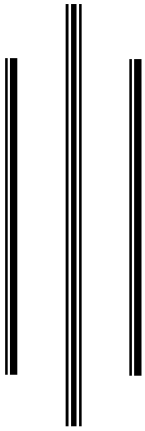
INVESTMENT ALTERNATIVES AND INVESTORS' PREFERENCES IN NEPAL



SUBMITTED BY:

SHAMBHU CHAUDHARY

Shankar Dev Campus

Roll No.: 1497/060

T.U. Regd. No.: 1257-93

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RECOMMENDATION

This is to certify that the thesis

Submitted by:

SHAMBHU CHAUDHARY

Entitled:

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has been prepared as approved by this Department in the prescribed format of the faculty of management. This thesis is forwarded for examination.

……..…..……..	…….....……..	……. ……
Shree Bhadra Neupane	**Prof. Bisheshwor Man Shrestha**	**Dr. Kamal Deep Dhakal**
(Thesis Supervisor)	(Head of Research Department)	(Campus Chief)

……..…..……..

Rabindra Bhattarai

(Thesis Supervisor)

VIVA-VOCE SHEET

We have conducted the VIVA-VOCE examination for the thesis presented by

SHAMBHU CHAUDHARY

Entitled:

INVESTMENT ALTERNATIVES AND INVESTORS' PREFERENCES IN NEPAL

And found the thesis to be the original work of the student and written according to the prescribed format. We recommended the thesis to be accepted as partial fulfillment for the Degree of Master of Business Studies (M.B.S).

VIVA-VOCE Committee:

Head Research Department : _____

:

Member (Thesis Supervisor) : _____

Member (Thesis Supervisor) : _____

Member (External Expert) : _____

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Faculty of management

Shanker Dev Campus

DECLARATION

I hereby declare that the work reported in this thesis entitled "**Investment Alternatives and Invesotors' Preferences in Nepal"** submitted to Shankar Dev Campus, Faculty of management,Tribhuvan University is my original work done in the form of partial fulfillment of the requirement of the Master of Business Studies (M.B.S) under the supervision of **Shree Bhadra Neupane and Rabindra Bhattarai**, Shankar Dev Campus,Putalisadak,Kathmandu.

Date:…….

……..

SHAMBHU CHAUDHARY

(Researcher)

Campus Roll No.:1497/060

T.U.regd. No:1257-93

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Investors and financial instruments are the very important and crucial part of capital market. Development of the security market in the present global scenario requires restructuring of the current market operation system and policies so that the transparency and credibility of the market can be maintained. For this to attain investors psychology towards financial instruments and their opinion as to the present policies should be explored and understood. This research, in this regard, may be of one of the important product.

I would like to extend thanks to my thesis advisors **Shree Bhadra Neupane and Rabindra Bhattarai** for their invaluable suggestions, co-operation, support, guidance and supervision to complete this thesis and making this research a product.

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I)

SHAMBHU CHAUDHARY
Researcher
Shanker Dev Campus
Tribhuvan University

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ABBREVIATIONS

B. S.	:	Bikram Sambat
FRN	:	Floating Rate Notes
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
MC	:	Market Capitalization Ind. Ins.
Mfg	:	Manufacturing
NEPSE	:	Nepal Stock Exchange
NGOs	:	Non Governmental Organization
NRB	:	Nepal Rastra Bank
OTC	:	Over the Counter
Q.N	:	Questionnaire Number
SAV	:	Saving
SEBO	:	Security Board
ST	:	Stock Turnover
Devt. Bank	:	Development Bank
Ins.	:	Institutional
Ind.	:	Individual

CHAPTER- I
INTRODUCTION

1.1 Background of the Study

Factors influencing investment behavior in Nepal are a matter of considerable interest among stockbrokers, business strategists, public officials and ordinary people. Recent years have witnessed enormous movement in trades and volume in Nepal stock exchange. This could be due largely to the investors' preferences towards the benefits of investing in shares. "The stock market in a developing nation, promotes the general availability of liquidity and risk diversification services, may serve to motivate entrepreneurs who may later go public, and provide incentives for managerial performance that make it easier for firms to raise capital"*(Ambachtsheer; 2006;28).*

In Nepal, generally all capital market investment avenues are perceived to be risky by the investors. But the younger generation investors are willing to invest in capital market instruments, especially in equity shares. Even though the knowledge to the investors in the financial segment is not adequate, they tend to take decisions with the help of the brokers or through their friends and were trying to invest in this market. This study was undertaken to find out the awareness level of various capital market instruments, and reasons for investing in particular securities and also to find out their risk preference in various segments.

Financial instruments refers to the stock, bond, debenture and other financial assets those represents the right of the holder to receive future prospective benefits under the terms and conditions provided in the instrument(s). Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buy and sell orders that flow from investors' demand and supply preferences determine the price of securities in the security market. Since securities market is the major component of capital market it is the need of today to address the investors' attitude as to the financial assets those are transacted in such markets. This study is a small effort toward that end.

Financial market facilitates the transaction of financial assets like deposits, loan, bonds, securities, stocks, cherubs, bills etc. Financial market refers to all the activities of financial institutions those transact on financial assets and liabilities.

"Financial market is defined as place where fund supplier and fund borrowers are brought together with the help of financial intermediaries directly or indirectly. These intermediaries channel nation's savings into most productive uses. Lenders or suppliers of funds exchange money for other financial assets that tend to provide a better future return. The net effect such a transaction is that they buy a claim against some one's money holding at some future date. In fact, they create loanable funds in the financial market" *(Hemming and Pigott; 1975:11).*

"Financial market in functional perspective is a rational system of collecting savings and allocating them efficiently to the ultimate users for investment in productive assets or current consumption" *(Kidwell and Peterson; 1981: 25).* Financial market can be better understood with a full-fledged knowledge on their various types and categories. The lines of demarcation are not clear-cut in practice. Even then for the purpose of simplification and made it understandable, financial market is classified as Capital market, Money market, Primary market, Secondary market and Loan and security market etc.

Capital market is an important part of financial market. The market in which long term financial instruments, such as equities and bonds, are raised and traded is capital market.

Capital market securities include such marketable debt securities with maturities of a year or more and equity securities. Most of associated markets come under the scope of capital market. In fact, capital market deals with longer term and relatively riskier securities. All those who needed longer-term funds depend on capital market. Likewise, business and industries issue shares and other securities to raise funds from capital market. In the context of our own country, capital market is slowly growing as well as improving. Growth of capital market has mad it possible for the public limited companies to raise the long term capital by issuing shares and other industrial bonds to the investing public. On the whole, capital market is proving very significant to enhance the country's financial sector development. It is mainly because capital market as much more diverse than those found in money market. Capital market is further classified into Stock market, Moneylenders, and Local Businessmen etc.

Whatever may be the classification, financial instruments is the main medium through which each of the markets discussed above deals. Securities market cannot remain aloof what kind of securities are dealt in securities market. Speaking another way, securities market and its status are determined by the securities that are transacted in the securities market. On the other the depth and breadth of financial instruments are highly dominated by investors preferences. Due to this very reason, this study attempts to identify the factors that influence investors while making investment decision so far as the matter of investing in financial instruments is concerned. To which securities investors give more priority, what the reasons are those mainly attract the investors to invest in a particular security, why they prefer one security over other (s) etc. are the issues to be addressed here in the study. Further, this study also strives to address whether or not the Nepalese investors are compensated rightly as per the risk they bear.

1.2 Financial Institutions in Nepal

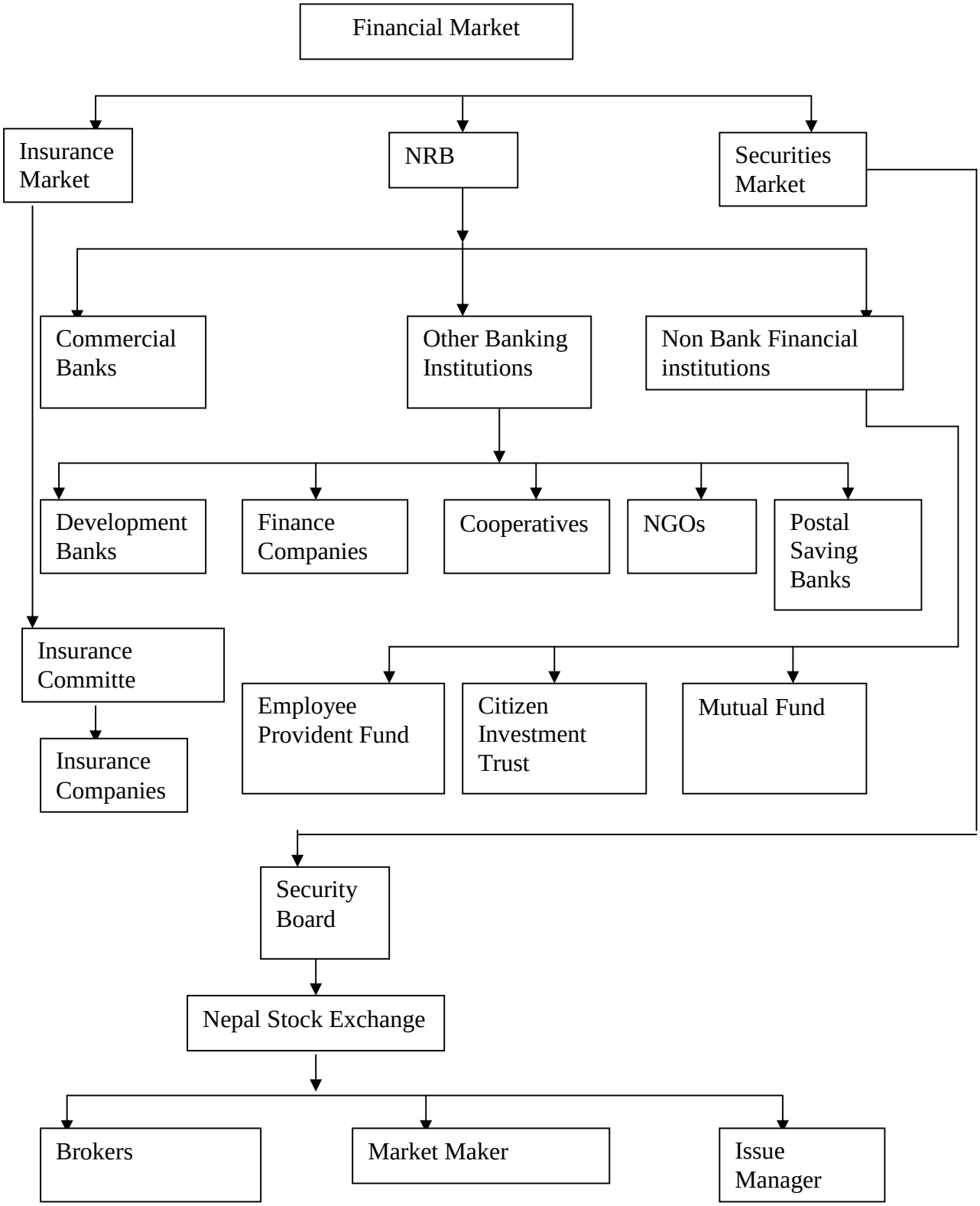
The Nepalese financial sector is composed of banking sector and nonbanking sector. Banking sector comprises Nepal Rastra Bank (NRB) and commercial banks. The non-banking sector includes development banks, finance companies, micro-credit development banks, co-operative financial institutions, non-government organizations (NGOs) performing limited banking activities and other financial institutions such as insurance companies, employee's provident fund, citizen investment trust, postal saving offices and Nepal stock exchange. However, this bulletin contains information only on those financial institutions which are licensed by NRB up to mid-July 2010.

"During the last two and half decades the number of financial institutions has grown significantly. At the beginning of the 1980s there were only two commercial bank and development banks in the country. After the induction of economic liberalization policy, particularly the financial sector liberalization, that impetus in the establishment of new bank and non bank financial institutions. Consequently, to the date there are altogether 28 'A' class commercial banks, 58 'B' class development banks, 76 'C' class finance companies, 12 'D' class micro-credit development banks, 16 saving and credit co-operatives, and 46 NGOs are in operations" *(NRB;2007:2).*

As shown in figure 1.1 Nepal Rastra Bank (NRB) is the apex body of Nepalese financial system, established in 2013 B. S. Nepal Rastra Bank can direct and regulate depository financial institutions.

Figure: 1.1

Financial Institutions and System in Nepal



In Nepal Financial market can simply describe in insurance market, securities market, bank and financial institutions regulated by NRB.

Three year interim plan (2007-2010) capital market development plans, objectives, policies and programs have been already spelled out. The task of maintaining financial stability remains a challenge due to problem ridden government owned, and some private sector financial institutions. As the private sector's loan demand is at a low level, the banking sector as a whole is facing the problem of an excess liquidity situation leading to an ever-low interest rate in the deposits. The rural areas still lack access to banking services. Together the impact on savings tends to be negative and hence there is a challenge of making the real interest rate positive. The objectives are: Maintain price stability and balance of payments. Manage required liquidity to facilitate sustainable and high economic growth rate. By strengthening and maintaining stability in the financial sector, access to the banking services will be expanded in the entire country and payment system will be strengthened. Quantitative Targets Inflation will be limited to an average of 5.6 percent per annum. Broad money supply growth rate per annum will be 16.4 percent. Private sector credit is to increase on an average of 20.3 percent. Balance of payments surplus will be reached to 1 percent of the GDP. The main policies of this plan are: Monetary management will be geared to maintaining macroeconomic stability and making available the liquidity required for sustainable and high economic growth rate, Open market operations will be used as a prime tool of the monetary policy. A system of non-paper settlement will be brought into practice with respect to government bond transactions, using the inflation rate target, monetary and credit aggregates and interest rates as required for the monetary strategic targets' alternatives will be studied, monetary management will be oriented towards increasing the volume of credit to the private sector and gradually decreasing the ratio of the banking sector credit to the government, as a matter of principle, commercial banks will be given the freedom to manage their portfolio with a view to maintaining financial sector stability, Poor Group Credit Program, operating through the commercial banks, will be continued to reduce poverty in the country, Financial institutions will be encouraged to issue an infrastructure development bond for channeling the private sector remittance inflow in the infrastructure development. With a view to facilitating commercial bank investment in infrastructure, such as hydropower development, the existing single borrower limit will be increased, the financial sector will be further strengthened by implementing international financial

standards, risk management oriented regulatory system will be enforced more effectively. In addition, market monitoring and regulating will be brought into practice as they play an important role in stabilizing the 56 financial sector, to safeguard the interest of small savers, a deposit insurance scheme will also be initiated, Legal provisions concerning the creditors rights will be formulated for inclusion in the financial sector legal reform and the legal provisions there under will be enforced effectively.

1.3 Statement of Problem

Investors are said to be the backbone of economic development. Therefore the investors should be encouraged to make investments in security markets by creating congenial investment environment. Government and concerned parties concerned to the financial field can create such environment. However they must know the preferences and attitude of investors.

It is necessary to make wise research on investor's preferences. This helps to identify the root cause of domination of one security over others. Following are the issues that the study is going to address:

1. What is the preference level of investors on various Capital Market instruments and investors prefer on security over others? What are the reasons for such preferences?
2. What are the types of risk which are considered by the investors? What are the ways through which the investors minimizes their risk
3. For what purpose Nepalese investors tend to invest?
4. Which Industrial sector investors prefer most in Nepal?
5. What are the influencing factors that attract investors to invest in one or other security or securities?

1.4 Objective of the Study

Security market is the most important branch of capital market. In our country, it is said that, stock market is slowly developing according to needs of the economy although they are not sophisticated as in the market of the advanced countries. The security market is taking its ride on a slow pace is, of course, affected by the investors' psychology. In this

context, it is relevant to address the investment alternatives and investors' preferences. Main objectives of this study can be outlined as follows:

- To find out the preference level of investors on various Capital Market instruments.
- To find out the type of risk which are considered by the investors and the ways through which the investors minimizes their risk.
- To examine the purpose of investors to invest in financial securities
- To find out which industrial sector they prefer most.
- To analyze the influencing factors those attract investors to invest in particular security or securities.

1.5 Significance of the Study

This study is very helpful for the investors who are risk averse for trade in securities. Awareness about the various uses of securities can help investors to reduce the risk and minimize the losses

This research is very useful to all the parties like security businesspersons, market makers, brokers, and companies etc. who are directly or indirectly involved in the stock market.

This research provides the guidelines to the stock market and potential investors to make investment decisions. Like wise issuer company may also take advantage of the study by examining the investors' psychology towards the investment in different financial instruments.

Security market plays vital role in the development of the countries. The level and pace of investment affect the whole economic environment of the nation. The investors are the sovereigns of security market so their needs and desires must be identified so that they can rightly be rewarded for the sacrifice from their part.

1.6 Limitations of the Study

The limiting cases in regard to this study are:

1. Measurement of preference cannot be assured of cent percent accuracy because preference is caused by numerous factors such as social, political, economic and managerial efficiency.

2. This research is mainly based on primary data. However secondary data will also be employed as per necessary to support the study.
3. Respondents are from Katmandu valley only.
4. There may be so many financial instruments but equity shares, preference shares, debentures, and government bond are considered in this study.
5. Understanding the nature of the risk is not adequate unless the investor or analyst is capable of expressing it in some quantitative terms. Expressing the risk of a stock in quantitative terms makes it comparable with other stocks.

