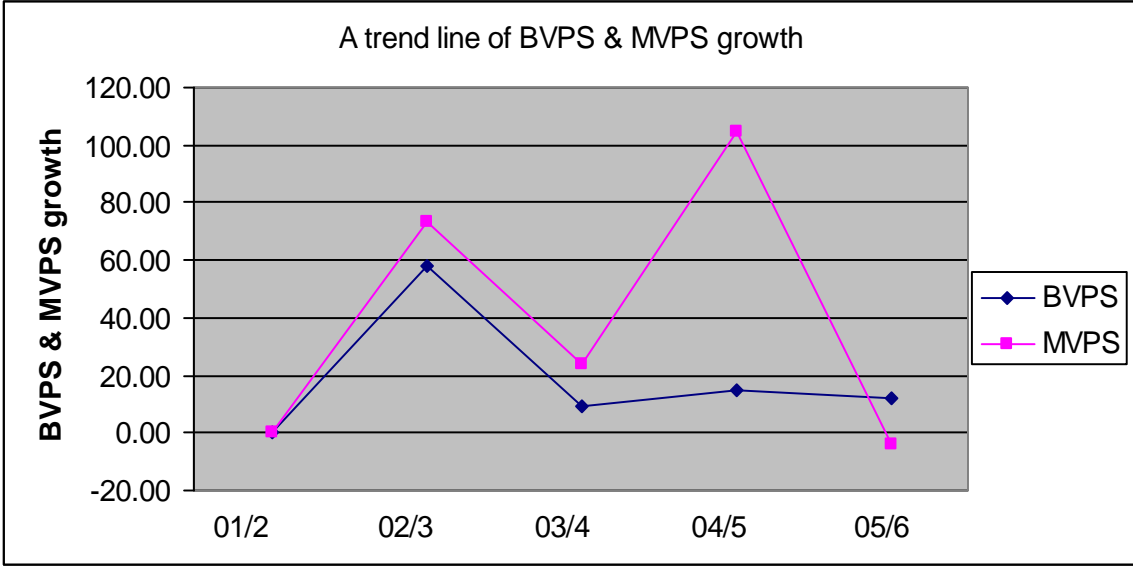
From the GRAPH-4.1.9(II), *we can see that there is increasing and decreasing trend in the MVPS but no give the dividend except in the last year. When bank give the dividend, MVPS is decreasing. In* GRAPH-4.1.9(III), *we can see that percentage change in MVPS is higher than percentage change in BVPS as change of sign.*
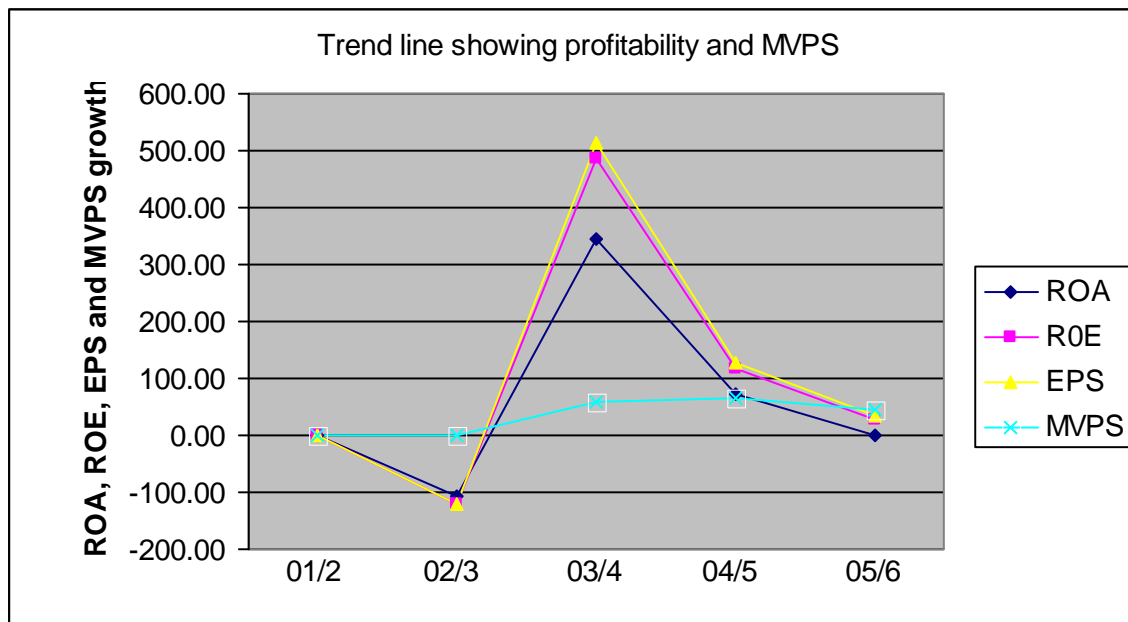
TABLE- 4.1.10

Laxmi Bank Limited

| Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	-1.1	0.09	0.4	0.69	0.68
ROE	-1.56	0.32	1.88	4.11	5.2
EPS	-1.53	0.31	1.9	4.34	5.8
DPS	0	0	0	0	0
BVPS	98.47	99.04	101.32	105.53	111.33
MVPS	98.47	99.04	156.06	257.03	368.05

GRAPH-4.1.10(I)

From the TABLE-4.1.10, *we can see that Laxmi Bank Limited hadn't give any dividend till now. Other all the financial indicators and MVPS are in increasing except ROA. ROA*

is decrease in the last year. By observing the GRAPH-4.1.10(I), *we can see that MVPS is relatively stable than other profitability ratio but almost they are in same trend.*

GRAPH-4.1.10(II)

DPS & MVPS growth trend

GRAPH-4.1.10(III)

