INVESTORS' PREFERENCES AND FINANCIAL INSTRUMENTS IN NEPAL

A Thesis

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RECOMMENDATION

This is to certify that the thesis

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

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DECLARATION

I hereby declare that this thesis entitled **"Investors' Preferences and Financial Instruments 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 requirements for the Master's Degree in Business Studies (MBS) under the supervision of Asso. Prof. Ruchila Pandey of Shankar Dev Campus

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ABBREVIATIONS

ADB	:	Asian Development Bank
BOD	:	Board of Directors
BVS	:	Book Value of Share
CDS	:	Central Depository System
CRO	:	Company Registrar's Office
EPS	:	Earning Per Share
F/Y	:	Fiscal Year
GDP	:	Gross Domestic Product
ICAN	:	Institute of Chartered Accountants of Nepal
IPO	:	Initial Public Offering
NEPSE	:	Nepal Stock Exchange
NG	:	Nepal Government
NHA	:	Null Hypothesis Accepted
NRB	:	Nepal Rastra Bank
OTC	:	Over–the Counter Market
P/E	:	Price Earning Ratio
SEA	:	Securities Exchange Act
SEBO/N	:	Security Board of Nepal
SEC	:	Securities Exchange Center
TU	:	Tribhuvan University
T+5	:	Settlement of Transactions Five Working Days after the Date of Trading

CHAPTER - I

INTRODUCTION

1.1 General Background

Finance is the science of funds management. [Webster's Third New International Dictionary] It is the set of activities dealing with the management of funds. More specially, it is the decision of collection and use of funds. It is a branch of economics that studies the management of money and other assets. Through financial analysis, companies and businesses can take decisions and corrective actions towards the sources of income and the expenses and investments that need to be made in order to stay competitive.

The general areas of finance are business finance, personal finance, and public finance. [Encyclopædia Britannica] Finance is used by individuals (personal finance), by governments (public finance), by businesses (corporate finance) and by a wide variety of other organizations, including schools and non-profit organizations. In general, the goals of each of the above activities are achieved through the use of appropriate financial instruments and methodologies, with consideration to their institutional setting.

In corporate finance, a company's capital structure is the total mix of financing methods it uses to raise funds. One method is debt financing, which includes bank loans and bond sales. Another method is equity financing - the sale of stock by a company to investors. Possession of stock gives the investor ownership in the company in proportion to the number of shares the investor owns. In return for the stock, the company receives cash, which it may use to expand its business or to reduce its debt.[Business.timesonline.uk] .

Finance includes saving money and often includes lending money. The field of finance deals with the concepts of time, money, and risk and how they are interrelated. It also deals with how money is spent and budgeted. , **J.M., & Moses**, *Fundamentals of Investment*

1.1.1 Financial markets

Financial markets consist of primary markets where some securities are initially issued and secondary markets where holders of securities can sell at will. Secondary markets provide the liquidity that many investors demand; otherwise, there would be less demand for financial securities. Liquidity is the ease in which an asset can be converted into a means of payment. Without liquidity, few people would be willing to invest in securities, which would lower the efficiency of the markets and the economy.

Organized financial markets provide a trusted means of clearing and settlement, which facilitates trade and promotes liquidity. In many financial markets, a clearinghouse takes the opposite side of every trade, so that traders do not have to worry about the counterparty's credit. Many financial markets started in coffeehouses or taverns in the 17th and 18th centuries, then evolved into businesses, such as banks and organized exchanges. For many standardized financial instruments, the financial market is an electronic exchange.

Financial markets determine prices, and prices determine allocation of economic resources and generally reflect all information about a security, which is the basis of the efficient market hypothesis. For example, if a company has good growth prospects, its stock price will be priced higher than a similar company with the same book value and earnings, but with little potential for growth. If a company has good financial strength to pay interest and principal on its bonds, then its bonds will be priced higher and the company will pay a lower interest rate than the bonds of another company that is financially weak. **Ackerman, I.L.**, *How to Invest in the Phiippine Stock Market p. 58*

Since the markets offer investors a wide variety of many different types of securities that have different risk profiles and whose risk varies differently from other securities, investors can lower their overall risk by maintaining a portfolio of securities, each of which have little, no, or negative correlation with the other assets in the portfolio. In this way, a portfolio can be constructed that has less risk than any individual security in the portfolio.

1.1.2 Financial Instruments

Financial instruments are legal agreements that require one party to pay money or something else of value or to promise to pay under stipulated conditions to a counter party in exchange for the payment of interest, for the acquisition of rights, for premiums, or for indemnification against risk. In exchange for the payment of the money, the counterparty hopes to profit by receiving interest, capital gains, premiums, or indemnification for a loss event. A financial instrument can be an actual document, such as a stock certificate or a loan contract. **Frank, J. F., & Franco, M.,** *Capital Markets: Institutions and Instruments p 122*

Some common financial instruments include checks, which transfer money from the payer, the writer of the check, to the payee, the receiver of the check. Stocks are issued by companies to raise money from investors. The investors pay for the stock, thereby giving money to the company, in exchange for an ownership interest in the company. Bonds are financial instruments that allow investors to lend money to the bond issuer for a stipulated amount of interest over a specified period.

1.1.3 Types of Financial Instruments

There are many types of financial instruments. Many instruments are custom agreements that the parties tailor to their own needs. However, many financial instruments are based on standardized contracts that have predetermined characteristics. Some of the most common examples of financial instruments are:

Loans and Bonds: A bond is a debt security, in which the authorized issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay interest (the coupon) and/or to repay the principal at a later date, termed maturity. A bond is a formal contract to repay borrowed money with interest at fixed intervals. A lender gives money to a borrower in exchange for regular payments of interest and principal. [http://en.wikipedia.org/wiki/Bond_(finance)]

Stocks: The capital stock (or just stock) of a business entity represents the original capital paid into or invested in the business by its founders. It serves as a security for the creditors of a business since it cannot be withdrawn to the detriment of the creditors. Stock is distinct from the property and the assets of a business which may fluctuate in quantity and value. [http://en.wikipedia.org/wiki/Stock]

1.1.4 Security

A security is a negotiable instrument representing financial value. Securities are broadly categorized into debt securities (such as banknotes, bonds and debentures) and equity securities, e.g., common stocks; and derivative contracts, such as forwards, futures, options and swaps. The company or other entity issuing the security is called the issuer. Securities are traditionally divided into debt securities and equities. [**Raghu, P.,** *Shares for Investment and Wealth p. 9*]

1.1.5 Debt

Debt securities may be called debentures, bonds, deposits, notes or commercial paper depending on their maturity and certain other characteristics. The holder of a debt security is typically entitled to the payment of principal & interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities may be protected by collateral or may be unsecured, and, if they are unsecured, may be contractually "senior" to other unsecured debt meaning their holders would have a priority in a bankruptcy of the issuer. Debt that is not senior is "subordinated". **Van Horne, J.C.,** *Financial Management Policy* p. 96

1.1.6 Equity

An equity security is a share of equity interest in an entity such as the capital stock of a company, trust or partnership. The most common form of equity interest is common stock, although preferred equity is also a form of capital stock. The holder of an equity is a shareholder, owning a share, or fractional part of the issuer. Unlike debt securities, which typically require regular payments (interest) to the holder, equity securities are not entitled to any payment. In bankruptcy, they share only in the residual interest of the issuer after all obligations have been paid out to creditors. However, equity generally entitles the holder to a pro rata portion of control of the company, meaning that a holder of a majority of the equity is usually entitled to control the issuer. Equity also enjoys the right to profits and capital gain, whereas holders of debt securities receive only interest and repayment of principal regardless of how well the issuer performs financially. **Van Horne, J.C.,** *Financial Management Policy* p. 99

1.1.7 Bond

A debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing. Generally, a bond is a promise to repay the principal along with interest (coupons) on a specified date (maturity). Some bonds do not pay interest, but all bonds require a repayment of principal. When an investor buys a bond, he/she becomes a creditor of the issuer. However, the buyer does not gain any kind of ownership rights to the issuer, unlike in the case of equities. On the hand, a bond holder has a greater claim on an issuer's income than a shareholder in the case of financial distress (this is true for all creditors).

Bonds are often divided into different categories based on tax status, credit quality, issuer type, maturity and secured/unsecured (and there are several other ways to classify bonds as well). The yield from a bond is made up of three components: coupon interest, capital gains and interest on interest (if a bond pays no coupon interest, the only yield will be capital gains). A bond might be sold at above or below par (the amount paid out at maturity), but the market price will approach par value as the bond approaches maturity. A riskier bond has to provide a higher payout to compensate for that additional risk. Some bonds are tax-exempt, and these are typically issued by municipal, county or state governments, whose interest payments are not subject to federal income tax, and sometimes also state or local income tax. **Pandey, I.M**. *Financial Management*

1.1.8 Stocks (Shares)

An instrument that signifies an ownership position (called equity) in a corporation, and represents a claim on its proportional share in the corporation's assets and profits. Ownership in the company is determined by the number of shares a person owns divided by the total number of shares outstanding. For example, if a company has 1000 shares of stock outstanding and a person owns

50 of them, then he/she owns 5% of the company. Most stock also provides voting rights, which give shareholders a proportional vote in certain corporate decisions. Only a certain type of company called a corporation has stock; other types of companies such as sole proprietorships and limited partnerships do not issue stock. also called equity or equity securities or corporate stock. http://en.wikipedia.org/wiki/Stock

1.1.9 Common shares

Common Shares represent ownership in a company and a claim (dividends) on a portion of profits. Investors get one vote per share to elect the board members, who oversee the major decisions made by management. Some holders of common stock also receive preemptive rights, which enable them to retain their proportional ownership in a company should it issue another stock offering. Over the long term, common stock, by means of capital growth, yields higher returns than almost every other investment. This higher return comes at a cost since common stocks entail the most risk. If a company goes bankrupt and liquidates, the common shareholders will not receive money until the creditors, bondholders, and preferred shareholders are paid. Additional benefits from common stock include earning dividends and capital appreciation. **Western, J.F., & Copeland, T.E.**, *Managerial Finance* p. 65

1.1.10 Preferred Stock

Preferred Stock represents some degree of ownership in a company but usually doesn't come with the same voting rights. (This may vary depending on the company.) With preferred shares investors are usually guaranteed a fixed dividend forever. This is different than common stock, which has variable dividends that are never guaranteed. Another advantage is that in the event of liquidation preferred shareholders are paid off before the common shareholder (but still after debt holders). Preferred stock may also be callable, meaning that the company has the option to purchase the shares from shareholders at anytime for any reason (usually for a premium). Some people consider preferred stock to be more like debt than equity. A good way to think of these kinds of shares is to see them as being in between bonds and common shares.

Smilar to bonds, preferred stocks are rated by the major credit rating companies. The rating for preferreds is generally lower since preferred dividends do not carry the same guarantees as interest payments from bonds and they are junior to all creditors. **Western, J.F., & Copeland, T.E.**, *Managerial Finance* p.66

1.2 Securities Market in Nepal

A security market is a place where investors buy and sell financial instruments, so investors can buy or sell securities immediately at a price that varies little from the previous selling price. Buying and selling orders that flow from investors demand and supply preferences determine share price in the security market. Security markets help to allocate its financial resources more effectively. Security market in Nepal is witnessed a sharp growth during the past couples of years, the volume of trading has increased. The size of the market has been widened. The number of investing population has grown up in aggregate. The tendency of raising capital from general public is rising. The most important is the market consciousness has been developed so that investors have begun to think about risks, return and availability or timely corporate information regarding the investment.

"As per the provision of the "Securities Exchange Act, 1983" and Securities Exchange Regulation, 1993 corporate bodies willing to manage and operate market for healthy trading of securities will first have to develop the infrastructures in matters relating to free and fair listing and trading of securities, membership to the securities businessperson, inspection, supervision and disciplining of the members and then apply to Security Board, Nepal (SEBO/N) to get license. The application should also include the memorandum, articles of the association feasibility report and documents related to promoters. Memorandum and/or the articles of association should clearly state that the corporate body is a not profit organization. SEBO/N, upon review of the application and the submitted documents, pewits authorizing corporate bodies to manage and facilitate secondary trading of securities."[NEPSE Annual Report, 2002, p. 6.]

1.2.1 Primary Market

Primary market is a place where original financial instruments are issued by the companies or government bodies. The company should approve its share through the authorized issue and sales agent.

Primary market constitutes investment bankers, which are also called underwriters. They purchases new issues from security issuers and arrange for their resale to the investing public. The underwriters are responsible for finding investors for the initial public offerings of securities sold in the primary market. "The Primary market denotes the markets for the original sale may be an underwriter to the public. The use of the words original sale may be some-what misleading the public several years ago (and initial have sold common stock to public company) had now decided to issue additional shares of common stock (a secondary offering). These additional shares will be indistinguishable from the shares sold in the public offering.