1.7 Organization of the Study

This research has been organized in the manner below:

Chapter I: Introduction: The first chapter deals with introduction. This includes background, statement of problem, objectives of the study, significance of the study, limitation of the study.

Chapter II: Review of Literature: Second chapter presents review of available literature. It includes review, book, reports, journal, previous thesis etc.

Chapter III: Research Methodology: Third chapter explains the research methodology used in the study, which includes research design, sources of data population and samples, methods of data collection and analysis etc.

Chapter IV: Presentation and Analysis of Data: The fourth chapter presents the data collected different sources. Based on the data analysis of analysis of investors' attitude has been performed.

Chapter V.: Summary, Conclusion and Recommendation:

The fifth chapter summaries, concludes the whole study and offers suggestions for further improvement.

After completion of these five chapters, a list of literature that reviewed earlier is included alphabetically in **bibliography**. Likewise, data, information, calculation sheet etc are incorporated in **appendices**.

CHAPTER- II

REVIEW OF LITERATURE

In this chapter, some of the basic literatures related to the topic are reviewed. It includes literatures regarding theories on the topic and review of the empirical evidences of previous studies.

The first section of this chapter contains a brief description of the theories of the financial market, investment and risk and return. It includes the technical analysis, fundamental analysis and efficient market theories. The second section provides reviews on empirical experience of previous studies.

2.1 Conceptual Framework

2.1.1 Concept of Financial Market

"Financial system refers to a set of institutional arrangement through which financial surpluses in the economy are mobilized from surplus units and transferred to the deficit units. The institutional arrangement includes: the conditions and mechanisms governing the production, distribution, exchange and holding of financial assets or instruments; working of financial markets; and organization and operation of financial institutions. Financial system is to be distinguished from payments system which refers to the set of institutional arrangements through which purchasing power is transferred from one transactor to another. The financial market is a broader system; the system covers both cash and credit transactions, whereas the payment system covers only cash payments" *(Paul; 2005:177).*

The term financial market refers to the place where financial transactions take place through the network of borrowers and lenders of funds. In other words, financial market within the economy brings borrowers and lenders together to place buying and selling orders with the help of brokerage and other financial intermediaries. Financial market is the hallmark of any modern business enterprise economy. Activity in the financial market takes place through the exchange of one financial asset or instrument with another. This is done with the help of market players called the financial intermediaries. The major

participants of financial markets serve in different capacities as savers, investors, borrowers, and users of funds. In the most indirectly, most individuals businesses and institutions are involved in the borrowing and lending of funds. They are involved in the purchase and sale of securities in the financial market and supported by financial intermediaries and facilitators. Individuals, corporate bodies, non-profit organizations and the government are the participants in these transactions of buying and selling of financial assets.

"Economics defines market as an institution or arrangement that facilitated the purchase and sale of goods, services and other utilities generating activities. But a financial market is an institution or arrangement that facilitates the exchange of financial assets, including deposits and loans, corporate stocks and bonds, government bond and more exotic instruments such as options and futures contract"*(Robinson and wrightman;1990:15).*

2.1.2 Securities Market Instruments

Securities are the main medium through which whole market works. Securities means shares, stock, debenture, etc. issued by a corporate body or a certificate relating to unit saving scheme or group saving scheme issued by any corporate body in accordance with the prevailing laws or negotiable certificate of deposit or treasury bill issued by Government and it includes the securities issued under full guarantee of the Government or securities as prescribed by government by a notification publishes in the Nepal Gazette or receipts relating to deposits of securities as well as rights and interest relating to securities.

Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buy and sell orders that flow from investors' demand and supply preferences determine the price of securities in deficit and surplus units of society. The common stock, preferred stock, debentures and government securities are mainly used in terms of securities in Nepal. The preferred stock and debentures are not commonly used in Nepal. Basically the common stocks are traded through NEPSE. Government securities are also important securities, which are issued by government

through Nepal Rastra Bank. The major financial instruments in securities market can be described in the following manner:

) Common stock

Shares are a type of securities, confirming the owner's (shareholder's) part in the ownership of a company and entitling him to the following: participation in the management of the company, a proportion of dividends, a portion of the value of the company in case of liquidation and other entitlements established by laws. The par value of a share is the value of one share set by a company's founders upon initial offering. The product of the par value of shares and the number of shares issued constitute authorized capital of the company. The par value of a share shall be expressed in litai, cents excluded. The par value of a share does not mean that it has the same market price because a share's price in the market can be higher or lower than the fixed par value of a share. The par value of shares can be changed by shareholders' resolution. All the shares of a company are registered and are classified into ordinary shares and preference shares, according to their owners' entitlements.

"Ordinary registered shares are one of the two types of shares obtainable by the investor. Ordinary registered shares make up the bulk of the company's shares at the company. Upon purchase of the given shares, investors acquire the right to vote at the general meeting. Shareholders are entitled to dividends however dividends are not warranted to the owners of ordinary registered shares. The owners of ordinary registered shares tend to receive larger dividends than fixed rate dividends received by the owners of preference registered shares during the period of the company's prosperity. In the event of the company's insolvency or liquidation, the owners of ordinary registered shares are the last among claimants – the state, creditors, bond holders and the owners of preference registered shares – for the assets of the company going into liquidation. Preference registered shares are the type of shares, entitling investors to secure dividends but usually without the right to vote at the general meeting. Preference registered shares typically carry a right to receive fixed rate dividends which shall be paid out prior to dividends for ordinary registered shares. In the event of the company's insolvency or liquidation, preference registered shares give their holders preferential treatment in respect of the owners of ordinary registered shares for receiving a portion of the assets of the company

going into liquidation. Preference registered shares can be converted (changed) into ordinary registered shares. According to the degree of risk, shares are the instruments bearing higher risk than deposits, bonds or funds but more secure than derivative instruments. The overall macro economical state and prospects of the country also have a great influence on the dynamics of the share price. Frequently, share prices correlate with the share prices at other enterprises, belonging to the same economical sector, or with general tendencies in the world markets. The price is also affected by the share turnover. When the share turnover is high, the difference between the purchase price and the sale price diminishes. Shares characteristic of high turnover are usually very liquid therefore easily purchased and sold. In this case, sale of a large quantity of shares does not influence the share price significantly. Conversely, if a share is of low liquidity and marketing is not active, fluctuations of share prices are noticeably stronger. Common stockholders hope to receive a return based on two sources dividends and capital gains. Dividends are received only if the company earns sufficient money and the board of directors deems it proper to declare dividends. Capital gain arises from advancement in the market price of the common stock, which is generally associated with a growth in per share earnings. Because earning often do not grow smoothly over time. This fact points the need for careful analysis in the selection of securities for purchase and sale, as well as, in the timing of these investment decisions, for common stock has no maturity date at which a fixed value will be realized. When a company needs capital for expansion, it sells shares of its stocks to the public. Most companies issue million numbers of shares so each share represents only a tiny piece of the company. These shares are also transferable" *(Fisher; 2002:2).* "The common stockholders of a corporation are its residual owners; their claim to income and assets comes after creditors and preferred stockholders have been paid in full. As a result, a stock holder's return on investment is less certain than the return to a lender or to a preferred stockholder is not bounded on the upside as are returns to the others" *(Prasanna; 1994:24).*

) Debt

Bonds are a type of securities, in which the authorized issuer owes the holder of debt securities a debt and is obliged to repay the principal – par value and interest, provided such were foreseen in the issue conditions of debt securities, at pre-defined terms. Interest can be paid in different ways subject to the defined conditions. Usually bonds interest

(‘strip’, ‘coupon’) is paid once a year but more frequent payments are also possible. There are bonds which do not pay periodical interest. They trade at a substantial discount from par value and are redeemed for face value (‘zero coupon bonds’ or ‘discount bonds’). Bonds can be of different terms and lengths. They can be issued by governments, banks It is one of the most secure instruments of investment however possible yield is not high. Bonds are often called fixed yield securities as the investor knows the amount he is going to recover. However the right to redeem a bond prior to maturity can also be determined. The following are the samples of company bonds:

a) With a fixed interest rate: upon acquisition of a bond, the investor knows the amount of interest that he will be paid;
b) With a variable interest rate: upon acquisition of a bond, the investor does not know the amount of interest that he will be paid but rules of interest establishing are introduced to him;
c) Convertible bonds: the investor receives a certain amount of the company’s shares at the maturity date of redemption of these bonds. The market value of a bond depends on the interest rate prevailing at the market at the moment. With interest rate growing, the bond value declines and vice versa, with interest rate declining, the bond value increases. The overall level of interest rates is influenced by monetary policy pursued by central banks, general situation in the market and expectations of its participants. Bonds issued by governments or municipalities are considered to be of a zero risk due to high guaranties of their redemption. The bond issuer’s credit ratings are of great significance. Generally, the lower they are, the higher the profitableness of bonds and the degree of credit risk. Inasmuch as a bond is a loan and its holder is a lender, investment in bonds is interrelated with the bankruptcy risk of the bond issuer. Every time he lends money, the customer is at risk that the money will not be recovered. Signally increasing inflation imperils the investor acquiring bonds.

“The holders of a company’s long-term debt, of course, are creditors. Generally, they cannot exercise control over the company and do not have a voice in management. If the debts contract, then these holders may be able to exert some influence on the direction of the company. Holders of long-term debt do not participate in the residual earnings of the company; instead, their return is fixed. Their debt instrument has a specific maturity,

whereas a share of common or preferred stock does not in liquidation, the claim of debt holders is before that of preferred and common stockholders. Depending on the nature of the debt instrument, however, there may be difference in the claim among the various creditors of a company" *(Vane Horne; 2000: 211).*

I) Debenture

"The term debenture usually applies to the unsecured bonds of a corporation. Investor looks to the earning power of the corporation. Because these general credit bonds are not secured by specific property. In The event of liquidation the holder becomes a general creditor. Although the bonds are unsecured, debenture holders are protected by the restrictions imposed in the indenture, particularly the negative pledge clause, which precludes the corporation from pledging its assets to other creditors" *(Vane Horne; 2000:513).*

II) Subordinated debentures

"Subordinated debentures represent debt that ranks behind debt senior to these debentures with respect to the claim on assets. In the event of liquidation, subordinated debenture holders usually receive settlement only is all senior creditors are paid the full amount owed them. These holders still would rank ahead of preferred stockholders in the event of liquidation. The existence of subordinated debentures may work to the advantage of senior holders, because senior holders are able to assume the claims of the subordinated debenture holders" *(Vane Horne; 2000:513).*

III) Mortgage Bonds

"A mortgage bond issue is separated by a lien on specific assets of the corporation-usually fixed assets. The specific property securing the bonds is described in detail in the mortgage, which is the legal document giving the bondholder a lien on the property. As with other secure lending arrangements, the market value of the collateral should the market value of the bond issue by a reasonable margin of safety" *(Vane Horne; 2000:513).*

IV) Income Bonds

Income bonds provide that interest must be paid only id the earnings of the firms are sufficient to meet the interest obligations. The principal, however, must be paid when due. Thus the interest itself is not a fixed charge. Income bonds, historically, have been issued because a firm has been in financial difficulties and its history suggests that it may by unable to meet a substantial level of fixed charges in the future. More generally, however, income bonds simply provide flexibility to the firm in the event that earnings do not cover the amount of interest that would otherwise have to be paid. Income bonds are like preferred stock in that the firm will not be default if current payments on the obligations are not made. They have an additional advantage over preferred stock in that the interest is a deductible expense for corporate income tax computations, while the dividends on preferred stock are not.

The main characteristic and distinct advantage of the income bond is that interest is payable only if the company achieves earnings. Since earnings calculations are subject to differing interpretations, the indenture if the income bonds carefully define income and expenses. If it did not, litigation might result. Some income bonds are cumulative indefinitely (if interest is not paid, it accumulates, and it must be paid at some future date); others are cumulative for the first three to five years, after which they become non-cumulative.

"Income bonds are usually contain sinking fund provisions to provide for their retirement. The annual payment to the sinking funds range between ½ and 1 percent of the face amount of the original issue. Because the sinking fund payment requirements are typically contingent on earnings, a fixed cash drain on the company is avoided. Typically, income bondholders do not have voting rights when the bonds are issued. Sometimes, bondholders are given the right to elect some specified number of directors if interest is not paid for a certain number of years" *(Weston and Copeland; 1990:967).*

V. Floating - Rate Notes

When inflation forces interest rates to high levels, borrowers are reluctant to commit themselves to long-term debt. Yield curves are typically inverted at such times, with short -term interest rates than long- term. One factor is that borrowers would rather pay a

premium for short - term funds than lock themselves into high long- term rates for two or three decades.

Those who defer long-term borrowing in hope that interest rates will soon fall face two risks. First, there is no assurance that rates will not rise even higher and remain unexpectedly high levels for an indefinite period. If long - term rates rise to 15 percent, for example, debt that looked expensive at 12.3 percent will seem like a bargain to a borrower who passed it up in the hope of waiting out the a rates crisis. Second, the short - term money may simply become unavailable.

“The floating - rate note (FRN) was developed to decrease the risks of interest rate volatility at high levels. In an FRN, the coupon rate varies at a given percentage above prevailing short- or long -term treasury debt yields. The FRN rate is typically either fixed or guaranteed to exceed a stated minimum for an initial period and then adjusted at specified intervals to movements in the treasury rates. FRNs were first issued in the United States by Citicorp in 1974. The rate was set at a minimum of9.7 percent for ten months and then adjusted semiannually to 1 percent above the current three month Treasury bill rate. Other firms followed Citicorp's lead. These early issues carried rates based on T-bill yields, and most allowed investors to "put" the FRN to the issuer at face value after a given date. Initial rates on the notes were well below the going rate on such short -term borrowing as commercial paper. In July 1974, the rate on three-month prime commercial paper was 11.9 percent, while Treasury bills of comparable maturity where yielding 7.6 percent. Because interest tares were generally expected to decline, borrowers hoped that FRNs would also cost less over the life of the notes than fixed- rate long- term debt” *(Weston and Copeland; 1990:967).*

) Preferred Stock

“Preferred stocks have fixed dividend and right of acquiring principal before common stock at the time of liquidation. "Preferred stock is said to be a "hybrid" security because it has features of both common stock and bonds. Preferred stocks are preferred with respect to assets and dividends. In the event of liquidation, preferred stockholders have a claim on available assets before the common - stockholders. Furthermore, preferred stockholders get their stated dividends before common stockholders can receive and dividends” *(Vane Horne; 2000:515).*

Government Securities

Government issues various types of securities to fulfill and undertake the development works under the deficit budget and raises scattered funds from public. These securities are assumed to be less riskily as compared with external debt. Government issues securities internally and externally. the main source of internal debt is government bonds. NRB has been actively issuing various government securities in the country. It is one of the most important issuance of the government to maintain the deficit budgetary system of Nepal. One of the important government securities in case of Nepal is government security which is the short -term government bond. It is issued to fulfill deficit budgetary system in Nepal. It normally matures in 91 days while some securities mature in 365 days. It is issued a collect scattered funds and to mobilize it in productive sector and conduct fiscal and monetary policies. It is issued on the basis of auction so that any individuals and institutions can invest in Treasury Bills.

2.1.3 Investment

"An investment is a commitment of money that is expected to generate additional money. Every investment entails some degree of risk; it requires a present certain sacrifice for a future uncertain benefit" (Francis; 1999:1).

Investment is a subject of growing importance. Investors in general have to be careful in making best use of their funds. If not, they have to lose from investment. Taking the example from our own country, many investors face serious losses due to irrational investment behavior. But informed and rational investors make investigation before investment and they can gain more from capital market. Investment as such is a rational process of making sound and profitable investment decision according to changing conditions of the capital market. For simplification and to make investors understand about investment, Investments can be conceptualized to employing savings in securities to generate future income.

In capital market perspective, investment is making transactions in shares and debentures through the use of brokers since they facilitate trading in the stock exchange. But this may not be investment to an economist. An economist uses the term investment to have addition to nation's physical stock of capital like establishing new factories installing new

machineries and addition to inventory. Since buying shares and debentures do not add to an addition to the stock of physical assets it does not constitute investment to an economist.

An entrepreneur thinks upon investment as profit generating vehicle. In this regard, investment is equated to the entrepreneur's self-employment of funds in his business. As for instance, many entrepreneurs employ their capital in doing business. In financial institution's perspective, investment is the channelization of collected saving from savers by way of credit and loans to those who need for meeting their varying needs and purposes. To the government investment involves the resource mobilizing process in the various productive sectors of the economy.

Looking still in other way, investment implies the process of channeling investors public funds in various securities issued by the government, companies, financial institutions, industries and many other undertakings through the intermediary network. In our country, many public limited companies have been successful enough to raise capital from capital market by issuing rosy prospects with higher commitment of returns to investing public that invest in the shares of such companies.