A trend line of BVPS & MVPS growth
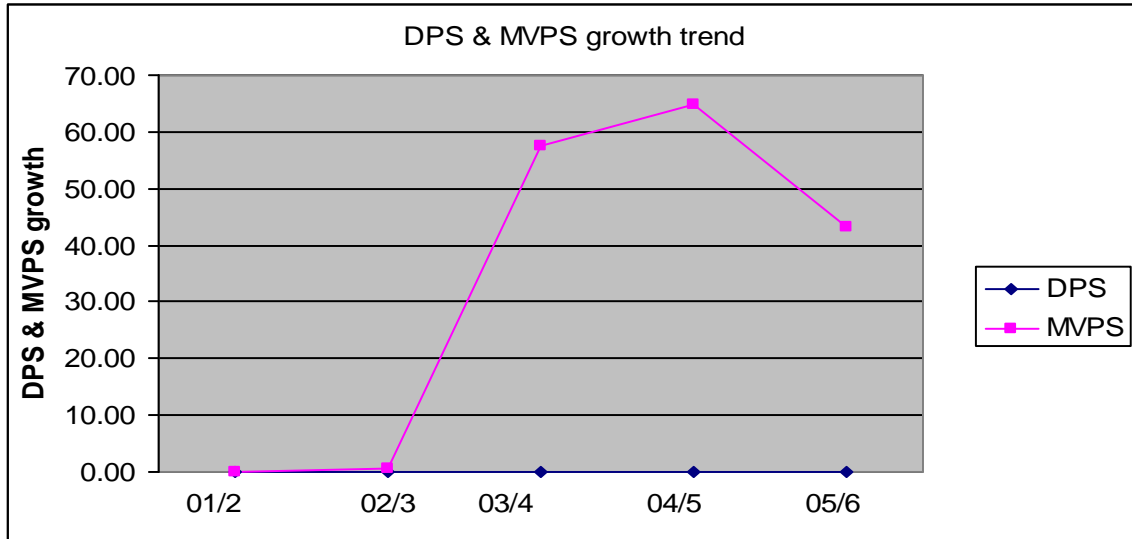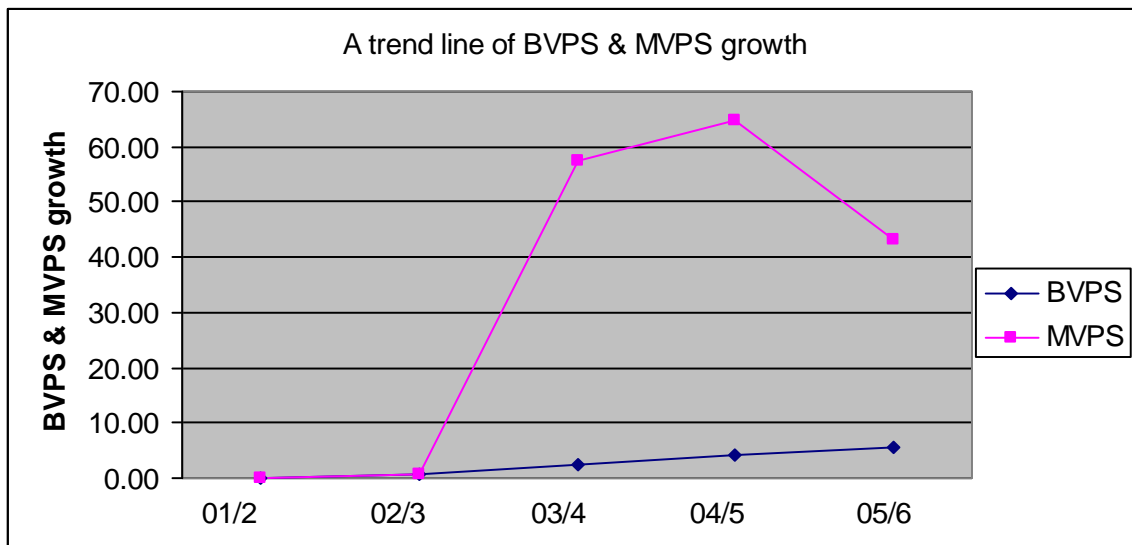
From the GRAPH-4.1.10(II & III), *we can say that bank hadn't give any dividend till now and BVPS of the company is continuously increasing in all the year but MVPS is increasing till the year 2004/05and then decrease in the last year.*
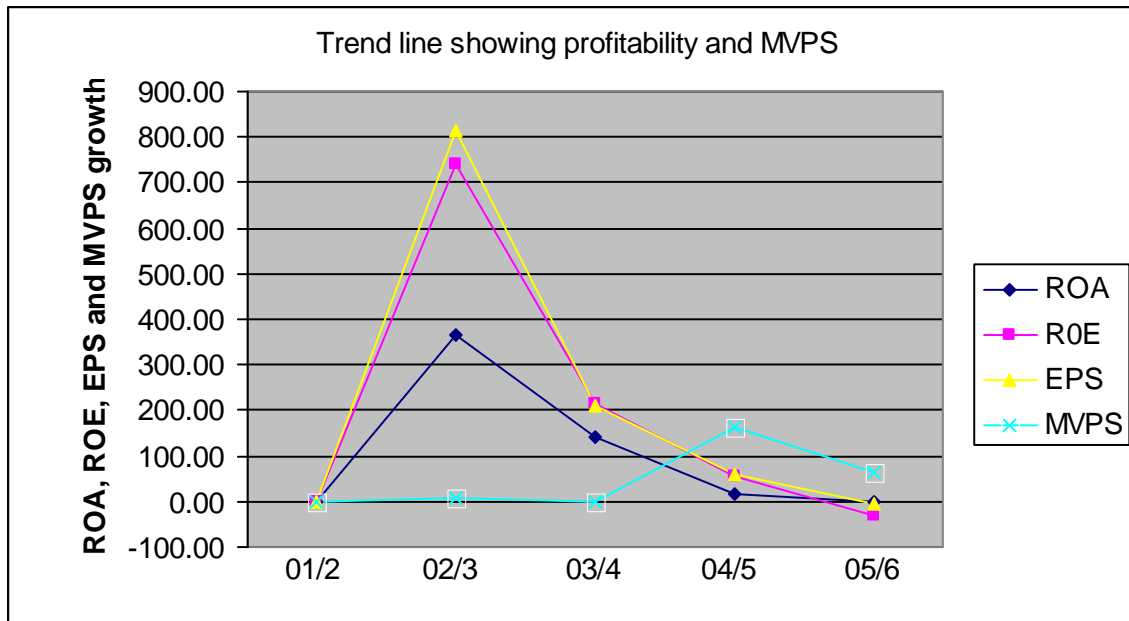
TABLE- 4.1.11

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Kumari Bank Limited

| Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
ROA	0.09	0.42	1.01	1.18	1.15
ROE	0.41	3.45	10.88	16.98	12
EPS	0.39	3.56	11.09	17.58	16.59
DPS	0	0	0	0	20
BVPS	95.88	103.15	101.95	103.52	138.22
MVPS	95.88	103.15	101.95	269	443

GRAPH-4.1.11(I)

From the TABLE-4.1.11*, ROA, EPS & DPS are increasing in all the year except in the year 2005/06 and also MVPS is increasing all the year. Kumari Bank Limited hadn't give any dividend except in the year in the last year. BVPS is also increasing except in the year 2003/04. Similarly by observing the* GRAPH-4.1.11(I)*, we can say that profitability ratios are increasing in the first year and then decreasing. But till the 2003/04, MVPS is constant then increase in the first year and then decrease.*

GRAPH-4.1.11(II)