The issuer receives cash that may then invest in the productive assets or net proceeds from the sale may be used for other purposes. The public receives the newly issued securities for the cash invested. Since in the primary market stocks are traded at par there is no problem of price."[Ibid.,p.11] "Securities available for the first time are offered through the primary markets. The issuer may be the brand new company or one that has been in business for many years."[**J.Fred Weston & Eugene F. Brigham**, *Managerial Finance p 20*]

1.2.2 Secondary Market

The secondary market liquidates the shares and provides the opportunity between the seller of the securities and investors. So the investors can buy and sell any securities of any business company that are listed in the secondary market. "After securities have been purchased from the primary market, they can be traded in the secondary market. The secondary market comprised the organized security exchange and a specialist facilities the transaction. The major of all capital market transaction occur in the sale of securities in the secondary markets do not go to the organizational issuer instead to the initial owners (seller) of the securities."[NEPSE, Annual Report, 2001, p.73]

So, secondary market is a place where old securities are traded. In other word, once the securities have been issued in primary market, then they are traded in secondary market. The trading of stocks in secondary market is held of different business companies without their involvement. Investors can buy or sell any securities of any business that are listed in secondary market.

The basic economic function of secondary market is to provide marketability and liquidity for long-term investments, thereby the supply of equity and long-term debt capital for the financing of business companies. Once the investors purchase security from the primary, they need a place to sell those securities, which is called secondary market.

"Once new issues have been purchased by investors, they change hands in the secondary markets. There are actually tow broad segments of the secondary markets: the organized exchanges and the over-the-counter (OTC) market."[**Fisher & jorden**, *Security Analysis and Protfolio*]

(a) Organized Stock Exchange

"The essential function of a stock exchange is to provide active market place for corporate shares and other listed securities. The stock exchange plays an indispensable role in mobilizing funds in the capital market. The various virtues governing stock exchange include enhanced marketability of securities, rational allocation of invest able funds; facilitate economic growth and wealth generation and proper maturity, liquidity and diversification of investment. The growth of capital market through the vehicle of stock exchange has brought a flow of the information about various securities in additional to the sound listing criteria that prove worthwhile to the investors."[Ibid.]

Security Exchange Center (SEC) was established in 1976 AD as an organized security exchange of Nepal with and objective of facilitating and promoting the growth of capital markets. Under the Security Exchange Act -1983, the government converted SEC into Nepal Stock Exchange (NEPSE) in 1993. Its history began from the flotation of shares by Biratnagar Jute Mill Ltd. and Nepal Bank Ltd. on 1937. before conversion into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government and corporate security by facilitating transaction in it's trading floors through member, marker intermediaries such as brokers market makers, etc. NEPSE opened its trading floor on 13th January 1994.

Nepal Stock Exchange Ltd.[http://www.nepalstock.com]

The history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. With the introduction of the Company Act, 1964, the first issuance of government Bond in 1964 and the establishment of Security Exchange Center Ltd. in 1976 was other significant development relating to capital markets.

Securities Exchange Center was established with and objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was the only capital markets institution undertaking the job of bordering, underwriting, managing public issue, market making for government bonds and other financial services.

His Majesty's Government, under a programme initiated to reform capital markets 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 basis objective of NEPSE is to impart free marketability and corporate securities by facilitating transactions in its trading floor through its members, market intermediates such as broker, market makers, etc. NEPSE opened its trading floor on 13th January 1994.

His Majesty's Government, NRB Nepal Industrial Development Corporation and members are the shareholders of the NEPSE.

(b) Over-the-counter (OTC) Market

The name itself says that OTC was originated in the time when the securities were traded over the counters of various dealers. OTC is a market for those securities, which is not listed on the stock exchange. When the company first sells its securities to the public, the securities are traded in the OTC markets performs the works of both primary and secondary market. The securities traded over the counter range from most speculative common stocks. In past days, OTC markets were assumed to be more important for bonds than stocks. In past days, OTC markets were assumed to be more important for bonds than stocks. It includes all transaction of securities other than that taking place on the stock exchange. It is actually a group of security brokers.

1.3 Focus of the Study

The investors invest their amount of money to get a good expected return. Efficient market is that place where the investors behave rationally. Market is nothing but the dealings of investors. So the investors should be efficient enough to recognize the potential for excess return, the most important condition for market is to know what the preference of the investor is. Thus, it is necessary to give guidelines frequently to the companies and investors for economic strength of the nation and ensure to give sound expected return to investors for making investment meaningful & rewarding.

Security market plays vital role on Nepalese economy. It affects the whole economic environment of the nation. Securities market is one of the prominent sources for the economic development. So the existing and potential investors are the biggest assets of the nation. Hence this study focuses to explore the investor's preferences on securities on the Nepalese securities market. Thus, this study is mainly focused to provide information about the present condition of Nepalese investors' preferences in choosing the securities.

This study covers the analysis of the securities, which are prevalent in Nepalese financial market. It is analyzed that what factors affect the preference of investors. Basically, the companies issue the common stocks and these stocks are transacted regularly in NEPSE. Why do Nepalese companies not issue the debentures and preferred stocks in the primary market of Nepal? However, the principle focus of this research is to analyze the preferences of Nepalese investors. In other words, how and why investors select the best financial instrument or securities is the focal point under this study.

This study tries to find out the different influential factors of the investors. So, the rationality and awareness of investors influence the whole security market.

Thus, this study focuses on the rationality and awareness of investors and also includes the impact of present existing situation faced by the general investors while making investment decision.

1.4 Statement of the Problem

The trading of stocks in secondary market is held of different business companies without their involvement. Secondary market does not provide liquidity to securities issuing companies. Stock market provides investors good investment opportunities with fair return and instant liquidity and it helps to mobilize financial resources for the investment in development project and thereby help economic development of the country.

Investors are the backbone of the economic development of the country. So, the investors should be encouraged to make investments in security markets by creating congenial investment environment. Government policies regarding the financial sector reforms and security market development can create such environment to derive the investors for the investment.

Nepalese security market is in the growth stage. Due to lack in the rules and regulations from the government sector there is no favorable and proper investment environment to develop the security market as well as to encourage investors to invest in this field.

It is necessary to research the investors' preferences. The flow of issuing of securities is very high in common stock. If the investors preferably want to invest in another financial instruments except common stock. They should have alternative opportunities. In Nepalese financial market, investors' awareness and preferences should be given high priority. This research covers what factors affect the investors to invest in securities and which instruments the investors preferably use.

Why do the investors purchase and sell the financial instruments of any company and why do they prefer particular type of financial instrument? The preferences of investor and financial instruments are the burning issues in the context of Nepal.

1.5 Objectives of the Study

The main objective of this research is to examine and analyze the preferences of the Nepalese investors in selecting securities. However, the specific objectives are as follows.

a) To analyze the investment trend in the security market of Nepal.

b) To analyze the preferences of the investors in the financial instruments/securities.

c) To assess investors' awareness regarding the investment decisions in selecting securities.

d) To suggest some practical recommendations on the basis of findings of the study.

1.6 Significance of the Study

This research may be more useful to all the parties who are involved in the stock market. It is also very helpful to the university graduates and undergraduates who are curious to have knowledge about the investors' preferences and financial instruments.

The research provides the guidelines to the stock market and potential investors to make investment decisions. This research is new in terms of its nature, which can provide literature to further researchers in this area. Previous researches were conducted regarding Nepal Stock Exchange and common stock. No much research works have been conducted on the preferences of investors and financial instruments. It is necessary to be researched about the investors' preference. In this regard, the previous researchers had undertaken many studies regarding the common stocks but they have failed to identify the preferences of investors and also to comparatively study another financial instruments-debenture, preferred stock and government securities. Hence, this research covers over the issues like what factors affect the investors to invest in securities and which instruments the investors preferably use.

It is well known fact that Security market plays a pivotal role in the economic development of the countries. The investment in securities affects the whole economic environment of the nation. The investors are very significant assets of the security market. Thus, this study will be more significant because it is conducted to provide some information about the present level of investors' preferences in the security market.

This research plays the significant role to apply the theoretical concepts and knowledge of Financial Management to the practical field as a partial fulfillment for Master of Business Studies (MBS) under the Faculty of Management, Tribhuvan University.

1.7 Limitations of the Study

The limitations of the study are as follows:

- This research is primarily based on primary data. However, secondary data have also been used to support the research.

- Annual reports and various publications of NEPSE, SEBO/N and NRB are the source for the secondary data.

- The data about the stocks traded in NEPSE within the respective last five years period from F/Y 2001/2002 are only considered in the study.

- The study area is limited. It is oriented in the Kathmandu valley only.

- The reality of the study fully depends on questionnaires, which are duly filled up by the respondents.

- This study may be affected by time and work force. Financial resources might be one of the many limiting factors.

1.8 Organization of the Study

This study has been divided into five chapters. They are as follows:

Chapter: I- Introduction

Chapter: II-Review of Literature

Chapter: III- Research Methodology

Chapter: IV- Data Presentation and Analysis

Chapter: V- Conclusions and Recommendation

Chapter I is devoted to the general background of the study, focus of the study, statement of the problem, significance of the study, research hypothesis, and limitations of the study and so on.

Chapter II includes the review of literature. Books, journals, articles and the previous related research reports have been reviewed. Review of literature is divided into three sections: **(a) conceptual/theoretical review, (b) article review, and (c) review of related studies.**

Chapter III contains the research methodology employed to attain the objective of the research. It contains research design, population and sample, sources of data, data collection techniques, data analysis tools and limitations of the methodology accordingly.

Chapter IV deals with the presentation, analysis and interpretation of gathered data. That is analyzed by testing the hypothesis and major findings on the basis of this study have been derived.

Chapter V is the last and concluding chapter which includes the conclusions, and recommendation of the study.

At the end, Appendices and Bibliography have been presented.

CHAPTER – II

REVIEW OF LITERATURE

This chapter deals with the review of literature related to investors' preferences and financial instruments in more detail by descriptive and analytical process. Under this chapter various books, journals and articles as well as past studies have been reviewed.

2.1 Theoretical/Conceptual Review

2.1.1 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." **Jack Clark Francis**, *Investment Analysis and Management p 15*

"Investment in its broadest sense, the sacrifice of current dollars for future dollars. Two different attributes are generally involved: **time** and **risk**. The sacrifice takes place in present and is certain. The reward comes later, if at all, and the magnitude is generally uncertain," Sharpe. et al., op. cit.,

"Investment choices (decisions) are found to be outcomes of three different but related classes of factors. The first may be described as factual or informational premises. The factual premises of investment decisions are provided by many stream of data which, taken together, represent to an investor the observable environment and the general and particular features of the securities and the firms in which he may invest. The second class of factors entering into investment decisions may be described as expectation premises. Expectations relating to the outcomes of alternative investments are subjective and hypothetical in any case but their foundations are necessarily provided by the environmental and financial facts available to investors. These limit not only the range of investments, which may be undertaken but also the expectations of outcomes, which may legitimately be entertained. The third and final class of factors may be described as valuation premises. For investors generally these comprise the structure of subjective preferences for the size and regularity of the income to be received from, and the safety and negotiability of, specific investments or combinations of investments, as these are appraised from tine to time." [V.K. Bhalla, Investment Management, Security Analysis and Portfolio Management]

2.1.1.1 The Investment Process

The investment process describes how an investor goes about making decisions with regard to what marketable securities to invest in, how extensive the investment should be, and when the investment should be made. A five step procedure for making these decisions forms the basis of investment process. [Sharpe, et al., *op. cit.*]

(i) Investment Policy:

The initial step, setting investment policy, involves determining the investor's objectives and the amount of his or her investable wealth. Because other 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 objective is to "make a lot of money". What is appropriate for an investor? In this situation, it can be stated that the objective is to attempt to make a lot of money while recognizing that there is some chance that large losses may be incurred.

Therefore, investment objectives should be stated in terms of both risk and return. This step in the investment process concludes with the identification of the potential categories of financial assets for consideration in the ultimate portfolio. This identification will be based on, among other things, the investment objectives, amount of investable wealth, and tax status of the investors.

(ii) Security Analysis:

The second step in the investment process, performing security analysis, involves examining a number of individual securities (or group of securities) within the broad categories of financial assets previously identified. One purpose for conducting such examinations is to identify those securities that currently appear to be mispriced. There are many approaches to security analysis. However, most of these approaches fall into one two classification. The first classification is known as technical analysis where as the second classification is known as fundamental analysis. Those who utilize it are know as fundamentalist or fundamental analysts. In decreasing these two approaches to security analysis, the focus at first, will be on common stocks.

(iii) Portfolio construction:

The step in the investment process, portfolio construction, involves identifying those specific assets in which to invest, as well as determining the proportions of the investor's wealth to put into each one. Here the issues of selectivity, timing and diversification need to be addressed by the investor. Selectively, also known as micro forecasting which refers to security analysis and thus focuses on forecasting, involves the forecasting of price movements of common stocks in general relative to fixed-income securities, such as corporate bonds. Diversification involves constructing the investors' portfolio in such a manner that risk is minimized, subject to certain restrictions.

(iv) Portfolio revision:

The fourth step in the investment process, portfolio revision, concerns the periodic repetition of the previous three steps. That is, over time the investor may change his or her investment objectives, which, in turn, means that the currently held portfolio many no longer be optimal. Instead, perhaps the investor should form a new portfolio by a selling certain securities that are currently held. Another motivation for revising a given portfolio is that over time the prices of securities change, meaning that some securities that initially were not attractive and others that were attractive at one time may no longer be so. Thus the investor may want to add the former to his or her portfolio, while simultaneously deleting the later. Such a decision will depend upon, among other things, the size of the transaction costs incurred in making these changes as well as the magnitude of the perceived improvement in the investment outlook for the revised portfolio.