2.1.3.1 Investment process

Investment process involves how an investor should make decisions about what marketable securities to invest in, how extensive the investment should by, and when the investment should be made. A five-step procedure for making these decisions is the basis of the investment process:

Investment policy

The first step, setting investment policy, involves determining the investor's objectives and the amount of his or her invest able wealth. Because there is a positive relationship between risk and return for sensible investment strategies, it is not appropriate for an investor to say that his or her objectives to attempt to "make a lot of money". What is appropriate is for an investor to state that his or her objective is to attempt to make a lot of money while recognizing that there is some chance that large losses may be incurred. Investment objectives should be stated in terms of both risk and return.

This step in the investment process concludes with the identification of potential categories of financial assets to be included in the portfolio. This identification will be based on, among other things, the investment objectives, among of inevestable wealth, and tax status of the investor. For example, as is discussed later, usually it does not make sense for individual investors to buy preferred stock or for tax-exempt investors to investing tax-exempt securities.

Investment policy is the cornerstone of the investment process. Without it, investors have no appropriate context in which to make investment decisions. Unfortunately, however, investment policy often receives the least attention from investors.

Security Analysis

The second step in the investment process is performing security analysis. it involves examining several individual securities within the broad categories of financial assets previously identified. One reason to examine securities is to identify those that seem mispriced. There are manta approaches to security analysis. However, most of these approaches fall into one of two classifications. The first classification is technical analysis; analysts who use this approach to security analysis are called technicians, or technical analysts. The second classification is fundamental analysis; those who use it are known as fundamentalists, or fundamental analysis, in discussing these two approaches to security analysis, the focus will be first on common stocks and then on other types of financial assets.

In its simplest form, technical analysis involves the study of stock market prices in an attempt to predict future price movements. Price prices are examined to identify recurring trends or patterns in price movements. Then more recent stock prices are analyzed to identify emerging trends or patterns that are similar to past ones. This analysis is done in the belief that these trends or patterns repeat themselves. By identifying an emerging trends or pattern, the analysts hope to predict accurately future price movements for a particular stock.

In its simplest form, fundamental analysis begins with the assertion that the true (or intrinsic) value of any financial asset equals the present value of all cash flows the owner of the assets expects to receive. Accordingly, the fundamental stock analyst attempts to forecast the timing and size of these cash flows and then converts the cash flows to their

equivalent present value using an appropriate discount rate. More specifically, the analysts attempt to estimate the discount rate and to forecast the dividends a particular stock will provide in the future; this process is equivalent to forecasting the firm's earnings per share and payout ratios. Once the true value of the common stock of a particular firm has been estimated, it is compared with the current market price of the common stock to determine whether the stock is fairly priced. Stocks whose estimated true value is less than their current market price are known overvalued, or overpriced, stocks, whereas those whose estimated true value is greater than their current market price are known as undervalued, or under priced, stocks. The magnitude of cause the strength of the true value and the current market price is important because the strength of the analyst's conviction that a given stock is mispriced will depend, in part, on it, fundamental analysts believe that any notable cases of mispricing will be corrected by the market in the near future, meaning that prices of undervalued stocks will show unusual appreciation and prices of overvalued stocks will show unusual depreciation.

Portfolio construction

The third step in the investment process, portfolio construction, involves identifying specific assets in which to invest and determining how much to invest each one. The issues of selectivity, timing, and diversification need to be addressed by the investor. Selectivity, also known as micro forecasting, refers to security analysis and focuses on forecasting price movements of individual securities. Timing, also known as macro forecasting, involves forecasting price movements of common stocks in general relative to fixed income securities, such as corporate bonds and treasury bills. Diversification, as mentioned earlier, involves constructing the investor's portfolio in such a manner that risk is minimized, subject to certain restrictions.

Portfolio Revision

The fourth step in the investment process, portfolio revision; concern the periodic repition of the previous three steps. Over time the investor may change his or her investment objectives, which, in turn, would make the currently held portfolio than optimal. The investor may create a new portfolio by selling certain securities and by purchasing others another motivation for revising a portfolio would be if the prices of securities changed - some securities that initially were not attractive may become attractive and others that

were attractive at one time may no longer be so. The investor may want to add the former to his or her portfolio and eliminate the latter. Such decisions depend on, among other things, transaction costs incurred in making changes and the magnitude if the perceived improvement in the investment outlook for the revised portfolio.

Portfolio Performance Evaluation

The fifth step in the investment process, portfolio performance evaluation, involves determining periodically how the portfolio is performing in terms of the return earned and also the risk experienced by the investor, thus, appropriate measures of return and risk as well as relevant standards (or benchmarks) are needed.

2.1.4 Types of Investors

There are various types of investors in the market. In the basis of information individual and institutional investors are the most important investors in the financial market.

2.1.4.1 Individual Investors

A person who invests in securities is called individual investors. They have a job apart from investing in securities. Individual investors have an opportunity cost on obtaining investment information from reading publication, tracking stocks, prices, companies' performance building files on securities. This opportunity cost is the time and resources forgone that could have been used in other endeavors.

2.1.4.2 Institutional investors

Institutional investors are those investors, which is an institution or organization. Their base is very small to mobilize saving in a cost effective manner for individual savers who otherwise might not participate in the stock market, the policy level authorities should encourage institutional buyers.

The institutional investors seek to derive the necessary information from stock recommendations, earning forecast, written reports, overall performances when talking investment decisions.

2.1.5 Market Risk and Return

Capital market are said to be efficient when security prices fully reflect all available information. In such a market, security prices adjust very rapidly to be new information. Another definition of market efficiency is the lack of security arbitrage opportunities, their having been eliminated by arbitragers.

The risk of a portfolio depends not only on the standard deviation of the individual securities comprising the portfolio but also on the correlation of possible returns. For a two-security portfolio, an opportunity set line describes the risk return trade off for various combinations. The diversification effect sometime causes the opportunities set line to bend back ward, with the minimum variance portfolio having a lower standard deviation than that of the least risky security. The efficient set is the portion of the opportunity set line going from the minimum variance portfolio to the one with the highest expected return.

By diversifying our holdings to include securities that are not perfectly correlated with each other, we can reduce risk relative to expected return. We wish to maximize utility as depicted by our indifference curves in relation to the opportunity set of risky security available. With the existence of a risk free security, the focus becomes a line from the risk free rate to the point of tangency with the opportunity set. This point is the market portfolio, given our assumptions. The most desirable combination of risk free security and market portfolio is determined by the point of tangency of investors' indifference curve with the capital market line. This two-phased approach investing constitutes separation theorem.

The capital asset pricing model allows us to draw certain implications about expected return of specific security. The key assumptions in the model are perfect capital markets exist and that investors have homogeneous expectations. In this context, the relevant risk of security is its undiversifiable risk. This risk is described by the slope if the characteristic line, here security returns in excessive of the risk free rate are related to excess return for market portfolio, known also as beta, it is used as a measure of the systematic risk of a security. The total risk of a security can be divided into unsystematic and unsystematic components. Systematic risk is risk that cannot be diversified away, for it affects all securities in the market. Unsystematic risk is unique the particular security and can be eliminated with efficient diversification.

2.1.6 Sources of Investment Risk

Every investment involves uncertainties that make future investment returns risky. Consider some of the sources of uncertainty that contribute to investment risk (Francis; 1999:3-9).

- **Interest Rate Risk**

Interest rate risk is defined as the potential variability of return caused by changes in the market interest rates. Interest rate risk can be demonstrated if interest rate rise or fall, then the investments' present value will fall or rise. Present value moves inversely with changes in the market rate of interest. The interest rate risk affects the prices of bonds, stocks, real estate, gold puts, calls, future contracts, and other investments as well

- **Purchasing Power Risk**

Purchasing power risk is the variability of return an investor suffers because of inflation. Economists measure the rate of inflation by using price index. The percentage change in the consumer price index widely followed measure of the rate or return.

- **Bull-Bear Market Risk**

It arises from the variability in market returns resulting from alternating bull and bear market forces.

When a security index rises fairly consistently from a low point, called a trough, for a period of time, this upward trend is called a bull market. The bull market ends when the market index reaches a peak and starts downward trends. The period during which the market declines to the next trough is called bear market. Bull markets that usually raise more then enough tot compensate for the bear market losses follow bear markets. But the alternating bull and bear market forces create a potential source of investment risk.

- **Management Risk**

Errors made by business managers can harm those who invested in their firms. Forecasting management errors is difficult work that may not be worth the effort and, as a result, imports a needlessly skeptical outlook. agency theory provides investor with as opportunity to replace skepticism with informed insight as they endeavor to analyze subjective management risks.

- **Default Risk**

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

- **Liquidity Risk**

Liquidity risk that portion of an assets total variability of return which results from price discounts given or sales commission paid in order to sell the asset without delay.

Perfectly liquid assets are highly marketable and suffer no liquidation costs. liquid assets are not readily marketable- either price discounts must be incurred by the seller ,in order to find a new investor for on liquid assets

- **Callability Risk**

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

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

- **Convertibility risk**

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

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

- **Political Risks**

Political risk arises from the exploitation of a political weak group for the benefit of a politically strong group, with the effects of various to improve their relative position increasing the variability of return from the effected asset regardless of whether the charges that causes political risk are sought by political or by economic interests, the resulting variability of returns is called political risk if it is accomplished through

legislative, judicial for administrative branches of the government. Political risk can be international as well as domestic.

- **Industry Risk**

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

2.1.7 Trade off Between Risk and Return

Risk is complicated subject and needs to be properly analyzed. The relationship between risk and return is described by investor' perception about risk and their demand for compensation. No investor will like to invest in risky assets unless he is assured of adequate compensation for the assumption of risk. Therefore, it is the investors required risk premiums that establish a link between risk and return. In a market dominated by rational investor, higher risk will command by rational premiums and the trade off between the two assumes a linear relationship between risk and risk premium.

2.2 Financial Market in Nepal

- **2.2.1 Money market**

"The market for short term securities is known as the money market. It deals with those debt instruments and other financial instruments that are issued with maturity of one year or less. In the financial market, money is proving significant. Money market instruments cover short-term, marketable, liquid a, low risk debt securities. Sometimes money market instruments are called just cash equivalents" *(Shrestha and Bhandari; 2008:62)*

The organized market in Nepalese context comprises Nepal Rastra Bank and commercial banks. It is called organized because the activities of commercial are systematically coordinated by the central bank. The unorganized market is largely made of indigenous bankers and moneylenders. It is unorganized because Nepal Rastra Bank does not systematically coordinate the activities of these indigenous bankers and moneylenders.

Nepalese money market is not well developed in terms of securities dealt with and institution involved in the market. Institution that dealt completely on money market

instruments is absent. Similarly, many of the instruments which are in developed money market like commercial paper, banker's acceptances, have not yet entered the Nepalese money market. Therefore the institutions that operate in the money market are basically Nepal Rastra Bank and commercial banks and instruments dealt are treasury bills, commercial bills and short-term bank loan.

"Treasury bill market is a major component of money market in Nepal, started in the year 1961-62. Since then it has been an important source of short term fund for the government except for few years taking from 1968 to 1974. But, because of low yield and absence of active secondary market with brokers, it remained mostly at the hand of the central bank. The holding of Treasury bill by commercial banks, though it was counted for the purpose of statutory liquid ratio, was uneven in the past particularly because of low yield. The interest rate was five percent until mid November 1988.since then, the rate is determined though auction in the market. The weighted average (annualized) ratio on 91- day Treasury bill increased from 5.2 percent in 1088/89 to 10.93 percent in 1995/96 and again declined to 2.33 percent in 1998/99. It then slightly increased to 4.96 percent in 2000/01. Treasury bills are being held mostly by commercial banks" *(Shrestha and Bhandari; 2003 :105).*

Commercial banks are major borrowers and lenders in the short-term money market. Although, commercial bank have been dealing with commercial bills since long, the bill market has its position as under developed in Nepal. Only a small amount of commercial banks lending is export and domestic bills and larger amount is invested in import and LCs and the purchase of export bills. Besides treasury and commercial bills, short-term credits also form another important money market in Nepal. Though short-term credit has not fully developed to encourage growth of money market in Nepal, even then it has been the convenient vehicle for lending and borrowings. This type of finance was largely the monopoly of commercial banks in the past but in recent years, NIDC and other development banks also provide such finance.

2.2.2 Capital market

Capital market is known as long-term financial market & long-term funds of firms are collected from the capital market. Hence, capital market is a long-term credit market. The meaning of capital market can be made clear from its definitions.

"Capital market is designed to finance long-term investments, financial instruments traded in the capital market have original matures of more than one year" *(Rose S.; 2001: 95).*

Capital is the lifeblood of any organization without the business activities. Capital structure is the combination or composition of long-term, proffered stock & common stock. An optimum capital structure decreases the cost of capital & increases the earning per share. A conscious financial analysis ever uses the low capital gearing (High percentage of equity share capital and low percentage of the debt and preferred stock capital in whole capital structure). Business finance is that business activities which is concerned with acquisition and conservation of capital fund in meeting the financial needs of capital funds in meeting the financial needs and overall objective of business enterprises. This is the thinking of company point of views.

"Investors are the real owner of joint stock company they purchase the shares and establish the company to get dividend and capital gain, but who protect theirs investment and right? Yes, securities Board Nepal (SEBO) protect and promote the interest of investors by regulating the securities market for this purpose, SEBO was established on 26th May, 19993 under the provision of securities Exchange Act, 19993 (first amendment). Besides the regulator role, it is also responsible for the development of security market in country. Nepal is developing country. For the balanced development of country, she has been adopting Planned economic development requires a steady supply of Medium and long-term capital funds. Supply of capital Market are the institution, which are engaged in mobilization of ideal saving in productive opportunity, development and expansion of capital market markets are essential for rapid economic development by mobilizing the long term" *(Ojha; 2001: 96).*

Nepal stock exchange Ltd. (NEPSE) is the only one- license hold Mediator of securities board Nepal (SEBO). All the broker company (who has received the certificate of stock trading and become the member of (NEPSE) trade in the trading floor of NEPSE. This is the secondary market of sock which market provides the liquidity in the stock. In this respect, capital market plays a crucial role in mobilization a constant flow of saving and changing these financial resources for expanding productive capacity in the country, Stock market is a medium through which corporate sector mobilizes funds to finance

productive projects by issuing share in the market, Similarly, stock market provides the best investment opportunity to the investor.

“Further, many profitable projects require long-term venture capital to finance. Most investor tempts to provide risk and is reluctant to tie their saving into long term commitment liquid stock market makes the investment less risky and more attractive. It encourages savers to invest in the long term project because they can they can sell the securities quickly and easily, if they want get bank their saving before the project matures. At the same time, companies receive easy access to capital through new issuance of shares” *(Shrestha; 1996: 3).*

The organized stock is recent phenomenon in Nepal. The history and securities market began with the floatation of shares by Biratnagar Jute Mill Ltd. and Nepal Bank Ltd. 1937 AD. Introduction of company act in 1951, the first issue of government bond in 1996 and the establishment of securities exchanges center in 1976, were other significant developments relating to capital markets. Securities exchange center was in 1976 with the objective of facilitating and promoting the growth of capital markets. Before conversion in to a stock exchange it was the only capital market institution under taking the job of brokering, underwriting, managing pubic issues, market making for government bonds and other financial services.

His Majesty's Government under a progress initiated to reform capital market converted securities exchange center into Nepal stock exchange in 1993. Nepal stock exchange in short NEPSE is a non-profit organization operating under securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity of government bond and corporate securities by facilitating transaction in its trading floor through market intermediaries, such as brokers, market makers etc.

In broad sense, capital market can be classified into two markets. First one is securities market and second one is non-securities market. Under the securities market, share, debenture bond and stocks are traded by the government and reputed organization where as under non-securities market financial institutions period the long-term loan to the industries and business. The market where securities are traded is known as capital

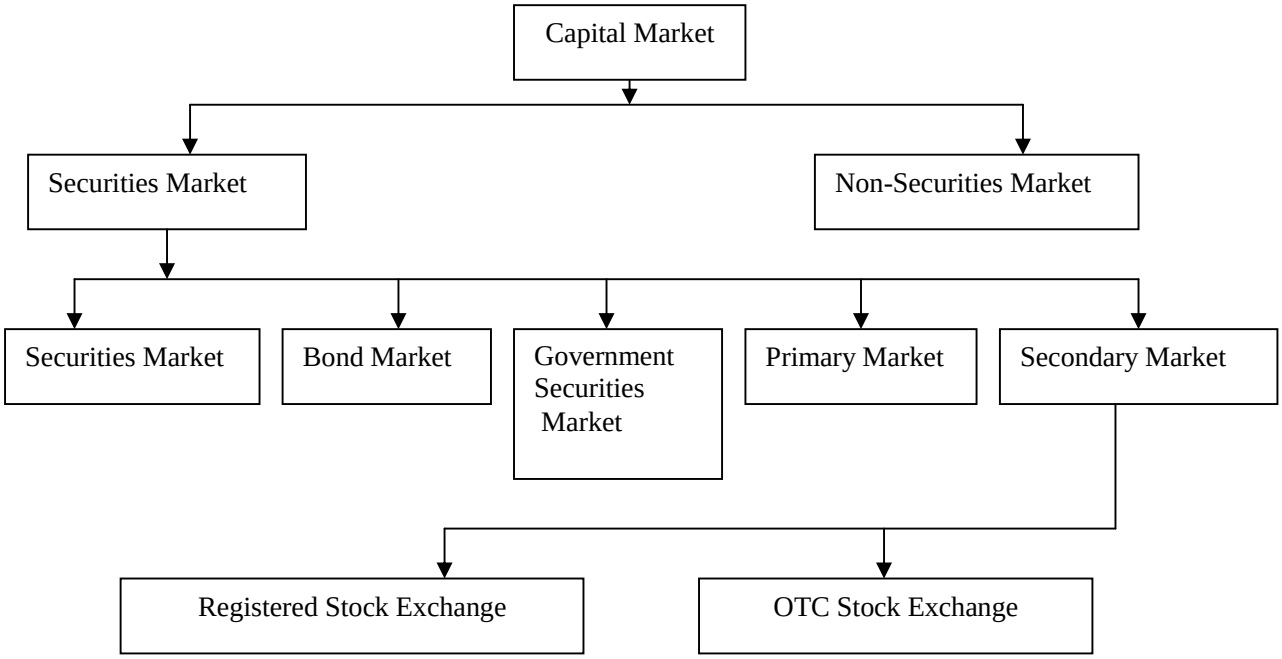
market. The capital market is broadly categorized into two markets. They are primary capital market and secondary market.