DPS & MVPS growth trend
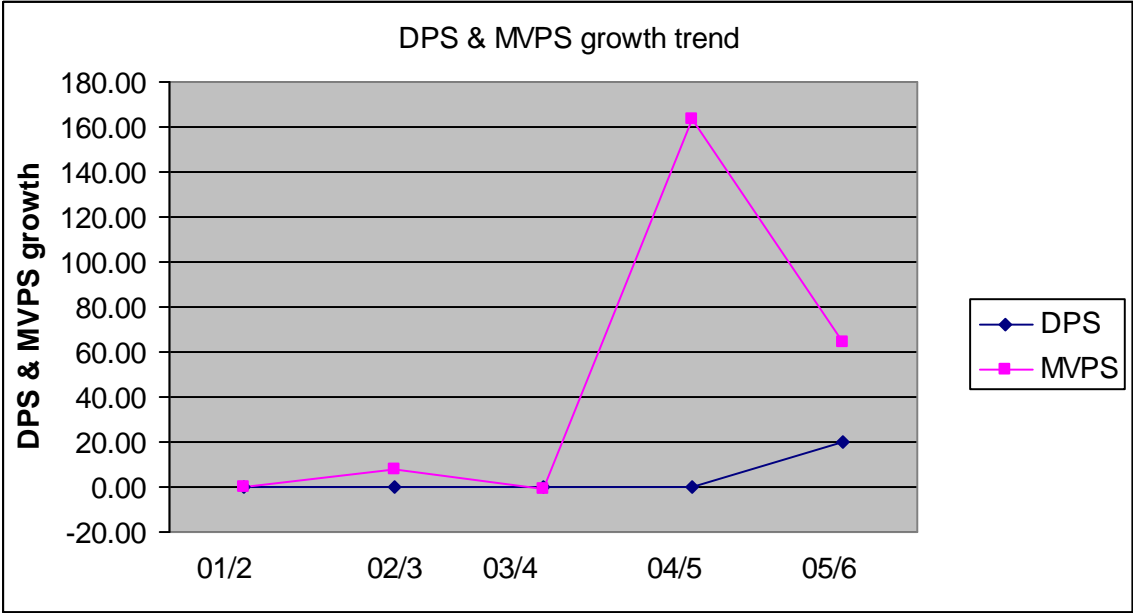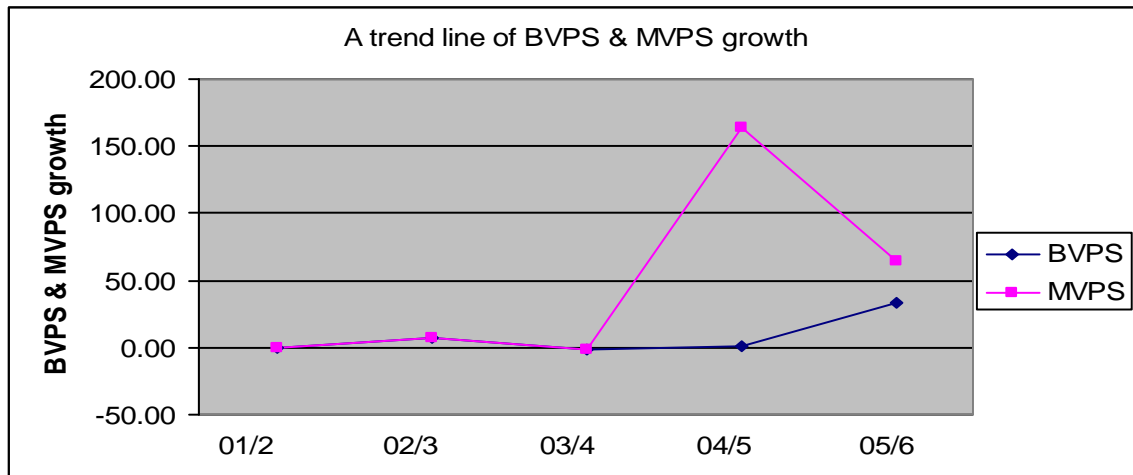
GRAPH-4.1.11(III)

From the GRAPH-4.1.11(II&III*), we can say that Kumari Bank hadn't give any dividend till 2004/05 and MVPS is sometime increase and sometime decrease where as BVPS is almost same till the year 2004/05 but in the last year it is rapidly increase.*

4.2 STATISTICAL MODEL SUMMARY AND HYPOTHESIS TESTING

This research have been conducted to test hypothesis that weather the financial performances and common stock market value of Nepalese commercial Bank are correlated
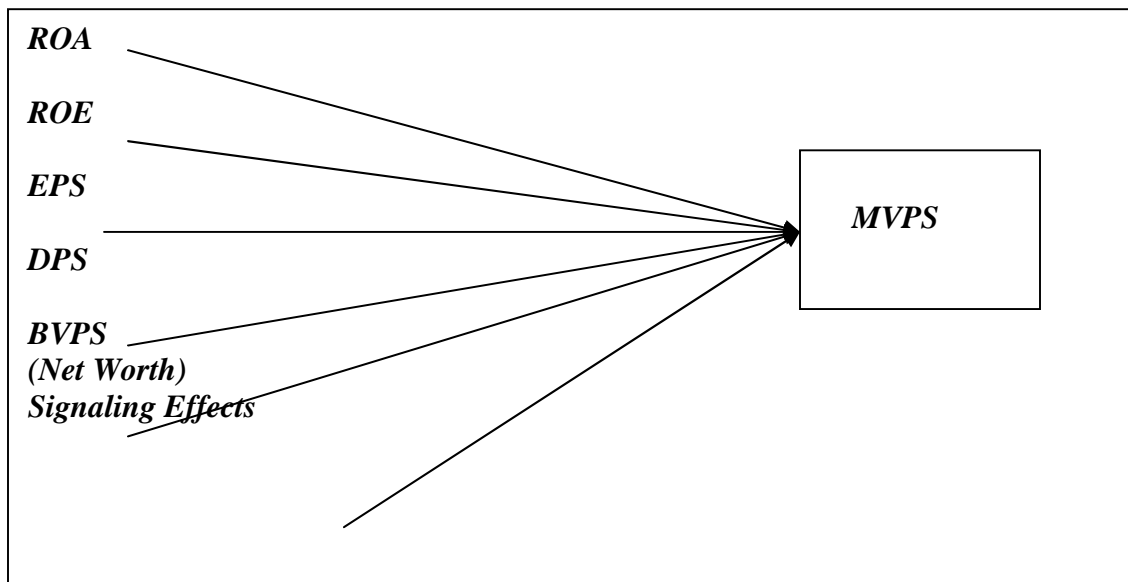
Financial Performances and Common Stock Pricing

Independent Variables (X)   Dependent Variables (Y)

(Predictors or Constant)

FIGURE-4.1.1

Statistical tools:

Pearson's Correlation Coefficient = R

Coefficient of Determination = R^2

Standard Error of Estimation = SEE

Constant of Regression = a

Slope of Variables = b

T- Statistics

Probability Value = p

TABLE-4.2.1

Model Summary

Predictors	*R*	*R^2*	*p*
ROA,ROE,EPS			
Nabil	*0.997*	*0.994*	*0.095*
NIBL	*0.984*	*0.969*	*0.224*
SCBN	*0.508*	*0.258*	*0.939*
HBL	*0.990*	*0.979*	*0.183*
SBI	*0.975*	*0.951*	*0.279*
EBL	*0.997*	*0.995*	*0.90*
BOK	*0.989*	*0.979*	*0.186*
NIC	*0.998*	*0.997*	*.074*
MBL	*1*	*1*	*.024*
LBL	*1*	*0.999*	*.032*
KBL	*0.998*	*0.996*	*.081*
Industry	*0.998*	*0.996*	*.084*
DPS			
Nabil	*0.82*	*0.67*	*0.089*
NIBL	*0.804*	*0.647*	*0.101*

SCBN	0.897	0.804	.039
HBL	0.115	0.013	0.854
SBI	0.323	0.104	0.596
EBL	0.804	0.646	0.101
BOK	0.957	0.917	0.10
NIC	0.699	0.488	0.189
MBL	0.558	0.312	0.328
LBL			
KBL	0.878	0.772	0.05
Industry	0.986	0.971	0.002
BVPS			
Nabil	0.95	0.903	0.013
NIBL	0.333	0.111	0.584
SCBN	0.935	0.874	0.02
HBL	0.202	0.041	0.744
SBI	0.678	0.459	0.209
EBL	0.979	0.958	0.004
BOK	0.969	0.94	0.006
NIC	0.632	0.4	0.253
MBL	0.909	0.825	0.033
LBL	0.998	0.996	000
KBL	0.906	0.82	0.034
Industry	0.903	0.815	0.036
ROA,DPS,BVPS			
Nabil	0.998	0.995	.086
NIBL	0.882	0.777	0.578
SCBN	0.988	0.976	0.196
HBL	0.915	0.838	0.499

SBI	0.99	0.98	0.181
EBL	0.998	0.996	0.085
BOK	0.999	0.999	0.047
NIC	0.997	0.994	0.101
MBL	0.999	0.999	0.041
LBL	0.998	0.996	0.004
KBL	0.937	0.878	0.435
Industry	0.999	0.999	0.04

Above summary of the statistical model has been extracted from the computer SPSS (Statistical Program for Social Science) program. Before the test of hypothesis, it is worthy to mention that the study may not reflect hundred percent true pictures of Nepalese Stock Market. But it is try to minimize the deficiencies of the study to the possible extent.