(v) Portfolio Performance Evaluation:

The fifth step in the investment process, portfolio performance evaluation, involves determining periodically how the portfolio performed, in terms of not only the return earned, but also the risk experienced by the investor. Thus appropriate measures of return and risk, as well as, relevant standard (or "benchmarks") are needed.

2.1.1.2 Types of Investors

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

(a) 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 in 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.

(b) Institutional Investors

Institutional investors are those investors, who are institutions or organizations. 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. "To ensure sustained price and market, the policy level authorities should encourage institutional buyers." [The Rising Nepal, November 19, 2002, p. 3.]

General Secretary of Securities Broker Association of Nepal, Parmeshwor Mall said, "Analytical and bulk buying of shares is rendered possible through such institutional buyers which in turn help make the market less volatile than at present."[Ibid]

2.1.2 Financial Instruments/Securities

"Securities" means shares, stock, bond, debenture, debenture stock issued by a corporate body or a certificate 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 Nepal Government and it includes the securities issued under full guarantee of Nepal Government by a notification published in the Nepal Gazette or receipts relating to deposits of securities as well as rights and interest relating to securities.[Security Exch Act, 1983]

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. Buying and selling orders that flow from investors' demand and supply preferences determine the price of securities in the security market. It plays a significant role in bridging gap between the 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 stock is traded through NEPSE. The government securities are also important securities, which are issued by Nepal Government through Nepal Rastra Bank (NRB). The major financial instruments are as follows:

(a) Common Stock

Common stock represents an ownership position. The holders of common stock are the owners of the firm, have the voting power that among other things elects the board of directors, and have a right to the earnings of the firm after all expenses and obligation have a right to the earrings of the firm after all expenses and obligation have been paid; but they also run the risk receiving nothing if earning are insufficient to cover all obligations.

Common stockholders hope to receive a return bared on two sources i.e. dividends and capital gains. Dividends are received only if the company earns sufficient money and the board of directors deems it proper to declare a dividend. Capital gains arise from an advance 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. Fisher. et.al., *op.cit.*, pp. 11-12

When a company needs capital for expansion, it seeks shares of its stocks to the public. "Most companies issue millions of shares of stock, so each share represents only a tiny piece of the company. These shares are also transferable. Prasanna Chandra, Financial Management Theory and Practice

"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 stockholder's return on investment is less certain than the return to a lender or to a preferred stockholder is not bounded on the upsides as are returns to the others. Van Horne, *op.cit.*, p. 25.

(b) Debt

"The holders of a company's long-term debt, of course, are creditors. Generally, they cannot exercise the power to 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 priority of claim among the various creditors of a company. *Ibid.*, p. 509

There are various types of debt instruments, which are as follows.

(i) Debenture

The term debenture usually applies to the unsecured bonds of a corporation. Investors look to the earning power of the corporation as their security. 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.

(ii) Subordinated Debenture

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 if 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.

(iii) Mortgage Bonds

A mortgage bond issue is separated by 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 bond holder 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.

(iv) Income Bonds

A company is obligated to pay interest on an income bond only when it is earned. There may be cumulative feature in the issue where unpaid interest in a particular year accumulates. If the company does generate earnings, it will have to pay the cumulative interest to the extent the earnings permit.

(v) Equipment Trust Certificates

Although equipment trust financing is a form of lease financing, the certificates themselves represent an intermediate long-term fixed income investment. This method of financing is used by railroads to finance the acquisition of rolling stock.

(vi) Equity-Linked Debt

Sometimes the investors in the debt instruments of a company are given an option on common stock with debt warrants, the debt holder have an option to purchase the common stock of the warrant is an 'equity sweetener' to make the instrument more attractive. A convertible bond is one that may be exchanged, at the option of the holder into a certain numbers of shares of common stock of the corporation. The number of shares into which bond is convertible is specified in the bond indenture. And these shares remain unissued until actual conversion.

(viii) Project Financing

The term project financing describes a variety of financing arrangements for large, individual investment projects. Often a separate legal entity is formed to own the project. Suppliers of capital then look at the earnings stream of the project for payment of their loan or for the return on their equity investment.

(c) Preferred Stock

Preferred stock has 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 stock is 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 any dividends. Fisher and Jordan, op. cit., p. 25.

(d) 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 risky 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. The Government Securities, which are issued by NRB, are described in brief below:

(i) Treasury Bills

It 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 364 days. It is issued to collect scattered funds and mobilize it in productive sectors and also conduct fiscal and monetary policies. It is issued on the basis of auction so that any individuals and institutions can invest in Treasury Bills.

(ii) Development Bonds

NRB has been issuing these bonds in the market. It is a long term government bond. It has normally 5 years maturity period. The security holders can use it as collateral if they had need money immediately. Institutional and individual investors purchase it. It has fixed and minimum interest percentage. The security holder normally obtains 90% amount of total value if he keeps them on collateral. The income from these bonds is taxable.

(iii) National Saving Bonds

It is a long-term government bond. It has normally 5 years maturity period. This bond is purchased by individuals, organizations, financial institutions etc. except commercial banks. In this bond, interest is paid semi-annual basis. It can be purchased as a promissory note. Principal is refunded after its maturity period. It has fixed interest rate, which can be sold easily one person to another in the market. It can be used as collateral as in the case of Development Bonds.

(iv) Citizen Saving Certificate

It is also a long-term government bond. It has normally 5 years maturity period. It has fixed interest rate is paid in semi-annual basis. It cannot be used as collateral. Individual and institutional purchasers can buy this bond. It is also a taxable bond.

(v) Special Bonds

This type of bond is issued on special occasions when government falls short of funds. The government can issue special bonds to those parties to whom government has to make payment. The holder can use it as collateral.

2.1.3 Market Risk and Return

"Capital markets 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 deviations of the individual securities comprising the portfolio but also on the correlation of possible returns. For a two-security portfolio, an opportunity set describes the risk-return trade off for various combinations. The diversification effect sometimes causes the opportunities set line to bend backward, with the minimum variance portfolio having a lower standard deviation that than 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 securities 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 combinations of risk-free security and market portfolio are determined by the point of tangency of investors' indifference curves with the capital market line. This two-phased approach investing constitutes the separation theorem.

The capital asset pricing model allows us to draw certain implications about the expected return of specific security. The key assumptions in the model are that perfect capital markets exist and that investors have homogenous expectations. In this context, the relevant risk of security is its undiversifiable risk. This risk is described by the slope of the characteristics line, where security returns in excess of the risk-free rate are related to excess returns for the 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 systematic and unsystematic components. Systematic risk is risk that cannot be diversified away, for it affects all securities in the market. Unsystematic risk is unique to the particular security and can be eliminated with efficient diversification. Van Horne, op. cit., pp. 76-77.

2.1.4 Sources of Investment Risk

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

(i) Interest Rate Risk:

It is defined as the potential variability of returns caused by changes in the market interest rates. If market interest rates rise or fall, then investment are 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.

(ii) Purchasing Power Risk:

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

(iii) Bull-Bear market Risk:

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

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

(iv) Management Risk:

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

(v) Default Risk:

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

(vi) Liquidity Risk:

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

Perfect liquid assets are highly marketable and suffer no liquidation costs. Liquid assets are not readily marketable-either price discounts must be given or sales omissions must be paid, or both of these costs must be incurred by the seller, in order to find a new investor for on illiquid asset.

(vii) Call ability Risk:

Some bonds and preferred stocks are issued with a call provision. Issuers like the call provision because it allows them to buy back outstanding preferred stocks and/or bonds with the funds from a new issue if market interest rates drop below the level being pain on the outstanding securities. But, whenever the issuing company gains by calling in on issue is gained at the expense of the investors who have their securities called. That portion of a security's total variability of returns that derives from the possibility that the issue may be called is the capability risk. Callability risk commands a risk premium that comes in the form of a slightly higher average rate of return. This additional return should increase as the risk that issue would be called increases.

(viii) Convertibility Risk:

Conversions a contractual stipulation that is included in the terms of original security issue. This provision alters the variability of returns from the affected security.
Convertibility risk is that portion of the total variability of return from a convertible bond or preferred stock that reflects the possibility that the investment may be converted into the issuer's common stock at a time or under terms harmful to the investors' best interest.

(ix) Political Risk:

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

(x) Industry Risk:

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

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

2.1.5 Trade-off between Risk and Return

Risk is complicated subject and needs to be properly analyzed. The relationship between risk and return is described by investor's 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.

Utility Functions and Investors Choice [Van Horne, op. cit.]

The best mix of expected return and standard deviation for a security portfolio depends on the investors' utility function. If you are a risk averse investor who associate risk with divergence from expected value of return, your utility function might be depicted in the following figure. The expected return is plotted on the vertical axis, while the standard deviation is along the horizontal. The curves are known as indifference curves; the investor is indifferent between any combination of expected return and standard deviation on a particular curve. In other words, a curve is defined by those combinations of expected return and standard deviation that results in a fixed level of expected utility.

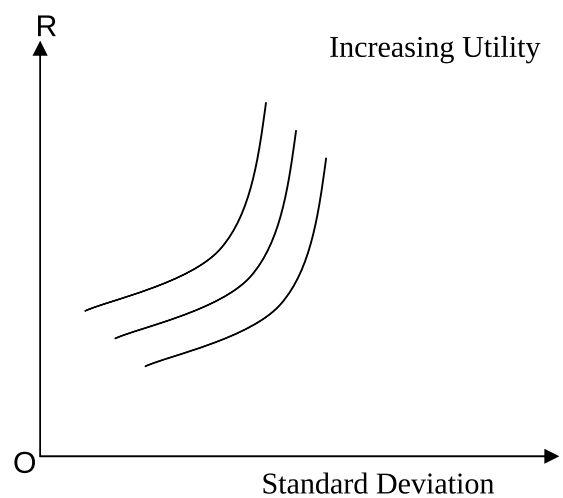


Figure-2.1: Hypothetical Indifference Curves

The greater the slope of indifference curves the more averse the investor is to risk. As we move to the left in **Fig. 2.1,** each successive curve represents a higher level of expected utility. It is important to note that the exact shape of the indifference curves will not be the same for different investors. While the curves for all risk-averse investors will be upward sloping, a variety of shapes are possible, depending on the risk preferences of the individual. As an investor, you want to hold that portfolio of securities that places you on the highest indifference curve.[Ibid]

2.1.6 The Positive Trade-Off between Risk and Return

An investment manager can usually attain more return by selecting dominant assets that involve risk. While it is not true that a riskier asset will pay higher average rate of return, it is usually true. The reason is that investors are risk averse. As a result, high-risk assets must offer investors high returns to induce them to make the riskier investments.

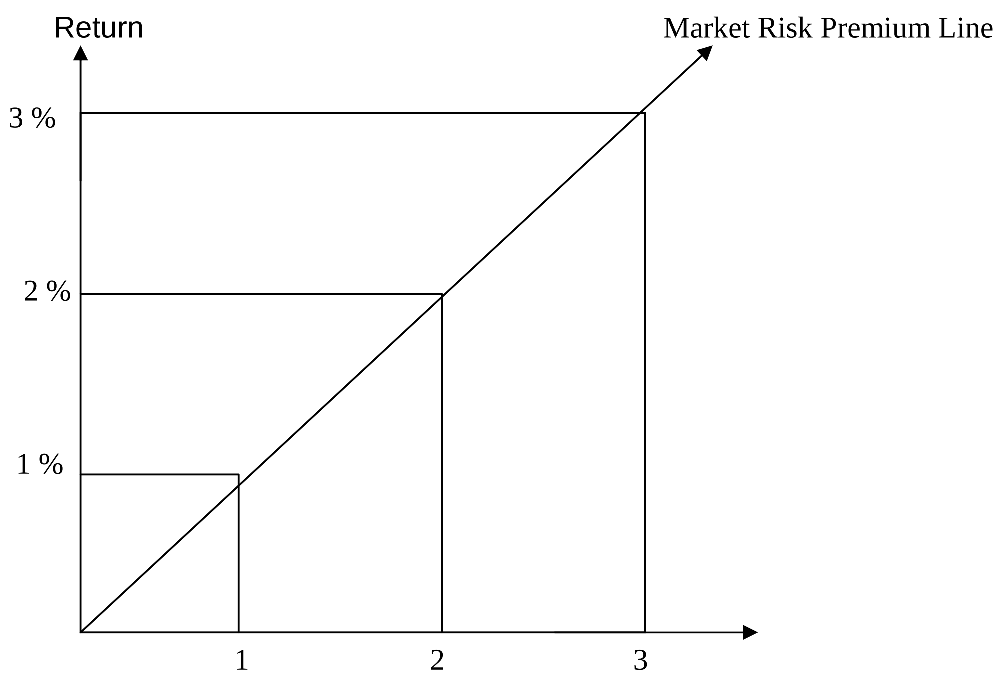


Figure 2.3: Positive Trade-off between Risk and Return

The figure 2.3 represents a higher risk premium. For taking risk 1, the expected return is r1 when an investor assumes risk 2, the return must be r2 increasing the return (risk premium) by r2-r1 for assuming more risk: 2- 1 the assumption of linear relationship states that the risk premium must increase or decrease in proportion to a change in level of risk. It also indicated higher the risk, higher the return and lower the risk lower than return.

2.1.7 Factors to be considered in Investment in Securities

Investors should consider to select the securities which are affected various factors such as good future prospects, risk factor, reliable manage of company beneficial sectors, higher growth rate of company etc. The investors who invest in the securities, they should compare the price of and value of share or debt. The rules and regulation alone cannot protect the investors' preferences. The investors should know about the securities and companies performances.