2.2.3 Primary capital market

"The company to trade in the capital market issues the new securities. Here the securities of large business firms issued for the first time bought and sold. The issuer of such securities may directly sell through private placement without underwriting to the investors. Besides, the securities may be sold after being made underwriting by the institution like investment bonding. The issuer (company) collect amount and invest in the productive sector to earn the profit" *(Bhandar and Shrestha; 2008:108).*

Figure 2.1

Classification of Nepalese Capital Market



In Nepal In the first nine months of FY 2007/08, 26 companies issued securities and mobilized capital equivalent to Rs.4.99 billion. Of the 26 companies, 8 companies issued ordinary shares, 17 issued right shares and one issued debentures. This amount is more than six fold compared to the amount mobilized through the issuance of securities in the same period last year. Of the issued securities, Rs.3.49 billion was mobilized through share capital and Rs.1.5 billion through debentures. In the first nine months of FY 2006/07, only 14 companies had mobilized Rs.702.9 million by issuing securities.

2.2.4 Secondary Capital Market

"Secondary market provides the liquidity and marketability opportunity to stock market. Stocks are traded second time in the agreement of buyer and seller in the stock market. Stock market either may be OTC Market or registered market. Usually, those buying the securities for the first time went to see the securities to wait for the profit in this market" *(Paul; 2004:108).*

Recent development of security market in Nepal shows that in the first nine months of FY 2007/08, Nepal Stock Exchange Limited (NEPSE) listed 12 more companies. With this, the total number of listed companies has reached 147 in mid-April 2008. The number of listed companies was 135 at the end of FY 2006/07. Market capitalization increased by 80.74 percent and reached Rs.241.11 billion in mid-April 2008 from that of Rs.133.39 billion a year ago. In the first nine months of FY 2007/08, the total turnover in the NEPSE increased by 171 percent to Rs.15.02 billion, compared to the turnover of Rs.5.53 billion in the same period last year. Altogether, 19.16 million units of shares were traded in the first nine months of FY 2010/08 compared to 11.08 million units of shares in the same period last year.

2.2.5 Introduction of NEPSE

The history of securities market began with the flotation of shares by Biratnagar Jute Mills Ltd. in 1937. The first issue of government bond in 1964 and the establishment of securities Exchange center Ltd. In 1976 was significant development resulting to capital markets.

Securities Exchange center was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was only the capital market institution undertaking the job of brokering underwriting, managing public issue, market making for government bonds and other financial services. Nepal stock Exchange in short NEPSE, is non-profit organization operating under securities Exchange Act 1983.

The basic objective of NEPSE is to free marketability and liquidity to the government and corporate securities by facilitating transaction in its trading floor through market intermediaries such as broker, market and market maker etc. NEPSE open its trading floor on 13th January 1994 through licensed members.

His Majesty's the government, Nepal Rastra Bank, Nepal industrial development corporation and licensed members the shareholders of the NEPSE.

2.3 Review of Journal and Articles

Firer (1988), published an article *"Management's disclosure of hedging activity: An empirical investigation of analysts and investors reactions"* the study aims to examine how market participants changed the way they process earnings information after learning of the implementation of hedging activities. Using a sample of derivative user and non-user firms, this study empirically compares earnings predictability, forecast revision behavior, and the earnings response coefficients before and after the disclosure of hedging activity. The findings indicate that analysts' forecast accuracy increased and that unexpected earnings were incorporated into subsequent earnings forecasts to a greater extent subsequent to disclosure of sustained hedging activity. Additionally, the findings indicate an increase in the earnings-return relation in the hedging activity period

Ravichandran (2003) published an article *"Investors Preferences towards various investment avenues in Capital Market with special reference to Derivatives"*. Main objectives of the studies are: to find out the general demographic factors of the investors dealing in capital market, to find out the preference level of investors on various Capital Market instruments, to find out the type of risk which are considered by the investors, to find out the ways through which the investors minimizes their risk, to find out the preferences of Investors in derivatives market. The main findings of the study are: respondents perceived that Market Risk and Credit risk are the two major risk observed in capital markets, most of the respondents (82%) wanted to minimize their risk involved in the capital market, most of the respondents (49%) said that News Papers and Financial Experts help them to minimize their risk, most of the respondents (63%) said that high Margin charged was their main barrier while dealing in Derivatives market, most of the respondents (38%) feel that the margin amount charged in derivatives market should be in between 5000-10000 and if it is less than 5000, they are very much happy, from Correlation test , it is found there exist a negative correlation between the income percentage on investment and the participation in derivative market, from One Way ANOVA it is found that there is significant difference between the annual income and the income percentage towards investment, from the Multiple Response test, it is found that

the investors who invest around 5-10% of their investment mostly considers the market risk(18%) as the major risk which prevails in the market, from the Multiple Response test, it is found that the investors whose investment is around 10% of their income, consider that the affordable margin amount for investment in Derivatives is up to Rs10000/-. Giving conclusive remark he said that in the current scenario, investing in stock markets is a major challenge ever for professionals. Derivatives acts as a major tool for reducing the risk involved in investing in stock markets for getting the best results out of it. The investors should be aware of the various hedging and speculation strategies, which can be used for reducing their risk. Awareness about the various uses of derivatives can help investors to reduce risk and increase profits. Though the stock market is subjected to high risk, by using derivatives the loss can be minimized to an extent.

Michel and Hennery (1985) published an article entitled *"International Portfolio Investment Flow"* in which they develop a model of international equity portfolio investment flows based on difference in informational endowment between foreign and domestic inventors. The model presents an informational difference between foreign and domestic investors. According to them, when domestic investors tend to purchase foreign securities in period when the return on foreign securities is high and to sell when the return is low. The article concludes that if foreign and domestic investors differently informed then portfolio flows between two countries would be a linier function of the contemporaneous return in all national market indices and if domestic investors about domestic securities, the coefficient of the host market return will be possible. The examination of US portfolio investment in emerging markets has shown the strong evidence that US purchase is positively associated with the local market return in many countries.

In minimization of risk, diversification is the most important component. However, it is not an ironclad guarantee against all loss. It is no matter how much diversification is employed; making investment involves bearing some sort of risk. While talking on diversification a major question arises- how many securities should be bought in order to reach optimal diversification? Portfolio theorist argues that, around twenty securities, investor can reduce almost all of the individual security risk in a portfolio. That means, investors should buy securities of different sizes from various industries in order to minimize the risk.

While making an investment, investors should analyze risk and return but there are so many factors to be considered because imperfect knowledge and incomplete data create more risk. Risk is not always terrifying thing that investors are not always risk averter. Some of investors are risk lovers also. But they require some compensation for bearing more risk. Investors are interested in various securities, which have incompatible risk because acceptance of risk level is different among them. Investors have unique risk bearing capacity and choice of investment alternatives varies as per the level of risk.

Chatarjee (1998) uploaded his article *"Selection of Portfolio"* mentions some guidelines to select optimal portfolio. He states that investors high expected return and low risk. Portfolios that offer the highest expected return for a given level of risk are efficient portfolios. If an investor wants to know the marginal impact of a stock on the risk of a portfolio, then s/he must not look at the risk of that stock in isolation but rather at its contribution to the portfolio risk. It depends upon the security's sensitivity to change in the value of the portfolio. If the investors can borrow and lend at the risk free rate of interest, then they should always hold a mixture of the risk free investment and one particular common stock portfolio. The composition of this portfolio depends only on investors' assessment of the prospects of each stock and not on their attitude towards risk. The risk associated with the type of a security would depend on when the investment liquidated. Risk is lower in the short term and diversification of the portfolio can reduce the unique risk. If such diversification results an expected portfolio return, risk level that is above, or blow the desired level, then lending and borrowing can be used to achieve the desired level. Each individual investor can implement different portfolio strategy according to his/her needs. Each portfolio provides an expected return based on a particular level of risk therefore, while constructing the portfolios, care should be taken to ensure that the portfolio does not exceed the risk bearing capacity of the investor. It should be constructed in such a way that it provides the highest return for a given acceptable level of risk. If be so, it is called an efficient portfolio, in which there is a straight-line relationship between the expected return and the marginal contribution to portfolio risk? In the straight-line relationship, an investor would include a security that contributes to increasing the risk of portfolio as a whole only when it offers higher return and increase the expected returns of the portfolio

William (1999) in his article entitled *"An Introduction to Investment Theory"* presents the idea of wealth maximization. He raises some challenges in his research that why investors construct portfolio for new investment, will it be profitable to him or her etc. Resolving these challenges, he examines financial decisions from the perspective of the purchaser of financial securities and concludes that investors hold a collection of different securities that minimizes the risk and maximizes the expected return. He states further that people and organizations anticipate future cash needs and expect that their earnings in the future will not meet these needs. Investors' desire is to increase wealth so they are always in research of the best investment alternatives.

Tiwari (1996) in his article *"Experts Propose Capital Market Overhaul"* expressed that ADB experts have seen many obstacles to the growth of the capital market. This includes low level of investors' confidence, disclosure of poor and manipulated financial information, week enforcement of regulation, absence of instructional investors, lack of diversity in range of financial instruments and the scope of active participation for the various intermediaries limited by vertical barriers.

Thapa (2002), in his article *"Managing Banking Risk"* stated that The current downtrend in share market is not so easy to recover unless strong regularly measures are not enforced. The honeymoon days of share market exist on more but there are still unlimited financial fortunes by sharp practices that went undetected during the period of share market boom among all, the regulation of share market to control on the unfair trade practice would be done of the strong measures to revive the share market in future. In order to curb the fraudulent practices and discourage the dissemination of misleading information in the current share market of Nepal, the regulating authorities must govern the activities in the share market. There should be immediate check on the unfair share trading practices. Wash sales should be discouraged by immediate action. Nepal Stock Exchange can from a watchdog team to investigate on the real existence of a share transaction. The present practice of share trading by mutual consent is a kind of wash sales that should be discouraged as wit creates distortion in the price determined by the market forces. Such action helps in avoidant fictions name created by several different share brokers in share transaction and also to check on the creating an illusion of rising price. Moreover, the challenge for the regulating authority is to control on the hidden

establishment of share market corners and pool by some market price manipulators. Surprise inspection and secret vigilance by a professional team (without making known who are its members and advisors) can check on the functioning of the office of such price manipulators interested to corner a share market in the hope of trapping or squeezing short sellers. If found dishonest in share market dealings, action should be taken against such price manipulators by imposing heavy penalties and punishment depending upon the nature of offence.

At the same time, the concerned authority has to discourage the practice of churning by the brokers since it helps brokers to generate sales commissions regardless of benefits of such transaction to the client. Moreover, it is a right time for the concerned authorities to develop transparent guidelines to have strict vigilance and control on misuse of insiders should be debarred from leaking price sensitive information by imposing heavy penalties and punishment for breach of legal provision. The revival of the share market requires minimum fulfillment of the responsibilities and accountabilities among company management to be shareholder focused. Time has come for company management to respond to shareholders expectation of return from their investment in shares of companies. Management should make it a habit to change attitude to think what is good for shareholders is good for company as a whole.

Immediate measures lies in giving attention to shareholders' grievances like timely conduction of annual general meeting, improving the quality, standard and coverage of reporting, developing minimum return on investment strategy and index. In order the downtrend in share market, various reformative measures are urgently necessary to curb on unfair share market practices through the development of comprehensive and transparent stock exchange guidelines by the concerned authorities. The existing company management has to reorient its positive attitude towards investors and shareholders by improving the quality of timely reporting and providing the expected return to win the losing confidence of shareholders. Investors should be self-conscious in the selection of brokers for trading in securities and organize themselves to be active to protect their rights. All these will help in the revival of share market to make it more active by attracting the investing public.

Rating the institutions on the basis of price earning ratio or dividend has traditionally done investment in share. Hardly do investors compare current assets with current liabilities or take a look at the debt equity ratio. Unless investors begin analyzing the intricate financial details of corporate institutions before making investment decision, the market cannot develop smoothly. Share investment has traditionally been guided by the investors' returns. Most earnings of investor here have been in the form of dividends rather than capital gains, though 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 slums in the 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 the 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 nascent stage. And that, investment are made more on an impulse, rather than through market study and credit rating.

Pradhan and Balampaki (2004), in their article *"Fundamentals of Stock Returns in Nepal"* acknowledged that the investors need to be aware of the relationship of financial variables, which helps them to predict future price and earnings and come with effective investment decision. In this regard a study reveals that earnings yield and cash flow yield have significant impact on dividend yield. Earning yield and cash flow yield have insignificant impact on book to market value whereas, size has negative impact in dividend yield In the case of earning yield and cash flow yield, cash flow yield has been found to be .ore informative than earnings yield.

Capital gain yield is positively influenced by earnings yield and size, whereas, the same is negatively influenced by book to market value and cash flow yield. Book to market value has been found to be statistically strong in predicting capital gain yield. Similarly, total yield is positively determined by earning yield and size, whereas the same is negatively

determined by book to market value and cash flow yield. Book to market value has been found to be more informative than other variable.

On the other investors must be careful while examining company's financial disclosures, as it is possible that while offering their securities to the public the IPO companies overstate their accounting figures to unjustly influence the investment decisions of investors.

Poudel (2008) in his article *"What Drives Stock Prices?"* says that despite some increase in share market indicators, and market capitalization of about 38 percent of GDP up to the second quarter of FY 2007/08 it is still less than in most emerging market economics. The five years average market capitalization remains only 13.2 percent of GDP. Similarly, other major indicators are also very weak in Nepal as compared to other south Asian and East Asian countries. Malaysia, for example, has a capitalization ratio of about 160 about. Moreover, the market of Nepal, is still immature: indicators of stock market development show that they are small and have few listed companies. Market liquidity is also low, with turnover ratio of around of 4 percent of the last 5 years, as compared with about 29 percent in Mexico. Supervision by regulatory authorities (SEBO and NEPSE) is often far from adequate. The development of stock markets in Nepal is expected boost domestic savings and increases the quantity and quality of investment. Stock market is seen as enhancing the operations of domestic financial system in particular and capital markets in particular. Cri tics, however, argue that a stock market might not perform efficiently in developing countries and that it may not be feasible for Nepal to promote stock markets, given the huge costs and relatively poor financial structures. Even though markets are gradually adopting electronic systems. Similarly, the markets do not have central depository systems, and have restricted foreign participation. Such bottlenecks slow trading and induce inactivity. Despite the political instability and low economic growth, Nepalese stock markets have received a great deal of attention, both as a source of financial development and investment return, and in the context of large swings in stock market valuation.

Different types of investors and their attitude depends upon different factors as reflected in the market sentiment. Fear also moves the stock market, but in a different direnction. The huge jump of market capitalization in Nepal in a very short period of time is a good

signal of stock market development but the lesser increment of paid up value and low trading show s the small supply of stocks as compare with the demand in the market. In this way there seems some mismatch of demand and supply of stocks in the market. The bullish trend of NEPSE is also characterized by this mismatch. Promoting stock market development in Nepal require policies to address institutional and infrastructural bottlenecks. For Nepal to garner broader economic benefits from its stock markets, the conditions necessary for the markets to function efficiently must be in place. Income levels, domestic savings, and investment may be the important determinants of stock market development in the efficient market. Stock market should follow financial sector development and Nepal is also moving in the same way in greater extent. For example, a 1 percentage point increase in banking sector development contributes 0.6 percentage points in the stock market development. Institutional investors at the forefront in promoting efficient market practices and financial innovation but this are not seen in Nepal. Regular disclosure, transparency, and enforcement are also the major weakness for the stock market development in Nepal.

2.4 Review of Thesis

Adhikari (1999) has also conducted a research on "*Corporate Dividend Practice in Nepal"*. The main objectives of the study were as follows:

- To explain whether companies paying larger dividends have a good financial position or not, whether the companies with higher payouts have an improved or not.
- Whether the companies with higher yield having an improved financial ratio or not.
- Whether the difference between dividends and stock prices, dividend payout affect the share prices of finance and non-finance sectors differently or not.
- The motives of paying cash and stock dividends whether dividend is a residual decision or not.
- If there is any types of company's announcements of earnings on market price of a share.
- Whether legal restriction on share repurchases should continue to prevail or not.
- Kind of dividend policy should be followed by Nepalese enterprises.