Interpretation of R^2

R^2 or co-efficient of determination is the best measurement of goodness of fit. The value of R^2 shows that how well the actual value fit with the prediction to be made by regression line. Larger the value of R^2 (close to 1), higher is the probability that the independent variable can significantly predict the dependent variable and less is the error in forecasting the values. Smaller the value of R^2 more is the error term in prediction which suggests a strong existence of intervening variables. For example, in case of variables ROA, ROE & EPS, the value of R^2 of the regression line on MVPS is 0.996. It means 99.6 percent, change in MVPS can be explained by change in ROA, ROE & EPS (Profitability ratio) and only 0.4 percent is the effect of other intervening variables. Similarly the value of R^2 of the regression line of net worth per share on MVPS is 0.815. It means to the extent of 81.5 percent change in MVPS can be explained by the change in net worth per share and 18.5 percent is the effect of other intervening variables.

Interpretation of p value

The customary levels of significance are 0.10, 0.05, and 0.01 and so on. In case of this research work, I have reasonable taken 5 percent (0.05) level of significance.

Therefore;

p>.05: We accept the null hypothesis.

P<.05: We reject the null hypothesis.

TABLE-4.2.2

Industry wise summary of p values

Independent variables of industry	p	Comparison with Level of significance	Null Hypothesis (H0)
ROA,ROE & EPS	0.084	p>.05	Accept
DPS	0.002	P<.05	Reject
BVPS	0.036	P<.05	Reject
ROA,DPS &BVPS	0.040	P<.05	Reject

Test of Hypothesis:

Hypothesis: 1

H0: There is no correlation between the profitability and stock prices.

H1: There is a significant correlation between the profitability and stock prices.

Result: In case of profitability ratios (ROA, ROE & EPS) of industry average, null hypothesis has been accepted (p>.05). It means there is no correlation between the profitability and stock price.

Hypothesis: 2

H0: There is no correlation between the dividends paid and stock prices.

H1: There is a significant correlation between the dividends paid and stock prices.

Result: Null hypothesis has been rejected in case of DPS of industry average (p<.05). Therefore we conclude that there is a significant correlation between the dividends paid and stock prices.

Hypothesis: 3

H0: There is no correlation between the Net Worth per Share (BVPS) and stock prices.
H1: There is a significant correlation between Net Worth per Share (BVPS) and stock prices.

Result: Null hypothesis has been rejected in case of industry average of BVPS (p<.05). Therefore we conclude that there is a significant correlation between the Net Worth Per Share (BVPS) and stock prices of commercial bank industry.

Hypothesis: 4

H0: There is no correlation between the financial performance indicators and stock prices.
H1: There is a significant correlation between financial performance indicators and stock price.

Result: Null hypothesis has been rejected in case of industry average of financial performance indicators (ROA, DPS & BVPS) (p<.05). Therefore we conclude that there is a significant correlation between the financial performance indicators and stock prices of commercial bank industry.

Hypothesis: 5

H0: Market index of commercial bank sector is in random manner.
H1: Marker index of commercial bank sector is not in random manner.

For that hypothesis test, I take run test as a tool. For that test following data has been used.

TABLE-4.2.3

NEPSE Index for Commercial Bank during Asadh, Srawan & Bhadra of 2064

Asadh		Srawan		Bhadra	
Date	Index	Date	Index	Date	Index
17-Jun-07	628.80	17-Jul-07	804.26	19-Aug-07	788.56
18-Jun-07	618.35	18-Jul-07	767.70	20-Aug-07	793.44
19-Jun-07	622.91	19-Jul-07	768.89	21-Aug-07	807.00
20-Jun-07	639.93	22-Jul-07	779.55	22-Aug-07	808.39
21-Jun-07	664.01	23-Jul-07	791.75	23-Aug-07	810.82
24-Jun-07	645.10	24-Jul-07	791.29	24-Aug-07	811.39
25-Jun-07	651.34	25-Jul-07	781.14	26-Aug-07	807.12
26-Jun-07	654.18	26-Jul-07	774.04	27-Aug-07	802.53
27-Jun-07	653.41	29-Jul-07	768.12	30-Aug-07	824.91
1-Jul-07	655.21	30-Jul-07	761.08	2-Sep-07	845.42
2-Jul-07	662.27	31-Jul-07	759.67	3-Sep-07	859.19
3-Jul-07	666.18	1-Aug-07	764.24	5-Sep-07	871.39
4-Jul-07	677.38	2-Aug-07	778.09	8-Sep-07	883.95
5-Jul-07	681.89	5-Aug-07	791.68	9-Sep-07	906.55
9-Jul-07	684.56	6-Aug-07	795.41	10-Sep-07	932.44
10-Jul-07	692.44	7-Aug-07	813.29	11-Sep-07	937.55
11-Jul-07	710.57	8-Aug-07	817.18	12-Sep-07	921.52
12-Jul-07	726.88	9-Aug-07	810.09	13-Sep-07	910.37
15-Jul-07	748.48	13-Aug-07	801.53	16-Sep-07	916.14
16-Jul-07	789.21	14-Aug-07	794.90	17-Sep-07	917.58
		15-Aug-07	782.86		
		16-Aug-07	782.55		

Source: www.nepalstock.com

Here in above data total sample (n) = 62

Median (Me) = $\frac{782.86 + 788.56}{2}$ = 785.71

Symbol sequence:

$\underline{- + +}$ $- - -$ $+ +$ $\underline{- - - - - - -}$ $\underline{+ + + + + + +}$ $- -$ $\underline{+ + + + +}$

           1   *2* *3* *4*   *5*   *6*   *7*   *8*

$\underline{+ + + + + + + + + + + + + + + +}$

Here,

Number of runs (r) = 8

Number of positive sign (n₁) = 31

Number of negative sign (n₂) = 31

The test statistic for testing H0 is

$$Z = \frac{r - \frac{2n_1 n_2}{n_1 + n_2} + 1}{\sqrt{\frac{2n_1 n_2 (2n_1 n_2 - n_1 - n_2)}{(n_1 + n_2)^2 (n_1 + n_2 - 1)}}} \quad or \quad Z = \frac{8 - \frac{2 \cdot 31 \cdot 31}{31 + 31} + 1}{\sqrt{\frac{2 \cdot 31 \cdot 31 (2 \cdot 31 \cdot 31 - 31 - 31)}{(31 + 31)^2 (31 + 31 - 1)}}}$$

         Z = -6.14

         <u>*Critical region:*</u>

         For 5 percent level of significance, we obtain the critical Value

         $Z_{0.05}$ = 1.96

<u>*Decision:*</u> *Since Z = 6.14 > 1.96 = $Z_{0.05}$, we may reject H_0.i.e. the market*

index of commercial bank is not in random order. It is influence by some factors. We can say that they may be financial performance indicators because it is also proved by the above four hypothesis test.

REGRESSION ANALYSIS:

Regression Analysis is known as the useful device to determine the strength of relationship between independent and dependent variables. It is considered to be an important statistical device that helps to predict or forecast the value of dependent

variable when the value of independent variable is already known. As this study focuses on the determinants of the share price (MPS). MPS may be dependent upon various financial indicators. That's why, it is attempted here to analyze and evaluate the influence of various financial indicators on MPS separately. All dates are calculated by the computer SSPSS program.