Usually the following factors should be considered in the investment decision.

- Risk of securities
- Liquidity
- Availability and Accessibility
- Investment Portfolio
- Stability of Income
- Strength
- Mobility
- Cash flow

The investors are to be informed about the following before making investment in the Initial Public Offerings (IPO). SEBO/N, Guideline of Securities Market in Nepal 2002, p. 11.

(a) Promoters, size of company, company's environment, Board of Directors (BOD), and the past and forecasted statements (Performa Balance Sheet) etc. from the prospectus, Articles, Memorandum of the concerned company, and company's promoters

(b) To study of the public announcement made by the company in national daily newspaper before 7 to 15 days the opening of the issue of shares.

The investors are required to be informed on the followings before investment in the share in the secondary market:

(a) Keep the information of companies, return on shareholders in the form of cash dividend, stock dividend, bonus share etc. and timely information about the companies Earning Per Share (EPS), Book price of share (BPS), price earning ratio (P/E ratio), future plan and growth of the company etc.

(b) Analyze the information notified to the investors in the notice board of SEBO and NEPSE about the listed companies.

(c) Study the articles related to the trading of shares and economic matters published in the different newspapers and magazines.

(d) Study the trading statements and financial analysis of listed companies published by NEPSE(e) Study annual reports and other information published by SEBO/N etc.

2.1.8 Efficient Financial Market

"Market efficiency means that the market price of a security represents the market's estimate of the value of that security. If the market is efficient, it uses all information available to it in setting the price. Investors who choose to hold a security are doing so because their information leads them to think that the security is worth at least its current market price. Those who do not purchase the stock interpret their information as a lower appraisal.

An efficient financial market exist security prices reflect all available public information about the economy, about financial markets, and about the specific company involved. The implication is that market prices of individual securities adjust very rapidly to new information. As a result, security prices are said to fluctuate randomly about their "intrinsic" values.

Expressed more formally market efficiency means that the unanticipated portion of the return earned on a security is unpredictable and, over a sufficient number of observations, does not differ systematically from zero. The unanticipated portion is simply the actual return less that which was expected based on some fundamental analysis (e.g., its 'intrinsic value). Put differently, it is the surprise element. Using the definition of fame, weak-form market efficiency means that the unanticipated return is not correlated with previous unanticipated returns. In other words, the market has no memory. Knowing the past does not help you earn future returns. Semi strong form market efficiency means it is not correlated with any publicly available information. Finally, strong from market efficiency, the anticipated return is not correlated with any information, be it publicly available or insider.[Van Horne, op.cit., pp. 49-50.]

Random Walk Model

The random walk theory that all future streams of income from the equity investment are independent of proceeding incomes. So the future prices of common stock can not be forecasted on the basis of part price behavior.

"Random model says that previous price changes or changes in price are useless in predicting future prices or return changes. It means if we attempt to predict future price in absolute term using only historical price change information, we will not be successful i.e. successive price changes are independent. This independence implies that prices at any time will on the average reflect the intrinsic value because among other things, different investors evaluate the available information differently or have different insights into future prospects of firm, professional investors and astute non professional well seize upon the short term or random deviations from the intrinsic value and through their active buying and selling of the stock in question will force the price back to its equilibrium positions. Finally, the efficient market theory holds that since price reflects all available information and since information arrives in a random fashion, there is little to be gained by any type of analysis whether fundamental or technical. It assumes that every piece of information has been collected and processed by thousands of investor and this information (both old and new) is correctly reflected in the price. Returns cannot be increased by studying historical data either fundamental or technical, since past data will have no effect on future prices.[Fisher, et al, op.cit., p. 553.]

Fundamental Analysis

Fundamental analysis involves working to analyze different factors such as economic influences, governmental auction, company's information, its competitors etc. the fundamentalist fundamental analyst determine the intrinsic value of stock. The intrinsic value is the true economic work of financial asset. "The fundamentalist maintain that any points of time every stock has an intrinsic value which should in principle be equal to the present value of the future stream of income from that stock discounted at an appropriate risk related rate of interest"[Bhalla, op.cit., p. 283.]

The value of common stock is simply the present value of all the future income which the owner of the share will receive.[Francis, op. cit., p. 398.]

Technical Analysis

The technical analysis theory is based on previous market information and it assumes that the history tends to repeat him; it is believed that knowledge of past patterns of share prices will help to predict future prices under similar circumstances. "The technician usually attempts to predict short-term price movements and thus makes recommendations concerning the timing of purchases and sales of either specific stock or groups of stocks (such as industrious) or stocks in general. It is sometimes said that fundamental analysis is designed to answer the question "What"? And technical analysis to answer the question "When"?[Sharpe, et al., op. cit. p. 844.]

"Technical analysts maintain that the price of a share at any time (present price) is the balance struck buyers and sellers at a point in time price movements take place on account of diverse internal and external factors (profits, political environment, predictions and the likes). Prices stabilize when equilibrium between buyers and sellers is achieved. They believe that a record of price movements over a period of time in the past. A whole theory is based on the assumptions that history repeats itself. That human nature does not change and that is likely to repeat his patterns of past movements will repeat themselves in the future. [Raghu Palat, Shares for Investment and Wealth, A Guide to Investing Wisely]

2.2 Review of Articles

R.R. Garside (1983) in his project report described, "At one level, capital markets are simple enough. The primary market is where companies raise capital by issuing securities, basically either shares or bonds. The secondary market is where those same securities are traded those definitions are simple and there is nothing very complex about the mechanisms for issuing, trading or settling. Sometimes the term capital market is extended to cover long-term bank loans to companies.

But at another level, the capital markets are more complex because when they function properly they are the very hubs of a free market economy. In them, all economic currents and forces meet and interact.

A healthy capital market is democratic and egalitarian. It shows no respect for class or caste. It does not acknowledge hierarchy. When the price of share price falls, it falls for all those who hold it. Financial analysts may have doctorate in math but some of the best traders of equities, and futures and options have been near a university." R.R Garside, **Capital Market Development**, GMA Capital Market Ltd. Vol. III, July 1983, p. 3

Prof. M. K. Shrestha (1995) published his one important book "Finance Companies in Nepal". According to writer "Finance companies have to be established, organized, managed and operated with professional team of mixing innovative ideas with money and experience. Economic liberalization policy of the government has encouraged the establishment and growth of finance companies in the country within a short span of time. In a situation when the existing financial institutions, especially commercial banks are unable to supply credit timely and carry capital market activities, finance companies have come timely to meet the individual credit needs, undertaken merchant banking functions and also curtail the operations of Upahar and Dhukuti programs.

There are clear explanations about the function of finance company in his book. One important thing is to be considered by finance companies is they have to generate income from fee based activities rather than always depending upon fund based activities. These include a broad range of merchant banking functions such as project planning, corporate counseling, loan syndication through underwriting and bridge financing, issue management, individual investment portfolio management, mutual fund, venture financing, merger and acquisitions, brokerage and management consultancy services etc. this provides a simple answer to have a clear line of distinctions between finance company and commercial bank. Finance company deals with individuals directly, or through capital market to fulfill their individual credit needs while commercial banks because of their bigger size in terms of resources deal more within institutional credit needs like developing business. The recycling of funds from individual to individual is done by finance company such as catering of the individual needs for timely credit financing." Manohar Krishana Shrestha, (1995), Financial Companies in Nepal

Ajaya Ghimire (2001) "Process involved in financing corporation: A Nepalese context", general manager of ACE Finance Company Ltd. wrote that, "Financing and investment are two sides of the same coin. A firm F taking money from G (G could be any legal entity including a financial institution) to finance activities of firm F can be interpreted as firm G investing in firm F. Such investment does not necessarily have to be in the form of equity or common stock (Residual Claim). Further, firm G's financing of firm F does not necessarily have to be in the form of debt or loan (Fixed Claim). Between common stock and plain vanilla debt a firm could design and sell many claims in order to finance its assets.

In his article he further emphasized towards the financing decision and says it is more important towards the finance companies. He added that in a hypothetical world where person managing a corporation acts with the sole objectives of maximizing value of the firm, the firm seeking finance will chose the financer and mode of financing that maximizes the value of the firm. Similarly, a hypothetical financial institution whose invest in firms and business in such a way that maximizes value of the institution.

In conclusion part on his paper, he said that "Financing and investing decision or for that matter any decision, of a firm is an outcome of a complex equilibrium process. Multiple of complex relationship is between the firm and owners of various resources (material, skill, capital etc.) and among various resource owners. Even the relationship of the consumer of output with various resources owners within and outside the firm affects the outcome. Therefore, there is no 'One best investment policy' of all organization. The organizations interested in optimizing its investment decision should formulate its investment policy taking into considerations the skilled, taste the preference of managers involved in the decision making process." Ajaya Ghimire, (2001), Process Involved in Financing Corpopration : A Nepalese Context

"Shiva Raj Shrestha (2003) writes "The principle of Risk management is greater the degree of diversification, the smaller is the degree of portfolio risk in individual assets" with more importance. Absolute quantitative Credit Deposit ratio has no relevance if the assets are not performing ones. Hence, it is felt that appraisal techniques of bank leading in competitive areas have to be more attuned to towards risk evaluation. A major aspect of this work has to be more attuned to towards risk evaluation. A major aspect of this work has been the development of more advanced methods for the quantitative measurement of risks. As one might expect, most progress has been made in the measurement of market risk; the extensive trading in financial instruments provides a good supply of price statistics and this is a considerable help when it comes to estimating markets risks.
In recent years, risk management skills have been revolutionized by advanced financial innovations and technology. Those improvements on risk management have helped financial transactions an increasing number of financial institutions

have developed and applied several risk models such as "value at risk" and credit risk model to quantify market and credit risks for many years. The quantifying model of operational risk is also under development, even though there are many arguments and difficulties on it. The new model based approaches not only strengthen the financial institution ability of risk measurement and management, but also contribute to more efficient resource allocation through better evaluation of risk. In result, the financial institutions can more thoroughly understand their risk exposure and hedge unwanted risk." Shiva Raj Shrestha, **"Financial Institutional in Nepal,"** ***Banking Pradhan.*** Vol. 16, June 2003, pp. 112-113.

2.3 Review of Unpublished Master Degree Thesis

Under this section some of the masters degree theses related to this study have been reviewed which are presented and analyzed below:

Study of Mr. Bhatta

Mr. Bharat Prasad Bhatta (2001) conducted a research on the topic "Dynamic of stock market in Nepal". The objectives were as follows:

- To analyze the trend of the Nepalese stock market.
- To diagnose and compare sectoral financial status of the stocks in Nepalese stock market.
- To analyze the market share prices of the Nepalese stock market.
- To find out the impact of the secondary on primary market and vice versa.

The main conclusions of his research were:

The stock market and economic activities move in similar direction. They influence each -other. The development of the former is reflected in the latter. The stock market raises and mobilizes the investable resources to finance the long-term large projects in the economy. The stock market, therefore, can be regarded as a heart of economy.

The investors are interested to invest their resources in the shares of corporate sector through the stock market in the Nepalese economy. It is necessary to develop the entrepreneurship and encourage the entrepreneurs to start the productive venture as soon as possible. Management capability of the entrepreneurs is a key for better performance of the firms. Government should launch programs to enhance management capability of the entrepreneurs, which may contribute to raise the return from the investment.

Development of manufacturing sector is the backbone of an economy, which in turn assists to foster banking, finance and insurance sectors. Unfortunately, the manufacturing sector does not have a good performance in Nepalese economy. Almost all firms in this sector have a sustained loss.

The secondary aspect of the stock market is not also functioning well in Nepal. There is almost no liquidity in the stock market for shares expects that of banking and some finance and insurance sectors.

Although it has become late to take steps to overcome such problems of the Nepalese stock market in order to make it active and supportive, the stock market has good prospect for the resource mobilization to finance the productive enterprises in Nepalese economy".

Study of Mr. Dahal

Mr. Dahal (2002) had conducted a study on "A Stock Market Behavior of Listed Joint Stock Companies in Nepal" for the partial fulfillment of Masters of Business studies. The study is somehow related with this study. The specific objectives of the study related to this were:

- To study and analyze the investors view regarding the decision on stock investment

- To study and examine the signaling factors impact on stock price with the help of NEPSE index.

The Study undertaken by Mr. Dahal had the following significant findings:

- Most of the Nepalese investors preferred the stocks of commercial banks.

- The stock market in Nepal is in developing stage as investors were not well aware about the investment

- Trading system in NEPSE trading floor is traditional rather systematic.

- The investors were not satisfied with the return on their investment.

- The main motivating factor of Nepalese investors for owning shares was to receive the dividends.

- It was found that investors in the stock market make the investment decision on the basis of market price of shares. It was also found that rumors are the most predominate factor to determine the market price of share.

- The efficiency of stock market's different parties, brokers, market makers, security exchange limited were not found efficient in terms of required support from these parties.

Study of Mr. Poudyal

Mr. Poudyal (2002) had conducted a thesis work on "A study on Government Securities Practices in Nepal" in course of his M.B.S. study. Mr. Poudyal thought that his thesis had expressed positive view toward public debt. Very cautious recommendations had been made regarding rising and use of public debt. He further added, "Public debt especially internal borrowing is required to meet deficit budget. Since internal borrowing being less inflationary, it is better than borrowing from commercial banks.