The major findings of the study were as follows:

Stocks with larger ratio of dividend per share to book value per share have higher liquidity. However, liquidity position of stocks paying higher dividends is also more variable as compared to stocks paying lower dividends. Stocks with larger ratio of dividend per share to book value per share have lower leverage ratios. It shows that companies paying higher dividends are reluctant to employ higher degree of leverage in their capital structure. Leverage ratios of stocks smaller dividends are also more variables as compared to stocks paying higher dividends.

When the difference between dividends and profitability is studied, it revealed that stocks with larger ratio of dividend per share to book value per share have higher profitability. However, these profitability ratios of stocks paying larger dividends are reluctant to employ higher degree of leverage in their capital structure. Leverage ratios of stocks smaller dividends are also more variables as compared to stocks paying higher dividends.

When the difference between dividends and profitability is studied, it revealed that stocks with larger ratio of dividend per share to book value per share have higher profitability. However, these profitability ratios of stocks paying larger dividends are also more variable as compared to stocks paying smaller dividends. Positive difference is observed between the ratio of dividend per share to book value per share also have higher turnover ratios. However, turnover ratios of stocks paying larger dividends are also more variable that of stocks paying smaller dividends.

There is also a positive difference between the ratio of dividend per share to book value per share and interest coverage. Stocks with higher ratio of dividend per share to book value pr share also have higher interest coverage. A positive difference is found between dividend payouts and current ratio where as negative difference is found between payouts and quick ratio. It may be due to more reduction of quick assets rather than current assets when more dividends are paid out. The position of current ratio of stocks paying larger dividends is also more variable as compared to stocks paying lower dividends where as the position of quick ratio of stocks paying larger dividend is less variable as compared to stocks paying lower dividends. There as a negative difference observed between dividend payouts and earnings before tax to net worth. On the other hand, there is a positive difference between dividend payouts and earning before tax to total assets. However, the

return on both of total assets and net worth is more variable for stock paying higher dividends. There is a negative difference observed between dividend payouts and earnings before tax to net worth. On the other hand there is positive difference between dividend payouts and earning before tax to total assets and net worth is more variable for stock paying higher dividends.

The difference between dividends payouts and turnover ratios has been observed to be positive. Stocks with larger dividend payouts have higher turnover ratios. However, turnover ratios of stocks paying larger dividend are more variable.

Positive difference is also observed between dividend payouts and interest coverage. Stocks with higher dividend payouts also have higher interest coverage, interest coverage of stocks paying larger dividends are also have move variables.
When studied the difference between dividend per share to market price per share ratio and liquidity ratio, the study revealed that the stocks with larger ratio of dividend per share to market price per share have higher liquidity. Liquidity positions of stocks paying larger dividends are also more variable as compared to stocks paying lower dividends.

Shrestha (1999) has conducted research on *"Stock Price Behavior in Nepal"* this study aims to examine the efficiency of the stock market in Nepal.
The specific objectives of this study are as follows:

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

The main findings of this study were as follows:

The serial correlations coefficients of the daily price changes for 1 and 2 lag days, and runs of the series of daily price changes lead to conclude that the successive price changes

are not independent random variable fro the 30 sample stocks listed in the Nepal stock exchange Ltd. (NEPSE). Therefore, the random walk theory is not a suitable description for the stock market price behavior in Nepal.

The dependence in the series of price changes observed imply that the price changes in the future market will not be independent from the price changes of the previous days. It implies that the information of the past price changes is helpful in predicting future price changes in a way that the speculation through technical analysis can make higher expected profit than they would be under naïve buy- and – hold policy (i.e. average market return). Therefore, opportunities are available to sophisticated (both institutional and individual) investors to earn higher return in the market. The existence and participation of the sophisticated investors have not been realized form the findings of this study. It is realized tan mostly the naïve investors have dominated in the market that can cause prices to diverge significantly form intrinsic values because the very existences of the sophisticated traders cause to erase the opportunities of persistence in prices which establish independence of successive price changes.

Pokharel (2000) submitted the thesis entitled "*Legal Provision to the Protection of Investors Under the Nepalese Law and an Analytical and Critical Study*" The following points were taken as the objectives of study.

- To identify the investors and focus on the investing process
- To make comparative study of Nepalese legal provisions in investors protection
- To analyze the trend of implementation of those legal provisions in regard to investors protection.

The study was based on doctrinal approach and as well as non doctrinal as needed to obtain information based on survey method. Most of the information had been taken from secondary sources of data. Mainly the study was based on doctrinal approach and as well as non doctrinal as needed to obtain information based on survey method. Most of the information had been taken from secondary sources of data. Mainly the study was undertaken as the descriptive and diagnostic in its theoretical point of information.

He had mainly focused to analyze the trend of implementation of Nepalese legal provisions with regards to investors protection and to find out the legal strengths and weaknesses of executive bodies with regards to investors protection.
In the study, pokharel found that Nepal had drafted various laws to protect the interest of investors on the scattered forms -- acts, regulation and byelaws. But there was still an absence of particular and separate legislation for the protection of investors. Likewise, Nepalese investors were not governed under the corporate norms and values due to lack of proper knowledge of their right. They could be victimized but they did not complain at concerned authority.

He further added, the main ground of investors deceiving are insider trading mal- motion on the prospectus, wrong financial statement of company, wrong auditing reports, wrong performance details, and public information. Beside these, various grievances like wrong details on underwriting and listing the share, delay on return of money, delay on distribution of bonus shares, dispatching proper information to shareholders or potential investors, misusing the application money are the main deceiving groups of investors in Nepalese context.

Upadhyaya (2004) has conducted a study similar to the present one entitled *"Investors' Preference and Financial Instruments"* putting the objective of study as:

I. To study the preferences of investors in the financial instruments
II. To assess investors' awareness regarding the investment decisions in selecting securities,
III. To analyze the investment trend in the security market of Nepal, and
IV. To suggest some practical recommendations on the basis of the findings of the study.

He gives the following important remarks in regard to the investors' preferences from the analysis, it seems that the Nepalese investors' prefer common stocks when making investment decision. The common stock has the largest chunk of trading in the market. The main attraction of common stock is due to return: dividend of the company. The stocks of banking sectors have the largest amount of trading in the market or the market capitalization of common stock of banking sectors is very high. Hence, the preference of investors is on common stock of banking sector.

The investors give the second priority to the government securities because the government securities are taken as risk less investment. The Nepalese investors least prefer the preferred stocks and debenture. It was found that from the primary data, no attraction of investors is the main reasons of the Nepalese companies for not preferring to issue debenture and preferred stock frequently.

The market capitalization of the securities shows that the Nepalese security market is in development stage since the capitalization is in increasing trend.

The Nepalese investors do not seem aware in regarding investment in the security market. They don't analyze the risk and return before making any investment in any securities. They invest their money just by observing the market trend, which is very unscientific in Nepalese context because Nepalese security market is not in equilibrium. The investors are feeling that the existing rules and regulations regarding sufficient and timely information from the companies where they have invested their money.

Oli (2006) entitled *"Stock Market Behavior in Nepal"* gives some important insight into the Nepalese stock market. Main objective of this study are:

1. To identify the trend and development of stock market and economic growth.
2. To assess the relationship of stock market indicators with different macro economic indicators.
3. To recognize the affect of factors of macro environment (cultural and political) upon stock market with the degree and significance.

Main findings of this study were as follows:

Since the ratio of market capitalization to GDP very low for the periods, stock market size is not yet sufficient to show its impact on nation's economy. On the other, trend of turnover ratio and value of share traded to GDP ratio show that stock market in Nepal is very small relative to its economy, and stock market in Nepal is yet to make its presence felt in the national economy.

Nepalese stock market is highly dominated by the largest companies in terms of turnover, as the concentration ratio is very high.

Stock volatility as measured by twelve month rolling standard deviation and stock volatility ratio give the basis to conclude the inability of Nepalese stock market to handle risk relatively to volume of stock in Nepal. It is interesting to note that none of these indicators viz. capitalization ratio, value of shares traded to GDP ratio, turnover ratio and value traded ratio to volatility ratio reveals a consistent trend, indicating that the development of stock market in Nepal lacks a definite direction and is not guided by clear cut policies and action, due to low volume of shares traded and wide fluctuations, the stock market in Nepal has been highly illiquid and volatile

Scrutiny of difference of NEPSE due to industrial sectors reveals that NEPSE index due to industrial sectors are significantly differ each other. This further confirms the conclusion that Nepalese stock market is highly concentrated to one or group of the industrial sector (s). It is the banking sector at which the market is highly concentrated.

Run test indicates cyclical variation in stock prices over the 12-year periods. It is, perhaps, due to the inconsistent price movement in Nepalese stock market. Observing the pattern of variation the price for closing date of coming year may happen to be positive if the same trend continues. This analysis of run test further confirms the results that there are wider fluctuations of average stock price in stock market.

Nepalese stock market cannot handle large volume of tracings with less price swings. As there are very week positive relationship is observed in Nepalese stock market between volatility and value of shares traded.

Numbers of listed companies have been found to have greater impact upon NEPSE index than value of stock traded and number of stock traded. However NEPSE index is also positively influenced by number of stock traded and value of stock traded.

NEPSE index remains unaffected by the advent of cultural event like Dashain. However it is affected by the political events as the results of two different political events suggested so. On the other way NEPSE index carries the political information but fails to carry the cultural information.

Research Gap

Efficient Securities market is not all the thing of securities involved and mechanism by which it is governed however it is also the thing that is influenced by the investment habit, psychology and awareness of investors. In this connection, this study contributes something new toward the securities market that is not sought yet by surveying the psychology and awareness of investors investing in various types of securities.

This research throws general light on the types of securities and investor's preferences towards this. Hence specific researches on the various securities like derivatives, units plan and investment funds can be conducted to identify the reason for a thin market on these in context of underdeveloped countries like Nepal. Like wise, researches on the basis of more representative and larger sample covering all the area of the country can be conducted to come up with better results.

CHAPTER- III
RESEARCH METHODOLOGY

This chapter stands for all the strategic plan and premises necessary to be followed throughout this research work in order to achieve and accomplish the objective of the study. Research design, sampling design, operational design, and statistical design employed in the study are put forwarded in a brief.

3.1 Research Design

A Research design is purely and simply the framework of plan for a study that guides the collection and analysis of data. The study is intended to find the investors preference towards financial instruments. The study design is descriptive in nature. Descriptive study is a fact-finding investigation with adequate interpretation. It is the simplest type of research and is more specific. Mainly designed to gather descriptive information and provides information for formulating more sophisticated studies.

3.2 Source of Data and Collection

Primary data are collected through Structured Questionnaire administered among the sample units. Required Secondary data are collected from earlier records from journals, magazines, reports and other sources.

3.3 Number of observations

All the investors those invest in financial securities in Nepal constitute population. Convenience method of sampling is used to collect the data from the respondents. Researchers have the freedom to choose whomever they find, thus the name “convenience”. Number of respondents selected for the study is 130 and are classified into two strata having individual and institutional investors as shown below:

Table 3.1
Number of Respondents

S.N.	Categories	Numbers
1	Individual investors	65
2	Institutional investors	65
	Total	130

There are total of 130 respondents. Out of them, first half respondents i.e. 65 respondents are individual investors and another half is institutional investor. This classification has been made for analyzing differences in their opinion with respect to major aspect of investors' attitudes towards financial instruments. Secondary data of over 12 year's periods are collected.

3.4 Tools for Analysis of Data

3.4.1 Median Values

Median values tell about the concentration of the data. It identifies the point where data are gathered. It is used to show the importance of respondents towards the events. If respondents opine their response form one extreme to another extreme (i.e.: 'satisfied very much' to 'dissatisfied very much'), the median can be used to identity their major importance (Pradhan, 2003). The median is a single value from the data set that measures the central item in the data. This tool is specially used to analyze the data collected from primary source and it is computed utilizing the equation below:

$$\text{Median} = (n+1)/2^{th} \text{ item}$$

$$\text{Median} = L_m + \frac{(N+1)/2 - F}{Fm}$$

Where,

N = Total number of items in the distribution

F = Sum of all the class of frequencies up to, but not including, the median class

F_m = frequency of the median class

L_m = Lower limit of the median class interval

3.4.2 Karl Pearson Coefficient of Correlation

This tool is utilized to identify the rank correlation between two or more sets of observation. It is especially useful to identify the association rank given to the two sets of data. It is calculated by utilizing the equation below:

$$\text{Rank Correlation Coefficient} = 1 - \frac{6 \quad d^2}{n(n^2 - 1)}$$

3.4.3 Chi-square Test

Chi-square, symbolically written as $\chi 2$, is a statistical measure used in the context of sampling analysis for comparing a variance to a theoretical variance. As a non-parametric test, it can be used to determine if categorical data shows dependency or the two classifications are independent. It can also be used to make comparisons between theoretical populations and actual data when categories are used. Thus, the chi square test is applicable in large number of problems. The test is, in fact, a technique through the use of which is possible for all researchers to i) test the goodness of fit: ii) test the significance of association between two attributes, and iii) test the homogeneity or the significance of population variance. Here in this study chi-square is utilized to test the significance of association between two attributes.

Chi Square is calculated utilizing the formula below:

$$\Re^2 = (O-E)^2/E$$

Where,

$\Re^2$ = Value of Chi Square

O = Observed Frequency

E = Expected Frequency

3.4.4 Testing of Hypothesis

In this research, following hypotheses have been tested. A set of hypothesis is the combination of two things viz. Null hypothesis and alternatives hypothesis denoted by Ho and H_1 respectively. These are given below:

Set i: In the first set, the difference between type of investors and their attitude towards securities have been tested, specifically

Ho: There is no any difference between type of investors and their attitude towards securities

Hi: There is difference between type of investors and their attitude towards securities

Set ii: In the second set, the differences between the type of bond and types of investors have been tested.

Ho: Individual and institutional investors do not differ due to bonds type.

H_1: Individual and institutional investors differ due to bonds type.

Set iii: In the third set, differences between the types of investors as to their tendency to perform risk-return analysis have been tested.

Ho: Individual and institutional investors do not differ as to their tendency to perform risk and return analysis.

H_1: Individual and institutional investors differ as to their tendency to perform risk and return analysis.

3.4.5 Arithmetic Mean:

Arithmetic mean is the average return over periods. Arithmetic mean of a given set of observation is their sum divided by the number of observations. To illustrate it, let's suppose that x1, x2, x3 …….. xn denote return of given 'n' number of respondents and $\overline{X}$ is the arithmetic mean of the given observation. It is calculated by,

$$\overline{X} \text{ X} \frac{X_1 \Gamma X_2 \Gamma X_3 \Gamma \ldots\ldots\ldots \Gamma X_n}{n}$$

Or, $\overline{X} = \frac{X}{n}$

Where,

$\overline{X}$ = Arithmetic mean

x1, x2, x3 …….. xn = Set of observations

n = total no. of observations

X = Sum of given observation

CHAPTER- IV

DATA PRESENTATION AND ANALYSIS

This chapter presents the data those are relevant for making contemplated comparisons and analysis. This chapter also related to a number of closely related operations, which are performed with the purpose of summarizing the collected data and organizing these in such a manner that they answer the research questions. Investors' preferences, reason for preferring one security over others, level of satisfaction they enjoy by buying security, investor's awareness in buying security etc are the issues to be presented and analyzed here in this chapter.

4.1 Type of Securities and Investors' Attitudes

An important thing in Nepalese capital market is to know what kinds of security investors prefer most. In this very regard, investors are identified in terms of what type of security they prefer most. On the other way investors are strived to identify which securities they prefer most given the certain number of securities those are generally transacted in Nepalese market. The table below shows how the investors rate these securities in a scale of 1 (most preferred) to 5 (least preferred).

Table 4.1
Number of Responses on preferences to Different Securities

Q.N.1		Number of Responses					Total	Weighted Value	Mean Weight	Overall Rank
		1	2	3	4	5				
Common Stock	Ind.	35	16	5	2	7	65	125	1.92	1
	Ins.	28	24	6	3	4	65	126	1.94	1
	Total	63	40	11	5	11	130	251	1.93	1
Preferred Stock	Ind.	18	6	24	7	10	65	180	2.77	3
	Ins.	7	21	15	6	16	65	198	3.05	3
	Total	25	27	39	13	26	130	378	2.91	3
Debentures	Ind.	5	13	17	12	18	65	220	3.38	4
	Ins.	6	17	18	9	15	65	205	3.15	4
	Total	11	30	35	21	33	130	425	3.27	4
Govt. bond	Ind.	13	27	7	11	7	65	167	2.57	2
	Ins.	19	11	9	17	9	65	181	2.78	2
	Total	32	38	16	28	16	130	348	2.68	2

Source: Field Survey, 2010, Kathmandu

As regards the attitudes of investors towards financial securities, respondents give the first priority to common stock, second priority to govt. bond, the third priority to preferred stock and the last priority to debenture. The opinion of responding groups of individual and institutional investors are similar for all the securities in consideration. The rank correlation coefficient between the responses of responding groups is 1.0 (Appendix-III).