TABLE-4.2.4

Regression Equation of MPS on ROA, ROE and EPS ($MPS = a + b_1ROA + b_2ROE + b_3EPS$)

		Description	a	b_1	b_2	b_3	r^2	SEE	F-value	Sig. F
Commercial Bank	Average	Coefficient values	-1054.71	-456.51	-67.62	83.23	0.996	38.707	76.499	0.084
		Standard Error	133.26	286.39	34.89	10.14				
		t-value	-7.92	-1.59	-1.94	8.21				
		Sig.t-value	0.08	0.357	0.303	0.077				

The regression coefficient of ROA (b_1) is -456.51 which implies that an increase of one rupee in ROA decrease MPS by rupees 451.65 on average if the other factors remain constant. The regression coefficient of ROE (b_2) is -67.62 which also implies that increase in one rupee of ROE decrease MPS by 67.62 on average if the other variables remain constant. Similarly the regression coefficient of EPS (b_3) is 83.23 which implies that an increase of one rupee in EPS increase MPS by 83.23 rupees. But the estimates of b_1, b_2 and b_3 may vary by 286.39, 34.89 and 10.14 respectively as indicated by standard error. The regression constant is -1054.71, which shows that when value of ROA, ROE and EPS are zero, then MPS will be negative 1054.71. But this could not be practical because the value of MPS can not go down to the zero level. The t-values for a, b_1, b_2, and b_3 are -7.32, -1.59, -1.94, and 8.24 respectively. The significant t-values and significant F-value are greater than 5% level. So coefficients mentioned above are not statistically significant. The regression model explains the variation of MPS by 99.6% due to the variation in ROA, ROE and EPS, as indicated by the coefficient of

determination. The figures of standard error of estimate (SEE) is 38.707, which states that the prediction of this model yields a clear variation of about 38.707 rupees.

TABLE-4.2.5

Regression Equation of MPS on DPS (MPS = a + b DPS)

Commercial Bank Average	Regression coefficient		SE of b	r^2	SEE	F	Sig. F
	Constant (a)	Slope (b)	3.24	0.971	57.33	102.07	0.002
	-188.42	32.77					

Prediction of MPS is strong because the coefficient of determination (r^2) is very high which 0.971 is. This implies that the variation in MPS due to the influence of DPS is 97.1%. But this prediction may vary by rupees 57.33 as shown by the figure in the column of standard error of estimate (SEE). The value of significance-F is less than 5%, which shows that the relation is statistically significant at 5% level of significance. This implies that the independent variable DPS describe the variation in MPS significant. Regression slope (b) is 32.77, which describe that increase one rupee in DPS, MPS increase by rupees 32.77. Similarly the regression constant is -188.42, which shows that when the value of DPS is zero, then MPS will be negative 188.42. But this could not be practical because the value of MPS can not go down to the zero level.

TABLE-4.2.6

Regression Equation of MPS on (BVPS) Net Worth (MPS = a + b BVPS)

Commercial Bank Average	Regression coefficient		SE of b	r^2	SEE	F	Sig. F
	Constant (a)	Slope (b)	3.15	0.815	145.82	13.24	0.036
	-1471.63	11.44					

Prediction of MPS is strong because the coefficient of determination (r^2) is very high which 0.815 is. This implies that the variation in MPS due to the influence of BVPS is 81.5%. But this prediction may vary by rupees 145.82 as shown by the figure in the column of standard error of estimate (SEE). The value of significance-F is less than 5%, which shows that the relation is statistically significant at 5% level of significance. This implies that the independent variable BVPS describe the variation in MPS significant.

Regression slope (b) is 11.44 which describe that increase one rupee in DPS, MPS increase by rupees 11.44. Similarly the regression constant is -1471.63, which shows that when the value of BVPS is zero, then MPS will be negative 1471.63. But this could not be practical because the value of MPS can not go down to the zero level.

TABLE-4.2.7

Regression Equation of MPS on ROA, DPS and BVPS ($MPS = a + b_1ROA + b_2DPS + b_3BVPS$)

		Description	a	b_1	b_2	b_3	r^2	SEE	F-value	Sig. F
Commercial Bank	Average	Coefficient values	-2842.5	-577.88	5.07	21.62	0.999	18.6	332.23	0.04
		Standard Error	507.06	112.82	5.49	4.12				
		t-value	-5.61	-5.12	0.92	5.24				
		Sig.t-value	0.112	0.123	0.526	0.12				

The regression coefficient of ROA (b_1) is -577.88 which implies that an increase of one rupee in ROA decrease MPS by rupees 577.88 on average if the other factors remain constant. The regression coefficient of DPS (b_2) is 5.07 which also implies that increase in one rupee of DPS increase MPS by 5.07 on average if the other variables remain constant. Similarly the regression coefficient of BVPS (b_3) is 21.62 which implies that an increase of one rupee in BVPS increase MPS by 21.62 rupees. But the estimates of b_1, b_2 and b_3 may vary by 112.82, 5.49 and 4.12 respectively as indicated by standard error. The regression constant is -2842.5, which shows that when value of ROA, DPS and BVPS are zero, then MPS will be negative 2842.5. But this could not be practical because the value of MPS can not go down to the zero level. The t-values for a, b_1, b_2, and b_3 are -5.61, -5.12, -0.92, and 5.24 respectively. The significant t-values are greater than 5% level. So coefficients mentioned above are not statistically significant. But all determinants (Financial performance indicators) are statistically significant because Sig.-F vale is less than 5% level of significance. The regression model explains the variation of MPS by 99.9% due to the variation in ROA, DPS and BVPS, as indicated by the coefficient of determination. The figures of standard error of estimate (SEE) is 18.6,

which states that the prediction of this model yields a clear variation of about 18.6 rupees.

4.3 EXPERTS OF INTERVIEWS AND QUESTIONNAIRES

Annex-2 reveals important information as to outlook of investment decisions of investors. In the course of acquiring first hand to justify the study of the topic primarily, interviews and questionnaire methods have been used.

4.3.1 EXPERTS OF INTERVIEWS

While taking interview with a senior official of NEPSE about the investors awareness in investment decision, it was learnt that the reason behind frequently swing in the market price of share due to lack of institutional investors who can properly analyze and study the market trends before making their investment decisions. According to the official, Nepalese stock market is dominated by retailing investors come forward to act in bullish manner. They emphasized that stability can not be fully achieved unless rational and institutional investors come forward to participate in the secondary market However, they agreed on the fact that lately the investors have become more sensitive and professional at least in the comparison in 1990s when market was at the nascent stage. While conducting the informal discussion with many investors in the stock market, they claimed that though they made investment decision after analyzing performance of the companies, they got less than the expected return from their investment. They accused brokers and NEPSE officials for joining hands for price manipulation. They also shared the experience of sharp wealth devaluation in the past days. It was learnt that unprecedented swings in the Nepal Stock Exchange market index caused uproar among investors.

In this way, it was seen in the Nepalese stock Exchange, investors and officials were at loggerheads' over the cause of stock market, blaming each other for the volatility of stock

prices. Though, they have different theories to offer over the price fluctuations, the effort to improve the domestic stock market should be done from all quarters.

4.3.2 QUESTIONNAIRE ANALYSIS

Another measured applied to garner information relevant to the topic was questionnaire method. A number of questions were put up by means of 50 copies of questionnaire and 40 were received. Categorically, the questions raised through this means were of three types, namely, yes/No questions, multiple choice questions, and open-end questions. Eighty percent of the questionnaires were collected during study period. The questionnaires were distributed to find out the first hand information from the investors of secondary stock market. Their responses have been analyzed as follows:

a. Investors' Awareness

In the question regarding their awareness of Nepalese stock market, 40% of investors are very much aware, 35% were moderate, 25% a little . From the table 4.3.2.1, it is clear that most of the respondents, i.e., 40% are very much aware of the Nepalese stock market.