"In the context of slow growth of economy of the country, it is required to intensify which also requires private sector and government sector investment. However, if public debt is expanded on unproductive may problems on country," added Mr. Poudyal.

Mr. Poudyal described "Public debt assets the government in solving the economic monitory and budgetary problems which are to be addressed by the states as per the situation. In addition people pride themselves in their financial contribution to the nation through the public debt. But in other sense if it is used in properly, it hurts the people. The government of Nepal has been collecting funds by selling various government securities. The main region is to recover deficit budgetary system. The trend of borrowing is increasing every year". Major findings included in the Mr. Poudyal research were as follows:

- The government has adopted budgetary system in the name of development functions. Treasury bills, development bonds, national saving bonds and special bonds are debt-borrowing instrument in Nepal.

- Nepal has been suffering capital shortage since the first budget speech of Nepal.

- The government has been following liberal policy in the matter of collecting funds. The main objective of internal borrowing is to collect significant impact on economy for future generation.

- Enormously increasing magnitude of public debt is becoming a great challenge for the nation.
- Between the period 1984/2001 the average annual growth rate of total outstanding public debt (only internal debt) is 16%.

Study of Mr. Pandey

Mr. Pandey (2002) has also conducted a study titled "Legal and Institutional Arrangements for investors protection in Capital Market of Nepal" faculty of Management, T.U. The study had the following objectives:

- To study and analyze the existing legal provisions regarding investors' protection in Nepalese capital market.

- To assess the development of capital market in Nepal.

- To recommend for improvement in legal and institutional arrangements for protection in Nepalese Capital Market.

In order to achieve the set objectives, Mr. Pandey had used descriptive and analytical research design. On the basis of analysis, following major findings were observed.

The existing legal provisions and regulations were insufficient for protecting investor's interest. Provisions were insufficient especially in case of timely disclosure of price sensitive information and insider trading.

It was found that there was duplication and redundancy of regulation in between ROC and SEBON, both of the institutions were doing some of the tasks under the regulations. For example, prospectus of issuing companies is first submitted to ROC and thereafter to SEBO/N, it is not clearly defined which agency is responsible for analyzing it.
Collective performance of regulations like SEBO/N, ROC, NEPSE, NRB and company board were found to be less effective and unsuccessful. No proper coordination among regulatory was found. He also added that, insider-tackling practice existed in Nepalese securities market. Sufficient legal provisions to check insider trading, did not exist. Regulatory authority like SEBO/N had no appropriate and adequate power to make investigation and take decisions.

Study of Mr. Subedi

Mr. Badri Subedi (2003) in his thesis entitled "Investors Awareness in the Securities Market in Nepal" concluded that fair and timely information disclosure was essential ingredients to function the securities market efficiency. Information deficiency in the capital market might be one of the reasons for determination by the gamblers and the speculation. This might lead to domination by the gamblers and the speculators in the capital market. Norms, regulatory submission and disclosure of information by listed companies are meant for ensuring good corporate governance, transparency and investors protection.

Since the quality of information available to investors, the rationality of the investors in Nepal is to be at quite low. They have very little knowledge of the trading procedures and the price formation mechanism of NEPSE. Considerable efforts should be given to expand the role of training and certification institute to include research and investors education. The size of the market is simply to small to make research and economically viable function to be offered by securities firms of investment banks in the next several years. At present, there is a general lack of investors' awareness about the listed companies, the operation and potential role of securities market techniques of financial analysis and risks and rewards of holding securities.

Study of Mr. Gautam:

Mr. Gautam (2005) on "A Study on Problems and Prospects of Primary and Secondary Stock Markets in Nepal" has concluded that most of the people considered stock market investment as black art that they have unrealistically optimistic or pessimistic expectations about stock market investment or perhaps a fear of the unknown.

We know that Nepalese stock market is in emerging stage. Its development is accelerating since the political change in 1990 in effect of openness and liberalization in national economy. But, Nepalese individual investors cannot analyze the securities as well as market properly because of the lack of information and poor knowledge about the analysis of securities for investment.

There is no alternative in securities market to allocate scare resources efficiently within economies and increase mass participation in country's development process. Though the institutional development of securities Market in Nepal started in 1976, it is still at an underdeveloped stage, characterized by legal inadequacy, low resource availability to the regulators, low liquidity, double taxation on dividend and capital gain tax/poor corporate governance practices, low involvement of institutional investors, poor disclosure practices, high cost of public issue, high transaction cost and lack of enforcement of accounting and auditing standards.

Public response is high due to lack of opportunities for investment in other fields. No proper investment analysis is been made. Despite this, public are attracted towards shares than other sectors, basically to increase their value of investment. The dynamism of the stock market has been greatly reduced by the domination of the long-term shareholders, who prefer holding the shares with the hope of increasing their wealth, who prefer holding the shares with the hope of increasing their wealth. This can be justified by small number of shares that are traded on the stock market Even though this reduces the dynamism of the stock market the investors have very few rather no alternative to holding shares.

Since 2051/52 the major companies have been registered in transport, finance and manufacturing sectors.

Similarly, there is a significant increment in the number of listed companies in stock exchange. In fiscal year 2063/64, the number of companies listed in on the NEPSE is 137. The structure of both segments of the market primary/New secondary/Stock exchange has witnessed significant change. Some of the important developments in the primary market are as follows:

(i) The establishment of merchant banks, provision of speedy up allotment refunds, proportionate allotment of shares, allotment of financial institution, increase in minimum application amount for investment in primary issues.

(ii) The secondary market which presented an institutional mechanism that was un equate nontransparent, hardly regulated and rarely geared to investor's protection, has also witnessed no table development. Among them are: prescription of norms far intermediaries like brokers in trading/settlement and the bound of stock exchange with participation from stock exchange members and investors. The Exchange has made tremendous effects in the volume of transaction, share turnover, number of shareholders, public response and market capitalization. However, a set back from the fiscal year 2052/53 B.S. is observed in the performance of both primary and secondary market as the price of share companies making loss has also tremendously increased and political instability which has buoyed down the country in recent times poor information dissemination to the public regarding share market. There are still quite a number of public companies which have not made their financial statements to public or disseminated requisite information.

Major findings of Gautam's study are as follows:

1. Tax system should be reformed and encourage to stimulate capital formation.

2. The NEPSE should adopt appropriate policies; membership and fee structure to attract members outside the Kathmandu valley similarly, the brokers from the Kathmandu valley need not be present on the floor or carry customs account. All type of securities firms, including broker-dealers, issue managers full managers as well as full service securities firm should be eligible for membership.

3. Restrictions on foreign direct and portfolio investment should be reviewed and the unnecessary impediments should be eliminated.

4. Accounting and audit standards for public companies should be strengthened through implementation of provisions of Charted Accounts Act, 2054 B.S requiring newly licensed Chartered Accounts to pass an examination and provide financial assistance to ICAN.

5. The NEPSE should establish an Arbitration committee to handle unresolved investors complaints. The NEPSE Bye-laws should be amended to establish procedures governing the process of arbitration.

6. Give the Securities Board the power to require the stock exchange to discharge its responsibilities for ensuring compliance by public issuers either their continuing disclosure obligation**.**

7. The Central Depositary System (CDS) may be interfaced to the current trade, trade capture of future potential automated trading systems. This means that very high volumes of trading can be cleared and settled in a timely and cost-effective way there by supporting the overall development of NEPSE.

8. Presently, Institutional players have not been able to play noticeable role in the Stock Exchange Limited Market, allotment procedures and emphasis for small investors have not helped to enhance the role of the instructional players. Increased role of players will make the market more competitive and also will help to check the manipulative trends if any of individual brokers. Additionally, it would add the professional dimension in the market too. To increase their roles, following strategies should be adopted.

9. Manipulative practices like wash sales and churning should be strictly controlled.

10. Shareholders should also learn and believe to facilities improvement in the performance of the companies.

11. While investing or trading in the primary or secondary market, the major consideration should be made that of the promoters, directors and managers in Nepal. Other Considerations may be market prospect, professionalization of management and environment.

2.4 Research Gap

Comparatively very few research efforts have been taken in Nepalese context. Questionnaires are distributed to the officials related to the organization, brokers, market makers, policy markers, investors hesitate to meet the researcher. Similarly, when humbly requested for interviews they directly deny such request. Therefore, considering these entire facts fair situation is to be created to avoid such an unfair hesitancy on the part of concerned authorities. An small effort have been taken to make a research work on practice and a satisfactory effort have been made to make a study on investors. Most of the effort made in the study of investors preference, have been made in broad context. The existing research works were poor in sample selection; very few similary type of investors. So, it is hard to generalize the result of the study. But this research work has selected random investors as samples on random sampling technique. It is therefore the results obtained are more accurate and easily can be generalized on the entire population. Very relevant statistical tools are used for better result. The research work is based primary data so; results are more accurate and reliable.

CHAPTER – III

RESEARCH METHODOLOGY

The principle objective of this study is to find out the investor's preferences in financial instruments. For this purpose, the specific research design has been presented to obtain the research objectives, which includes the research design, population and sample, sources of data, data collection techniques, data analysis tools and limitation of the methodology.

3.1 Research Design

This study attempts to analyze the preferences of investors and financial instruments. To achieve the objective of this research, descriptive and analytical research design has been used. As per the nature of this research, primary data has been used to find the research objectives. The individual person and some share brokers are the main source of data. The collected data are only primary data and it represents the investors preference on financial instruments.

3.2 Populations and Sample

The opinion of professional investors and Broker and other related parties to securities are included in this research. Stratified and purposive sampling methods have been used to extract required information. Altogether 274 companies [*http://www.nepalstock.com/listedcompany.php*] have listed their shares in NEPSE in order to make them eligible for trading. All the companies listed in NEPSE have been considered in this research.. Issue manager, stockbroker, securities dealer and market maker are working as security's professional. The concerned staff members of NEPSE have also been considered in this research.

The samples under study are as follows:

S.N.	Categories	Samples
1.	Professional investors	20
2.	Market makers/brokers	5

There are indifferent numbers of professional investors. Total population size of the professional investors includes those indifferent numbers. Only 25 investors are selected for this research who was involved in buying and selling the shares. There are altogether 23 licensed brokers [http://www.nepalstock.com/members/brokers.php]. These all have been categorized into a group of brokers/market makers. Altogether 5 brokers/market makers are taken as samples who were met on the trading floor of NEPSE.

3.3 Sources of Data

The information and data have been collected through primary sources. Discussions and interview with existing and potential investors, staff members of NEPSE and brokers, financial intermediaries and other concerned parties have been conducted to collect the primary data.

3.4 Data Analysis Tools

The collected data and information through primary sources have been tabulated, categorized and analyzed by using appropriate statistical and financial tools. Tick mark is included in the questionnaires. Data from questionnaires will be gathered and tabulated systematically and then will be analyzed using percentage. The comparative analysis has also been undertaken using graphs. The responses of related parties of questionnaires have been presented according to question patterns in the columns of table with observed and expected frequencies.

CHAPTER- IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter includes the presentation and analysis of data. The basic objective of this chapter is to analyze the collected data from various sources. Analysis is based on primary data only. Since primary data are the main source to analysis the preference of investors, secondary datas are not included on analysis. The recently received responses from different investors, market makers and staff of NEPSE are primary datas. This chapter is divided into two sections. The first section includes the presentation and analysis of primary data collected from different respondents. And second section encompasses the major findings of the study.

4.2 Presentation and Analysis of Primary Data

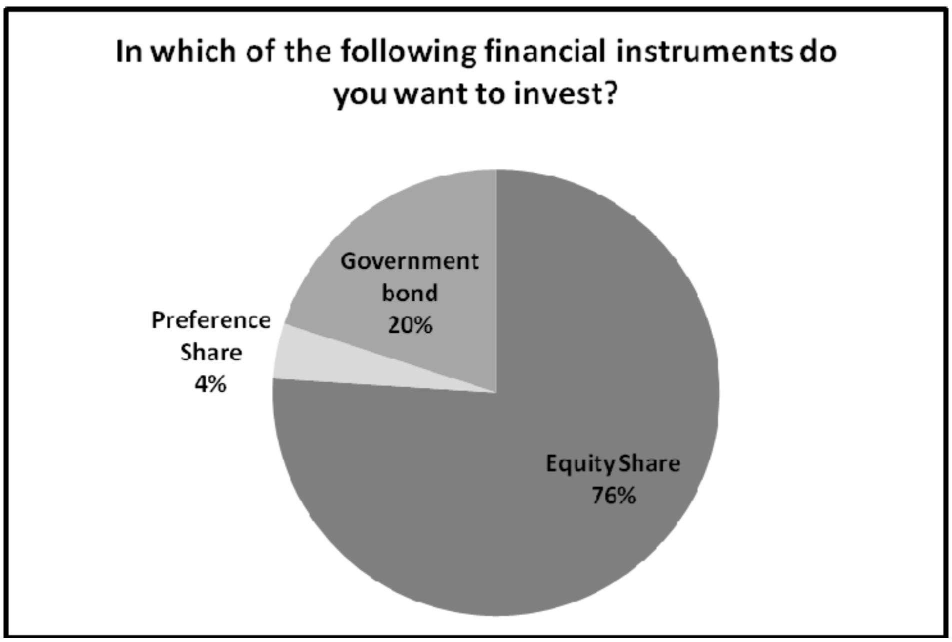
This section includes the presentation and analysis of primary data collected from different respondents. The primary data have been collected through the questionnaires distributed to the staff members of NEPSE , Broker/Market Markets and Professional Investors. The questioneries were made on such a way that the investors preference could be extracted through it. All together thirteen datas were submitted to the investors, broker/market maker and staff members of NEPSE. Similar questionaries were submitted to all of them. The questionaries inclued the investers preference sector wise, insturment wise, having knowledge of risk return, trading of shares, purpose wise etc. The collected data have been presented in the table and pie figure. The datas are then analyzed one after another. The purpose of the analysis of primary data is to achieve the objectives of the study. Since the questionaries does not include the reason for the selection of the particular option, we couldn't analyse each questionary giving the reason. The analysis was made only on the basis of the number of choices made by the investors, broker/market makers and professional investors.