To test whether the difference in opinion of the individual and institutional respondents is significant, the chi square value is computed.

Table below shows the result of the two types of investors viz. individual and institutional and their responses to the statement they would prefer or not transacting on the each of the given securities. Total number of each of the responses on each security according investors category are presented.

Table 4.2

Difference of Attitude of Investor towards Securities

Q.N.1		Number of responses					Computed Value of Chi Square
		1	2	3	4	5	
A.	Ind.	35	16	5	2	7	3.49
	Ins.	28	24	6	3	4	
	Total	63	40	11	5	11	
B.	Ind.	18	6	24	7	10	16.71
	Ins.	7	21	15	6	16	
	Total	25	27	39	13	26	
C.	Ind.	5	13	17	12	18	1.35
	Ins.	6	17	18	9	15	
	Total	11	30	35	21	33	
D.	Ind.	13	27	7	11	7	9.65
	Ins.	19	11	9	17	9	
	Total	32	38	16	28	16	

Source: Field Survey, 2010, Kathamandu

Note:i) Tabulated value at $\chi 2_{0.01}$ at 4 d.f. is 13.28.

Hypothesis Testing

The difference between type of investors and their attitude towards securities have been tested, specifically

Ho: There is no any difference between type of investors and their attitude towards securities.

Hi: There is difference between type of investors and their attitude towards securities

Difference in opinion of individual and institutional respondents is tested in the null hypothesis that the type of security and type of investors are independent against the alternative hypothesis that these two attributes are associated and the association is not because of some chance factor but it exists in reality.

For common stock, government bond and debenture the table value of $\chi 2$ is higher than the computed value. Hence we conclude that the preference of two types of investors do not differ and are similar as regards the attitude of transacting on

common stock, government bond and debentures. In case of preferred stock the calculated value of $\chi 2$ is greater than the tabulated value, hence it can be concluded that the preference of two types of investors in regards to the debentures differs significantly.

4.2Industrial Sectors and Investment Attitude of Investors

There are different industrial sectors one can invest in but which is the most attractive is the issue to be addressed here in this section. Investors are provided with the following industrial sectors and are asked to rate them as on the basis of perceived attractiveness. The results of their ratings are appeared as in the table below:

Table 4.3

Industrial Sectors and Investors' Attitude

S.N.	Industrial sector	Number of Responses								Median value	Overall Rank
		1	2	3	4	5	6	7	8		
1	Bank	53	24	9	6	10	12	9	7	1.52	1
2	Devt.Bank	40	17	13	17	14	15	11	3	2.65	2
3	Finance	19	27	18	22	21	9	2	12	3.07	3
4	Hotel	10	23	21	22	11	5	8	30	3.52	4
5	Mfg. and Processing	11	22	9	25	18	17	19	9	3.94	5
6	Insurance	8	12	24	16	19	20	23	8	4.29	6
7	Trading	13	5	27	15	13	21	15	21	4.42	7
8	Others	13	7	17	12	15	18	21	27	5.08	8

Source: Field Survey, 2010, Kathmandu

From the table one can observe that the most attractive sector for Nepalese investors is banking sector, as the median value for this sector is 1.52. Thus the respondents are centered for the first ranking as opposed to other ranking. Development bank is the next most attractive sector to banking sector for Nepalese investors. This finding supports the growing tendency of investment in this sector. The median value of Development bank, finance, hotel, Mfg. and processing, insurance, trading, and other sectors are2.65,3.07, 3.52, 3.94, 4.29, 4.42, and 5.08 respectively indicating the consecutive priority of investors so far as their matter of investing in different industrial sectors is concerned.

4.3Investment objectives of the Investors

Investment objective is the foundation of investment on the basis of which selection of security, evaluation of the performance and time horizon of investment etc are assessed and evaluated. The investment objectives of investor are not only a basis to identify investor's investment psychology but also a milestone to set investment related policies and to set price and other features of securities. In this regard, the investors are identified on the basis of what type of objective they bear in mind while investing in securities. Investors are asked to rank given major objectives in order of their importance to them. The detail result of their responses is given in the table below:

Table 4.4

Number of Respondents on Investment objectives

Q.N.3		Number of Responses						Total	Weighted Value	Mean Weight	Overall Rank
		1	2	3	4	5	6				
A.	Ind.	27	20	5	4	3	6	65	149	2.29	1
	Ins.	28	24	7	1	2	3	65	129	1.98	1
	Total	**55**	**44**	**12**	**5**	**5**	**9**	**130**	**278**	**2.14**	**1**
B.	Ind.	4	21	12	21	6	1	65	202	3.11	2
	Ins.	18	11	17	13	4	2	65	175	2.69	2
	Total	**22**	**32**	**29**	**34**	**10**	**3**	**130**	**377**	**2.9**	**2**
C.	Ind.	13	5	18	22	4	3	65	203	3.12	3
	Ins.	19	7	22	9	6	2	65	177	2.72	3
	Total	**32**	**12**	**40**	**31**	**10**	**5**	**130**	**380**	**2.92**	**3**
D.	Ind.	2	4	3	1	26	29	65	327	5.03	6
	Ins.	6	5	1	7	20	26	65	303	4.66	5
	Total	**8**	**9**	**4**	**8**	**46**	**55**	**130**	**630**	**4.85**	**6**
E.	Ind.	5	4	8	9	29	10	65	278	4.28	5
	Ins.	2	5	2	5	25	26	65	319	4.91	6
	Total	**7**	**9**	**10**	**14**	**54**	**36**	**130**	**597**	**4.59**	**5**
F.	**Ind.**	**1**	**10**	**23**	**15**	**2**	**14**	**65**	**244**	**3.75**	**4**
	Ins.	**3**	**11**	**12**	**22**	**5**	**12**	**65**	**246**	**3.78**	**4**
	Total	**4**	**21**	**35**	**37**	**7**	**26**	**130**	**490**	**3.77**	**4**

Source: Field Survey, 2010, Kathmandu

As regards the investment objective, respondents give the first priority to income generation, second priority to risk avoidance, the third priority to liquidity maintenance, the forth priority to speculation, the fifth priority to saving and the last priority to social status. The opinion of responding groups of individual and institutional investors is

similar except for Social status and speculation. Individual investors give sixth priority to social status while institutional investors give fifth priority to it. Fifth priority is given to saving by individual investors while institutional investors give sixth priority to it. The rank correlation coefficient between the responses of responding groups is 0.94 (Appendix-III). Thus the opinion of responding groups correlated positively.

4.4Relative Importance of Features of Common Stock

Respondents are given several features of common stock (refer to Q.N. 4) to rate as per the features' importance to investors; the results of the responses of the respondents are as follows:

Table 4.5
Number of Responses on Features of Common Stock

Q.N.4		Number of Responses						Total	Weighted Value	Mean weight	Overall Rank
		1	2	3	4	5	6				
A.	Ind.	11	15	13	12	7	7	65	205	3.15	2
	Ins.	9	8	11	15	13	9	65	237	3.65	3
	Total	**20**	**23**	**24**	**27**	**20**	**16**	**130**	**442**	**3.40**	**2**
B.	Ind.	8	14	9	8	18	8	65	233	3.58	4
	Ins.	3	13	10	14	10	15	65	255	3.92	4
	Total	**11**	**27**	**19**	**22**	**28**	**23**	**130**	**488**	**3.75**	**5**
C.	Ind.	2	6	16	12	13	16	65	271	4.17	5
	Ins.	2	4	16	23	13	7	65	257	3.95	5
	Total	**4**	**10**	**32**	**35**	**26**	**23**	**130**	**528**	**4.06**	**6**
D.	Ind.	32	9	7	11	5	1	65	146	2.25	1
	Ins.	21	13	10	7	8	6	65	181	2.78	1
	Total	**53**	**22**	**17**	**18**	**13**	**7**	**130**	**327**	**2.52**	**1**
E.	Ind.	8	9	3	10	9	26	65	276	4.25	6
	Ins.	14	15	10	11	14	1	65	194	2.98	2
	Total	**22**	**24**	**13**	**21**	**23**	**27**	**130**	**470**	**3.62**	**3**
F.	Ind.	12	21	6	3	10	13	65	212	3.26	3
	Ins.	10	5	6	11	13	20	65	267	4.11	6
	Total	**22**	**26**	**12**	**14**	**23**	**33**	**130**	**479**	**3.68**	**4**

Source: Field Survey, 2010, Kathmandu

The main reason to prefer common stock is because it entrusts holders the rights to participate in earnings. Among the various features of common stock the most preferred feature is that it entails the right to participate in earnings. Next to this, the second priority is for sense of ownership. In this way Bulk transaction, marketability and power to exercise right are in third, forth and fifth priority in the Nepalese investor's perception.

Participation in management is in last to attract the motive of investor to purchase common stock. Thus the reason of Nepalese investors' inclination towards the common stock can be attributed to their willingness to participate in the earnings of the firm. Like wise common stock is relatively liquid and it has attribute of marketability. This is also a factor that attracts Nepalese investors to transact on the common stock.

Positive rank correlation coefficient between the responses of responding group is 0.26 (Appendix-III) indicating the positive relationship of response of individual and institutional investors.

4.5 Shortcomings of debentures and preferred stock

Debentures and preferred stock are not used as commonly as common stock in Nepalese market as this is discussed in part in 4.1. Moreover the tendency of this is same for both the institutional and individual investors. What are such reasons that get the Nepalese investors feel so alienated with debt security is a question to be analyzed here onwards. The answer of this, perhaps will be the solution in itself to correct the problems that has been apparent in Nepalese bond market. Respondents are provided with several alternative statements those describe the problem of investing in bond and preferred stock and asked to rank the same in order of the importance, the result of which is provided in the table below:

Table 4.6

Rankwise Number of Responses on Problems in Investing in Debt and Preferred Stock

Q.N.5		Rank wise Number of Responses							Total	Weghted Value	Mean Weight	Overall Rank
		1	2	3	4	5	6	7				
A.	Ind.	7	16	6	9	10	3	14	65	259	3.98	4
	Ins.	23	8	11	2	7	10	4	65	203	3.12	1
	Total	**30**	**24**	**17**	**11**	**17**	**13**	**18**	**130**	**462**	**3.55**	**1**
B.	Ind.	12	10	16	6	1	7	13	65	242	3.72	1
	Ins.	10	14	7	7	3	12	12	65	258	3.97	3
	Total	**22**	**24**	**23**	**13**	**4**	**19**	**25**	**130**	**500**	**3.85**	**3**
C.	Ind.	7	3	12	4	27	8	4	65	276	4.25	6
	Ins.	4	9	14	8	17	7	6	65	265	4.08	5
	Total	**11**	**12**	**26**	**12**	**44**	**15**	**10**	**130**	**541**	**4.16**	**4**
D.	Ind.	16	3	9	13	7	8	9	65	247	3.80	3
	Ins.	6	7	8	22	14	4	4	65	254	3.91	2
	Total	**22**	**10**	**17**	**35**	**21**	**12**	**13**	**130**	**501**	**3.85**	**2**
E.	Ind.	14	12	4	11	4	9	11	65	245	3.77	2
	Ins.	7	4	6	13	8	12	15	65	302	4.65	7
	Total	**21**	**16**	**10**	**24**	**12**	**21**	**26**	**130**	**547**	**4.21**	**6**
F.	Ind.	4	6	8	11	12	16	8	65	296	4.55	7
	Ins.	1	13	13	14	6	15	3	65	263	4.05	4
	Total	**5**	**19**	**21**	**25**	**18**	**31**	**11**	**130**	**559**	**4.30**	**7**
G.	Ind.	12	7	8	8	9	13	8	65	261	4.02	5
	Ins.	5	19	3	2	11	5	20	65	285	4.38	6
	Total	**17**	**26**	**11**	**10**	**20**	**18**	**28**	**130**	**546**	**4.20**	**5**

Source: Field Survey, 2010, Kathmandu

While investors are asked to give their views as to the reasons in terms of reasons' importance to explain the cause of less use of debt and preferred stock, the result appears as in the table above. Comparing the rank value computed on the basis of the mean value, it is apparent that the respondents give the first priority to no provision of handsome return that compensates the perceived risk of investors, the second priority to lack of marketability and liquidity, the third priority to lack of wide varieties in these kind of securities, the fourth priority to overburden to legal formalities, the fifth priority to these financial securities provides only fixed return, the sixth priority to no adequate legal protection in favor of investors' and the last priority to lack of professional practices among investors.

The opinion of the responding groups differs for each of the options. Individual investors give fourth priority to no provision of handsome return that compensates perceived risk of investors' however institutional investors give first priority to it. Individual investors give first priority to lack of wide verities in these kinds of securities' while institutional investors give third priority to it. Overburden of legal formalities is placed in 6^{th} rank by individual investors while it is placed in 5^{th} rank by institutional investors. In this way individual investors give third priority to lack of marketability and liquidity but institutional investors give second priority to it. In this way individual investor give 2^{nd}, 7^{th} and 5^{th} rank to no adequate legal protection in favor of investors', due to professional practices and these financial instruments provides only fixed return respectively. However institutional investors give 7^{th}, 4^{th} and 6^{th} rank to these options respectively. The rank correlation of the opinion of the responding group is 0.11 (Appendix-III) showing weak correlation among the groups.

4.6 Bond preference

Of course bond market is not as in the height as stock market. However there are so many types of bonds that can meet the investors' need and get them propel to invest in these securities but what is such bond that can win the investor's psychology is the main question to be addressed. Investors are given the bond option having following alternative features and asked which of these they like most. The results of their views are provided in table below:

Table 4.7

Preference of Alternative Bonds

Observation	No. of respondents					
	Ins.	%	Ind.	%	Total	%
Bond that gets you participates in profits and or loss	8	12.31	15	23.08	23	17.69
Bond that adjusts promised interest rate according to the rate in the market.	9	13.85	17	26.15	26	20.00
Bond that is pledged against the firm's assets	28	43.08	13	20.00	41	31.54
Simple debt that pays regular interest.	20	30.77	20	30.77	40	30.77
Calculated value of $\chi 2$	10.08					

Source: Field Survey, 2010, Kathmandu.

Note: (i) Tabulated value of $\chi 2_{0.05}$ at 3 d.f. is 7.815

Hypothesis Testing

The differences between the type of bond and types of investors have been tested.

Ho: Individual and institutional investors do not differ due to bonds type.

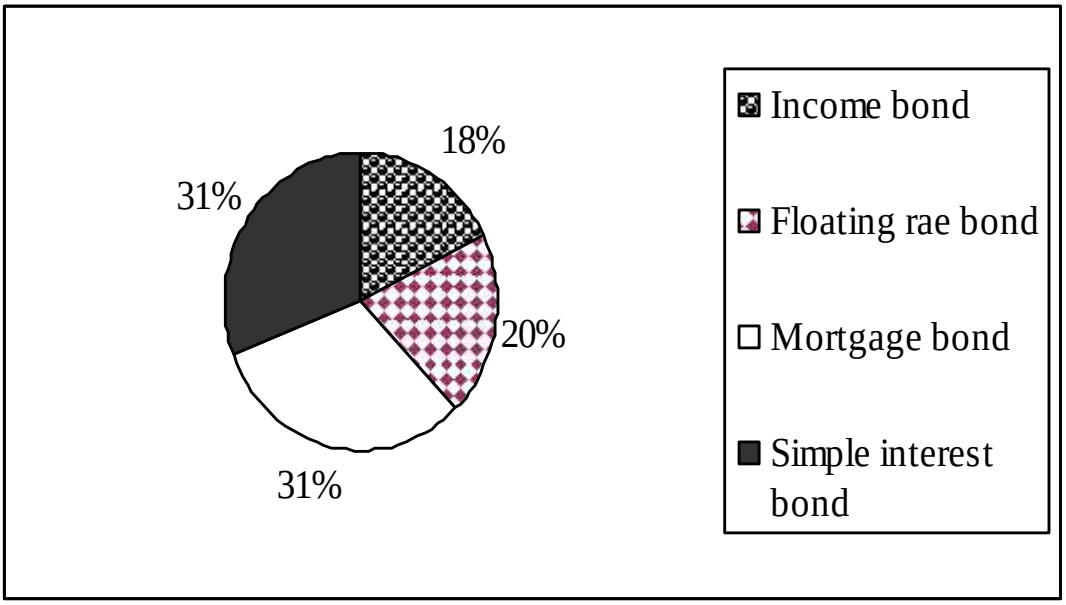
H_1: Individual and institutional investors differ due to bonds type.

To test whether the opinion the two responding groups differ significantly, value of Chi Square is computed. Calculated value of $\chi 2$ at the last row of the table shows that this value is greater than the tabulated value thus the null hypothesis is rejected as such it can be concluded that the difference observed between the institutional and individual investors in their views is significant and they forward different views as to the type of bonds they like or dislike.

From the table above one can observe that out of the total respondents 41 respondents like such bond that is pledged against the firm's assets and it is technically called mortgaged

bond. On the other way mortgage bond is the most favored bond followed by simple interest bond, floating rate bond and income bond. The result of the survey has also been presented in figure below. It shows that out of the total respondents 41 (31.54 percent), 40 (30.33 percent), 26 (20 percent) and 23 (17.69 percent) respondents are in favor of mortgage, simple interest, floating rate and income bond respectively. This shows that firms should not only issue bond of traditional nature but they should also add some feature(s) in bond to pull bond market up to an inspiring level.