Table-4.3.2.1

Awareness of Nepalese stock market

S. No.	Research Variable	No. of respondents %	% of investors
a.	Very much	16	40
b.	Moderate	14	35
c.	Little	10	25
d.	Not yet all	0	0
	Total	40	100

Source: Field Survey

b. Preferred Market of investment:

When investors were asked in which market they are interest for investment. 45% replied that they preferred to invest in primary market, 40% preferred secondary market and 5% replied that they don't know about it. 5%

respondents not give any reply and 5% preferred both primary and secondary market.

Table-4.3.2.2

Preferred market of Investment

S. No.	Research Variable	No. of respondents %	% of investors
a.	Primary	18	45
b.	Secondary	16	40
c.	Don't know	2	5
	Total	**36**	**90**

Source: Field Survey

c. Reasons for invest in stock market

For regarding that question, nobody give the answer for saving and rumors. 30% give the answer for dividend and 50% for capital gain. Similarly 5% give answer for others and 5% give answer for saving, rumors and dividend, 5% gives for rumors and others, 5% gives for dividend and capital gain.

Table-4.3.2.3

Reasons for invest in stock market

S. No.	Research Variable	No. of respondents %	% of investors
a.	For saving	0	0
b.	Rumors	0	0
c.	Dividend	12	30
d.	Capital gain	20	50
e	others	2	5
	Total	**34**	**85**

Source: Field Survey

d. Factors consider while making decision for investment

30% of the respondents say that they consider the net worth for investment, 45% consider the price trend of the company, 20% see the volume of stock

traded and 5% respondents reply that they see other things while making investment decision.

Table-4.3.2.4

Factors consider while making decision for investment

S. No.	Research Variable	No. of respondents %	% of investors
a.	Net worth	12	30
b.	Price trend	18	45
c.	Volume of stock traded	8	20
d.	Others	2	5
	Total	40	100

Source: Field Survey

e. Planning to invest in the share available in NEPSE

In the question regarding planning to invest in the share available in NEPSE, 45% of investors are planning for invest, 25% are not interested for investment and remaining i.e. 30% give not any answer.

Table-4.3.2.5

Planning to invest in the share available in NEPSE

S. No.	Research Variable	No. of respondents %	% of investors
a.	Yes	18	45
b.	No	10	25
	Total	28	70

Source: Field Survey

f. Sectors of investment falls

For regarding that question, 25% investors' investment fall in banking sector, 10 percent in Finance and insurance, 5% in manufacturing and processing,

5% in others and 10% investors' investment fall in both in financing and banking sector and 40% not give any answer.

Table-4.3.2.6

Sectors of investment falls

S. No.	Research Variable	No. of respondents %	% of investors
a.	Banking	10	25
b.	Finance/ Insurance	4	10
c.	Manufacturing & planning	2	5
d.	Others	4	10
	Total	20	50

g. Investors' Satisfaction

Regarding the satisfaction of the investors, 50% replied that they are satisfied. Only 25% of the respondents are satisfied and 15% said that they are unknown about the fact and remaining 10% give not any answer. The table 4.3.2.7 gives the facts regarding investors' satisfaction.

Table-4.3.2.7

Investors' satisfaction from the return on their investment

S. No.	Research Variable	No. of respondents %	% of investors
a.	Yes	20	50
b.	No	10	25
c.	Don't know	6	15
	Total	36	90

h. Reasons for owing the share

Investors were asked for their purpose behind owing the shares that if they were interested with dividend, capital gain, social status, marketability or above all, 20% said that they are more interested in dividend income, 40% replied in favor of capital gain, nobody give an answer for social status and marketability, 35% gives the answer for all the above and remaining 10% give the answer for marketability and capital gain both. The following table describes their reasons behind owing the shares.

Table-4.3.2.8

Reasons for owing the share of the stock market

S. No.	Research Variable	No. of respondents %	% of investors
a.	Dividend	8	20
b.	Capital gain	16	40
c.	Social status	0	0
d.	Marketability	0	0
e.	all	14	35
	Total	36	90

Source: Field Survey

i. Interest in the management of the bank or company

When they were asked whether they want to have any role in the management, 40% were not interested for a role, 40% replied in favor of the role, and remaining 20% replied that they have no idea regarding this.

Table-4.3.2.9

Interest in the management of the bank or company

S. No.	Research Variable	No. of respondents %	% of investors
a.	Yes	16	40
b.	No	16	40
c.	No idea	8	20
	Total	40	100

j. **Bases of decision for investment in secondary market**

Regarding the investment decision making procedures, 5% of the respondents replied that they made decision on the basic of market index, 30% replied that they made decision on the basis of company's profitability, 15% replied that they made on the basis of market price trend, 35% made on the basis of dividend declared, 5% made on the basic of friends opinion, 5% said that they made on the basic of other factors and remaining 5% not give any answer.

Table-4.3.2.10

Bases of decision for investment in secondary market

S. No.	Research Variable	No. of respondents %	% of investors
a.	Market Index	2	5
b.	Profitability	12	30
c.	Dividend	14	35
d.	Market price	6	15
e.	Advice of friend	2	5
f.	others	2	5
	Total	38	95

k. **Factors influencing the stock price**

They have made mixed opinion in this question; 45% of them their views as dividend as the influencing factors, 20% said rumors, 10% said company's profit, 5% said net worth, nobody said major events, 5% said other factor influence the stock price and remaining 5% said dividend and rumors, 5% said all of the above and 5% give not any answer.

Table-4.3.2.11

Factors influencing the stock price

S. No.	Research Variable	No. of respondents %	% of investors
a.	Dividend	18	45
b.	Rumors	8	20
c.	Profitability	4	10
d.	Net worth	2	5
e.	Major events	0	0
f.	Others	2	5
	Total	34	85

l.   Difficulties in share market

Regarding the question are any difficulties in the share market, 60% said that there are difficulties in the share market, 20% said that there are not any difficulties in share market and remaining 20% said that they don't know about the difficulties of share market.

Table-4.3.2.12

Difficulties in Share Market

S. No.	Research Variable	No. of respondents %	% of investors
a.	Yes	24	60
b.	No	8	20
c.	Don't know	8	20
	Total	40	100

m. Analysis of open end question

Only two open end questions were asked to investors under the study to take their opinions on important aspect of secondary market. One is the solution to

solve the stock market problems and next is what are the measures to be taken to develop Nepalese secondary market?