Table 4.2.1

Investor's preference : Instrument wise

Options	No. Of Selection	Percentage
Equity Share	19	76
Preference Share	1	4
Debendtuer/ bonds	0	0
Government bond	5	20

Figure 4.2.1



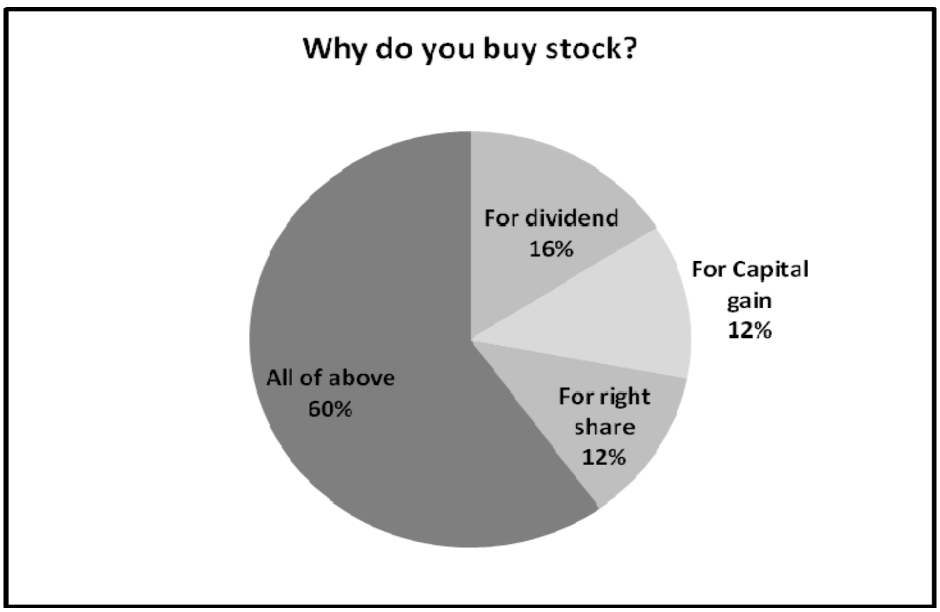
With respect to preference of investors in financial instruments available in Nepalese security market, majority of the respondents (76%) stated that the Nepalese investors preferred to invest in equity share. 20% of the respondents stated that the preference of investors is in government securities. Only 4% of respondents stated that the investors prefer to invest in preference share. Among the respondents no one was interest to invest on debunture bond. Here we can make the analysis that equity share is the most preferable among the investors and debenture bond is the leaste preferable one.

Table 4.2.2

Investor's preference : Purpose wise

Options	No. Of Selection	Percentage
For dividend	4	16
For Capital gain	3	12
For right share	3	12
All of above	15	60

Figure 4.2.2



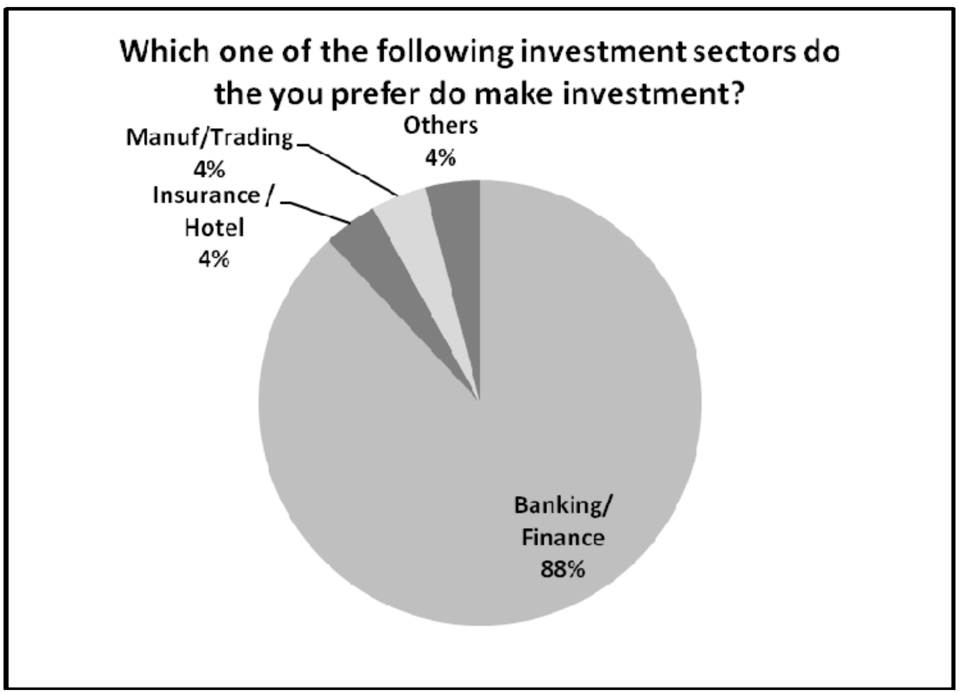
According to the above table, 60% of the investors are investing for the return of all possible factors which they can get after investing on shares, the possible factors which they can get only after investing on shares are capital gain, right share and dividend. Among the respondent 16% opinions revealed that investors invest only for dividend. and 12% of respondent invest on shares for capital gain and right share. Here we can say that, all the investors invest only to achieve something from their investment. Though some of them choose only for dividend and some of them only for capital gain and some of them only for right share, they would be happy if they receive the other factors also for which they have not invested.

Table 4.2.3

Investor's preference : Sector wise

Options	No. Of Selection	Percentage
Banking/ Finance	20	88
Insurance / Hotel	1	4
Manufacturing/Processing/Trading	1	4
Others	1	4

Figure 4.2.3



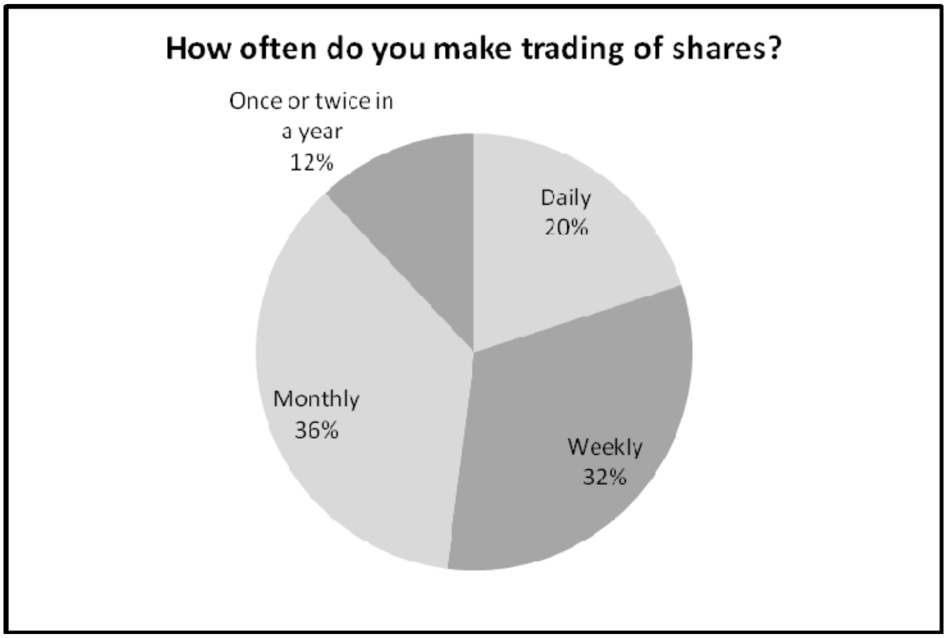
The respondent were asked on which sector do the think to make their investment. It has been seen from the above table that majority of the opinions (88%) supported banking sector investment. 4% respondents stated that they prefer to invest on Insurance/Hotel, 4% on manufacturing and trading & 4% on others rather than banking, manufacturing & insurance. Most of the respondent choose banking sector as thir preferred sector for their investment. In Nepalese market most of the share are also isssed from banking/ financial sector in comparision to other sectors. The financial sector also has good position in security market than other sectors like hotel, manufacturing and trading etc.

Table 4.2.4

Investors Share Trading

Options	**No. Of Selection**	**Percentage**
Daily	5	20
Weekly	8	32
Monthly	9	36
Once or twice in a year	3	12

Figure 4.2.4



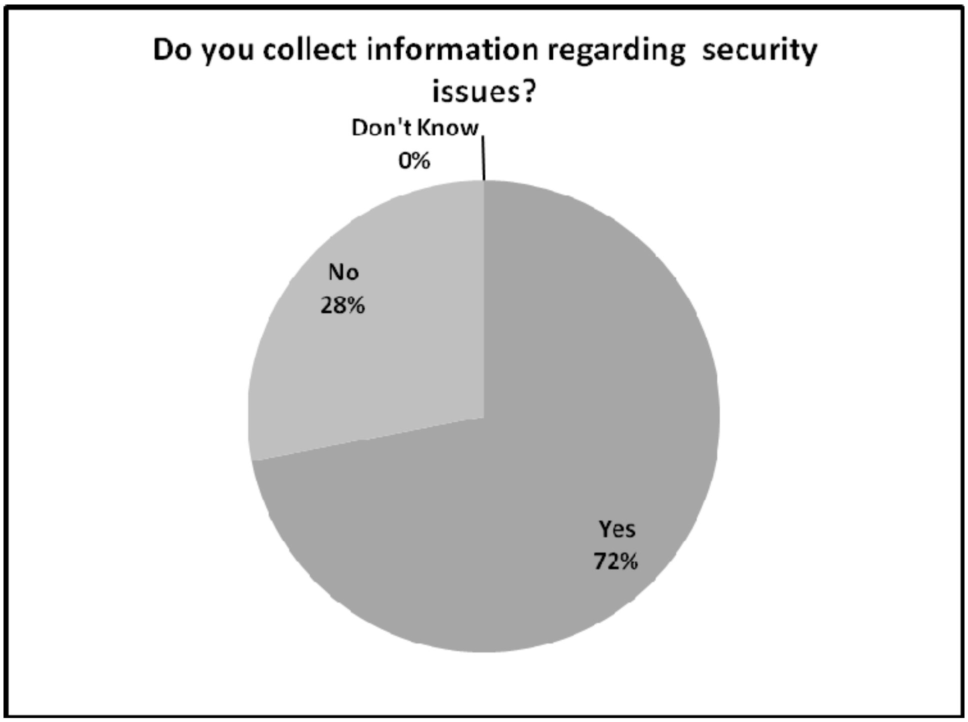
It was asked to professional investors, market makers/ brokers that how frequently do the make their transaction on security market. Among the respondents, 36% of them said that they have average transaction monthy. 32% of the respondent said that the have transaction weekly. Among them 20% said that they daily involve in the transaction of securities. And the least respondents (12%) said that they have trading of share once or twice in a year. Here what we can say is that most of the repondents make their transaction in the security market weekly or monthly. Since they are professional investors and market makers they do not wait for a year for the transactions and due to the situation of security market the also couldn’t make trading of shares daily.

Table 4.2.5

Collection of Information

Options	No. Of Selection	Percentage
Yes	18	72
No	7	28
Don't Know	0	0

Figure 4.2.5



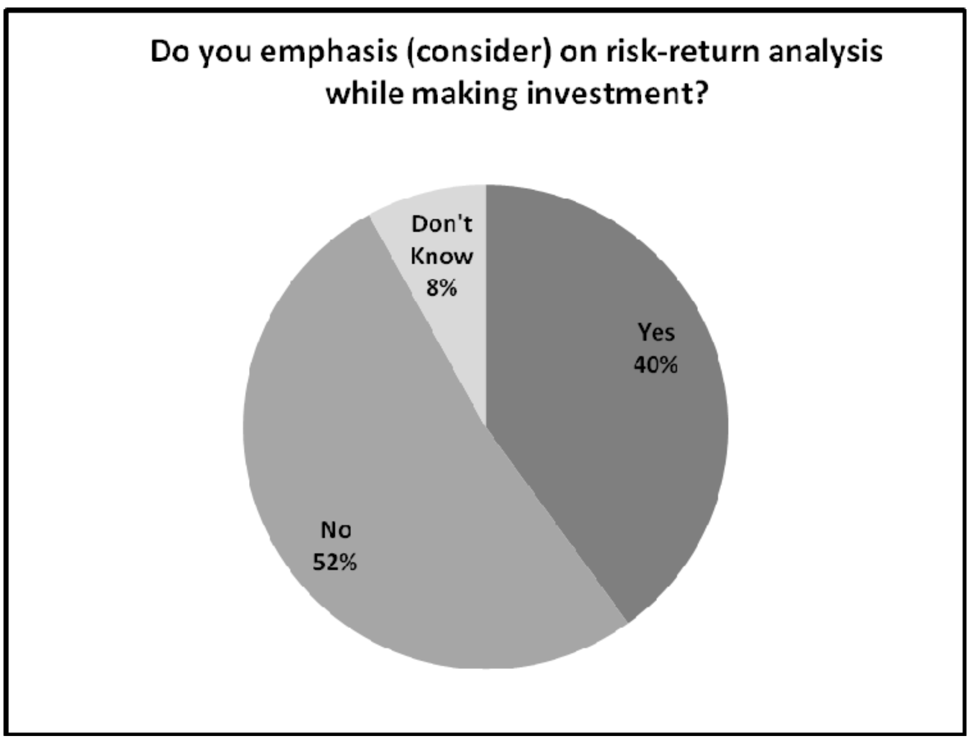
The respondents were asked if they collect information regarding security issues. Most of the respondents reply that they do collect informations. 72% of them said they collect all information regarding security issues. Against this, very few of them 28% answered that they don't collect information regarding security issues. None of the respondents were unknown about this so 0% of respondents answered they don't know about this. Since they are professional invstors and market makers, they must have the collection of information regarding all issues in the security market.