Figure 4.1
Preference of Investors towards Different Kinds of bond



4.7 Factors Affecting Choice of Security

Factors those affect or determine the choice of security may be innumerable depending upon the status of security market in the country and investor's psychology. As a matter of fact nothing can fully explain the determining factors those affect the choice of the investors in buying security notwithstanding here an attempt has been made to identify some of the important factors that may affect their choice. Given the following important four factors influencing the choice of security, investors is asked to rate these giving 1 for most influencing to 4 for least influencing factor. The results of their rating are appeared as follows:

Table 4.8

Rankwise Number of Respondents on Factors Affecting Choice of Security

Q.N. 7		Number of Responses				Total	Weighted Value	Mean Weighted	Overall Rank
		1	2	3	4				
A.	Ind.	17	35	9	4	65	130	2.00	2
	Ins.	15	34	10	6	65	137	2.11	2
	Total	**32**	**69**	**19**	**10**	**130**	**267**	**2.05**	**2**
B.	Ind.	14	16	25	10	65	161	2.48	3
	Ins.	15	10	17	23	65	178	2.74	4
	Total	**29**	**26**	**42**	**33**	**130**	**339**	**2.61**	**3**
C.	Ind.	38	9	8	10	65	120	1.85	1
	Ins.	45	7	6	7	65	105	1.62	1
	Total	**83**	**16**	**14**	**17**	**130**	**225**	**1.73**	**1**
D.	Ind.	8	14	16	27	65	192	2.95	4
	Ins.	12	16	15	22	65	177	2.72	3
	Total	**20**	**30**	**31**	**49**	**130**	**369**	**2.84**	**4**

*Source**:** Field Survey 2010, Kathmandu.*

As regard the factors affecting choice of securities, respondents give the first priority to earnings, the second priority to company's overall performance, the third priority to availability and the last priority to rumors. The responses of two responding groups are similar except for availability and rumors. The correlation coefficient is 0.8 (Appendix-III) of the responses of two responding group.

4.8 Reason for Preferring Government Securities

As per the analysis in part 4.1 investors are inclined more towards government bonds than corporate bonds and preferred stock. In course of identifying the reason for preferring government security following analysis is performed and presented. On the other way, it is the needs to identify what are such features of government security that make the investors prefer the security. As an attempt towards that end, features of government bonds are presented and asked to rate these as per their importance giving 1 to most important and 5 to least important.

Table 4.9

Number of Responses on Reason for preferring govt. bond

Q.N. 8		Number of Responses					Total	Weighted Value	Mean Weight	Overall Rank
		1	2	3	4	5				
A.	Ind.	41	9	7	2	6	65	118	1.82	1
	Ins.	38	12	6	5	4	65	120	1.85	1
	Total	**79**	**21**	**13**	**7**	**10**	**130**	**238**	**1.83**	**1**
B.	Ind.	9	19	8	22	7	65	194	2.98	2
	Ins.	5	25	6	22	7	65	196	3.02	2
	Total	**14**	**44**	**14**	**44**	**14**	**130**	**390**	**3.00**	**2**
C.	Ind.	5	14	16	25	5	65	206	3.17	3
	Ins.	5	12	17	18	13	65	217	3.34	4.5
	Total	**10**	**26**	**33**	**43**	**18**	**130**	**423**	**3.25**	**3**
D.	Ind.	1	9	23	11	21	65	237	3.65	5
	Ins.	4	11	22	14	14	65	218	3.35	5
	Total	**5**	**20**	**45**	**25**	**35**	**130**	**455**	**3.50**	**5**
E.	Ind.	9	11	16	15	14	65	209	3.22	4
	Ins.	8	12	15	10	20	65	217	3.34	4.5
	Total	**17**	**23**	**31**	**25**	**34**	**130**	**426**	**3.28**	**4**

Source: Field Survey, 2010, Kathmandu

The results portrayed in the table above show that the most important feature of government security to propel investors to purchase these is it is risk free. Next to this, investors favor this security for it being advantageous to construct portfolio as it can be used to uplift the opportunity set thereby provides more wide risk return space. Like wise as per the overall ranking based on mean value stable return is in the third ranking. The respondents give fourth priority to protection against malpractices and fifth priority to less legal formality. Individual respondents give fourth priority to protection against malpractices while institutional investors give equal ranking to it and to stable return. The correlation coefficient of the opinion of the two responding group is 0.9 (Appendix-III). This shows that the opinion of the two respondents is highly positively correlated.

4.9 Methodological Process of Risk and Return Analysis

Whether the Nepalese investors are fully aware of the risk and return or not are analyzed here or do the investors tend to adopt any particular method of analyzing risk and return of the security before investing in or not is the question to be addressed here in this section. Following is the result of survey conducted to identify behavior of investors in this regard.

Table 4.10
Status of Investors Performing Risk and Return Analysis

Observation	No. of respondents				Total	%
	Individual	%	Institutional	%		
Yes	29	22.31	42	32.31	71	54.62
No	20	15.38	18	13.84	38	29.23
Don't know	16	12.31	5	3.85	21	16.15
Total	65	50	65	50	130	100
Value of $\chi 2$	8.25					

Source: Field Survey, 2010, Kathmandu
Note: i) Tabulated value of $\chi 2_{0.05}$ at 2 d.f. is 5.991

Hypothesis Testing

The differences between the types of investors as to their tendency to perform risk-return analysis have been tested.

Ho: Individual and institutional investors do not differ as to their tendency to perform risk and return analysis.

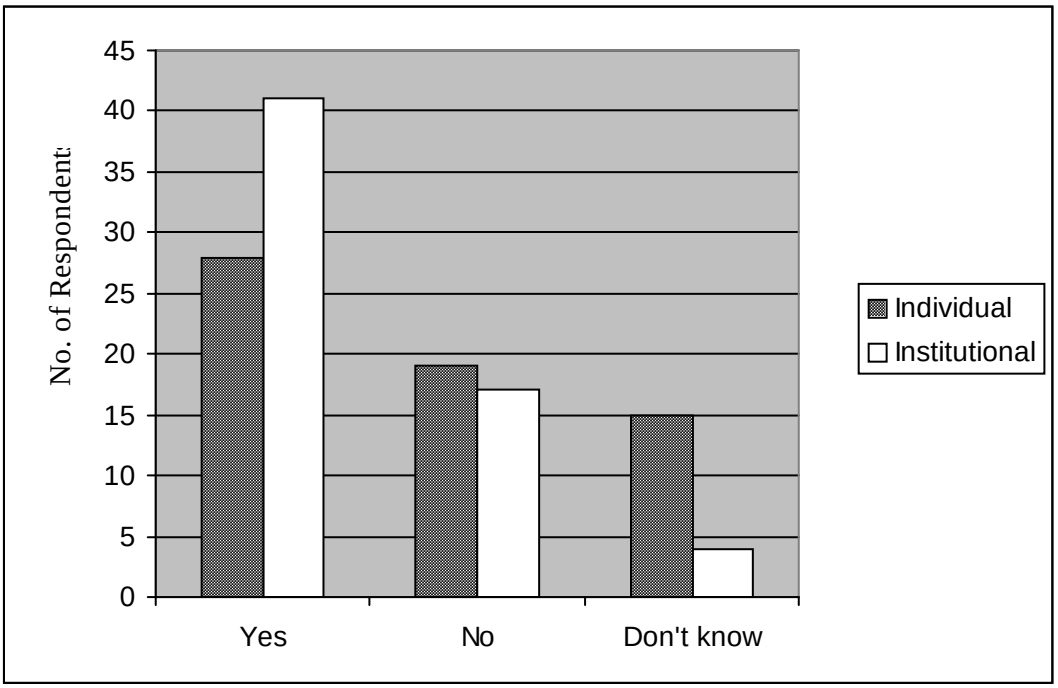
H_1: Individual and institutional investors differ as to their tendency to perform risk and return analysis.

The last column of the table presents the calculated value of $\chi 2$ that is greater than table value of $\chi 2_{0.05}$ at 2 d.f. This indicates that the tendency of individual and institutional investors differ significantly to perform risk and return analysis while investing in securities. Thus the null hypothesis is rejected. On the other way the differences observed between the individual and institutional investors is statistically significant giving the proof of they are not same so far as the matter of risk and return analysis is concerned.

Out of the total respondents more of institutional investors (i.e. 32.31 percent) perform risk and return analysis while investing in securities. Like wise investors who don't perform risk and return are 38 as opposed to who perform are 71. Investors having no idea as to this are 21. This is also presented in the figure below:

Figure 4.2

Investors Tendency to Perform Risk and Return Analysis



Out of the total respondents 54.62 percent perform risk and return analysis while rest 29.23 percent don't perform the analysis and still balances have no idea as to what does it mean. The figure also shows that individual investors are less sensitive to the performance of risk and return analysis in comparison to institutional investors.

institutional investors is statistically significant giving the proof of they are not same so far as the matter of risk and return analysis is concerned.

4.10 Techniques Followed to Mitigate Risks

What sort of techniques Nepalese investors tend to follow to mitigate the risks in their investments is analyzed and tested in this section. The responses of the respondents towards the several techniques are provided with the table below:

Table 4.11

Number of respondents on techniques of reducing risk

Q.N. 11	Number of responses						
	1	**2**	**3**	**4**	**5**	**Median**	**Rank**
A.	15	22	21	37	35	3.2	3
B.	52	21	30	9	18	1.64	2
C.	54	61	11	3	1	1.18	1
D.	6	12	31	56	25	3.29	4
E.	3	14	37	25	51	3.46	5
Total	130	130	130	130	130		

The results portrayed in the table above and the median value show that the method of reducing risk the investors tend to use most is investment in high performing firms. Next to this, investors favor the methods like investment in risk free securities, random selection of securities, investment in only one firm and do nothing respectively.

4.11 Investment processes

Investment processes are the sequential steps of making investment decision and going through these processes over the investment horizon. Whether or not Nepalese investors follow the investment processes is analyzed and interpreted in this section. Investors are provided with the following five investment processes and asked to mark yes if the respondents follow the process or processes. The results of their markings have been appeared as in the table below:

Table 4.12

Investment Processes as Followed by Nepalese Investors

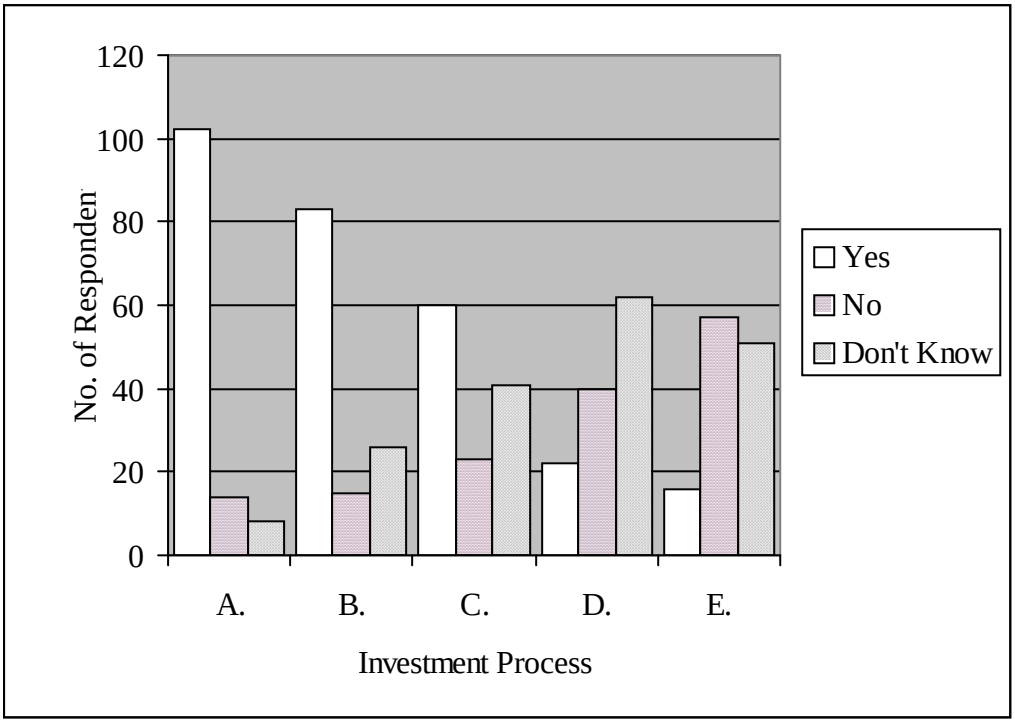
Investment Processes		Number of Responses						
		Yes	**%**	**No**	**%**	**Don't know**	**%**	**Total**
A.	Set investment policy	107	82.31	15	11.54	8	6.15	130
B.	Analyze security	88	67.69	15	11.54	27	20.77	130
C.	Portfolio construction	63	48.46	25	19.23	42	32.31	130
D.	Portfolio Revision	24	18.46	42	32.31	64	49.23	130
E.	Portfolio performance evaluation	19	14.62	58	44.62	53	40.77	130

Source: Field Survey, 2010, Kathmandu

Out of the total respondents 82.31 percent set investment policy and remaining do not set investment policy. Like wise 67.69 of the total respondents analyze security before making investment decision remaining does not analyze security. Here is an interesting result that most of the respondents do not construct portfolio deliberately either they do not know about it or they simply do not construct portfolio. Like number of respondents those revise and evaluate their portfolio are also minimum. Here out of the total respondents 18.46 percent revise portfolio but next 32.31 percent do not and still another 49.23 percent of respondents even don't know as to the revision of portfolio.

The last step in investment process is portfolio performance evaluation. For this step too Nepalese investors seem alienated, as there are only 14.62 percent of respondents who evaluate performance of portfolio and others do not evaluate the performance of portfolio.

Figure 4.3
Investment Process Followed by Investors



From the figure above it is clear that more of the investors set investment policy, analyze security, construct portfolio. However the next two processes is not followed by more of the respondents.

4.12 Most Concerned Investment Risk

Toward what type of risk investors are more concerned are the issues to be dealt here. Investors are provided with several risk and asked to what risk they are most concerned. The responses of investors are provided in the table below:

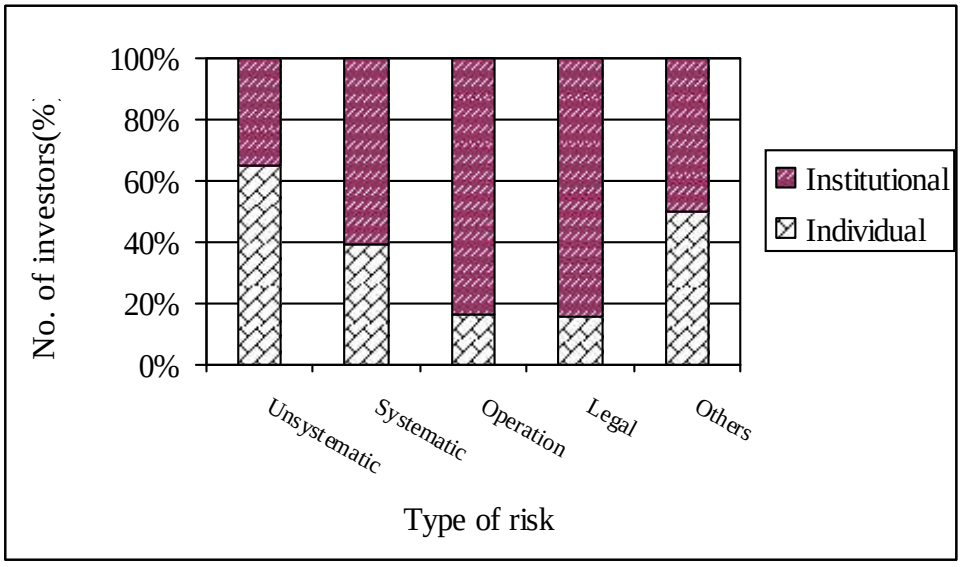
Table: 4.13

Most concerned investment risk

Types of risk	Individual		Institutional		Total	
	No.	%	No.	%	No.	%
Unsystematic	45	69.23	24	36.92	69	53.08
Systematic	15	23.08	23	35.38	38	29.23
Operation	1	1.54	5	7.69	6	4.62
Legal	2	3.08	11	16.92	13	10.00
Others	2	3.08	2	3.08	4	3.08
Total	65	100	65	100	65	100

Figure: 4.4

Investor's risk concern



As per the table and figure above the most concerned risk of Nepalese investors as a whole is unsystematic risk followed by systematic legal, operational and others respectively. The comparison of these facts among individual and institutional investors

shows that individual investors are more concerned to unsystematic risk whereas institutional investors are more concerned to systematic risk.

4.13 Overall Efficiency of Security Market

In order to know the overall efficiency of the security market, investors are asked to which extent they agree or disagree with the statement that Nepalese security market is efficient. There rank wise number of response is given with the table below:

Table: 4.14

Number of respondents on Efficiency on security Market

Statement	Number of respondents					Median
	1	2	3	4	5	
Nepalese security market is efficient	6	12	27	32	53	3.64

Source: Field Survey, 2010

From the table it is clear that Most of the Nepalese investors disagree with the statement that Nepalese security market is efficient. It is because median value as per the given scale and frequency of respondents lies in between the 3 and 4 resulting into the median of 3.64. In this context, it can be said that Nepalese investors perceive that Nepalese security market is inefficient.