Respondents state the following solution to solve the stock market problems:
- ➤ *Definite legal provision*
- ➤ *Advanced technology should be adopt for share transaction.*
- ➤ *Program should be conducted for public awareness.*
- ➤ *Should be establishing of central depository system of securities.*
- ➤ *Real sectors must be listed.*
- ➤ *Collection of photocopies of citizenship ID should be stopped by speculators.*
- ➤ *Original ID should be submitted while transaction.*
- ➤ *Should be mechanism for quick transfer of share.*
- ➤ *Abolition of capital gain tax.*
- ➤ *Broker should be well trained.*
- ➤ *Trading floor should be extended in several place.*
- ➤ *Should be providing sufficient information about financial securities to the investors.*

Respondents state the following measures to be taken to develop Nepalese secondary market
- ➤ *To make the people aware about the financial market.*
- ➤ *Provide correct information about the secondary market.*
- ➤ *Investment ceiling should be initiated by regulatory body.*
- ➤ *Should be establishing of central depository system of securities.*
- ➤ *Program should be conducted for public awareness.*
- ➤ *Should be enhance the mutual fund.*
- ➤ *Should be stable the political situation of the country.*
- ➤ *OTC market and facilities for derivatives market.*
- ➤ *Secondary market expansion by providing license to the private sector.*
- ➤ *Should be transparent of company's activities.*
- ➤ *Encourage institutional investors to enter in the market.*

> ➢ *Capacity building of regulators.*

4.4. NON-FINANCIAL FACTORS AFFECTING STOCK PRICE

After consulting various people involved in this field like investors, brokers, employees of Security Exchange Board and Bank Manager, we find basic five factors that effect the stock prices. These are:

) *Inadequate public awareness*
) *High liquidity*
) *Expectation of bonus share*
) *Speculation*
) *Manipulation on stock prices*

Inadequate public awareness:
Behavior of Nepalese Investors in the field of securities market is quite irrational. Most of investors do not give any attention to the financial performance of concerned organization. And even if they get the information, they lack the accurate or even appropriate interpretation.

From my research, I have found that most of investors themselves decide about the selling and buying price on the judgmental basis. Such activities facilitate the brokers to have appropriate benefits from the investors. The people in Nepalese security market invest their fund in expectation of capital gain. They do not consider anything about dividend yield of their investment. Value of stock is nothing but a present value of expected dividends. Expectation of better growth in future dividend is the only cause of capital gain. But in Nepalese practice, capital gain is realized not due to the future expectations of dividend but due to the high marketability of the stocks.

Most of the investors don't use the fundamental and technical tools in analyzing financial information and interpreting the result there of for making rational investment decision.

Instead, their investment decision is based on rumor and more expectation regarding future benefits, basically, bonus shares.

Such irrational behaviors of Nepalese investors have made the market quit inefficient. At present if an investor follows the theory, he/she can not sustain in this market. For example, theory says when stock is over valued, it should not be be kept for long time. But in Nepalese corporate world, it is not applied.

Unless investors start giving proper attention to the financial performance of concerned organization, demand for stock is not affected by the financial performance indicators, rather high degree of imperfection in the market still will prevail. This brings a very insignificant impact on stock prices due to any major or minor changes in the financial performance indicators.

High liquidity:

Due to inadequate investment opportunity, public liquidity is very high. Banks have been able to collect to sufficient amount of deposit from public but not been able to recognize proper investment sectors to mobilize their funds. This has led a high liquidity in the national economy, which later resulted into lower interest rate for investors.

Thus investors are seeking other alternative investment opportunity where they can employ their savings at least to earn minimum rate of return. In such situation, banking is the only sector, which is reporting better return on investment each year. However, they too are unable to offer adequate dividend, which can justify their share prices in the market. But the trend is already established.

Considering only the positive aspect of these joint ventures banks, people are trying to invest their idle fund in the stock of banking sectors. So, the demand for stock of banking sector is very high which has resulted in to over valuation of stock prices.

Expectation of bonus share:

Most of the investors think that the company will grant them bonus share and this will recover their excess payment. People say that now value of their stock is Rs.1000. After the declaration of bonus share of 1:1 it will be Rs.2000 (1000*2). Thus, they are interpreting the information very differently. Though their expectation about bonus share may be right but thinking of getting benefit by bonus share is wrong. Bonus share is just an alteration in books of account. The company's assets before and after bonus share issue will remain the same, only change is that the reserve or retained earning are transferred to paid up capital.

Since bonus is given out of stock holders share of reserves and retained earning, declaration of bonus stock decreases the price of stock by the equal value of bonus shares. Bonus stock can be regarded as the split of stock. However, there may be signaling effect and stock price may decrease by more or less than the value of bonus shares.

For example, a company has following shareholders equity in the balance sheet:

Table -4.4.1

Share holders equity	Before bonus share	After bonus share
Paid up capital-2000 shares @Rs.100	200000	400000
Retained earning	400000	200000
Total SHE	600000	600000

Market value per share =Rs.1200 (before bonus shares)

Wealth of an investor having 100 shares

Before bonus share	After bonus share
100*1200=120000	200*600=120000

Hence, bonus share does not affect the wealth of an investor. However positive or negative signaling effect may change the position of wealth.

But Nepalese investors think that they will get benefit equal to market price of share by declaration of bonus share. That is after deceleration of bonus share, they will have the share value double to their previous share value.

Thus the behavior of Nepalese investors has made the market quite inefficient. Price of stock in NEPSE after declaration of bonus share will not decrease as theory says.

Speculation:

investment made by public in Nepalese security market is like speculation. Speculation is short period investment in anticipation of fluctuation in the stock market in order to gain heavily in a limited time. Because of small size of Nepalese stock market, financial information is not readily available to the potential investors, so the investors are prone to speculation.

Generally, active investors speculate by taking a long and short position as per circumstances. Since, speculators make investment decision based on limited information and analysis, stock price in market is not reflecting financial performance of concerned company.

Manipulation of stock prices:

Nepalese security market is strongly affected by some parties who are holding large no. of stocks. They may rise the rumor that the stock price will raise in future and that the irrational investors believing it gives rise to demand, and supply being controlled by these party take advantage of increasing price of stock.

In Nepal, management of the organization may manipulate the financial information and so can directly/indirectly speculate in the stock price to fluctuate non financial.

CHAPTER-V
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 SUMMARY OF FINDINGS

Industrialization and economic prosperity of a country heavily depend upon effective mobilization of savings. Stock markets are the corner stones for the mobilization of people's savings. Equity or ordinary shares in Nepalese corporate firms comprise the largest category of securities listed with the stock exchange. It has predominance in both quantity and value. The magnitude of preference shares and debentures is very small. On the whole, equity shares accounted for more than 98 percent of all the listed securities.

This research work was carried to study and analyze the relationship between the financial performances and common stock market values of commercial bank. This study attempts to establish a validation about the public response on stock market in the context of Nepal. The study is assumed to be much helpful to all the stockholders of stock market in Nepal.

The main purpose of this study was to examine the relationship between the financial performances (profitability, dividends and net worth) and the common stock price (MVPS) of commercial bank. Besides, the study has made an attempt towards the signaling effects upon the stock prices.

Many literatures were reviewed including books, researches, journals, daily papers and materials found on different internet sites. All the literatures have suggested that, of course, there ought to be a correlation between the financial indicators and common stock values.

Correlation research design and Regression analysis has been used for this study. Financial data were extracted from the web sites of Nepal Stock Exchange, SEBO

publications, different Commercial Bank's Annual Reports and NEPSE Records. Structured intensive interviews were conducted to derive some in-depth insights regarding the stock market performance. 11 Commercial banks were selected for the research study. These are taken on the basis of availability of information in the SEBON, which includes the Commercial Banks which have been regularly submitting the Annual Reports from last 5 years. In this way, I have taken all the Commercial banks meeting my study requirements in terms of data availability for 5 years. Past 5 year's trends have been analyzed for each Commercial bank. The study had assumed Five main hypotheses relating to the correlation test between the independent variables (DPS, EPS, ROE, ROA and Net worth per share). To compute the value of R. R^2, P, etc., a computer software-SPSS program was used.

Analyses of financial indicators have shown that Nepalese stock market is not in its infancy stage for the commercial bank sector. Financial indicators are more stable of commercial bank. Growth rates are super normal. Potential investors are highly attracted by banking industries.