Table 4.2.6

Risk and Return before Investment

Options	No. Of Selection	Percentage
Yes	10	40
No	13	52
Don't Know	2	8

Figure 4.2.6



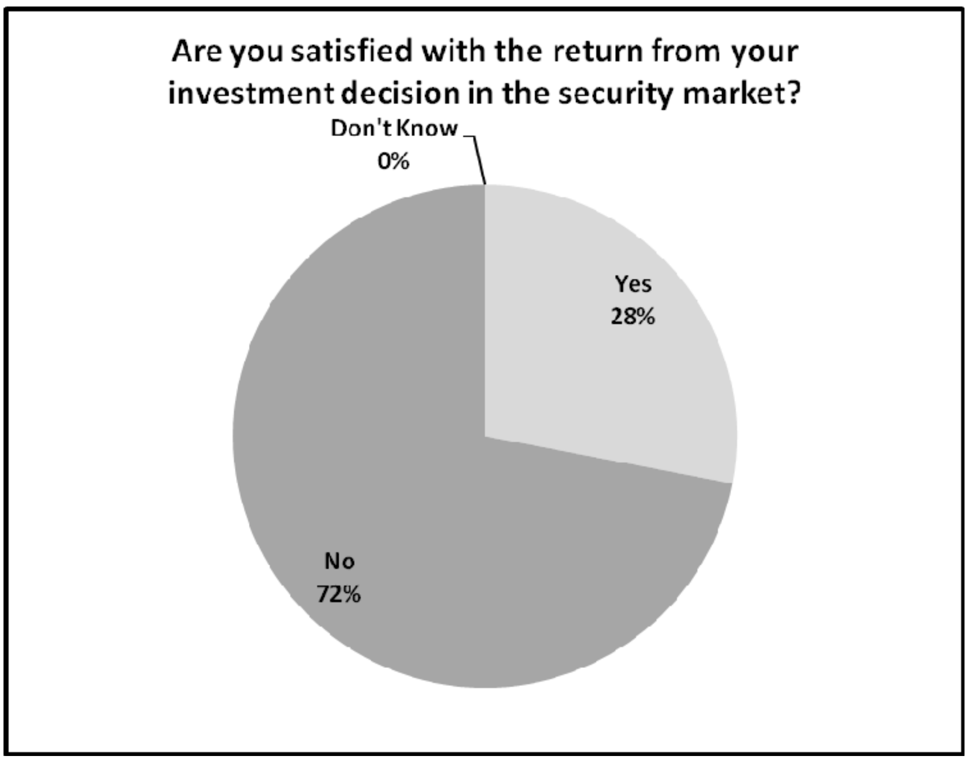
The respondents were asked whether they analyze risk and return before making investment. The majority of the respondents (52%) stated that they don't do risk and return analysis before making investment in financial instruments. Only 40% respondents stated that they analyze the risk and return before making investment in any securities. 8% respondents stated they don't know how to make an analysis on risk and return and don't do this before investing on any security. Here we can make an analysis that in security market most of the investors are making investment without have knowledge of risk or return.

Table 4.2.7

Satisfication from return

Options	**No. Of Selection**	**Percentage**
Yes	7	28
No	18	72
Don't Know	0	0

Figure 4.2.7



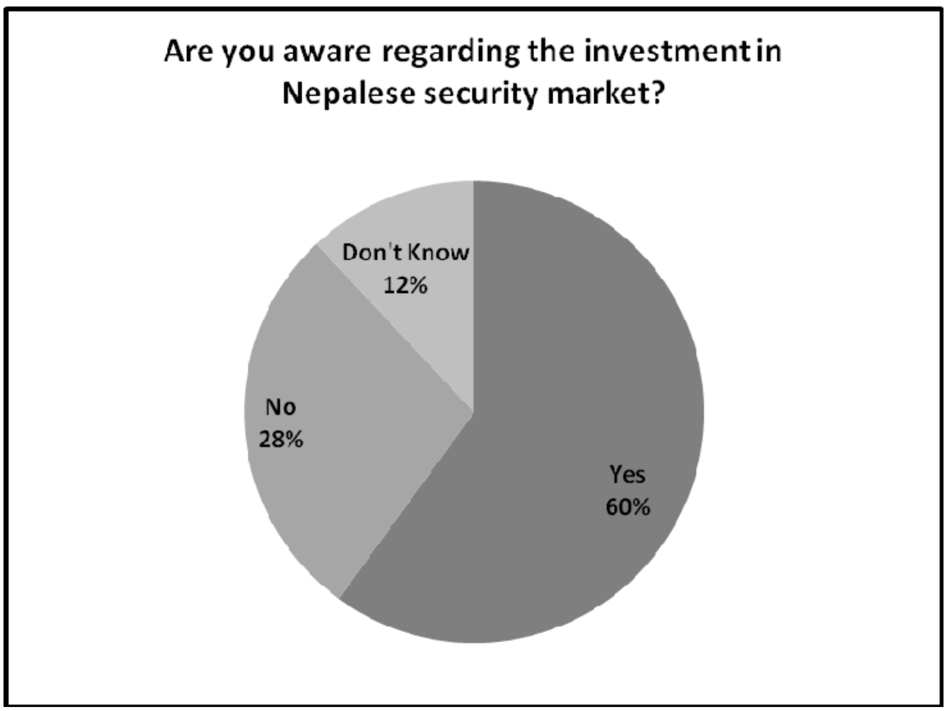
The respondents were asked whether they are satisfied with the return on their investment, the majority of the respondents i.e. 72% stated that the investors are not satisfied from return on their investment. 28% respondents stated that the investors are satisfied from their return and 0% respondents clarified that they don’t know about the investors’ satisfaction for their return.

Table 4.2.8

Investors Awareness

Options	No. Of Selection	Percentage
Yes	15	60
No	7	28
Don't Know	3	12

Figure 4.2.8



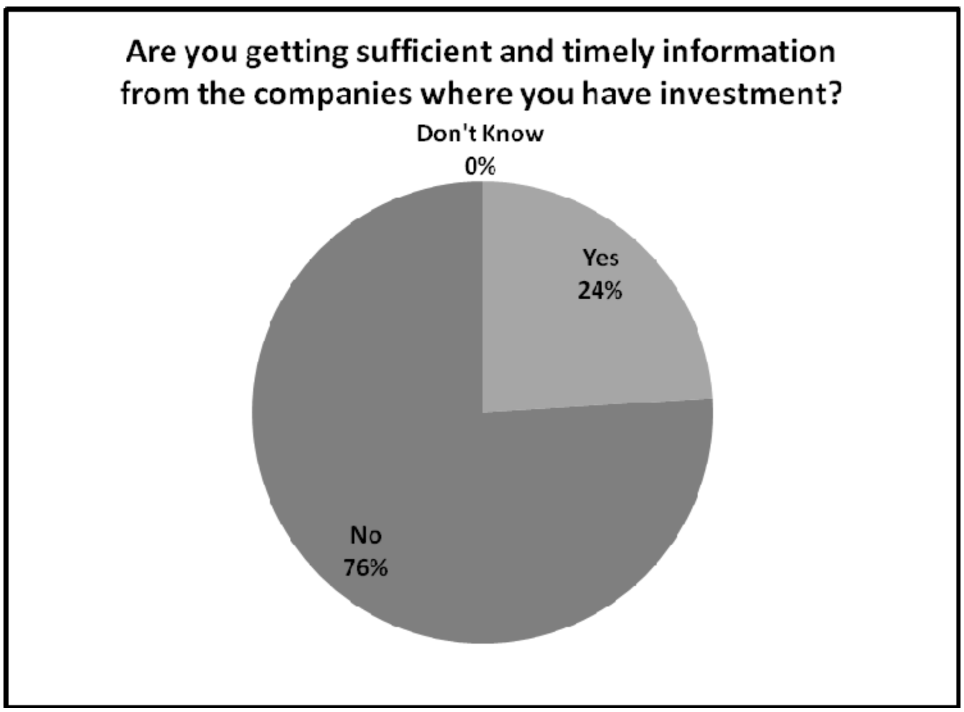
Awareness of the investors regarding the investment in financial instrument helps to the development of the security market. With respect to the investor' awareness about the investment in financial instrument in security market, the majority of the respondents (60%) stated that they are aware regarding the their investment. 28% of the respondents stated that investors are not aware in their investment in financial instruments. 12% respondents replied that they don't know about the investors' awareness.

Table 4.2.9

Availability of Information to Investors from Companies

Options	No. Of Selection	Percentage
Yes	6	24
No	19	76
Don't Know	0	0

Figure 4.2.9



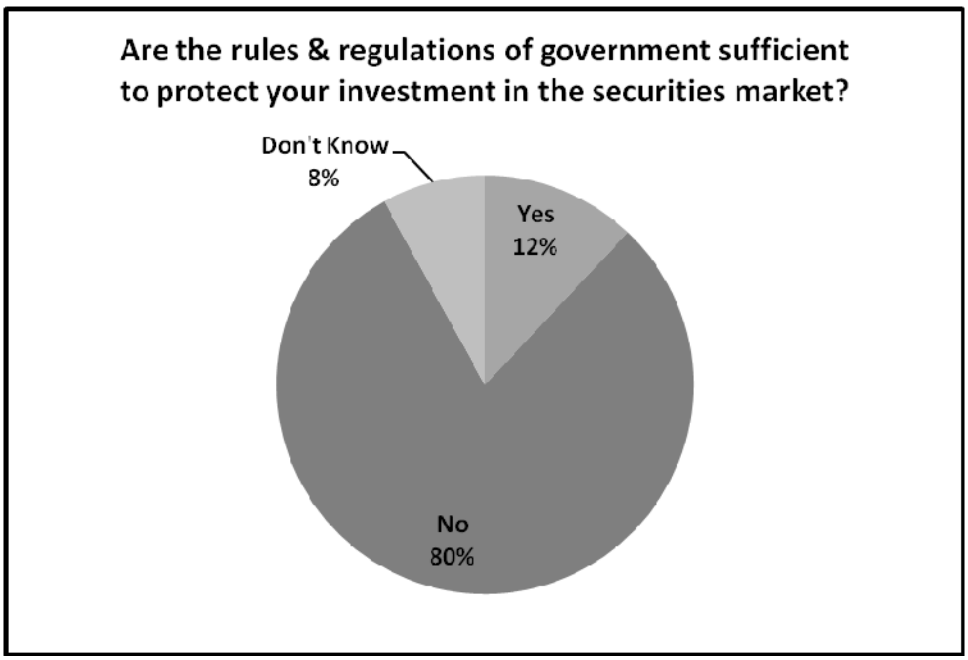
The respondents were asked whether the investors are getting sufficient and timely information from the companies where they have made investments. The majority of the respondents i.e. 76% stated that the investors are not getting the sufficient and timely information regarding the investment from the companies. 24% respondents stated that they are getting sufficient and timely information from the concerned companies. Likewise, 0% respondents didn't know about getting sufficient and timely information from the companies.