4.14Necessary Actions to Accelerate State of Security Market

As discussed above transactions of securities and overall situation of security market is in its developing phase and it is the need of today to get it accelerated. With a view to identify actions that possibly help upgrade the present state of security market following type of actions are identified and asked to rate these as per their necessity and urgency in the context of Nepalese security market. The results of their rankings are appeared as follows

Table 4.15

Number of Responses on Necessary Action to Develop Security Market

Q.N. 16		Number of Responses							Total	Weighted Value	Mean Weight	Overall Rank
		1	2	3	4	5	6	7				
A.	Ind.	23	17	10	7	3	1	4	65	164	2.52	1
	Ins.	24	19	8	10	1	1	2	65	151	2.32	1
	Total	**47**	**36**	**18**	**17**	**4**	**2**	**6**	**130**	**315**	**2.42**	**1**
B.	Ind.	14	19	16	7	1	2	6	65	187	2.88	2
	Ins.	7	12	26	14	3	1	2	65	200	3.08	2
	Total	**21**	**31**	**42**	**21**	**4**	**3**	**8**	**130**	**387**	**2.98**	**2**
C.	Ind.	5	3	5	19	22	0	11	65	289	4.45	4
	Ins.	7	4	3	22	25	2	2	65	263	4.05	3
	Total	**12**	**7**	**8**	**41**	**47**	**2**	**13**	**130**	**552**	**4.25**	**4**
D.	Ind.	19	7	12	3	5	3	16	65	236	3.63	3
	Ins.	6	18	19	1	3	8	10	65	236	3.63	3
	Total	**25**	**25**	**31**	**4**	**8**	**11**	**26**	**130**	**472**	**3.63**	**3**
E.	Ind.	3	4	7	8	12	22	9	65	319	4.91	5
	Ins.	5	8	2	18	14	11	7	65	284	4.37	5
	Total	**8**	**12**	**9**	**26**	**26**	**33**	**16**	**130**	**603**	**4.64**	**5**
F.	Ind.	2	8	6	1	11	26	11	65	328	5.05	6
	Ins.	3	2	2	5	26	23	4	65	329	5.06	6
	Total	**5**	**10**	**8**	**6**	**37**	**49**	**15**	**130**	**657**	**5.05**	**6**
G.	Ind.	5	1	6	5	6	16	26	65	353	5.43	7
	Ins.	4	6	5	9	1	15	25	65	337	5.18	7
	Total	**9**	**7**	**11**	**14**	**7**	**31**	**51**	**130**	**690**	**5.31**	**7**

Source: Field Survey, 2010, Kathmandu

As regards the necessary action to develop security market, the respondents give the first priority to systematic operation of newly established electronic trading system, the second priority to Making provision of central depository system,the third priority to developing effective information system and market network, the fourth priority to expansion of security market beyond capital city, the fifth priority to developing SEBO as an independent and autonomous regulatory body, the sixth priority to sufficient publicity as security and security market and the last priority to amendment and strict implementation of laws. The respondents of the two responding groups are unanimous as to all the developing measures that can be initiated to develop security market. The correlation coefficient of the opinion of the two responding group is 1 (Appendix-III). It shows that the opinion of the individual and institutional investors is perfectly positively correlated.

4.15 Major Findings

On the basis of the whole issues dealt here in this research, following major findings can be pointed out:

- As regards the attitudes of investors towards financial securities, respondents give the first priority to common stock, second priority to govt. bond, the third priority to preferred stock and the last priority to debenture. The opinion of responding groups of individual and institutional investors are similar for all the securities in consideration. The rank correlation coefficient between the responses of responding groups is 1.0.

- For common stock, government bond and debenture the table value of $\chi 2$ is higher than the computed value. Hence we conclude that the preference of two types of investors do not differ and are similar as regards the attitude of transacting on common stock, government bond and debentures. In case of preferred stock the calculated value of $\chi 2$ is greater than the tabulated value, hence it can be concluded that the preference of two types of investors in regards to the debentures differs significantly.

- The main reason to prefer common stock is because it entrusts holders the rights to participate in earnings. Among the various features of common stock the most preferred feature is that it entails the right to participate in earnings. Next to this, the second priority is for sense of ownership. In this way Bulk transaction, marketability and power to exercise right are in third, forth and fifth priority in the Nepalese investor's perception. Participation in management is in last to attract the motive of investor to purchase common stock. Thus the reason of Nepalese investors' inclination towards the common stock can be attributed to their willingness to participate in the earnings of the firm. Like wise common stock is relatively liquid and it has attribute of marketability. This is also a factor that attracts Nepalese investors to transact on the common stock.

- Given the various Industrial sectors, the most attractive sector for Nepalese investors is banking sector. Thus the respondents are centered for the first ranking as opposed to other ranking. Devt.bank and finance sector is the next most attractive sector for

Nepalese investors. This finding supports the growing tendency of investment in this sector. The median value of hotel, Mfg. and processing, insurance, trading and other sectors are in respective position indicating the consecutive priority of investors so far as their matter of preferring the different industrial sectors is concerned.

- As regards the investment objective, respondents give the first priority to income generation, second priority to risk avoidance, the third priority to liquidity maintenance, the forth priority to speculation, the fifth priority to saving and the last priority to social status. The opinion of responding groups of individual and institutional investors is similar except for Social status and speculation. Individual investors give sixth priority to social status while institutional investors give fifth priority to it. Fifth priority is given to saving by individual investors while institutional investors give sixth priority to it. The rank correlation coefficient between the responses of responding groups is 0.94. Thus the opinion of responding groups is correlated positively.

- Analysis of the reason to prefer bond and preferred stock less shows that no provision of handsome return that compensates the perceived risk of investors, lack of marketability and liquidity, lack of wide varieties in these kind of securities, overburden to legal formalities are some of the top reasons for which investors less prefer the securities.

  From the table above one can observe that out of the total respondents 41 respondents like such bond that is pledged against the firm's assets and it is technically called mortgaged bond. On the other way mortgage bond is the most favored bond followed by simple interest bond, floating rate bond and income bond.

- As regard the factors affecting choice of securities, respondents give the first priority to earnings, the second priority to company’s overall performance, the third priority to availability and the last priority to rumors. The responses of two responding groups are similar except for availability and rumors. The correlation coefficient is 0.8 of the responses of two responding group.

- Analysis show that the most important feature of government security to propel investors to purchase these is it is risk free. Next to this, investors favor this security

for it being advantageous to construct portfolio as it can be used to uplift the opportunity set thereby provides more wide risk return space. Like wise as per the overall ranking based on mean value stable return is in the third ranking. The respondents give fourth priority to protection against malpractices and fifth priority to less legal formality. Individual respondents give fourth priority to protection against malpractices while institutional investors give equal ranking to it and to stable return. The correlation coefficient of the opinion of the two responding group is 0.9. This shows that the opinion of the two respondents is highly positively correlated.

- Out of the total respondents more of institutional investors (i.e. 32.31 percent) perform risk and return analysis while investing in securities. Like wise investors who don't perform risk and return are 38 as opposed to who perform are 71. Investors having no idea as to this are 21.

- Out of the total respondents 82.31 percent set investment policy and remaining do not set investment policy. Like wise 67.69 of the total respondents analyze security before making investment decisions remaining do not analyze security. Here is an interesting result that most of the respondents do not construct portfolio deliberately either they do not know about it or they simply do not construct portfolio. Like number of respondents those revise and evaluate their portfolio are also minimum. Here out of the total respondents 18.46 percent revise portfolio but next 32.31 percent do not and still another 49.23 percent of respondents even don't know as to the revision of portfolio. The last step in investment process is portfolio performance evaluation. For this step too Nepalese investors seem alienated, as there are only 14.62 percent of respondents who evaluate performance of portfolio and others do not evaluate the performance of portfolio.

- Among the method of reducing risk the investors tend to use most is investment in high performing firms. Next to this, investors favor the methods like investment in risk free securities, random selection of securities, investment in only one firm and do nothing respectively. The most concerned risk of Nepalese investors as a whole is unsystematic risk followed by systematic legal, operational and others respectively. The comparison of these facts among individual and institutional investors shows that

individual investors are more concerned to unsystematic risk whereas institutional investors are more concerned to systematic risk.

Like wise as per the opinion ire of the respondents, Nepalese security market is inefficient.

- As regards the necessary action to develop security market, the respondents give the first priority to systematic operation of newly established electronic trading system, the second priority to Making provision of central depository system, the third priority to developing effective information system and market network, the fourth priority to expansion of security market beyond capital city, the fifth priority to developing SEBO as an independent and autonomous regulatory body,the sixth priority to sufficient publicity as security and security market and the last priority to amendment and strict implementation of laws. The respondents of the two responding groups are unanimous as to all the developing measures that can be initiated to develop security market. The correlation coefficient of the opinion of the two responding group is 1. It shows that the opinion of the individual and institutional investors is perfectly positively correlated.

CHAPTER-V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter attempts to summarize, give conclusive and suggestive end to the whole study. As essence to the study, the conclusion and suggestion would be of great help for the concerned parties. This chapter is divided into different parts namely summary, conclusion, recommendation, and suggestion, which are as follows:

5.1 Summary

This study is mainly related to identify the Nepalese investors' attitudes toward different kind of financial securities such as common stock, bond, government securities and preferred stock etc. This study is mainly descriptive and exploratory for it attempts to describe and explore the status of investors' attitude toward securities. The important inferences have been drawn on the basis of sample size of 130 respondents applying different tools and techniques of analyzing and presenting the data. Every constituents of the capital market may take advantage of this study for restructuring the operational and polices issues in respect to the capital market. Main findings of the study can be summarized in the manner below:

As regards the attitudes of investors towards financial securities, respondents give the first priority to common stock, second priority to govt. bond, the third priority to preferred stock and the last priority to debenture. The opinion of responding groups of individual and institutional investors are similar for all the securities in consideration. The rank correlation coefficient between the responses of responding groups is 1.0.

To test whether the difference in opinion of the individual and institutional respondents is significant, the chi square value is computed. For common stock, government bond and debenture the table value of $\chi 2$ is higher than the computed value. Hence we conclude that the preference of two types of investors do not differ and are similar as regards the attitude of transacting on common stock, government bond and debentures. In case of preferred stock the calculated value of $\chi 2$ is greater than the tabulated value, hence it can be concluded that the preference of two types of investors in regards to the debentures differs significantly.

The main reason to prefer common stock is because it entrusts holders the rights to participate in earnings. Among the various features of common stock the most preferred feature is that it entails the right to participate in earnings. Next to this, the second priority is for sense of ownership. In this way Bulk transaction, marketability and power to exercise right are in third, forth and fifth priority in the Nepalese investor's perception. Participation in management is in last to attract the motive of investor to purchase common stock. Thus the reason of Nepalese investors' inclination towards the common stock can be attributed to their willingness to participate in the earnings of the firm. Like wise common stock is relatively liquid and it has attribute of marketability. This is also a factor that attracts Nepalese investors to transact on the common stock.

Given the various Industrial sectors, the most attractive sector for Nepalese investors is banking sector, as the median value for this sector is 1.52.Thus the respondents are centered for the first ranking as opposed to other ranking. Devt. bank and Finance sector is the next most attractive sector for Nepalese investors. This finding supports the growing tendency of investment in this sector. The median value of devt. Bank, finance hotel, Mfg. and processing, insurance ,trading and other sectors are 3.07, 3.52, 3.94, 4.29, 4.42 and5.08 respectively indicating the consecutive priority of investors so far as their matter of investing in different industrial sectors is concerned.

As regards the investment objective, respondents give the first priority to income generation, second priority to risk avoidance, the third priority to liquidity maintenance, the forth priority to speculation, the fifth priority to saving and the last priority to social status. The opinion of responding groups of individual and institutional investors is similar except for Social status and speculation. Individual investors give sixth priority to social status while institutional investors give fifth priority to it. Fifth priority is given to saving by individual investors while institutional investors give sixth priority to it. The rank correlation coefficient between the responses of responding groups is 0.94. Thus the opinion of responding groups is correlated positively.

Analysis of the reason to prefer bond and preferred stock less shows that no provision of handsome return that compensates the perceived risk of investors, lack of marketability and liquidity, lack of wide varieties in these kind of securities, overburden to legal formalities are some of the top reasons for which investors less prefer the securities.

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Analysis show that the most important feature of government security to propel investors to purchase these is it is risk free. Next to this, investors favor this security for it being advantageous to construct portfolio as it can be used to uplift the opportunity set thereby provides more wide risk return space. Like wise as per the overall ranking based on mean value 'stable return' is in the third ranking. The respondents give fourth priority to protection against malpractices and fifth priority to less legal formality. Individual respondents give fourth priority to protection against malpractices while institutional investors give equal ranking to it and to stable return. The correlation coefficient of the opinion of the two responding group is 0.9. This shows that the opinion of the two respondents is highly positively correlated.

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As regards the necessary action to develop security market, the respondents give the first priority to systematic operation of newly established electronic trading system, the second priority to Making provision of central depository system, the third priority to developing effective information system and market network, the fourth priority to expansion of security market beyond capital city, the fifth priority to developing SEBO as an independent and autonomous regulatory body, the sixth priority to sufficient publicity as security and security market and the last priority to amendment and strict implementation of laws. The respondents of the two responding groups are unanimous as to all the developing measures that can be initiated to develop security market. The correlation coefficient of the opinion of the two responding group is 1. It shows that the opinion of the individual and institutional investors is perfectly positively correlated.

5.2 Conclusion

On the basis of the whole study following conclusive end can be provided to this research:

- Analysis of investors' attitudes towards the financial securities paves the way to conclude that Nepalese investors' most preferred security is common stock. The most important characteristic that attracts investors to this security is that it allows investors to actively participate in company's earnings. Like wise they prefer this security more as compared to other security, for it being more marketable.

- Given the various Industrial sectors, the most attractive sector for Nepalese investors is banking sector. Finance sector is the next most attractive sector to banking sector for Nepalese investors. This finding supports the growing tendency of investment in this sector.

- The debt and preferred stock in Nepalese securities market do not provide handsome return that compensates the perceived risk of investors. The securities in Nepalese case are illiquid and less marketable, and debt and preferred stock lack wide varieties in these kinds.

- Company's overall performance and return pattern of the security under consideration are the factor those can be regarded as the most important factor determining their choice of security.

- Government bond is less risky and this attribute of the security attracts to invest in. Next to this, investors favors this security for it being advantageous to construct portfolio as it can be used to uplift the opportunity set thereby provides more wide risk return space.

- More of the institutional investors perform risk and return analysis while investing in securities. Most of the respondents do not construct portfolio deliberately either they do not know about it or they simply do not construct portfolio.

- As regards the investment processes, this study reveals that more of the investors set investment policy, analyze security, construct portfolio while investing in financial assets. Portfolio revision and portfolio performance evaluation is the steps in the process but less practiced by Nepalese investors.

- Nepalese investors tend to minimize risk by investing in high performing firm.
- Nepalese security market is opined as being inefficient.

- systematic operation of newly established electronic trading system, Making provision of central depository system, developing effective information system and market network, expansion of security market beyond capital city, developing SEBO as an independent and autonomous regulatory body, sufficient publicity as security and security market and amendment and strict implementation of laws are the actions that should be taken in order to improve the state of Nepalese security market on the priority basis.

5.3 Recommendation

- To issue common stock as a source of finance is relatively easy for Issuer Company since investors like to purchase common stock as compare to other securities. However, issue of debt capital should not be undermined as this allows the firm to take advantage of leverage effect on earning and value of the firm.

- Debt and preferred stock are the kind of securities that are less preferred by Nepalese investors. One of the prime reasons for this is due to the lack of varieties in these securities. These demands for dynamic debt market with a good maturity mix of the debt scurrilities. For this, policymaking body and other related institution should pay their attention.

- Investors prefer to invest in the securities of the company performance of which is outstanding. This suggests that development of security market is not only the matter of investor's awareness but also a thing of company's performances. This calls for the new initiatives from the part of the Nepalese companies to enhance their deteriorating performance.

- Nepalese investors invest in 'high performing firms' in order to mitigate perceived risk of investment. This violates the principal of 'Markowitz portfolio' which advocates that stocks' returns should have negative correlation to be more beneficial to investors. In this context investors require to consider the correlation of returns of several firms.

- Since the market is opined as inefficient, authorities and other concerned parties must be effortful to gain the efficiency as regards the valuation, operational, and arbitrage etc.

- Current condition of stock trader and market seems lacking professionalism hence it needs to be professional in trading stock in the market, like wise security services are bounded in the capital city only and this needs to be corrected by expanding the services in outskirts too that propels all the people in the country to participate in the investment activities that may result into the more developed security market. Though change of the open tendering system into electronic system is initiated it has added more challenge for greater transparency, efficiency and making services professional and extending it nationwide.

- Necessary arrangement of legal provisions in line with international practices and the development of fair, dynamic and credible securities market is a challenging task. Likewise establishment of credit rating agency is the most important task in order to develop the security market in the country.

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