Tests of hypotheses suggested that, in case of commercial bank sector, there is almost perfect positive correlation between the financial performances and stock prices. Investors do not buy the shares analyzing the financial position of the firm. The role of signaling effect is very dominant to fluctuate the share prices in Nepalese stock market. Investors of the stock market are not showing rational behaviors. Stock investors are showing their investment behavior in such a manner that it is almost impossible to fit a theory or prescription for pre-determining the market value of stocks.

The determinants of market value per share, behavior of stock investors and other aspects relating to stock market in Nepal for commercial bank were extensively studied taking some stratified samples. Findings and conclusions of the study are summarized in following key points:

1. *Basically investors and sellers of stocks are not aware with the financial parameters such as DPS, EPS, ROA, ROE, BVPS etc., stocks are not traded*

because of good financial parameters but because of non-financial factors such as lack of other investment opportunity, Expectation of bonus shares, right shares, rumors, speculations, and like.

2. *Nepalese stock market is in infancy stage. In general, it is very new and has just started to develop.*

3. *Commercial Bank with a long history have a relatively stable profitability parameters than the new Commercial Bank.*

4. *Dividend per share of commercial bank is more or less stable.*

5. *Capital gains are not only supernormal, more ever, those are abnormal. Most of the investors make security transactions for speculation purpose in stead of normal return.*

6. *Due to lack of proper investment opportunity, most of the investors have directed their savings towards the secondary stock market. This factor has created a bulk demand for stocks.*

7. *People have a misconception that the issuances of bonus shares and dividend which actually decreases the net worth per share, and resultantly out to decrease the market price of stock also, do not decrease the prices and this makes them to invest even at a too high price with a expectation of getting the same to increase their overall wealth.*

8. *Findings of Test of Hypothesis:*

   a. *There is not significant positive correlation between the profitability parameters (ROA, ROE, DPS) and the stock prices of the commercial bank.*

   b. *There is a significant positive correlation between the dividend paid and stock prices of commercial bank.*

   c. *There is a significant positive correlation between the Book value per share (Net worth) and stock prices of commercial bank.*

   d. *There is a moderately positive correlation between financial performance indicators and stock price of commercial bank.*

   e. *Market index of commercial bank is not in random manner.*

9. *Findings of Regression Analysis: Regression analyses also give the same result as in above hypothesis test.*

5.2 CONCLUSIONS:

An Investment in common stock of a corporate firm neither ensures an annual return nor ensures the return of principal. Therefore, investment in common stock is very sensitive on the ground of the risk. Dividends to common stockholders are paid only if the firm makes an operating profit after tax and preference dividend. The company can return the principal in case of its liquidation only to the extent of the residual assets after satisfying to all of its creditors and preference shareholders. Besides this, the investors have to sacrifice the return of their investment in common stocks, which could be earned investing the fund elsewhere in the next best alternative.

Therefore, a rational investor of common stock needs to consider at least one of following three factors:

1. *Profitability of the corporation*
2. *Net assets value per share*
3. *Opportunity cost of the fund*

Nepalese stock market is an imperfect stock market, but in the case of only commercial bank sector it has been seen that there is perfect stock market because almost all the financial indicators are in increasing order with its market price, although market price is very much than its book value per share. Limited bulk investors, VIP shareholders, brokers, under writers and the firms are dominating the whole stock market. Their coalition, intention and rumors highly affect to the market price of their targeted corporations. Some of the firms under those industries have a market value per share less than the book value per share. Whereas in case of banking it is in some cases, 10 times greater than the book value per share.

Stock market in Nepal has not been properly analyzed and understood by many investors in Nepal and because of this there is degree of imperfection in the market. It is quite obvious that if any degree of imperfection prevails in any system that leads to a

manipulation or an arbitrage opportunity to the players. Therefore, even if the investors are well known about the theory and concepts of the stock market, they fail in the reality because of the malpractices prevailed in the system. There are so many examples where investors failed when they based their decisions on the theoretical knowledge of the stock market. Stock market in Nepal is required to an overall restructuring because there is a huge gap between the generalized theories of stock prices and the reality so happening here in Nepal. Stocks market behaves generally in response to the whims and rumors spread by the major players of the market in most of the times than the actual financial performances of the companies shown by the indicators.

5.3 RECOMMENDATIONS

1. Mutual Fund should be promoted for collect small amount of low income level people and to give them the opportunity of getting the benefit from the financial sector investment.
2. Central Depository System should be initiated for making the faster transaction of stock.
3. The promoters of stock issuing company, the management, the VIP shareholders and the market makers should not encourage to rumors which ultimately vanish the stock market. Rumors and other artificial factors as well as the intangible factors make the security market inefficient which becomes a hurdle for the smooth growth of the stock market. Thus the intelligent stakeholders of the stock market should make the ordinary stock investors aware about the rational investment decision by disseminating the proper message.
4. Speculation and potential investors are scattered. It should be made possible for them to transact in the secondary market easily. Most of the scattered shareholders and potential investors are passive due to inaccessibility of the security exchange. They should be brought into the boundary of security market in order to develop the stock market.

5. *Speculation should be discouraged since it inflates the price of stocks. Speculators, holding bulk shares, raise the rumors that the uneducated and irrational investors believing it give rise to demand. Supply being controlled by the speculators; they take undue advantages of the artificially increased price of stocks. Speculation involves high degree of risk and it is a short period effect making the stock market inefficient. It should be discouraged through increasing awareness among the outstanding and potential investors.*

6. *Security Board and security Exchange Centre should attempt to make aware to the investors regarding the factors which ought to be considered for making less risky and rational investment. The authorities related to the stock market should have effective packages and programs to educate and train to the stake holders who directly involve in security transactions. This can be done by; a) publishing the matters of stock investment more frequently b) disseminating the recent information and knowledge through mass media c) launching program like seminars, workshops, trainings, round table talks, etc. which develop a skill and awareness among the investors and market makers.*

7. *The corporate firms should communicate the real financial statements. Value of assets and liabilities should not be manipulated to report the under or over profitability. Every decision of the corporation should be made to maximize the value of the firm and value per share.*

8. *Corporate firms should not hesitate to hire the experts of financial management. Of course, they get the advantages in excess of the costs of hiring such manpower.*

9. *An attempt by the concerned stakeholders should be made to establish a credit Rating Agency.*

10. *Immediate action should be taken by the concerned authority over the market makers indulging in unethical transactions and activities.*

11. *Few years' back, NG had announced a tax on dividend income. It is quite unjustifiable and discouraging to the potential common stock investors. Therefore income tax should not be imposed on dividend income since the corporation already pays income tax on total profits before distributing dividends.*

12. Investors should make their investment decisions based on financial parameters of the company. They should not rush over the rumors.

13. Price should be paid for shares correlating it with at least one of the following:

a. Net worth per share

b. Dividend yield plus growth rate

C. opportunity cost market rate of return

    if the investors have no idea about the proper valuation of securities, they can consult with the expert of this sector. At least, they can take advice to subject faculties of different universities.

14. There is a great potentiality of starting financial consultancy and research institutions on financial market. this is an opportunity to the finance intelligent. The authorities should encourage the up comers and established academicians and practitioners to initiate such career. This will definitely contribute in maturing the financial market.

15. I strongly suggest to the further researchers on this area to take more samples and all the sector, if possible the whole population, and more intensive primary data based research to generalize the facts about the market value per share of common stocks. But it requires a great deal of effort to collect the data of other corporate firms that are not included in this research.

Last but not least, all the stakeholders of the Nepalese stock market should realize that our stock market is in infancy stage. There are many arbitrage opportunities prevail in our system. Therefore, if sufficient concern is not paid by every stakeholders of our financial system, it is sure that the same indecisive situation may last even for coming many years.

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