Table 4.2.10

Sufficiency of Rules and Regulations

Options	No. Of Selection	Percentage
Yes	3	12
No	20	80
Don't Know	2	8

Figure 4.2.10



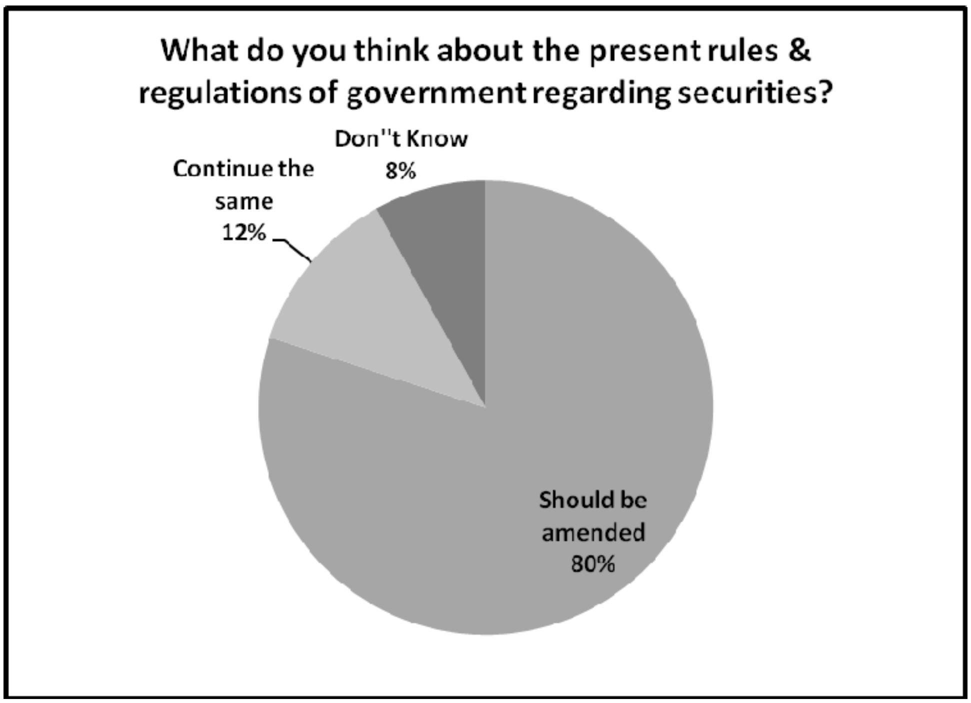
The respondents were asked whether the existing rules and regulations regarding the investment in securities market are effective /sufficient or not, majority of the respondents i.e. 80.0% stated that existing rules and regulation of the government are not sufficient and effective. 12% respondents concluded that the rules and regulation are sufficient for the protection of investment in security market and 8% respondents replied that they don't know the rules and regulation of government regarding the investment in the security market.

Table 4.2.11

Revision of Present Rules and Regulation

Options	No. Of Selection	Percentage
Should be amended	20	80
Continue the same	3	12
Don"t Know	2	8

Figure 4.2.11



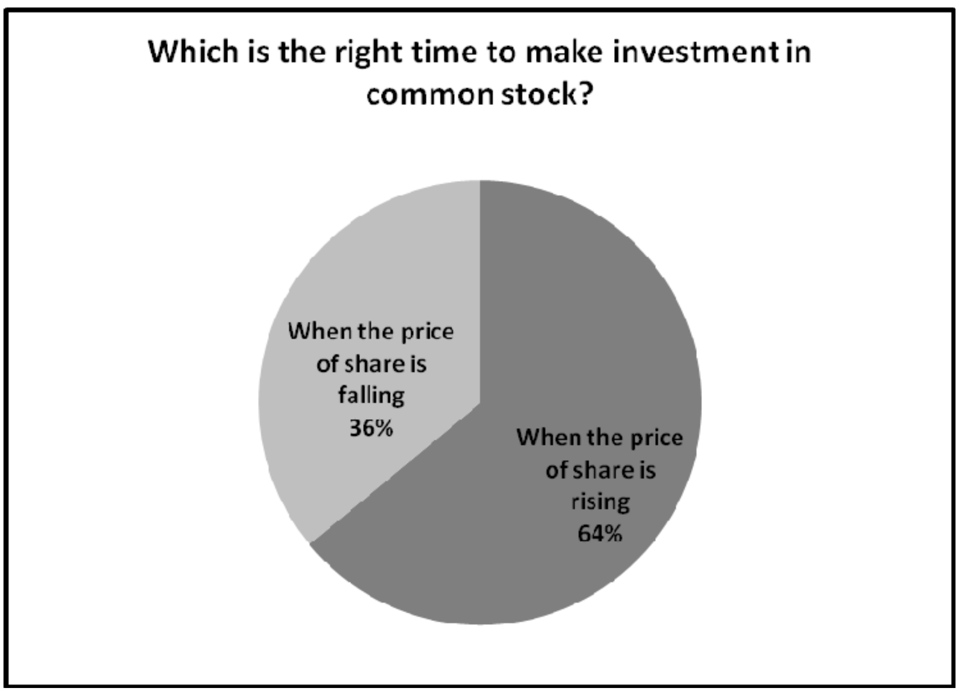
The respondents were asked whether the existing rules and regulations are favourable to investors or should make revision, majority of the respondents i.e. 80.0% stated that the rules and regulation should be amended. 12% respondents state that the government should continue the same rules and regulation for the protection of investment in security market and 8% respondents replied that they don’t know about the rules and regulation of government regarding the investment in the security market.

Table 4.2.12

Most preferable time to make investment

Options	No. Of Selection	Percentage
When the price of share is rising	16	64
When the price of share is falling	9	36

Figure 4.2.12



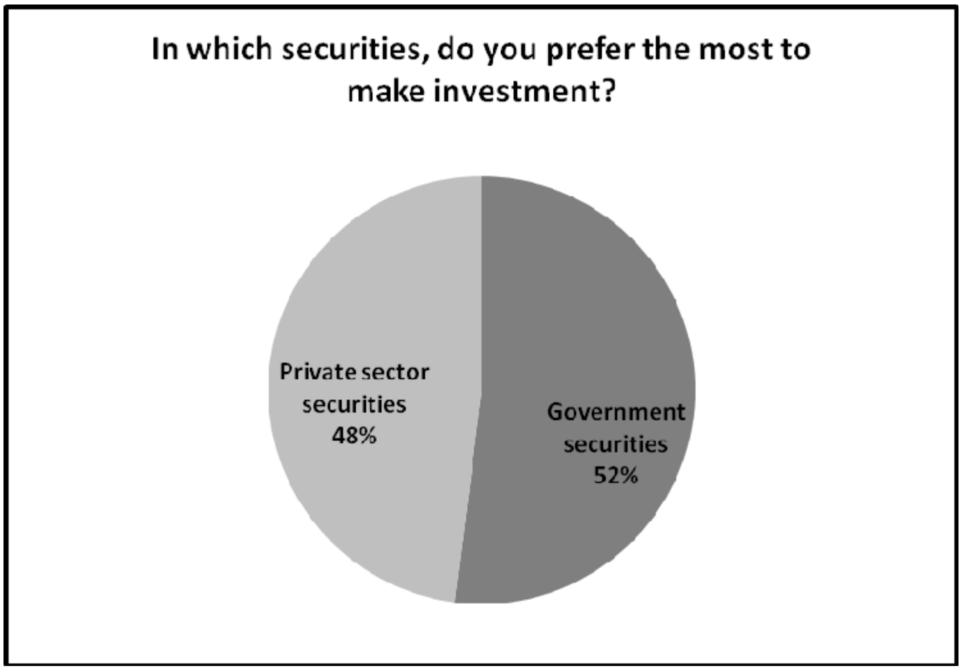
The respondents were asked when do they prefer to invest, when the price of the share is falling or when the price of the share is rising. In this case the investors are some what indifference between these two options. But according to the table it is shown that the majority of the respondents want to invest on the share when the price is rising up, i.e. 64%. Against this statement 36% of respondents states that they want to invest on the share when the price is falling down.

Table 4.2.13

Government or Private Securities

Options	No. Of Selection	Percentage
Government securities	13	52
Private sector securities	12	48

Figure 4.2.13



The respondents were asked in which security do they prefer most among private sector securities or government sector securities. Among them 52% shows the interest to invest on government securities and 48% shows the interest to invest on private sector securities. Here, the investors wants both private and government securities. Since they had to choose option among the available options they choose the most preferable one, but they showed indifference between these two securities.

4.3 Findings of the datas

The major findings of this study are summarized below:

1. The majority of the Nepalese investors preferred the equity share for investment. They preferred government securities after common stocks to avoide risk on their investment. The preferred stocks and debentures come on their least preference.

2. The purpose of the investement in common stock is that they want to have capital gain from the investment by receiving dividends and right shares. Few investors have made their investment either to receive dividends or right share.

3. In present situation maximum investors have invested on banking sectors and they want to keep banking sector as their first choice for the investment and they want to keep other sectors as their alternative sector to make investment.

4. Investors mostly make trading of their securities monthly, weekly or daily. Only few investors make their trading once or twice in a year. In average they have their trading weekly.

5. Before making and investment most of the investors used to collect the information regarding secruity issues. Only few of them invest without knowing or collecting the information of the security issues.

6. Most of the investors do not make risk-return analysis before making investment decision. Only few investors make analysis on risk-return before they invest.

7. The investors were not satisfied with their return from investment decision in securities, only few investors were satisfied with their return on the investment decision in the security market.

8. The majority of the investors are aware regarding the investment in security market.

9. The investors do not get timely and sufficient information from the companies where they have investment. Most of the companies do not give sufficient and timely information to its share holders. Now some of the companies are providing information through their websites.

10. The rules and regulations of government are not sufficient to protect the investors in the security market.The investors who have invested in some of the companies in past have already been collapsed and the investors have not received the return so the government should make effort to recover their lost investment from the fixed assets of the concerned companies.

11. Majority investors think the present rules and regulations shuld be amended and few investors think the present rules and regualtions are favourable to the investors.

12. Most investors think that it is good to invest in the security when the price of the security is rising.

13. It was seen that the main attraction of Nepalese investors towards the government securities due to absent of risk.

CHAPTER-V

CONCLUSION & RECOMMENDATION

This chapter includes the conclusion and the recommendations based on the findings of the study.

5.1 Conclusion

From the above 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 of 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 of the government securities because the government securities are taken as risk less investment. The Nepalese investors least prefer the preferred stocks and debenture. The main reason behind the Nepalese companies for not preferring to issue debenture and preferred stock frequently is lack of attraction of investors towards debenture and preferred stock. 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 increasing trend. The Nepalese investors do not seem aware in regarding investment in the security market. Though they collect information before investing on security they don't analysis 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 not satisfied by the current return from the security market so they have the feeling that the existing rules and regulations regarding the security market are insufficient. They claimed that they are not getting sufficient and timely information from the companies where they have invested their money.

5.2 Recommendations

Nepalese security market is in growing stage. It is one of the prominent sources for the economic development. The flow of issuing of securities is very high in common stock of commercials banks. Investors are the backbone of the economic development of the country. So, the investors should be encouraged to make investments in security market by creating congenial investment environment. Government policies regarding the financial sector reforms and security market development can create such environment. The government is still unable to create favorable and proper investment environment to develop the security market as well as to encourage investors to invest in this field.

The Nepalese investors are not getting the required information from the companies where they have invested their money. Hence, concerned authorities should be liable to disseminate the required information to the general public through appropriate means. Under the study, it was found that the brokers and market makers are not making appropriate suggestions. Considering this fact, they are required to provide assistance and make aware the investors. Furthermore, the government concerned public limited companies, market makers, brokers and other intermediaries are required to make the awareness programs for general regarding the investment opportunities in the secondary market.

Lengthy paper work process to buy or sell the securities should be removed and very transparent system should be adopted. In Nepal, it is found that there are no professionals firms providing financial assistance and advice to the existing as well as prospective investors. Hence, the government should arrange for creating such environment for the development of financial professionalism. Computer-aided technologies should be adopted for analyzing the securities. It is felt that the NEPSE should computerize its transaction system. There should be provisions to buy or sell securities through internet, which will be provisions to buy or sell securities through internet, which will attract the prospective investors residing outside the Kathmandu Valley to make investment through centrally located secondary market of Nepal-- NEPSE.

The existing rules and regulations related to security market and transactions have been felt insufficient. This is why the government should amend the existing rules and regulations make the trading scientific and transparent. The security exchange centers around the world are autonomous and public owned. Many secondary markets are established according to the need of the time. However, there is only one secondary market in Nepal i.e. Nepal Stock Exchange Limited. In Nepal also there is the requirement of another secondary market.

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ANNEX

Research Questionnaire

Name:

Address:

Qualification:

Date:

Please place (√) mark on the correct box and express your ideas and views where necessary.

1. In which of the following financial instruments do you want to invest?

   a) Equity share ( ) b) Preference share ( )

   c) Debenture/bonds d) Government bond ( )

2. Why do you buy stock?

   a) For dividend ( ) b) For capital gain ( )

   c) For right share ( ) d) All of above ( )

3. In your opinion, which one of the following investment sectors do the you prefer do make investment?

   a) Banking /Finance ( ) b) Insurance /Hotel ( )

   c) Manufacturing/Processing/Trading company ( )

   d) Others ( )

4. How often do you make trading of shares?

a) Daily ( ) b) Weekly ( )

c) Monthly ( ) d) Once or twice in a year ( )

5. Do you collect information regarding security issues.

a) Yes ( ) b) No ( )

c) Don't know ( )

6. Do you emphasis (consider) on risk-return analysis while making investment?

a) Yes ( ) b) No ( )

c) Don't know ( )

7. Are you satisfied with the return from your investment decision in the security market?

a) Yes ( ) b) No ( )

c) Don't know ( )

8. Are you aware regarding the investment in Nepalese security market?

a) Yes ( ) b) No ( )

c) Don't know ( )

9. Are you getting sufficient and timely information from the companies where you have investment?

a) Yes ( ) b) No ( )

c) Don’t know ( )

10. Are the rules and regulations of the government sufficient to protect your investment in the securities market?

a) Yes ( ) b) No ( )

c) Don’t know ( )

11. What do you think about the present rules and regulations of the government regarding securities?

a) Should be amended ( ) b) Continue the same ( )

c) Don't know ( )

12. Which is the right time to make investment in common stock?

a) When the price of share is rising ( )

b) When the price of share is falling ( )

13. In which securities, do you prefer the most to make investment?

a) Govt. securities ( ) b) Private sector securities ( )